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RESPONDING TO GLOBALIZATION: STOCK MARKET NETWORKING FOR REGIONAL INTEGRATION IN THE ESCWA REGION

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Preface

This study was prepared at the request of the 13 members of the Economic and Social Commission for Western Asia (ESCWA) as part of the Commission's programme of work for the biennium 2002-2003. In response to that request, the issues and challenges faced by ESCWA member countries with regard to regional stock market networking have been identified, with particular attention given to various technical details at the corporate, legislative and regulatory levels, and to the necessary infrastructures. The background information and analysis contained in this study form the basis for a number of useful recommendations for facilitating the development and networking of the emerging Arab capital markets. Mr. Soliman Al-Mondhiry, Mr. George Azar, and Ms. Amal El-Beshbishi served as consultants in the preparation of the study.

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During the 1990s the proportion of capital resources entering developing countries in the form of official development assistance fell dramatically, declining from 56 per cent of total resources in 1990 to 14 per cent in 1996. Over the same period, the share of equity capital rose from 3 per cent of development resources to 16 per cent. The increasing importance of emerging stock markets as a channel for supplying capital resources is apparent. Equity markets in developing countries provide the necessary linkages to regional and global capital markets. They contribute to the mobilization of domestic financial resources and may attract funds from foreign investors. Additional investments, both domestic and foreign, accelerate economic growth and development and reduce unemployment and poverty. Equity market development is especially important for the Arab region, which receives the smallest per capita share of foreign direct investment in the world and suffers from a net outflow of domestic capital resources, as Arab investors find developed markets more attractive for their capital funds. The development and networking of the emerging regional financial markets are essential requirements for repatriating Arab capital and attracting foreign investment, management expertise and technology.

The stock markets of the members of the Economic and Social Commission for Western Asia (ESCWA)[1] have combined listings of 734 companies and total market capitalization of US$ 255 billion (as at July 2003). The New York Stock Exchange (NYSE) alone has approximately 2,800 listed companies and market capitalization of US$ 13.5 trillion. The depth, openness and transparency of the NYSE and other developed capital markets attract investors from around the world. The emerging stock markets in the ESCWA region are dominated by large financial and real estate companies, monopolies and State-owned enterprises, with a disproportionately low level of representation from other sectors of the economy and from family-owned businesses. By the late 1980s, most ESCWA member countries recognized the important role the stock market could play in their economic development plans. Many have since made significant strides in the development of their domestic markets. However, in an age when the world is moving towards greater financial integration—especially with the signing of the General Agreement on Trade in Services (GATS), and particularly in the light of its fifth amendment, calling for financial liberalization—Arab stock markets continue to lack significant regional linkages.

The active stock markets in the ESCWA region include the Abu Dhabi Securities Market, Amman Stock Exchange, Bahrain Stock Exchange, Beirut Stock Exchange, Cairo and Alexandria Stock Exchanges, Doha Securities Market, Dubai Financial Market, Kuwait Stock Exchange, Muscat Securities Market, and Saudi Stock Market. The Palestine Securities Exchange suspended operations in March 2002, and the Baghdad Stock Exchange closed in March 2003. The Syrian Arab Republic is considering opening a stock market in 2004.

Multilateral efforts to network the region's stock markets began with the establishment of the Union of Arab Stock Exchanges and Securities Commissions (UASE) in 1982. The UASE was set up to provide assistance in the organization of member stock markets, to promote the exchange of technical expertise and other forms of coordination, to identify and remove legislative barriers hindering intra-Arab investment flows, and to facilitate the cross-border trading of Arab stocks. Action has been taken with regard to the last of these four objectives through the Union's establishment of a regional institution for clearing and settlement in 1999 and the Arab Financial Markets Network (AFMN) in September 2001. Through its web site, the AFMN is helping to establish greater financial transparency among the Arab stock markets. It is also in the process of developing a virtual stock exchange that incorporates electronic interfacing between brokers and the member stock markets to facilitate intra-Arab cross-border transactions. The Kuwait Stock Exchange, Egypt's Capital Market Authority, and the Beirut Stock Exchange signed an agreement in the mid-1990s that led to the establishment of the region's first successful stock market network. The agreement, which entered into effect in January 1997, regulated the clearing and settlement operations in each market, which was made possible by the infrastructure compatibility between Egypt, Kuwait and Lebanon. The six

[1] The 13 members of the Commission include Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Oman, the Palestinian Authority, Qatar, Saudi Arabia, the Syrian Arab Republic, the United Arab Emirates and Yemen.

Gulf Cooperation Council (GCC) members[2] have made some initial moves towards the networking of their stock markets. The heads of these markets met in March 2000 to discuss ways to unify legislation, corporate frameworks, settlements, deposits and transfers. Cross-border trading in the Gulf subregion has been facilitated in recent years through the easing of restrictions on GCC investors in the markets of Bahrain, Kuwait and Oman.

The stock markets of the ESCWA member countries, like other emerging stock markets, lack many of the requirements for success, including liquidity, transparency, reliability, appropriate legal procedures, investor protection, and low transaction costs. A stable and supportive legal, economic and sociocultural environment is necessary to encourage investment in publicly listed companies. Laws that protect the rights of investors create trust and market credibility. Corporate laws are the cornerstone of the securities market. The absence of or deficiencies in auditing practices in some Arab markets, the lack of accurate financial information, and the differences in executive regulations pertaining to auditing are all factors that weaken the region's stock markets.

The essential stock market structures include the trading system, the central securities depository, and clearing and settlement codes. Modern technology has allowed the rapid dissemination of information through the Internet, contributing to the development of the Arab stock markets. Most of the Arab markets are utilizing new information and communication technologies, including electronic trading, to satisfy the needs of investors, as they now have the means to increase transparency and market efficiency and to reduce market transaction clearance times. While significant progress has been made in many areas, some of the region's stock markets are still characterized by clearing and settlement delays that increase the securities risk to investors.

Sound financial markets are the product of sound macroeconomic policies. Foreign exchange rate stability reduces foreign exchange risks, an essential component for attracting foreign investors. High interest rates on alternative financial instruments such as bonds and Treasury bills make equity markets less attractive for investors. Governments should make optimal use of the region's stock markets in their ongoing privatization efforts, both to benefit the companies involved and to increase market depth. Regional stock market networking efforts will receive a boost if initial public offerings of shares in government-owned companies are available on more than one Arab exchange.

In an international context, seven of the thirteen ESCWA members have joined the World Trade Organization (WTO) and have scheduled commitments to liberalize their financial services sectors in line with GATS rules and principles. The degree of financial system development varies within the region. Some ESCWA members require internal reforms before participating fully in the multilateral GATS framework, while others are at a more advanced stage, providing open market access in financial services.

The success of a stock market depends on the underlying assets of its publicly listed financial instruments. Stocks reflect, among other things, the financial standing and performance of the issuing companies, their growth potential, liquidity and solvency, and investor expectations of financial and corporate growth. The attractiveness of securities to investors depends on the issuing companies' financial status and prospects. One of the thorniest issues undermining the development of Arab stock markets is the corporate sector's inability to provide accurate and transparent financial information and analysis (full disclosure) on a regular basis to allow investors to make well-informed investment decisions.

The large number of family-owned businesses in the Arab economies constitutes a serious challenge to the development of the region's stock markets. Traditional sources of funding for these small and medium-sized Arab companies include lending institutions (a more expensive option than equity funding) or family-owned assets (which may limit company growth and international competitiveness). Arab family-owned businesses should be encouraged to explore equity financing through education programmes and examples of successful family companies participating in the stock markets.

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[2] The six Council members include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

The increased participation of Arab women in capital markets as both entrepreneurs and investors will allow the region's economies to benefit from a largely untapped development resource. The Kuwait Stock Exchange has opened a separate trading floor for women staffed entirely by female brokers. In 1992 the Egyptian stock market admitted its first woman to the trading floor. Female entrepreneurs are poised to make a vital contribution to the economic development of the region, and the stock markets are excellent sources of capital for their businesses and outlets for their investment funds.

A vibrant regional stock market would greatly contribute to economic integration in the ESCWA region and the Arab world.

The following recommendations, along with others,[3] are presented for consideration by the Arab private sector and decision makers in the ESCWA member countries to facilitate the development and networking of the emerging Arab stock markets:

(a) Adopt International Accounting Standards in financial reporting;

(b) Provide transparent financial disclosure on a regular basis through, for example, corporate web sites;

(c) Diversify the types of financial instruments available to investors on the region's stock markets;

(d) Harmonize stock market rules and regulations and standardize the relevant terminology within the ESCWA region;

(e) Facilitate cross-border electronic trading among the ESCWA members;

(f) Restructure weak banking sectors before opening the economy to foreign banks and capital (in order to limit bank failures);

(g) Adopt policies—in particular those relating to interest and exchange rates—that ensure macroeconomic stability;

(h) Implement GATS concessions on financial sector liberalization (for the WTO members in the region);

(i) Promote the public listing of family-owned small and medium-sized companies;

(j) Encourage women's participation in the capital markets as both investors and entrepreneurs.

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[3] See chapter IV of the present study.

ABBREVIATIONS AND EXPLANATORY NOTES

ABS	asset-backed securities
ADSM	Abu Dhabi Securities Market
AFMN	Arab Financial Markets Network
AMF	Arab Monetary Fund
AMM	Amman Stock Exchange
BD	Bahrain dinar(s)
BMA	Bahrain Market Authority
BSE	Bahrain Stock Exchange
BY	Beirut Stock Exchange
CASE	Cairo and Alexandria Stock Exchanges
DFM	Dubai Financial Market
DSM	Doha Securities Market
EAOSEF	East Asian and Oceanian Stock Exchanges Federation
EPS	earnings per share
ESCWA	Economic and Social Commission for Western Asia
EU	European Union
FDI	foreign direct investment
FEAS	Federation of Euro-Asian Stock Exchanges
FESE	Federation of European Securities Exchanges
FIBV	International Federation of Stock Exchanges
FIX	financial interface exchange
GAFTA	Greater Arab Free Trade Area
GAAP	Generally Accepted Accounting Principles
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
IAS	International Accounting Standards
IPO	initial public offering
ISE	Istanbul Stock Exchange
JD	Jordanian dinar(s)
JVB	joint venture bank
KD	Kuwaiti dinar(s)
KSE	Kuwait Stock Exchange
LE	Egyptian pound(s)
MFN	most favoured nation
MSM	Muscat Securities Market
NYSE	New York Stock Exchange
OECD	Organization for Economic Cooperation and Development
PSE	Palestine Securities Exchange
Q-TEL	Qatar Telecom
RO	representative office
SAFE	South Asian Federation of Exchanges
SSM	Saudi Stock Market
UASE	Union of Arab Stock Exchanges and Securities Commissions
WFE	World Federation of Exchanges
WTO	World Trade Organization

The following symbols have been used in the tables and/or text of the present publication:

Two dots (..) indicate that the data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A hyphen (-) indicates that the item is not applicable.

ABBREVIATIONS AND EXPLANATORY NOTES (*continued*)

A full stop (.) is used to indicate decimals.

Parentheses ( ) indicate a deficit or decrease, except as otherwise stated.

A slash (/) between years indicates a crop or financial year (for example, 1981/82).

Use of a hyphen (-) between years, for example, 1981-1983, signifies the full year involved, including the beginning and end years.

Details and percentages do not necessarily add up to totals, because of rounding.

References to "dollars" ($) indicate United States dollars, unless otherwise stated.

The term "country" as used in the text of this study also refers, as appropriate, to territories or areas.

Bibliographical and other references have, wherever possible, been verified.

I. OVERVIEW OF STOCK MARKETS IN THE ESCWA MEMBER COUNTRIES

There are a number of reasons why stock markets are important for economic growth and development in the ESCWA region. During the 1990s, the proportion of capital resources entering developing countries in the form of official development assistance (ODA) fell dramatically, declining from 56 per cent of the total in 1990 to 14 per cent in 1996.[4] Over the same period, equity capital rose from 3 per cent of incoming development resources to 16 per cent. "Private capital flows to emerging market economies exceeded US$ 320 billion in 1996 and [fell to] almost US$ 200 billion in 2000."[5] The increasing importance of emerging stock markets in providing a channel for capital resources is apparent. In addition, "the ongoing third world debt crisis motivates developing countries to rely on equity rather than debt".[6] There is a growing role for emerging stock markets in facilitating the implementation of government privatization programmes to reduce budget deficits. Stock markets in developing countries provide necessary linkages to regional and global capital markets. This is especially important for the Arab region, which receives the smallest per capita share of foreign direct investment (FDI) in the world,[7] and "statistics still show substantial capital outflows from the region"[8] as Arab investors find developed markets more attractive for their capital funds; the "latest World Wealth Report compiled by Merrill Lynch estimated that 220,000 individuals in the Middle East have US$ 1.2 billion held overseas".[9] Development of the emerging regional financial markets and their effective networking are essential requirements for repatriating Arab capital and attracting foreign investment, management expertise and technology.

A. STOCK MARKETS IN THE ESCWA MEMBER COUNTRIES

The stock markets of ESCWA members had combined listings of 734 companies in July 2003 and combined market capitalization of US$ 255 billion. However, the Arab region's stock markets account for only "6.5 per cent of total market capitalization of the 38 emerging markets in Asia, Latin America, Africa and Eastern Europe, and for around 0.6 per cent of the world's total stock market capitalization".[10] By comparison, the New York Stock Exchange (NYSE) has approximately 2,800 listed companies and market capitalization of US$ 13.5 trillion.[11] The NYSE is "the largest equities marketplace in the world" and exemplifies a highly developed capital market. Companies listed on the NYSE represent a broad "cross-section of leading U.S. companies, midsize and small capitalization companies". Most of the Arab stock markets list shares of a few large financial and real estate companies, monopolies and State-owned enterprises, with a disproportionately low level of representation from other sectors of the economy and from small to medium-sized family-owned businesses. The NYSE is fully integrated into the global financial market; some 470 foreign-owned companies are listed and account for US$ 3.4 trillion of the Exchange's market capitalization. The depth, openness and transparency of developed capital markets such as the NYSE attract investors from around the world. Conversely, the emerging stock markets of the ESCWA member countries remain underdeveloped in many respects and have a long way to go to reach their full potential as a capital resource for regional growth and development.

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[4] Clement Henry, "Challenges of global capital markets to information-shy regimes: the case of Tunisia", Occasional Paper No. 19 (Abu Dhabi, Emirates Center for Strategic Studies and Research, 1998), p. 6, table 2.

[5] Maria Carkovic and Ross Levine, "Does foreign direct investment accelerate economic growth?", working paper (Minneapolis, University of Minnesota, May 2002), p. 1.

[6] Kamal Naser, "Investment prospects in a sample of Arab stock exchanges", Occasional Paper No. 17 (Abu Dhabi, Emirates Center for Strategic Studies and Research, 1998), p. 2.

[7] EIU Viewswire, "Underdeveloped stockmarkets" (London, Economist Intelligence Unit, 26 July 2002).

[8] Clare Woodcraft, "Regional capital markets must reform to capture growth in indigenous capital", *Middle East Economic Survey*, vol. XLV, No. 6 (11 February 2002) (http://www.mees.com/update/v45n06/a45n06b01.htm), p. B3.

[9] Henry Azzam, "Positioning the region's capital markets to attract repatriated Arab funds from abroad", *The Jordan Times*, Economy Section (20 October 2002), p. 1.

[10] Ibid., p. 2.

[11] New York Stock Exchange (http://www.nyse.com/listed).

The active stock markets in the ESCWA member countries include the Abu Dhabi Securities Market (ADSM), Amman Stock Exchange (AMM), Bahrain Stock Exchange (BSE), Beirut Stock Exchange (BY), Cairo and Alexandria Stock Exchanges (CASE), Doha Securities Market (DSM), Dubai Financial Market (DFM), Kuwait Stock Exchange (KSE), Muscat Securities Market (MSM), and Saudi Stock Market (SSM).[12] The Palestine Securities Exchange (PSE) suspended operations in March 2002,[13] and the Baghdad Stock Exchange closed in March 2003.[14] The Syrian Arab Republic is considering opening a stock market in 2004. Table 1 provides figures on market capitalization[15] for each of the stock markets in the ESCWA region, and table 2 offers a sectoral breakdown of the number of companies listed on the region's exchanges.

1. *Brief overview of the active stock markets in ESCWA member countries*

The Amman Financial Market was first established in 1976 for the trading of securities and was reorganized in March 1999, becoming the Amman Stock Exchange, a private non-profit organization. Securities Law No. 23 of 1997 was implemented as part of the rehabilitation of the AMM. The Exchange's market capitalization rose by 27.5 per cent, from US$ 7.1 billion to US$ 9 billion, between December 2002 and July 2003 (see table 1). The AMM has 178 listed companies, the second highest number in the ESCWA region (see table 2).[16] Among the companies listed, the largest proportion are in the manufacturing sector (41 per cent), followed by the financial services sector (33 per cent) and the services sector (7 per cent). Thirty-seven per cent of the market capitalization is held by non-Jordanian investors.[17] Jordan has undergone a wide range of economic reforms in the past decade in preparation for membership in the World Trade Organization (WTO) and the ratification of the Jordan-United States Free Trade Agreement and the Jordan-EU Association Agreement, and as part of its overall development policy to attract foreign investment and diversify its economic base. These reforms will help sustain the upward trend in market capitalization and the volume of trading activity on the Exchange.

The Bahrain Stock Exchange was established under Amiri Decree No. 4 of 1987 and commenced operations in June 1989, with 29 companies listed initially. BSE market capitalization rose by 6.8 per cent, from US$ 7.7 billion to US$ 8.2 billion, between December 2002 and July 2003 (see table 1). There are 42 companies currently listed on the Exchange, almost two thirds of which are in the financial services sector (see table 2). Non-Bahraini companies represent 14 per cent of the total listings. The BSE was partially opened to foreign investors starting in 1999. Citizens of Gulf Cooperation Council (GCC) States have 100 per cent access, while that of investors from non-GCC countries ranges from 49 to 100 per cent and is contingent upon shareholder approval.[18] Bahraini nationals accounted for approximately 65 per cent of the total value traded in 2002, while other GCC States' nationals accounted for 31 per cent and non-GCC investors only 4 per cent.

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[12] The abbreviations used for the various exchanges correspond with those used by the Arab Financial Markets Network, based in Abu Dhabi (see http://www.alshabaca.com).

[13] Arab Financial Markets Network, "Palestine Securities Exchange suspends trading" (http://www.alshabaca.com/mefn/info), accessed on 14 April 2003.

[14] Cynthia Johnston, "Coalition wants to build new Iraqi stock exchange complex", *The Daily Star* (Beirut, 25 July 2003).

[15] The total number of issued shares multiplied by their respective prices at a given time (see World Federation of Exchanges, "Equity market capitalization" [http://www.world-exchanges.org/fibvforum/statistic]).

[16] In the present subsection, all references to current company listings on the region's exchanges are for July 2003.

[17] "Non-Jordanian ownership stands at 37.4 per cent of market value", *The Jordan Times*, Economy Section (17 February 2003).

[18] Clare Woodcraft, loc. cit., p. B1.

TABLE 1. STOCK MARKET CAPITALIZATION IN ESCWA MEMBER COUNTRIES

Securities market	Year established	Market capitalization (millions of US dollars)		Percentage change
		December 2002	July 2003	
Abu Dhabi Securities Market	2000	20 376	23 883	17.2
Dubai Financial Market	1998	9 470	9 995	5.5
Amman Stock Exchange	1976	7 087	9 033	27.5
Bahrain Stock Exchange	1987	7 716	8 238	6.8
Beirut Stock Exchange	1920	1 395	1 453	4.2
Doha Securities Market	1995	10 567	15 029	42.2
Cairo and Alexandria Stock Exchanges	1903, 1888	26 339	29 867	13.4
Kuwait Stock Exchange	1977	35 099	48 275	37.5
Muscat Securities Market	1989	5 268	5 988	13.7
Saudi Stock Market	1984	74 851	103 576	38.4
Total		198 168	255 337	28.8

Sources: Arab Monetary Fund (AMF), "Quarterly report", fourth quarter 2002, No. 32 (in Arabic); AMF, "Arab capital markets performance" (http://www.amf.org.ae/vEnglish), accessed on 28 July 2003; ABQ Zawya Ltd., "Country equities", section on listed companies (http://www.zawya.com/equities), accessed on 30 July 2003; and Abu Dhabi Securities Market, *Monthly Statistical Bulletin* (April 2003), p. 7.

TABLE 2. COMPANIES LISTED ON STOCK EXCHANGES IN THE ESCWA REGION, BY SECTOR*

Sector	AMM	BSE	BY	CASE	DFM	DSM	KSE	MSM	SSM
Academia	3	—	—	—	—	—	1	3	—
Agriculture	2	1	—	5	—	—	4	6	8
Communications and computing	1	1	—	3	—	1	2	—	1
Conglomerates	—	—	—	1	—	—	1	1	—
Construction	—	—	—	28	—	—	2	1	1
Financial services	58	27	6	44	12	13	45	40	13
Health care	3	—	—	5	—	1	—	1	—
Manufacturing	73	3	3	118	—	4	19	59	26
Media and broadcasting	3	1	—	1	—	—	1	—	—
Mining and minerals	5	—	—	—	—	—	—	1	—
Oil and gas	3	—	—	2	—	1	2	3	4
Power and utilities	2	—	—	—	1	1	—	3	1
Services	13	5	1	16	2	3	19	12	8
Trading and retailing	4	4	2	9	—	—	6	2	3
Transport and shipping	8	—	—	8	—	2	4	4	4
Total	178	42	12	240	15	26	106	136	69

Source: ABQ Zawya Ltd., "Country equities", section on listed companies (http://www.zawya.com/equities), accessed on 30 July 2003.

Note: AMM: Amman Stock Exchange; BSE: Bahrain Stock Exchange; BY: Beirut Stock Exchange; CASE: Cairo and Alexandria Stock Exchanges; DFM: Dubai Financial Market; DSM: Doha Securities Market; KSE: Kuwait Stock Exchange; MSM: Muscat Securities Market; and SSM: Saudi Stock Market. (The abbreviations used for the various exchanges correspond with those used by the Arab Financial Markets Network, based in Abu Dhabi [http://www.alshabaca.com]).

* The number of companies with shares listed on the specified stock exchange as at end-July 2003.

The Beirut Stock Exchange is one of the oldest and smallest Arab investment markets. It was established in 1920 as a currency exchange, attracting investments from France, Lebanon and the Syrian Arab Republic. The market closed in 1983 as a result of the Lebanese civil conflict and reopened in January 1996.[19] There are 12 companies currently listed; 50 per cent are in the financial services sector, and 25 per cent are in the manufacturing sector (see table 2). The Beirut Exchange has the lowest market capitalization and smallest number of listed companies among the ESCWA member countries. Market capitalization totalled almost US$ 1.5 billion in July 2003, up only 4.2 per cent from December 2002 (see table 1). Macroeconomic policies responsible for the country's high interest rates,[20] "huge public debt, poor fiscal stance, [and] lack of sweeping economic reforms"[21] will continue to strangle the growth of the Exchange in the near future.

The first Egyptian stock market was established in Alexandria in 1888. The Cairo exchange opened in 1903. The market capitalization of the Cairo and Alexandria Stock Exchanges, the third highest in the ESCWA region, rose from US$ 26.3 billion to almost US$ 30 billion (13.4 per cent) between December 2002 and July 2003 (see table 1). There are 240 companies listed on the CASE, the highest number among the ESCWA members (see table 2). The largest proportion of listed companies are in the manufacturing sector (49 per cent), followed by the financial services sector (18 per cent) and the construction sector (12 per cent). The CASE is poised to become one of the strongest stock markets in the region, given the size and diversity of the Egyptian economy. However, "recurrent pressures on the Egyptian pound and mixed corporate results [have] dampened investors' confidence in the market".[22]

The Doha Securities Market was established in 1995 and began operations in May 1997.[23] Market capitalization rose by 42 per cent between December 2002 and July 2003, reaching US$ 15 billion (see table 1). Half of the 26 companies listed on the exchange are in the financial services sector (see table 2). Serious constraints are placed on foreign investors, and GCC investors have only marginally improved access to publicly listed shares.[24] The citizens of GCC States are restricted to investments in the industrial and services sectors, while foreign investors in general are limited to purchases of equity in newly established or privatized Qatari companies.

The United Arab Emirates has the two most recently established stock markets in the region. The March 2000 inauguration of the Dubai Financial Market, established in 1998,[25] was followed by the establishment of the Abu Dhabi Securities Market under Law No. 3 of 2000. The Dubai exchange has 15 listed companies (see table 2); 80 per cent are involved in financial services, 13 per cent in services, and 7 per cent in power and utilities. Market capitalization for the DFM rose by only 5.5 per cent between December 2002 and July 2003, from US$ 9.5 billion to US$ 10 billion. ADSM market capitalization increased from US$ 20.3 billion to almost US$ 24 billion, or by more than 17 per cent, during the same period (see table 1). Although it is the newest stock market in the region, the exchange in Abu Dhabi has the fourth highest market capitalization among the ESCWA members. As is the case with several other stock markets in the Gulf subregion, foreign investment is limited to 49 per cent, and shareholder approval is required for investors from other GCC and non-GCC countries.[26]

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[19] "Stuck market", *Lebanon Opportunities*, Finance Section (April 2002), p. 98.

[20] Ibid., p. 99.

[21] Henry Azzam, "Performance and outlook of Arab stock markets", *The Jordan Times*, Economy Section (19 January 2003).

[22] Ibid.

[23] Doha Securities Market, "About DSM: developments" (http://www.dsm.com.qa/aboutdsm), accessed on 1 August 2003.

[24] Clare Woodcraft, loc. cit.

[25] ArabicNews.com, "Dubai inaugurates official stock market", United Arab Emirates, Business Section (27 March 2000).

[26] Clare Woodcraft, loc. cit.

The first law authorizing a Kuwaiti securities market was issued in October 1962, and the Kuwait Stock Exchange opened in April 1977.[27] In August 1983 the KSE was reorganized, becoming an independent financial institution. There are 106 companies listed on the Exchange, with the largest proportion (42 per cent) doing business in the financial services sector; the remaining companies reflect a diverse mix of economic activities including agriculture, computing, construction, manufacturing, broadcasting, oil and gas, services, retailing, and transport (see table 2). Market capitalization totalled US$ 48 billion in July 2003, the second highest figure among the ESCWA member countries, having risen by 38 per cent between December 2002 and the following July (see table 1). In May 2000, Kuwait adopted legislation allowing outside investors to purchase shares in local companies, opening the way for foreign investment.[28] The KSE has excellent potential for growth, in terms of both market capitalization and the ability to attract foreign investment, as Kuwaiti companies and the stock market are well situated to participate in the rebuilding of the Iraqi economy.

The Muscat Securities Market opened in 1989 with 47 publicly listed companies; by July 2003 this figure had risen to 136 (see table 2). The manufacturing sector accounts for the largest proportion of listed companies (43 per cent), followed by financial services (29 per cent) and services (9 per cent). Market capitalization totalled US$ 6 billion in July 2003, up 14 per cent from December 2002 (see table 1). In 1999, Oman established the Capital Market Authority to regulate the MSM and the listed companies and to protect the rights of investors.[29] While the nationals of GCC countries have unlimited access to this market, fewer than one third of the existing investment opportunities on the exchange are open to non-GCC investors; however, new initial public offerings (IPOs) must be made available to foreign investors, "up to at least 49 per cent" of market capitalization.[30]

The Saudi Stock Market does not have a physical trading floor; however, there have been joint stock companies operating in the country since the 1930s. A formal market was established in 1984. It is regulated by the Saudi Arabian Monetary Agency and operated through the electronic trading of publicly listed shares. A law was passed in June 2003 to regulate the stock market and to provide a physical location for trading.[31] The market capitalization of the SSM—the highest in the region, accounting for 41 per cent of the total in the Arab world—rose from US$ 75 billion to US$ 104 billion (38 per cent) between December 2002 and July 2003 (see table 1). The Market has 69 companies listed, with most situated in the manufacturing and financial services sectors (see table 2). A few companies from the agriculture, services and transport sectors give the market some depth. This is the most restrictive Arab market in terms of foreign ownership, allowing foreign investment only in mutual funds; other GCC nationals are allowed to own a maximum of 25 per cent of locally listed companies.[32]

B. STOCK MARKET NETWORKING IN THE ESCWA REGION

Financial liberalization, the process of lowering institutional barriers to the movement of funds in and out of national capital markets, began among the industrialized countries around the 1950s;[33] however, significant progress was not made until the 1970s. The integration of world capital markets through FDI has done much to stimulate international short-term capital flows in the liberalized markets. On the downside, the globalization of a country's financial market can result in a more volatile exchange rate and less of a

[27] Kuwait Stock Exchange, informational brochure on relevant decree (in Arabic).

[28] *Middle East Economic Digest*, Companies/Kuwait web page (14 December 2001) (http://www.meed.com).

[29] ArabicNews.com, "Oman begins implementation of modern security laws and structure to protect investors", Oman, Economics Section (16 January 1999), p. 1.

[30] Muscat Securities Market (http://ww.msm.gov.om/html_pages/organise.htm), accessed on 29 January 2003.

[31] Jordan Investment Trust Plc. (Jordinvest), "Saudi cabinet clears the way for a formal stock market", *Weekly Review & Analysis*, vol. III, No. 21 (Amman, 22 June 2003).

[32] Clare Woodcraft, loc. cit.

[33] Franklin Root, *International Trade and Investment*, 7th ed. (Cincinnati, Ohio, South-Western College/West Publishing Co., January 1999).

response of short-term interest rates to domestic monetary policy. Since the late 1980s, most ESCWA members have acknowledged the importance of the stock market and the private sector in the achievement of economic development objectives. Accordingly, they have followed the lead of the international community and have taken steps to empower the private sector. These Arab countries have realized that the stock markets represent an essential mechanism for the mobilization of national capital resources and their utilization for investment and ultimately economic development. Stock markets, if well managed and strongly supported by effective disclosure methods and a fair penal code, can inspire the trust and provide the credibility necessary for private savings and investment in a country, and thus create the proper climate for private sector projects. During the last part of the twentieth century, the interest and commitment these countries exhibited in developing and reforming their economic structures was reflected in the increase in the number of active stock markets—from only four in the 1970s (Egypt, Jordan, Kuwait and Lebanon) to 11 by the year 2000.

The next step is for the emerging stock markets of the ESCWA region to share their pool of capital resources through networking. However, a common framework should be established first; essential elements include the harmonization of stock market terminology and rules, infrastructure compatibility, and good corporate governance that includes reliance on International Accounting Standards. The capital markets in the ESCWA member countries vary in terms of their institutional organization and management and the separation or unification of executive and supervisory functions. Brokerage requirements also vary; individuals are permitted to practise in countries such as Lebanon, while in Egypt and Kuwait only companies are allowed to serve as intermediaries. The stock markets differ with regard to the level of transparency required of listed companies and the procedures applied in the trading and pricing of shares. Legislation protecting investors has improved greatly in some areas, including Jordan and Kuwait. Some of the markets still restrict the participation of foreign investors, including other Arabs. The GCC members give the citizens of GCC States priority over other Arab and non-Arab investors. Other stock markets in the region are less restrictive; Egypt and Lebanon, for instance, allow all foreign investors to trade freely in publicly listed shares.

1. *Efforts to develop an Arab stock market network*

Upon the recommendation of the Council of Governors of Arab Central Banks, and with the agreement of the Economic and Social Council of the League of Arab States, the Union of Arab Stock Exchanges and Securities Commissions (UASE) was established in 1982. The stock markets of Amman, Beirut, Casablanca and Tunis were the first to join, followed rapidly by several others; currently there are 11 members. The UASE was set up to organize the member stock markets, promote the exchange of technical expertise, identify and remove legislative barriers hindering intra-Arab investment flows, and facilitate the cross-border trading of Arab stocks. The UASE ultimately seeks to establish a regional stock market that facilitates intra-Arab investment flows.[34]

The objectives of the UASE are to assist in the development of Arab stock markets and improve the quality of brokerage companies, to establish lines of communication between the Arab stock markets and facilitate the joint listing of those Arab companies that seek to contribute to financial interdependence among the members of the UASE, and to increase the freedom of Arab citizens to participate in the region's stock markets. Achieving the goal of exchanging lists of stocks registered in the various Arab markets has proved difficult. Relevant studies suggest that the differences in listing regulations, the lack of essential institutions for providing effective settlement and brokerage services, and the discrepancies in the levels of development among the Arab markets all hinder the cross-listing of securities. Among the more important obstacles to market networking through cross-listing are the differences in investment laws in the Arab stock markets and the stock ownership limits imposed on the citizens of other Arab countries by laws requiring minimum share ownership percentages among nationals. All these factors effectively hinder intra-Arab investment flows. Legislation governing the establishment of companies, stock markets and taxation codes have influenced

[34] Union of Arab Stock Exchanges and Securities Commissions, *The Basic System* (Kuwait) (in Arabic).

trading practices in different Arab countries.[35] It is difficult to break down the barriers that discourage cross-listing among Arab stock markets. During the first phase of efforts to promote Arab stock market networking by the UASE, comparative studies explored the different listing rules for each market with the aim of identifying similarities between them. The UASE used its research findings to establish a set of common rules for the different markets; however, each market preferred its own system. It became clear that market development derives from the particular situation in each area, and that it is necessary to respect community values and local realities.[36]

2. *Bilateral and multilateral Arab stock market networking*

The experiences of the first phase of the UASE networking efforts led to the search for another system to link the Arab stock markets. It was deemed necessary to create a mechanism to promote intra-Arab investment flows with minimum company and investor costs and legislative action. The liberalization of trade and services and the spread of privatization policies starting in the mid-1990s improved prospects for the adoption of a new mechanism to connect Arab markets. This time the UASE tried to strike a balance between regional stock market networking requirements and the specific characteristics of each Arab market.[37] The first multilateral Arab stock market networking experience began with an agreement between the Kuwait Stock Exchange and Egypt's Capital Market Authority in April 1996. The agreement was designed to enhance cooperation in organizing the issuing and trading of stocks and to encourage investment.[38] In September 1996 the Beirut Stock Exchange signed the agreement, which stressed that all parties should together try to coordinate and facilitate procedures and requirements for offering stocks in their markets. The agreement entered into effect on 1 January 1997,[39] regulating the clearing and settlement operations in each market to ensure that those trading on any of the markets received their equity shares, and facilitating the exchange of information and the organization of disclosure procedures relevant to the companies listed on the markets. A joint committee consisting of representatives of the three markets and the UASE was formed to establish the executive regulations necessary to achieve the objectives of the agreement.[40] First, the three clearing and settlement agencies working in the markets of Egypt, Kuwait and Lebanon signed a cooperation agreement in October 1996, clarifying the principles governing cooperation in the clearing and settlement of transactions. In November 1996, executives from the three markets met to finalize the procedures and regulations for payment, delivery and transfers. Second, a conference was held for brokers in December 1996, leading to the signing of a brokers' cooperation agreement. It was necessary for brokers, as the agents trading on behalf of investors, to understand their new responsibilities in the networked market, and to get acquainted with each other and with the clearing and settlement agencies involved in the networking project. It was also necessary for brokerage companies to find agents to represent their interests in the network's other two markets.[41]

This first step towards multilateral Arab stock market networking was made possible by the infrastructure compatibility between Egypt, Kuwait and Lebanon. Two sets of factors have been particularly important for the success of this agreement: (a) the existence of modern systems for electronic trading, providing security and improving transparency; and (b) the availability of clearing and settlement institutions and securities depositories, mechanisms for ensuring the rapid completion of property transfers, and guarantees to protect the equities of both local and foreign shareholders in each of the three markets.

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[35] Soliman Al-Mondhiry, "Arab stock markets: the role, relations, and challenges of liberalization", *Strategic Economic Trends*, quarterly journal (Cairo, Al-Ahram Financial Reports, 2000), p. 146.

[36] Adel Allam, "Building an Arab institution for clearing and settlement", *Stock Markets*, a magazine published by the Union of Arab Stock Exchanges and Securities Commissions (Kuwait, 14 May 1997) (in Arabic).

[37] Ibid., p. 48.

[38] There are various bilateral agreements between Bahrain and Jordan, Bahrain and Kuwait, and Jordan and Oman.

[39] "Arab stock exchanges: UASE calls for integration", *Middle East Economic Survey*, vol. XLI, No. 29 (20 July 1998), p. 1.

[40] Saafak Al-Rakaiby, "Arab stock exchange networking: mechanisms and objectives", paper prepared for the annual conference of the Union of Arab Stock Exchanges and Securities Commissions, Cairo, 15-17 June 1997 (in Arabic).

[41] Ibid.

Ensuring that all the appropriate mechanisms are in place has facilitated networking by reducing the investor risks associated with cross-border stock market transactions.

Networking of the stock markets in Egypt, Kuwait and Lebanon has produced a number of benefits.[42] Investors from each country have been able to invest in companies listed on the other two markets without having to travel there, and have benefited from the guarantees the markets offer. The clearing and settlement system in each country has remained the same as before the agreement was signed, and local legislation has remained unchanged, saving time and resources that would have been required to negotiate the harmonization of laws and regulations. Brokers have been encouraged to establish professional relations with their counterparts in the other markets. It is possible to consider this trilateral networking arrangement as an organizational framework for an Arab financial market, especially if the institutional component is created.

Various challenges have arisen for those attempting to invest in the other two markets. Some have encountered difficulties with the clearing and settlement agencies and brokerage companies. Studies[43] indicate that the problems tend to be caused by differences in the ability to handle certain aspects of trading; there are those that have been unable to execute orders with the required speed, some brokerage companies have not complied with the orders they have received, and many have hesitated to execute orders because they lack the necessary information about the standing of listed companies.[44] A solution to the major problems faced by clearing and settlement companies may lie in the following recommendations: first, brokers should increase their financial resources to allow for the extra costs (over and above their commission) that clients are presently paying; second, brokers must be provided with reports detailing the financial standing of their clients; third, regulations that prohibit clients from buying and selling on the same day should be changed; and fourth, brokerage companies should be permitted to participate in Arab clearing institutions, a practice the UASE has adopted.

Cross-listing agreements also exist between Bahrain, Jordan and Oman, and between Jordan and Kuwait.[45] In 1997 Kuwait and Bahrain signed a bilateral pact that establishes a common settlements system to facilitate transactions and reduce investor costs, similar to the agreement Kuwait signed with Egypt and Lebanon.[46] Arab financial markets with restrictions on foreign investors are moving towards increased openness. For example, some GCC members (Bahrain, Kuwait and Oman) are in the process of eliminating restrictions on capital shares owned by the citizens of GCC States. "A single unified Gulf market may be a long way off, but moves are under way to start the ball rolling."[47] These policy changes are moving the GCC countries towards a common capital market, but each market will be able to maintain its own identity in terms of domestic legislation. The six GCC States are negotiating to form a multilateral network of their stock markets. The heads of these markets met in March 2000 to discuss ways to unify legislation, corporate frameworks, settlement and depository arrangements, and inter-country transfers.[48] However, as is evident from the long delays experienced in the establishment of the GCC customs union, the harmonization of financial legislation and stock market regulations is likely to involve a long negotiation process.

3. *Ongoing efforts towards Arab stock market networking*

UASE members approved the creation of the Arab Financial Markets Network (AFMN) and a joint Arab institution for clearing and settlement; the former was established in September 2001, but concerns

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[42] Adel Allam, loc. cit., p. 48.

[43] Ibid., p. 30.

[44] Saafak Al-Rakaiby, op. cit, p. 31.

[45] Kamal Naser, op. cit.

[46] ArabicNews.com, "Pact on linking bourses in Kuwait and Bahrain", Bahrain-Kuwait, Economics Section (10 February 1997).

[47] Clare Woodcraft, loc. cit., p. B2.

[48] ArabicNews.com, "Heads of the Gulf stock markets in Mascut [sic] to tackle improvements", Gulf, Economics Section (5 March 2000).

over initial capital requirements have delayed the establishment of the latter, which was to have taken place in early 2001. The clearing and settlement institution, once inaugurated, will facilitate cross-border trading for investors from UASE member States. Its objectives extend beyond clearing and settlement activities; the institution will participate in the transfer of funds between Arab countries and will organize operations for issuing and offering stocks, greatly improving prospects for Arab stock market networking. It will also function as an international stock depository. The UASE describes the designated activities of the institution as follows: (a) it should clear and settle transactions between different Arab markets; (b) it should function as a depository and central registry; and (c) it should facilitate operations for the listing and trading of Arab company stocks.

The UASE is addressing the equally important issue of investor education. Potential regional investors may not be aware of new opportunities created by the networking of their stock markets. The AFMN, established by the UASE, plays a key role in providing investor education and promoting transparency among the Arab stock markets. Through the AFMN, investors have easy access to time-sensitive online information about the standing of listed companies, share prices and market indicators across the region, a repository of information on the listed companies, information on the rules and regulations of the different stock markets, updated stock market news, research and financial market analysis, order routing, and coverage of live events and market activity. This phase of the UASE project was completed with the launching of the AFMN web site.

The aim of the second AFMN phase is to facilitate regional stock market networking through the creation of a virtual stock exchange in cyberspace, referred to as the Net; this mechanism is currently under development.[49] The UASE has proposed the formation of an Arab stock exchange corporation to identify the most actively traded stocks so that they may be listed electronically on all the Arab stock markets, facilitating cross-border transactions and improving access to regional investment funds for Arab companies.[50] The Net will incorporate electronic interfacing between brokers and the networked stock markets to accommodate the various rules and regulations applicable to the individual markets. For the broker the interface will be invisible, and the participating companies will appear to be listed on the one virtual exchange, when in reality they will be listed on their domestic stock markets and governed by local rules and regulations. In this sense, a virtual stock exchange is easier to implement than a single Arab trading platform, which would require the complete harmonization of regulations and the unification of financial legislation. Comprehensive information on the rules and regulations of each stock market will be available to investors through the Net web site. Arab investors participating in developed capital markets outside the region must educate themselves on the rules and regulations governing their transactions on those exchanges, and intraregional investors conducting transactions through a virtual Arab stock market will need to do the same. Under the Net system, each national exchange will maintain its identity and local flavour to better serve the needs of its domestic companies. However, the Net will also facilitate cross-border transactions, providing regional investors faster and better access to publicly listed shares of Arab companies throughout the region.

A number of different strategies can be employed to facilitate intraregional investment flows and stock market networking. First, a company can list shares on more than one stock exchange to increase its access to capital funds. For example, Qatar Telecom (Q-TEL) is jointly listed on the Doha Securities Market, the Bahrain Stock Exchange, and the Abu Dhabi Financial Market, giving the company access to investment funds in all three countries. Q-TEL managers spent a substantial amount of time and money learning the rules and regulations of each stock market and meeting their respective requirements in terms of market capitalization, financial disclosure, listing fees and so on. This is a costly way to raise equity capital for all but the largest companies. A second option is for a company to increase its access to regional investment funds by petitioning its Government to allow foreign investors access to its domestic stock market. For Q-TEL, this would eliminate the need for joint listings on three exchanges and the associated costs to the company. However, investors in Bahrain and the United Arab Emirates would have to absorb new costs

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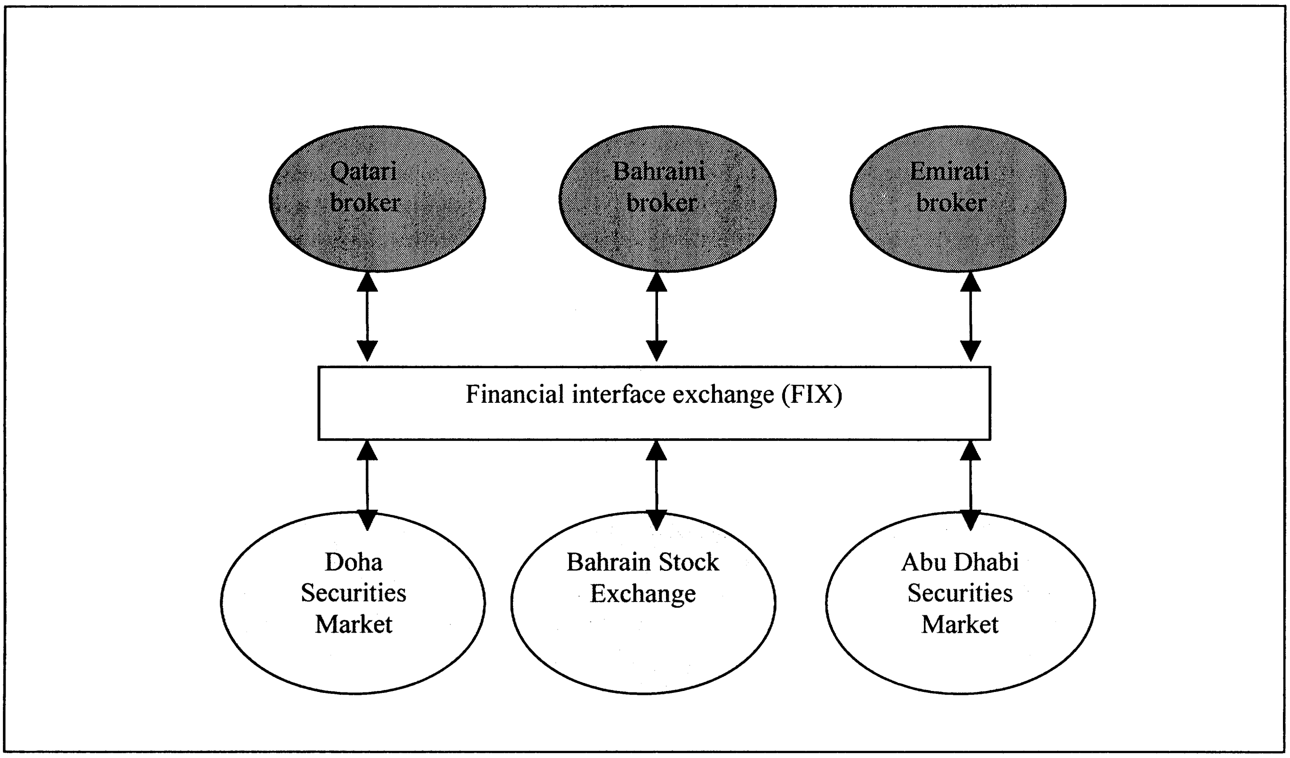
[49] Arab Financial Markets Network, home page (http://www.alshabaca.com/mefn/home/aboutprofile.jhtml), accessed on 4 August 2003.

[50] Interview with Saafak Al-Rakaiby, General Secretary, Union of Arab Stock Exchanges and Securities Commissions (Cairo, 11 March 2003).

linked to obtaining timely financial information on a company listed outside their stock markets, registering as foreign investors on the Doha Securities Market, and conducting transactions through Qatari brokerage firms. A third strategy, promoted by the UASE through its Net project, is to link the Arab stock markets electronically. This format would make the publicly listed shares of Q-TEL on the Doha Securities Market available to local brokers in Bahrain and the United Arab Emirates through a financial interface exchange (FIX), as if the shares were jointly listed on their domestic stock markets. The Net interface will be transparent for brokers and investors and, as previously mentioned, will be programmed to accommodate the various rules and regulations of the individual stock markets (see the figure).[51] A virtual stock exchange that facilitates cross-border trading can increase the depth and liquidity of the Arab financial market, reduce the transaction costs associated with such trading, provide timely information through state-of-the-art technology, and help eliminate the informational inefficiency and long memory typical of the Arab stock markets.

Figure. Example of an effective electronic cross-border trading mechanism



[51] Interview with Mohammad Al-Qubaisi, Executive Director, Arab Financial Markets Network (Abu Dhabi, 7 June 2003).

II. STOCK MARKET NETWORKING AND TECHNICAL REQUIREMENTS

A. THE HARMONIZATION OF FINANCIAL LEGISLATION AND INFRASTRUCTURE COMPATIBILITY NECESSARY FOR STOCK MARKET NETWORKING

This section analyses the differences in the financial legislation and institutional frameworks that constitute the essential structure for capital markets in ESCWA member countries. Market management and organization, listing and disclosure requirements, and trading and pricing procedures all vary, to the extent that each market now has its own shape and values, as well as inherent factors for success and failure. Levels of market development also vary radically. Each domestic market has its particular history, experiences and mechanisms, which makes regional generalizations difficult.[52] Specific examples from selected ESCWA member stock markets will be provided for each of the legislative and institutional topics addressed in this section.

The most important factors for market networking are the harmonization of financial legislation and infrastructure compatibility, neither of which has been achieved thus far in the ESCWA member countries, in spite of the recent market reforms. The most successful networking experience in the region has been between the capital markets of Egypt, Kuwait and Lebanon, though various obstacles have been faced in practice, in particular the lack of a regional institution for clearing and settlement (capital subscription concerns have delayed the inauguration of this institution; see chapter I). This experience encouraged the development of a new method to improve the performance of the more successful blue chip stocks. Such efforts, however, do not diminish the necessity of improving the regulations in the region's stock markets so that better conditions exist to facilitate effective networking among the Arab markets.

1. *The legislative framework*

A stable and supportive legal, economic and sociocultural environment encourages the investment of capital in developing countries in general, and in the Arab countries in particular. The growth of savings and the development of fiscal structures influence and are affected by these factors. Appropriate legislation and effective control mechanisms and practices are not sufficient to promote investment and enhance trading in a given market; it is also necessary to take measures such as offering tax incentives and ensuring the availability of information. Laws that protect the rights of investors are vital as well, as they create a sense of trust.[53] The legislative framework for stock markets consists of the laws, company acts and executive orders that regulate the issuing and trading of stocks. Stock market laws and company acts are crucial, as are other relevant legal instruments such as investment promotion and banking laws and rules governing auditing practices. Two areas require attention in adapting the legislative environment to the needs of the stock market: first is the harmonization of laws relating to stock issuance, exchange and investment; second is the achievement of a balance between the auditorial and developmental roles of these laws—starting with the objectives, which include organizing the markets and developing them in a way that ensures credibility.

The availability of relevant legislation and institutions means little without a minimum level of harmonization and compatibility between a country's laws; an internally consistent body of law, applied within an appropriate institutional framework, creates the infrastructure necessary for a successful financial market that responds to the demands of savers and investors and guarantees the continuation of brokerage intermediation for the market.[54]

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[52] Arab Investment Guarantee Corporation, *The Arab Capital Markets 1985* (Kuwait) (in Arabic); also see Soliman Al-Mondhiry's doctoral dissertation relating to capital markets, entitled *Historical Background, Basic Characteristics and Means of Integration* (Beirut, Al-Razy Publications, 1987) (in Arabic).

[53] Soliman Al-Mondhiry, "The economic environment for stock markets", Al-Ahram Financial Reports, No. 96 (Cairo, January 1996), p. 30 (in Arabic).

[54] Ahmad Abi Sourour, "The financial markets: towards development to face the challenges", paper prepared for the annual conference of the Union of Arab Stock Exchanges and Securities Commissions, Cairo, 15-17 June 1997 (in Arabic).

(a) *Stock market laws and regulations*

Stock market law encompasses the basic rules pertaining to the objectives and factors of the market and to its management and financial organization. It also defines and organizes market relations and specifies the procedures and structure of operations, the processes to be followed in listing and trading stocks, and disclosure requirements. This legislation is explained through executive regulations, which clarify it by application and expansion.

Financial market laws in a number of ESCWA member countries address the same basic issues and concerns, including management and the institutional structure, membership, listing requirements, financial disclosure, and trading and pricing procedures.

(i) *Management and the institutional structure*

The institutional framework for the market incorporates the various mechanisms for managing and supervising trading activities. There are differences in the legal organization of the markets in the ESCWA region. In Bahrain, Kuwait, Lebanon and Qatar, market management is allowed to serve both executive and supervisory functions under the umbrella of a securities and exchange commission. In the markets of Egypt, Jordan and the GCC countries these roles are divided between two institutions, one responsible for the stock exchange and the other for supervision. Each option has its advantages and disadvantages. The first system, which unifies financial sector management and supervision under a financial services authority, follows the British model; the second system, which gives the responsibility of supervising the market to financial services institutions, is based on the American approach. According to recent studies, the lessons learned from the South-East Asian economic crisis confirm that unifying the management and supervision of the financial sector is the better of the two options, since it provides a better environment for securing the national economy against internal and external shocks.[55]

Egypt was the first Arab country to separate executive and supervisory responsibilities. The Capital Market Authority—established through Presidential Decree No. 520 of 1979 to develop and regulate the market, conduct market surveillance, and provide market information—oversees trading on the Cairo and Alexandria Stock Exchanges.[56] Jordan decided, after reviewing its experience in creating the Amman Financial Market and its legislation on issuing securities, to establish the Jordan Securities Commission as a supervising agency. Article 7 of the relevant law indicates that the Commission will endeavour to create a stable and secure environment for the exchange of stocks. It is also responsible for organizing, developing and supervising the Kingdom's stock market, protecting the rights of shareholders and investors, and penalizing those who engage in illegal activities or generally try to abuse the system.[57]

The laws governing the market in countries such as Kuwait, Lebanon and Qatar, in which the executive and supervisory roles are combined, have given the stock market management teams extensive authority to oversee various activities. In Kuwait, for instance, the Stock Exchange Commission is chaired by the Minister of Commerce and Industry. Others on the Commission include the market's general manager, two experienced and knowledgeable individuals selected by the Council of Ministers, and four members chosen by the Kuwait Chamber of Commerce and Industry, one of whom is capable of functioning as an intermediary. The management structure includes a subcommittee headed by a judge to resolve conflicts. This group fulfils a wide range of managerial functions for a period of four years.

In line with the trend towards public sector privatization and enhancing the role of the private sector, some Governments in the region have started privatizing their stock markets. In Jordan, the stock market was recently separated from the legislature and State supervision. Intermediaries working in the market were given the right to manage it as an independent body. In Egypt, even though supervision is separated from

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[55] Moneer Hindy, unpublished report on a study about the restructuring of the Kuwait Stock Exchange (in Arabic).

[56] Bank of Egypt, "Egypt's stock markets: problems and specific features of an emerging stock market, 1990-1996", Bank of Egypt research paper, No. 1 (1997), p. 10 (in Arabic).

[57] Jordan Securities Commission, "Securities Law: Law No. 23 of 1997" (http://www.jsc.go.jo) (in Arabic).

management, the market is still considered a government institution. The Chairman of the Capital Market Authority in Egypt stated recently that there were plans for the self-regulation of the CASE, with 18 bankers, insurance companies, brokerages and investors managing the privatized stock market.[58]

(ii) *Membership*

The stock exchange laws in the ESCWA member countries identify the members of the market as the listed shareholding companies and the approved market intermediaries. The laws and executive regulations define the legal requirements for and institutional role of the mediator, as well as his obligations and rights. Legal definitions of intermediaries differ from one country to another, but a common premise is that stock trading should occur on the floor through a registered mediator. The UASE notes the following in a comparative study on the laws regulating intermediation in Arab stock markets:[59]

(a) The legislation in Egypt, Oman and Qatar considers trading in listed stocks illegal if transactions are not executed through one of the official mediators, limits stock trading to the market floor, and prohibits any other form of trading;

(b) The legislation in Bahrain, Kuwait and Oman permits the trading of listed stocks outside a specific location on the condition that the exchange occurs in accordance with certain regulations. Though this might be considered a restriction, it still opens up the possibility of trading in listed stocks outside these markets. It would be more effective to permit the buying and selling of the stocks listed on a specific market in all circumstances through the listed intermediaries. This method would guarantee the safety of such transactions and permit the authorities to supervise them.[60]

The markets of ESCWA member countries differ in their definitions of intermediaries. Bahrain, Jordan, Lebanon and Qatar permit individuals to act in this capacity, while Egypt, Kuwait, Oman and the United Arab Emirates limit market mediation activity to companies. Some GCC countries allow international brokerage companies to intermediate, on the condition that they set up local branches to perform this function. Most Arab stock markets agree on the conditions for intermediaries' registration and licensing and on start-up requirements relating to minimum capital reserves, bank guarantees, academic qualifications, specialization in the field, and the legal authority to practise. Some markets have a pledge of honour by which intermediaries are expected to abide, covering rules of conduct and the maintenance of good relations among mediators; the UASE has such a pledge for Arab intermediaries.[61] In some cases there are societies mediators can join.

Firm regulations are set by financial market laws of ESCWA member countries to delineate the responsibilities of intermediators in the markets in which they work, to specify the penalties imposed for the failure to fulfil their duties and obligations towards their clients, and to regulate the supervision of mediation activities. Supervision covers what occurs inside the market and serves to guarantee that proper procedures are followed; it is a major responsibility of the management team. Mediators are expected to provide supervisors with whatever documents they require. Self-compliance with the rules of professional conduct are also necessary to allow the stock markets to carry out their functions.[62]

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[58] Abdulhameed Ibrahim, statements released to *Al-Ahram* newspaper (Cairo, 7 July 2003), p. 12 (in Arabic).

[59] Adel Allam, "Intermediation in the Arab stock markets: comparative study of the laws governing the brokerage professions", paper prepared for the annual conference of the Union of Arab Stock Exchanges and Securities Commissions, Damascus, 1-3 June 1996, p. 3 (in Arabic).

[60] Ibid., p. 3.

[61] Union of Arab Stock Exchanges and Securities Commissions, "Pledge of honour for mediators" (Kuwait, 1997) (in Arabic).

[62] Adel Allam, "Intermediation in the Arab stock markets...", op. cit., p. 32.

(iii) *Listing requirements*

Each company is responsible for meeting listing requirements, which are central to the functioning of the market since they heavily influence the supply of available stocks. Some ESCWA member countries share common rules and requirements for listing companies on their stock exchanges, but the differences are sufficient to prevent unification. Below is a review of relevant regulations for the markets of Egypt, Jordan, Kuwait, Lebanon, Oman, Qatar and the United Arab Emirates, focusing on listing requirements in the primary market.

a. *Capital requirements*

Examples of capital requirements include the following:

(a) The Abu Dhabi market requires the listed stocks to be issued by joint stock companies with paid-up capital of not less than 50 per cent of the listed value, which should be a minimum of 20 million Emirati dirhams (approximately US$ 5.4 million);[63]

(b) Bahrain's market law requires that the paid-up capital of a listed company be no less than US$ 1,315,000, and that the shares be worth at least US$ 500,000;

(c) In the Beirut stock market, the capital of a listed company should equal a minimum of US$ 3 million in Lebanese pounds. The shareholders providing 25 per cent of a company's capital should comprise a group of at least of 50 individuals;[64]

(d) In Egypt, the resolution of the Capital Market Authority regarding regulations for the continued listing or cancellation of stocks on the Alexandria and Cairo markets requires that the shares available for public offering equal at least 30 per cent of a company's total shares. Another requirement is that the capital issued be paid in full and equal a minimum of 20 million Egyptian pounds (LE) (approximately US$ 3.3 million) or its equivalent. There are two official lists in the Egyptian market: the first includes the stocks of companies that have fulfilled the necessary requirements; the second includes stocks the State issues and makes available in a public offering, stocks issued by the public sector but not necessarily included in a public offering, and company stocks for which the necessary shareholder minimum has not been met. There is an unofficial list, also divided into two categories, for those stocks that do not meet the principal requirements and thus cannot be placed on the formal lists. The unofficial lists include companies that, for example, lack the number of necessary shareholders or have an insufficient proportion of their stock offered for trading. Foreign stocks are also on the unofficial lists;[65]

(e) In Kuwait, Decision No. 1 of 1993, concerning the approval and listing of shares for trading, requires that the paid-up capital for a listed company not be less than 1 million Kuwaiti dinars (KD) (approximately US$ 3.4 million) or the equivalent sum in another currency;[66]

(f) According to article 5 of the Directives for Listing Securities on the Amman Stock Exchange, companies in Jordan must have paid-in capital or market capitalization of no less than 2 million Jordanian dinars (JD) (approximately US$ 2.8 million) for the listing of stocks, and a minimum of 10 per cent of a company's total subscribed shares must have been traded in during the 12 months preceding the change in

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[63] Abu Dhabi Securities Market, *Management-Objectives-Membership*, an introductory publication (Abu Dhabi, 2000) (in Arabic).

[64] Beirut Stock Exchange, "Trading operations", information document, No. 516/96/Mh (in Arabic).

[65] Ibid., p. 8; also see Egypt, Capital Market Authority, *Annual Report 2000* (Cairo, 2001), p. 42.

[66] Kuwait Stock Exchange, *Listing Requirements for Securities and Investment Funds* (Kuwait, Technical Bureau, 1993), p. 20.

the listing from the secondary to the primary market.[67] (The Amman Stock Exchange includes three markets; the first and second list and trade stocks according to special listing rules, and the third deals with unlisted stocks in the market).[68]

b. *Shareholder equity requirements*

Examples of shareholder equity requirements include the following:

(a) The Abu Dhabi Securities Market requires that the shareholder equity for each group of shares a company issues be equal, and that the value of the equities exceed the paid-up capital of the company by no less than 20 per cent;[69]

(b) Executive Regulation No. 7667 of 1995 for the Beirut Stock Exchange makes no reference to shareholder equity requirements;

(c) According to legislation adopted by Egypt's Capital Market Authority, shareholder equities should be no lower at the end of the year than at the beginning of the same year;

(d) Kuwait's stock market regulations do not refer to shareholder equities;

(e) Oman's stock exchange requires that shareholder equities for a company asking to be listed should, at the end of the year preceding the request, exceed paid-up capital by at least 10 per cent.

c. *Activity time-span requirements*

Examples of activity time-span requirements include the following:

(a) For the Abu Dhabi market, each company wishing to list its stock has to have been established at least two years earlier and to have issued annual financial statements audited by a party or parties authorized to do so;

(b) For the Egyptian market, the issuing company has to have published financial reports for the three years prior to the request for listing, and the reports must fulfil all relevant legal requirements;

(c) To participate in Kuwait's market, a company must have fulfilled the time-span requirements specified in the relevant law(s) in the country of origin; these provisions appear to apply to Kuwaiti and foreign companies alike. The second article of Decision No. 1 of 1993 does not include any time-span requirements;

(d) A company may not be listed on the Amman Stock Exchange unless it has spent an entire year on the parallel market.

d. *Company profit requirements*

Examples of regulations concerning company profits include the following:

(a) For the Abu Dhabi market, the company to be listed has to have achieved annual profits of at least 5 per cent during the two years preceding the listing request, and the profits must have been distributed to the shareholders;

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[67] Jordan, "Procedures for listing stocks on the Amman Stock Exchange", article 5 of the Directives for Listing Securities on the Amman Stock Exchange (2000), issued by virtue of the provisions of article 26A of Law No. 23 of 1997 (in Arabic).

[68] Ibid.

[69] Abu Dhabi Securities Market, *Management-Objectives-Membership…*

(b) There are no rules concerning profits for companies to be listed on the Beirut Stock Exchange;

(c) For the Egyptian market, a decision by the Board of the Capital Market Authority indicates that a company must show a profit of 5 per cent (excluding taxes) for the past year before the listing request will be accepted;[70]

(d) Decision No. 1 of 1993 indicates that a company wishing to be listed on the Kuwait exchange should not have sustained losses during the past year (though sufficient reason may be found to suspend this requirement);

(e) The Amman Stock Exchange requires that a company show some pre-tax profit for the year preceding its listing request.

e. *Shareholder requirements*

Some of the region's stock markets have particular listing requirements relating to shareholder equities, company sales, the volume of trading and the number of shareholders. The CASE requires at least 150 shareholders per company, regardless of nationality, and the stock exchanges in Amman and Doha have set a corresponding minimum of 100 individuals for each company. The Beirut market requires that 25 per cent of a company's stock be owned by a group of no less than 50 shareholders.

f. *Foreign company requirements*

Financial laws in ESCWA member countries generally specify the same requirements for both foreign and local companies, with some additional provisions included to protect the rights of market investors and ensure honesty in trading. A review of rules for the listing of foreign stocks on the markets of selected ESCWA member countries indicates the following:

(a) In the Abu Dhabi market, the securities and other financial instruments issued by foreign companies are subject to local listing requirements;

(b) For the Cairo and Alexandria exchanges, the Egyptian Capital Market Authority requires that foreign stocks be placed on the unofficial lists, and only if the same requirements applying to Egyptian companies are met.[71] In addition, a stock must be listed on a foreign exchange supervised by an authority practising procedures similar to those of Egypt's Authority, the shares must be in a foreign currency exchangeable with the Egyptian pound, and the foreign company must apply international auditing and control standards in the preparation of its financial reports. These reports, with the auditor's statements and necessary explanations attached, must appear in the morning edition of one of the popular public newspapers published in Egypt within a month of their accreditation in the country in which the company is located;

(c) For the Beirut Stock Exchange, article 83 of Law No. 7667 of 1995 permits foreign companies to request that they be listed on the official or the parallel market.[72] Article 86 indicates that the same requirements apply to Lebanese and foreign companies seeking to be listed. Each applicant is requested to provide all documents referred to in article 85 or its equivalent in the country of listing. An internationally accepted accounting method must be used for all financial documentation. Article 87 gives the market committee the right to reject any or all of the documents in any file supplied by the foreign source, even if all other requirements are met;[73]

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[70] Egypt, Capital Market Authority, "Decision No. 30" (18 June 2002) (in Arabic).

[71] Ibid.

[72] Lebanon, *Official Journal*, No. 51 (21 December 1995) (in Arabic).

[73] Ibid.

(d) In Kuwait, legislation adopted in 1986 requests that non-Kuwaiti joint stock companies submit the documents necessary to fulfil all requirements when applying for listing.[74] A company should prove that it is either listed on an international stock market acceptable to the Stock Exchange Commission or has made 25 per cent of its capital available for public offering in Kuwait. The paid-up capital must amount to at least KD 5 million, and the company cannot have sustained losses in the two years preceding the request for listing. The company's contract and essential system of operation must not contravene the laws of Kuwait. There can be no restrictions on the rights of new shareholders to trade in the stock of the company. A non-Kuwaiti joint stock company listed on the market must abide by the relevant national laws; within this context, the financial reports required by the Commission are to be submitted in a timely manner, along with the name and address of the auditor of the reports. A company also needs to notify the market administration of any decisions that could affect the price of its listed stock. Trade transactions involving the listed foreign companies' stocks must be handled by the brokerage companies selected by the market administration. Shareholding companies originating in any of the GCC States are exempted from these requirements;

(e) Article 14 of the Directives for Listing Securities on the Amman Stock Exchange indicates that the terms and conditions for listing stocks apply equally to Jordanian and non-Jordanian companies. The following is stipulated with regard to listing non-Jordanian securities (except mutual funds): the foreign securities must have been listed for at least two years on a non-Jordanian market that also permits the listing of Jordanian stocks if they fulfil its requirements, and the listed company's articles of association must not include any provisions prohibiting the transfer of ownership. However, if a Jordanian company wishes to list its securities on any stock exchange outside the Kingdom, it is required to inform the market authorities of the reasons for the request. This explanation is then sent, together with the opinions of the market authorities, to the Securities Commission to obtain the required permission (in accordance with article 15).

(iv) *Financial disclosure*

All stock market laws and company acts include provisions detailing the conditions and requirements for disclosure. Full disclosure is one of the most important market requirements; effective supervision and auditing practices invigorate trading and inspire trust in shareholders.[75] In addition, the disclosed information helps investors make the right decisions.

The quality and accuracy of disclosure derive from the accounting and auditing methods used. It is essential that listed companies prepare their respective financial reports in accordance with internationally accepted accounting and auditing standards, as this strengthens market supervision and ensures equal opportunities for participants. The stock market laws of ESCWA member countries require companies to disclose their budgets and any other information that may affects stock prices.

There are some clear differences among the Arab markets with regard to the nature of the required information, its dissemination, and the penalties imposed on those who provide false or incomplete reports or benefit from insider trading information. Authorities and listed companies share responsibility for the regular dissemination of accurate information. Most of the region's stock markets publish pertinent information in local journals or gazettes, focusing on trading activities, the daily price changes influencing market indicators, and the performance of the various economic sectors. The Arab Monetary Fund, for instance, regularly publishes a report that provides detailed financial data and summarizes the activities of the Arab stock markets. The following are examples of the rules relating to disclosure for three markets in the ESCWA region:

(a) Law No. 7667 of 1995, encompassing the executive regulations for the Beirut Stock Exchange, includes no rules concerning disclosure. However, article 222 of this Law requires the stock market to produce a free official publication that contains all information of interest to intermediaries, issuers and the general public; article 224 notes that this official publication should include all relevant documents; and article 225 indicates that all the documents pertaining to companies active in the stock market will be kept in

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[74] Kuwait Stock Exchange, *Listing Requirements for Securities and Investment Funds...*, p. 20.

[75] League of Arab States and others, *Unified Arab Economic Report, 2000* (Cairo, September 2000), p. 130 (in Arabic).

a special department that also houses other important resources dealing with stock market trading. This information is available to the general public from 9 a.m. to noon on working days, following the submission of a written request, in accordance with the rules set by the market committee. The disclosure system for the Beirut stock market is characterized by obvious flaws and should be modernized;[76]

(b) The Egyptian system of disclosure is perhaps the most detailed among the ESCWA region's stock exchanges. The Capital Market Authority plays an active role in ensuring transparency in the market, recognizing that this constitutes an essential, ongoing process that should reflect every major change and development. The Authority's decision[77] on the listing, continuation and cancellation of stocks on the Cairo and Alexandria exchanges includes rules concerning disclosure (articles 12-19) that apply to all the listed companies. Companies are not allowed to exaggerate or to disseminate information that does not reflect their actual financial standing. In all circumstances, they are required to make their documentation available to the authorities upon request. Companies are not permitted to give information to financial analysts or financial institutions before releasing it to the public. They must provide the Authority with the mandate of the shareholders' general assembly and notify it of any managerial decisions or actions within 10 days of each meeting. Disclosure occurs through notification of opportunities for public subscription. Before any company can make shares available in a public offering, it needs to obtain the permission of the Capital Market Authority, which will publicize all the relevant information in two daily periodicals, at least one of which is a popular Egyptian newspaper printed in Arabic. Disclosure also occurs through financial reporting. Every six months, each company with stock available in a public offering is required to disseminate information about its activities and their results or impact. The reports should disclose the company's financial, budgetary and other necessary information in accordance with auditing criteria. A company is required to publish summaries of its mid-year and annual reports within a week of their issuance by its general assembly in two daily journals, at least one of which is in Arabic (article 22). The decision of the Capital Market Authority also includes provisions dealing with a company's obligation to disseminate information about any irregular general meeting held as a result of accidents or unexpected activity on the trading screen of the stock market (article 24);

(c) One of the causes of the Al-Manakh crisis in Kuwait in the early 1980s was the absence of information or, more precisely, the lack of a system to provide the financial information necessary for investors. In organizing the market after the crisis, there was increased recognition of the need to provide investor security, establish procedures for dealing with illegal activities, and develop disciplinary codes to prevent cheating. The legal provisions that apply to the Kuwait Stock Exchange make no mention of disclosure for listed Kuwaiti companies. The only reference to the subject relates to the establishment of specialized agencies necessary for the market, one of which should gather, analyse and disseminate information relevant to the market and its stocks. This agency must also prepare studies and issue daily reports on the trading, prices and profits of the listed companies.[78] Kuwait's legislature should have dealt with the matter of disclosure in a more focused and detailed manner, especially considering that the organization of the market occurred after the Al-Manakh crisis. The fact that the relevant legislation stresses penalties and their applications (market discipline) indicates that the legislature sought to strengthen control mechanisms in order to secure the equity necessary for companies and shareholders in the market. Law No. 15 of 1960, which deals with trading companies, requires that each company issuing shares for public offering should publish a report in the popular press that includes the name of the company owner(s), details regarding its contract, aims, and system of operation, and the number of shares and their value.[79] Companies issuing stocks are also required to publish their budgets and the names of their board members and auditors within two months of being listed (article 93). The management of the Kuwait market requires companies to make their financial statements available following the quarterly, semiannual and annual review of these statements by an accredited auditing bureau. The market management also ensures the rapid dissemination of accurate information necessary for investors in daily, weekly and monthly formats, and through the

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[76] Lebanon, *Official Journal*, No. 51...

[77] Egypt, Capital Market Authority, "Decision No. 30"...

[78] Kuwait Stock Exchange, *Listing Requirements for Securities and Investment Funds...*, p. 20.

[79] Ibid.

publication of an investor's guide. Market management plays a central role in the disclosure process,[80] as it is responsible for ensuring that indicators reflect the rise and fall of prices during trading activities, that the data bank contains comprehensive and up-to-date resources to provide investors with accurate information about the financial growth of each listed company, that the auditing profession is developed so that it can better serve the needs of the market, and that the specialized agencies collect, analyse and provide certain types of information.

(v) *Procedures for trading and pricing*

Various laws and executive regulations in the ESCWA member countries deal with procedures for trading, circulation, and the transfer of ownership. Most Arab stock markets have updated their systems, and the modern technology they use has increased the speed and quality of trading operations.[81] In the subsection dealing with infrastructure, the trading systems of the Arab stock markets are analysed in detail. It is imperative that more advanced and compatible trading systems be adopted in the Arab markets to allow networking and thereby facilitate trading between the different markets.[82]

(b) *Corporate laws*

Corporate laws are the cornerstone of the primary market. These laws specify the procedures necessary for the establishment of joint stock companies, define the various kinds of stocks, and set the requirements for issuing companies. The laws also include rules designed to protect shareholder equities and guarantee the safety of the economic system; examples include provisions relating to disclosure and auditing requirements. In most ESCWA member countries, company acts have been revised to encourage the creation of joint stock companies, to develop the various requirements and benefits associated with the issuance of stocks of all kinds, and to increase shareholder trust and security. Monitoring and supervisory operations have been improved and brought in line with international standards. All of these developments have generally been aimed at vitalizing the issuing process, which represents real investments, and promoting increased participation in the accumulation of capital. Egypt issued Law No. 159 for companies in 1981, Jordan issued the New Company Act (No. 22) in 1997, and Kuwait has continued to apply Law No. 15 of 1960 and its recent amendments. The Egyptian law and its executive regulations constitute the most specific set of Arab rules concerning the various kinds of companies and their management, auditing and penalties. The law also deals with administration, particularly with regard to foreign companies in Egypt, and with company changes such as mergers. The first chapter of the law's second section deals with joint stock companies, focusing on issues relating to the financial structure, management and auditing. Law No. 159 replaced previous instruments issued in the 1950s and 1960s.[83] In the past, corporate laws meant to organize relations between the partners involved in shareholding activities were amended periodically, but the problem was actually in the methods of applying these laws in ways that would improve management and provide better protection for investors. This situation is encountered in many countries.[84] Some Arab States began paying more attention to corporate governance a few years ago, after the Organization for Economic Cooperation and Development (OECD) issued a set of relevant standards that addresses the rights and equitable treatment of shareholders, the role of stakeholders in corporate governance, the responsibilities of the board, and disclosure and transparency issues.

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[80] Saafak Al-Rakaiby, "Disclosure in Kuwait: its beginnings and development", paper prepared for the Symposium on the Importance of Disclosure in Arab Stock Markets, held by the Union of Arab Stock Exchanges and Securities Commissions, Cairo, 15-17 November 1987, p. 22 (in Arabic).

[81] League of Arab States and others, *Unified Arab Economic Report, 2000…*, p. 132.

[82] Union of Arab Stock Exchanges and Securities Commissions, "Recommendations for networking the Arab financial markets", paper prepared for the annual conference of the Union of Arab Stock Exhanges and Securities Commissions, Cairo, 15-17 June 1997 (in Arabic).

[83] Egypt, "Law No. 159 of 1981 concerning joint stock companies (and explanatory notes)", 21st ed. (2000) (in Arabic).

[84] "Symposium on Corporate Governance", comments of Sameh Al-Turjoman, *Al-Ahram* newspaper (Cairo, 11 July 2003).

A company's commitment to observing the essential standards of governance is a very important factor in investment decisions. In 2001, Egypt collaborated with the World Bank and OECD in evaluating the country's compliance with international standards of corporate governance, focusing on 48 principles. It was found that 39 of the 48 standards in question were being observed or largely observed. Seven of the international standards, though incorporated in the governance laws, were not being observed in the Egyptian market, perhaps owing to a lack of awareness among shareholders or companies. Two of the international principles were neither legally recognized nor observed in the country. The first principle pertained to the concept of registered owners (nominees) and beneficial owners; this omission was rectified through the incorporation of new provisions into the Central Securities Depository and Registry Law (Law No. 93 of 2000). The second principle related to the use of return and cost measurements to calculate voting rights.[85]

(c) *Other laws and regulations relevant to the stock market*

Various rules pertaining to the stock market are included in instruments such as taxation, auditing and foreign investment laws. Tax codes frequently incorporate exemptions that may be offered to potential and existing shareholders to promote investment in stocks, and the legislature may introduce supply-side exemptions to encourage closed family-owned businesses to become joint stock companies. Exemptions may involve the reduction or even elimination of taxes on stock dividends and/or on profits from the sale of shares. Some ESCWA member countries have changed their laws to reduce the tax burden on joint stock companies and have exempted the profits divided among shareholders from taxation in order to encourage new and continued market involvement. It should be noted that there are no taxation codes relating to stocks in the Gulf States.

Most Arab countries require joint stock companies to apply international auditing standards so that the general public may have a clear idea of their financial situation. A good auditing law improves the quality of disclosure and helps in organizing the information system of the market. This law should specify the responsibilities of auditors, the procedures involved in fulfilling those responsibilities, and the penalties imposed for breaking laws. In Egypt, the final draft of an auditing requirements bill was presented to the public for open discussion in 2001, then brought before the People's Assembly, where it was voted into law. This represents a step in the right direction in terms of organizing and developing the profession.[86] In Kuwait, Law No. 5 of 1981 spells out the requirements and responsibilities of auditors, as well as the penalty codes and the circumstances under which they are applied to ensure that any wrongdoing is fairly and effectively punished.[87] More studies are required to determine whether auditing and quality assurance practices in the Arab market are in accordance with international standards.[88] It is essential to use compatible procedures and terminology in the various Arab stock markets in order to ensure at least a minimum level of regional harmonization. The absence of or deficiencies in auditing practices in some Arab markets, the lack of accurate financial information, and the differences in executive regulations concerning auditing are all factors that weaken the market system. Conversely, effective harmonization facilitates investment decisions,[89] and developing auditing practices promotes transparency, which benefits investors.

In order to encourage investment flows, most ESCWA member countries have amended their investment laws, provided guarantees, increased incentives, and facilitated trading processes. However, the level of openness in the markets varies somewhat among countries, with good reason. Legislative bodies operate on the premise that some regulation of the movement of capital is necessary to stabilize the market and limit speculation. Indirect foreign investment in some of the region's stock markets are explored in the following:

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[85] Egypt, Capital Market Authority, *Annual Report 2001* (Cairo, 2002), p. 52.

[86] Ibid., p. 26.

[87] Kuwait Stock Exchange, *Laws, Decrees, and Ministerial Decisions Relevant to the Stock Market* (Kuwait, 1983), p. 75 (in Arabic).

[88] Jaleel Taref, "Transparency in the Jordanian Securities Law", *Stock Markets*, a magazine published by the Union of Arab Stock Exchanges and Securities Commissions (22 March 1998), p. 19 (in Arabic).

[89] Ahmad Abi Sourour, op. cit., pp. 49-50.

(a) In the Egyptian market, Law No. 95 of 1992 permits foreigners to invest in the stocks and bonds being traded without any restrictions other than those in company acts that prevent foreigners from investing in the company's name. In the latter case, it is the responsibility of the intermediary to notify the foreign investor.[90] Foreign investment has generally increased since the application of this law, accounting for 16.5 per cent of total trading in 1997, 20.2 per cent in 1998, 22.2 per cent in 1999, 41.9 per cent in 2000, and 32.4 per cent in 2001;[91]

(b) In Kuwait, Law No. 20 of 2000 permits non-nationals to own stocks in Kuwaiti joint stock companies and to participate in the establishment of such companies. However, this law permits the Minister of Trade and Industry—with the consent of the Cabinet of Ministers—to restrict foreign participation in joint stock companies by limiting or prohibiting such investment. This restriction does not apply to citizens of the Gulf States, who are subject to Law No. 32 of 1988.[92] Gulf nationals have been allowed to own and trade shares in Kuwaiti joint stock companies in all sectors of the economy since 1987.[93]

Most ESCWA member countries, including Egypt, Jordan and Lebanon, place no restrictions on foreign investment. Laws have been amended in Bahrain to allow the citizens of Gulf States to own 100 per cent of a company's shares (as opposed to 49 per cent previously); other foreigners may now own up to 49 per cent of any listed company (compared with 24 per cent before, and then only in certain sectors of the economy).[94]

2. *The infrastructure of stock markets in ESCWA member countries*

The essential structural elements of the stock market include the trading system, the central securities depository, and the clearing and settlement codes. Together they form the market infrastructure in a number of ESCWA member countries. All of these components will be examined in this subsection, though particular attention will be given to clearing and settlement codes because of their relative importance.

(a) *The trading system*

The trading system comprises the rules and procedures governing all operations associated with trading in stocks, including those linked to supply and demand, deal approval, and price issues. Most operations in the stock market are automated, particularly those connected with trading, clearing and settlement, and modern technology allows the dissemination of information through the Internet. These developments have facilitated trading operations. Modern technologies have allowed Arab stock markets to satisfy the needs of investors and have provided a higher level of transparency and effectiveness.[95] Three trading systems are in operation in the Arab world. The EFA system of Canada is used by the markets in Bahrain, Egypt, Qatar, Saudi Arabia and the United Arab Emirates, while the markets in Jordan, Lebanon, Morocco and Tunisia apply the French trading system (NSC-UNIX). Kuwait's stock market utilizes a unique system, adopted in January 1996.[96]

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[90] Cairo and Alexandria Stock Exchanges, *Factbook, 2001* (Cairo), p. 71.

[91] Union of Arab Stock Exchanges and Securities Commissions, "Results of a poll concerning foreign investments in Arab stock markets", unpublished internal report (June 2000) (in Arabic). Soliman Al-Mondhiry addresses this issue in "Arab stock markets: the role, relations, and challenges of liberalization", loc. cit.

[92] *Kuwait Today*, stock market journal, No. 464 (May 2000) (in Arabic).

[93] Kuwait Stock Exchange, *Laws, Decrees, and Ministerial Decisions Relevant to the Stock Market...*, p. 75.

[94] League of Arab States and others, *Unified Arab Economic Report, 2000...*, p. 121.

[95] Jaleel Taref, loc. cit., p. 21.

[96] Union of Arab Stock Exchanges and Securities Commissions, *Stock Markets* magazine (16 December 1995), p. 6 (in Arabic).

(b) *The central securities depository*

Books, records, and transfers of securities ownership are all stored in the central securities depository, which serves as a securities bank. Companies issuing stocks, brokerage companies, investment institutions and shareholders all deal with the depository. This agency plays a crucial role in enhancing the efficiency of the market and in reducing the errors and other difficulties resulting from the loss, theft, forgery, and intentional or unintentional destruction of documents. Interaction in the market now consists of simple financial settlements, with no need to trade the same stocks a second time. The central securities depository represents an extension of the clearing and settlement codes and can influence the velocity of trading in shares.[97]

(c) *Clearing and settlement*

As settlements require a central system to retain information and documentation, the three Arab countries whose markets are networked (Egypt, Kuwait and Lebanon) decided to create special companies, separate from the market, to perform settlement, depository and clearing functions. Kuwait established the first clearing and settlement company in 1982, followed by Lebanon in 1994 and Egypt in 1996. The activities of the three companies derive from the recommendations of the G-30 international standards for clearing and settlement systems. Details relating to these companies are as follows:

(a) The Kuwait Clearing Company was established in 1982, following the Al-Manakh crisis. Acting upon a request from the Kuwait stock market in 1986, the Company developed its methods into a programme that was officially adopted by the Exchange in 1987. In May 1988 the second phase of the programme was formally inaugurated. Account numbers were created for each shareholder, and training practices were organized through intermediaries of the Company itself. The Kuwait Clearing Company successfully stabilized the market. Its methods are compatible with the most advanced in the world. Daily clearing practices entail comparing and settling the accounts of shareholders. The account created for each shareholder is used for all that individual's trade transactions, including deliveries of shares purchased and transfers of those sold, and payments received or sent; the account also provides a record of shareholder activity, reflecting all changes in standing. Intermediaries provide the Company with daily reports listing the names and costs of the stocks traded that day. The following morning, the Company gives each intermediary a report on the financial position of each client in terms of what was bought or sold and the profits earned the previous day.[98] The clearing and settlement system in the Kuwait stock market allows shareholders to use the profits of their trade as soon as the trade is completed. It fulfils the market requirements without any major structural alterations. The system calculates and automatically deducts all costs and commissions. It also helps prevent trading in stocks without sufficient capital.[99] The settlement of accounts in the Kuwaiti market occurs on the same day as the trading. The Kuwait Stock Exchange is establishing a settlement fund with capital estimated at KD 3 million (approximately US$ 10.2 million) to mediate between the intermediaries, the market management, and the settlement company;

(b) The Lebanese system reflects the influence of the French Sicovam system. Midclear (formally designated the Custodian and Clearing Centre of Financial Instruments for Lebanon and the Middle East) is the country's clearing and settlement agency. Its two primary functions are to centrally deposit all transferred shares in the Beirut stock market and to manage the settlement and clearing of Exchange accounts. It delivers the stocks immediately for cash payment in accordance with the specific regulations for each market (primary or secondary, local or international).[100] The aim of Midclear is to deliver shareholder equities from

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[97] Moneer Hindy, "Capital markets and their institutions", paper prepared for the Conference on Investment in Capital Markets, Beirut, 28-30 March 2003 (in Arabic).

[98] Soliman Al-Mondhiry, "The role of clearing and settlement in dealing with securities", paper prepared for the annual conference of the Union of Arab Stock Exchanges and Securities Commissions, Damascus, 1-3 July 1996, p. 46.

[99] Ibid.

[100] Asaad Swaya, "The functions of Midclear", paper prepared for the First Arab Brokerage Conference, Beirut, 5-7 July 1995 (in Arabic).

the moment the trade is transacted; however, the actual clearing and settlement period in the Lebanese stock market is approximately three days, compared with one day in the GCC markets;

(c) In Egypt, Misr for Clearing, Settlement and Central Depository (MCSD) was established under the Capital Market Law (Law No. 95 of 1992), which deals with companies trading in stock markets and considers the clearing and settlement of securities one of the activities to be undertaken by these companies. The third section of the executive regulations for stock markets permits the creation of companies that are responsible for organizing the receipt and delivery of stocks traded by brokerage companies, and for settling accounts in accordance with the rules established by the Capital Market Authority.[101] MCSD started as a joint stock company in 1996. With the adoption of the Central Securities Depository and Registry Law (Law No. 93 of 2000), MCSD became the only company in Egypt permitted to engage in clearing and settlement activities for the Cairo and Alexandria stock markets. The company serves as the market's central depository and bookkeeping agency; completes the procedures for transferring stock ownership; and keeps records of transactions for a period of at least five years, and all files relating to such transactions for a period of no less than three years.[102] A settlement guarantee fund was established in 2000 to protect investors and provide security and stability in the market. Membership in this fund includes all brokerage companies in charge of settlements on behalf of their clients and the other companies' representatives in the clearing and settlement system. By the end of 2002 MSCD was serving 1,044 members, including 870 share issuers, 146 brokers, and 9 mutual funds.[103] The company is working to reduce the settlement period for all traded stocks placed in the central depository from three to two days. This will increase the trading volume and reduce the risks associated with the slow clearance of securities transactions.[104]

Some experts point out that in certain Arab stock markets the G-30 recommendations concerning clearing and settlement have not yet been implemented. The use of the delivery-versus-payment (DVP) principle and the international securities identifying number, in particular, can facilitate trading as well as the networking of Arab stock markets.[105]

(d) *Information dissemination*

Information dissemination is one of the operations that supports trading. The proper authorities in the market develop certain procedures for releasing information at appropriate times for market participants and the general public. There are usually two types of required information; the first is mainly factual data including the volume of trading in the market, stock prices, new contracts and company statements; the second type is value-added information derived from the data and includes market indicators, market analysis and historic information about the effectiveness of the market and its companies, and local and international economic information.[106] The UASE established the AFMN in September 2001 in order to provide timely and easily accessible information on the member stock markets. Prior to the existence of this Network, the markets of Egypt, Kuwait and Lebanon had agreements with Reuters to convey information to investors in the three countries.[107]

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[101] Egypt, Capital Market Authority, "Stock Market Law: No. 95 of 1992" (Cairo) (in Arabic).

[102] Ibid., p. 16.

[103] Egypt, Misr for Clearing, Settlement and Central Depository, *MCDR*, company magazine (June-September 2002), p. 14 (in Arabic).

[104] Egypt, Capital Market Authority, *Annual Report 2000…*, p. 17.

[105] Jaleel Taref, loc. cit., p. 22.

[106] Anderson Company for Economic Systems, paper dealing with trade-related operations in the Arab markets, presented at the UASE First Arab Brokerage Conference, Beirut, 5-7 July 1995, p. 22.

[107] Isam Maky, "The role of information in the networking of Arab stock markets", paper prepared for the annual conference of the Union of Arab Stock Exchanges and Securities Commissions, Cairo, 15-17 June 1997 (in Arabic).

B. FIRM- AND INDUSTRY-LEVEL PREREQUISITES FOR STOCK MARKET NETWORKING

1. *Introduction*

Successful regional stock market networking requires some investigation into the underlying assets and liabilities of the financial instruments that are listed or will be listed. Stocks, which constitute the main engine of any stock exchange, embody a multitude of factors including the financial standing and performance of the issuing companies, their growth potential, liquidity, and solvency, and investor expectations of financial and commercial growth. Unless both the public and private segments of the member countries' corporate sector rise to the challenge of providing transparent and attractive cross-national investment opportunities, the level of interest in marketable securities in the Arab region will remain weak.

In the respective markets of Jordan, Lebanon and Egypt, around 81, 92 and 98 per cent of the listed securities are stocks or other equity-related financial instruments (see table 3). Equity-related securities include stocks, equity funds, global depositary receipts, and hybrids such as convertible debentures. The fundamental factors behind the value of these securities include the issuing companies' actual financial status and expected results. These factors apply not only to stocks and their derivatives but also to corporate fixed-income securities, though in the latter case, more weight is given to the issuing company's solvency or its ability to meet its debt obligations on time than to profitability or expected dividends. Corporate asset-backed securities (ABS), a growing and attractive source of funding, constitute yet another financial instrument underlain by specific corporate assets such as receivable accounts rather than by the issuing company itself. In sum, the intraregional attractiveness and marketability of all these securities depend largely on the financial status and prospects of the issuing companies or, in the case of ABS, on some of their specific assets.

TABLE 3. SECURITIES LISTED ON THE AMMAN, BEIRUT, AND CAIRO AND ALEXANDRIA STOCK EXCHANGES, BY TYPE

Financial instrument and market	Number of listed securities	Percentage of total
Amman Stock Exchange (June 2003)		
Stocks	158	81
Bonds	37	19
Total	195	100
Beirut Stock Exchange (June 2003)		
Stocks	11	84.6
Equity funds	1	7.7
Bond funds	1	7.7
Total	13	100
Cairo and Alexandria Stock Exchanges (August 2002)[a/]		
Stocks	1 154	97.5
Bonds	25	2.1
Equity funds	4	0.3
Total	1 183	100

Sources: Beirut Stock Exchange, Amman Stock Exchange, and Capital Market Authority of Egypt.

Note: Totals may not add up due to rounding.

a/ According to articles 5 and 6 of the new listing rules incorporated in Decision No. 30 of 2002, listed companies (a total of 1,154 as at 1 August 2002) are required to adjust their listing status as per the new requirements within a period of one year, ending 1 August 2003, though the CASE is considering extending that period to 30 September 2003 before delisting all companies that have failed to comply with the directive within the given time frame.

2. *Corporate financial disclosure and the availability of information*

One of the thorniest issues faced by the Arab stock markets relates to disclosure, or more precisely, to the corporate sector's ability and willingness to provide appropriate and transparent financial information on a regular basis; an accurate fundamental analysis of the issuing companies and their securities is impossible without the right facts and figures. This issue is not unique to the Arab world; American and European public companies are required to abide by accounting and disclosure rules that are constantly being refined by regulatory bodies seeking to ensure transparent and unbiased reporting for all stakeholders, especially investors and creditors. It is important to remember that proper and transparent financial reporting is not an either-or matter, but encompasses a wide spectrum of possibilities ranging from minimum acceptable to all-inclusive reporting. Another consideration is that disclosure is not limited to audited financial statements and related notes but should also include pertinent information and analysis provided in a company's annual report, including the management's review and discussion of financial results.

In order to boost intraregional investments in listed securities, the Arab corporate sector needs to enhance transparency in reporting and facilitate the availability of relevant information beyond national borders.

(a) *Accounting standards*

Accounting standards form the basis of transparent financial reporting, but there is not yet a consensus on whether it would be more feasible to harmonize Arab standards or to adopt existing international standards within the region. The European Union (EU) does not have its own uniform accounting standards; in 1995, the Union ended its efforts to develop a unique European system that would have been comparable to the American Financial Accounting Standards Board's Generally Accepted Accounting Principles (GAAP).[108] The International Accounting Standards Board had been urging the EU members to replace their national accounting rules with International Accounting Standards (IAS);[109] the EU eventually adopted the IAS package and formally approved a set of rules requiring the Union's publicly listed companies to adopt common accounting standards by 2005. The Commissioner of the single European market noted that this move would "put an end to the current Tower of Babel in financial reporting, improve competition and transparency and make the free movement of capital much easier".[110] The International Accounting Standards Committee,[111] established in 1973 by Australia, Canada, France, Germany, Ireland, Japan, Mexico, the Netherlands, the United Kingdom and the United States, highlights the following three primary objectives in its revised constitution:[112]

(a) "To develop, in the public interest, a single set of high-quality, understandable and enforceable global accounting standards that require high-quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions";

(b) "To promote the use and rigorous application of those standards";

(c) "To bring about convergence of national accounting standards and International Accounting Standards to high-quality solutions".[113]

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[108] Barry Epstein and Abbas Mirza, *IAS 2001: Interpretation and Application* (New York, John Wiley and Sons, Inc., 2001), p. 21.

[109] Gregory Crouch with Suzanne Kapner, "Accounting fears reignited by Dutch grocer's profit error", *The New York Times* (25 February 2003).

[110] "EU adopts uniform rules for accounting standards", *The International Herald Tribune* (30 September 2003), p. 1.

[111] Now the International Accounting Standards Board.

[112] Barry Epstein and Abbas Mirza, op. cit., pp. 10-11.

[113] Ibid., p. 11.

(b) *National and international accounting standards*

The examples to follow illustrate the importance of accounting standards and transparency within the securities markets. A Dutch food conglomerate shocked its investors in April 2002 when it announced that its profits would be 90 per cent lower with the preparation of its financial reports according to the American GAAP rather than national standards.[114] The chief executive officer tried to soothe investors by promising to reconcile the company's financial statements with the GAAP at the end of each quarter. On 24 February 2003, the company declared that earnings had been inflated by US$ 500 million for 2001 and 2002 because of "irregularities" in accounting linked to income received to promote products at a subsidiary.

In another example, a supermarket and department store chain listed on the Beirut Stock Exchange did not prepare its audited financial statements in accordance with IAS prior to 2001. The company posted net earnings of US$ 1.9 million, US$ 0.38 million and US$ 0.77 million for 1998, 1999 and 2000 respectively.[115] Upon the application of IAS, the company posted a loss of US$ 4.8 million before prior year adjustments, and a loss of US$ 4.4 million from prior year adjustments, for a total loss of about US$ 9.2 million in 2000, mainly owing to the previous capitalization of various expenses. An investor evaluating the company on an earnings-per-share (EPS) basis and comparing the figures to another company's EPS calculated using IAS would have been misled by the former's inflated earnings.

The globalization of capital markets has intensified the need to unify financial reporting standards and requirements.[116] Today, the American GAAP and the IAS are competing to become the de facto world standards.[117]

(c) *The regional benefits of applying the International Accounting Standards*

The Amman, Beirut, and Cairo and Alexandria stock exchanges all require financial reporting according to IAS. The benefits of applying a unified standard within the ESCWA region would include the following:

(a) Financial reporting among listed companies would gain much-needed credibility, and the statements thus issued would constitute a reliable base for analysts and investors to assess the financial performance and status of these companies and their securities;

(b) Unified accounting standards for all regionally listed companies would allow accurate intraregional comparison of corporate financial results. Comprehensive analysis of a company's financial performance goes far beyond simple comparisons of financial figures and ratios (as explained further below), but unified standards establish a solid common foundation that ensures the relevance of subsequently undertaken corporate financial analyses and comparisons;

(c) Adopting IAS would give the Arab markets accounting standards similar to those being considered by EU members, enhancing prospects for potential intercontinental corporate transactions;

(d) Standards would be set, giving non-listed companies aiming for institutionalization, equity funding, and IPO status a benchmark to follow so that they could better position themselves (in terms of reporting and transparency) for the successful transition into public companies.

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[114] Gregory Crouch with Suzanne Kapner, loc. cit.

[115] Financial Funds Advisors International SAL, "Fiscal year 2000 evaluation report: Bou Khalil markets" (Beirut, March 2001), pp. 6-8.

[116] Ibid., p. 9.

[117] Ibid., p. 7.

(d) *Financial reporting*

Proper financial reporting is above all a corporate responsibility. Legislative bodies require and enforce the application of appropriate reporting standards, but transparency and accountability in financial reporting must start at the source—within the company itself—in order to encourage long-term strategic investment. For the Arab region's corporate sector to gain credibility and attract investment, it must improve its accounting practices in terms of transparency, accountability and comprehensiveness. Audits are the responsibility of auditing firms, but financial statements remain the responsibility of the companies themselves.

(e) *Necessary disclosure to holders of listed securities*

Corporate disclosure is not limited to the financial statements and audit reports required by each stock exchange. The corporate sector in the ESCWA region and other parts of the Arab world should go beyond legal disclosure requirements and make available to the public all relevant information on past and present performance, management analysis of financial results, plans for expansion, and prospects for the future, all of which serve to enhance transparency. The availability of this information would likely arouse interest among intraregional investors at both the individual and institutional levels. The corporate sector must ensure that detailed and up-to-date information is both available and accessible within the region.

(i) *Corporate action and responsibility*

A public company will not gain credibility among investors unless it reports extensively on all areas of concern, including its financial status and performance, business strategy, growth and revenue expectations, and expansionary plans. Arab investors, including those from the ESCWA region, have easy access to the more transparent corporate reporting and information typically provided within the developed economies of Europe and North America. Unless companies in the ESCWA region can achieve this level of disclosure and better satisfy investor expectations, little can be done to enhance confidence in regionally listed securities. The following is expected with regard to reporting:

(a) Annually audited financial statements for present and past years, prepared in accordance with reliable and internationally accepted standards; such reports should be made available within four to five months of the end of the financial year, as timely provision is an important factor;

(b) Quarterly unaudited financial statements, also prepared in accordance with internationally accepted standards, issued within two months of the end of each of the first three quarters of the financial year; again, the timely provision of interim financial statements is required to keep investors updated on financial performance;

(c) Annual reports providing background information on the company and its management, a review of operations, and management's analysis of financial results;

(d) Timely updates of company information and notices of any changes (in business strategies, shareholder structures, acquisitions and so on);

(e) Regular updates on business activities and the company's relative position, including market share, new products and services, the penetration of new markets, foreseen dividend distribution, and other relevant information;

(f) A record of corporate governance practices including standards of corporate conduct, principles of corporate governance, and the code of ethics for senior financial personnel;

(g) Sufficient information on internal corporate policy to discourage illegal insider trading of securities by company officials, which enhances a company's credibility among investors. This is part of a company's corporate governance, but it warrants special mention, as it represents one of the main issues of corporate transparency for traded companies;

(h) The timely issuance of the above-mentioned items, as this is essential for investors in terms of sectoral transparency and accountability; the companies represent the real assets of the listed securities.

(ii) *Dissemination of information*

The availability and accessibility of information are as important to investors as the actual facts, figures and analyses provided. Companies listed in the ESCWA region's markets should strive to make comprehensive and up-to-date reports more accessible to present and potential investors throughout the region. This is best achieved through corporate web sites. Each company site should include a brief on its background and management, an investor section containing past and present annual reports, audited and interim comparative financial statements, and the other investor-relevant information mentioned previously. Specialized Arab research centres and research departments in Arab financial institutions can help with the dissemination of corporate information and provide objective, standardized analyses of listed securities, similar to those available through the AFMN.

Independent companies involved in research and analysis can also play a role in disseminating corporate disclosures. These companies can compile comprehensive and continuously updated reporting information on regionally listed companies and release this information to the public through their web sites and regular publications. Affiliates or departments of financial institutions can also provide such services. The corporate information being disseminated should be accompanied by standardized, unbiased analyses of the listed securities. The AFMN maintains a web site with current information on regionally listed companies, including financial ratios, trade histories, and links to web sites of interest. The Network also provides online research reports prepared by Arab and international research centres. This site is an excellent source of information and links. The accuracy and thoroughness of the material produced and disseminated by independent research houses is dependent on the quality of the financial information provided by the companies; the role of these institutions should therefore be seen as complementary to the corporate sector role in this respect. Table 4 indicates that among the companies included in the CASE 30 Index, only 17 list web sites; nine of these sites provide audited annual financial statements, and only three furnish annual company reports. The potential investor is left with little information on which to base investment decisions. Among the companies listed on the Beirut Stock Exchange in June 2003, only five had audited statements available on their web sites (all five were local financial companies). The largest company listed on Lebanon's exchange does not post its audited financial results on its web site. An interested investor would have to contact the company directly to ask for a hard copy of its annual report and audited financial statements—not an easy task for an investor outside Lebanon.

TABLE 4. CAIRO AND ALEXANDRIA STOCK EXCHANGES: CASE 30 INDEX COMPANIES

Web site availability	Available reports	Company
Available	Audited financial statements	Commercial International Bank (Egypt)
Available	Financial highlights only	Eastern Tobacco
Available	Annual reports and audited financial statements	Egyptian American Bank (EAB)
Available	Annual reports and audited financial statements	Egyptian Company for Mobile Services
Available	Audited financial statements	Egyptian Financial Group—Hermes
Available	Non-updated annual reports	Egyptian International Pharmaceuticals
Available	Audited financial statements	El-Ezz Porcelain (Gemma)
Available	Audited financial statements	El-Ezz Steel Rebars
Available	Audited financial statements	Misr International Bank
Available	Audited financial statements	National Société Generale Bank
Available	Financial highlights only	Orascom Construction Industries
Available	Annual reports and audited financial statements	Orascom Telecom Holding
Available	None	AIC
Available	None	Egyptian Financial & Industrial
Available	None	Egyptian Media Production City
Available	None	Oriental Weavers

TABLE 4 (*continued*)

Web site availability	Available reports	Company
Available	None	Sinai Cement
Not available	None	Arab Polvara Spinning and Weaving Co.
Not available	None	El-Kahera Housing
Not available	None	El-Watany Bank of Egypt
Not available	None	Export Development Bank of Egypt
Not available	None	General Silos & Storage
Not available	None	Medinet Nasr Housing
Not available	None	Misr Beni Suef Cement
Not available	None	Misr Cement (Qena)
Not available	None	Olympic Group Financial Investments
Not available	None	Orascom Hotel Holdings
Not available	None	Paint & Chemicals Industries
Not available	None	Suez Cement
Not available	None	Torah Cement

Source: Cairo and Alexandria Stock Exchanges, CASE 30 Index table (http://www.egyptse.com/download/case30.xls); and Arab Financial Markets Network (www.alshabaca.com).

(iii) *Corporate disclosures and financial forecasts for initial public offerings*

An IPO prospectus, through which public funds are raised for a company, should include the company's audited financial statements for the previous three years, a description of the business and its prospects, and a share valuation. The issuing company's role in an IPO is to provide extensive information on all aspects of its business—past, present and future—as well as financial forecasts that reflect plausible and attainable objectives. The issuing company should avoid setting a non- justifiable share price, as this would have an adverse impact on the post-listing performance of the stock issue and undermine confidence in the newly listed company.

3. *The role of securities analysts*

In order to enhance investor interest and confidence in the region's market offerings, company and stock analysts should provide professional assessment and valuation reports on listed stocks and fixed-income securities (bonds), which in turn should help investors make informed investment decisions. Analyses of fixed-income securities focus exclusively on the solvency issue, or the ability of the issuing party to honour its fixed-payment obligations; however, the type of analysis differs for government-issued bonds and company-issued bonds. Analysis of equity-related securities—mainly common stocks—involves assessments of solvency, operational performance and growth, corporate profitability, projected free cash flows and expected dividends. Accurate and thorough analysis of equity-related securities constitutes the "engine" of capital markets and stock exchanges, stimulating growth and development. The professionalism of the security analysts in a given market is instrumental in determining the credibility and intraregional attractiveness of the listed securities.

(a) *Earnings versus free cash flows*

Corporate financial ratios can be misleading if not judiciously interpreted. Specifically, earnings ratios must be considered in tandem with other financial data and ratios to ascertain the financial strength and performance of a company. Simon Benninga and Oded Sarig qualify the use of multiples in corporate valuations as more problematic than the use of discounted cash flows.[118] An American fund manager who specializes in ferreting out fraud advocates analysts' stock assessment based on excess cash flows, computed

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[118] Simon Benninga and Oded Sarig, *Corporate Finance: A Valuation Approach*, International Edition (New York, McGraw-Hill, 1997), p. 85.

by adjusting a company's net earnings to depreciation expenses, capital expenditures and changes in working capital: "Any other metric, whether page views, hidden assets, [or] multiples of revenues, must be converted to excess cash flow".[119] Regional security analysts should possess a thorough understanding of corporate financial analysis, without which their assessments of listed securities, notably stocks, would lack depth and would fail to satisfy investors' expectations in terms of the seriousness and credibility of the analysis and advice provided. As a company's earnings can be substantially different from its generated cash flows to equity holders within a fiscal year, profitability ratios can mislead analysts and investors. The comparison of a company's earnings with its generated cash flows is vital for a fundamental valuation of a listed equity-related security.

Earnings and free cash flows can differ for the following reasons:

(a) Depreciation is a non-cash expense that is included in a company's income statement; it must be added back for cash-flow adjustments;

(b) While the IAS benchmark treatment for corporate borrowing costs is to expense these costs as incurred, it allows for the capitalization of such costs when they are incurred to finance the acquisition, construction or production of a "qualifying" asset (one that takes an extended period of time to prepare for its own use).[120] In cases of interest capitalization, the capitalized amount is added to the carrying value of the asset;

(c) Capital expenditures consist of a company's investments in fixed assets within a fiscal year. Such investments entail financing and a cash outflow on the part of the company, but this outflow does not appear on its income statement and thus does not affect earnings. An analyst needs to assess a company's past, present and projected investment needs in terms of tangible and intangible fixed assets, as these significantly affect the company's ability to generate cash;

(d) Changes in the current portion of a company's balance sheet (working capital) can significantly affect its operational cash flow. These may include period-to-period changes in inventory, accounts payable and receivable, and other short-term assets and liabilities;

(e) While a company's interest expenses appear on its income statement and thus affect its earnings, its acquisition of new loans and its principal payment dues do not affect its posted earnings. Consequently, if funding is not analysed in parallel with profitability, one ends up with a deceptive assessment of a company's financial standing and ability to meet its obligations. To provide serious analyses of regionally listed companies, analysts should clearly identify the factors behind the companies' cash-flow performance. These factors may be temporary or permanent. A company's excess cash flow for a fiscal year could be low because of regular capital expenditure needs, which would be expected to continue over the medium term; alternatively, they could be the result of an occasional operational cash outflow due to circumstantial changes in working capital. The effect on stock price valuation would influence investor decisions.

(b) *Standardizing analysis of listed companies and stocks*

Establishing rules and guidelines for stock analysis is a challenging task in terms of both development and implementation. For enhancing intraregional investment in listed securities, however, standardizing such analysis is no less important than standardizing accounting and auditing procedures. Investors around the globe, including those interested in regionally listed companies, count on the availability and reliability of research analysts' reports. The standardization of these reports would prevent the use of misleading profitability ratios, dubious security valuations, and unsubstantiated buy and sell recommendations. ESCWA member countries may benefit from the experience of developed capital markets in overcoming various obstacles in this area. The following rules, developed by Robert Olstein,[121] manager of the Olstein Financial

[119] Gretchen Morgenson, "Simple rules to keep analysts honest", *The New York Times* (25 November 2002).

[120] Barry Epstein and Abbas Mirza, op. cit., pp. 319-320.

[121] Gretchen Morgenson, loc. cit.

Alert Fund in New York, constitute a standard methodology to be followed by research companies that allows investors to base their decisions on comparable reports:

(a) All analysts' reports should include "a company's balance sheet and show its income and cash flow for the past two years". The reports "should also incorporate a three-year projection of [the company's] earnings, cash flow, capital expenditures and working capital needs";

(b) "A stock should be valued based on its excess cash flow", computed by adjusting a company's earnings to depreciation expenses, capital expenditures, and changes in working capital;

(c) Analysts' reports should not include buy or sell recommendations, but "should indicate whether the stock, based on cash flow projections, is undervalued, fairly valued, or overvalued";

(d) Analysts' reports should state the following: "Accounting reporting and disclosure practices at this company have been reviewed, and any material deviations in working capital and liquidity ratios or reporting practices that in the analyst's opinion are not in accord with economic reality have been discussed in this or prior reports";

(e) Estimates of earnings should be produced annually, and quarterly earnings should be assessed to determine whether they necessitate a change in the stock's future valuation. Quarterly assessments should reflect consideration of the long-term value of a company rather than comprising penny-to-penny comparisons of actual versus budgeted figures;

(f) Analysts should not send corporate executives advance copies of reports on their companies;

(g) "Stock-price targets should be banned";

(h) "Potential risks to cash-flow forecasts and valuations should be discussed";

(i) "When valuing a company, analysts must subtract so-called non-recurring write-offs from reported operating earnings", even if these expenses are designated by the company's management as such.[122]

Devising a standardized methodology for analysing listed companies and stocks in ESCWA member countries and ensuring compliance with the rules established on that basis constitute a prerequisite for the successful growth of Arab capital markets.

(c) *Non-tangible corporate factors*

The most important non-tangible factor is the quality of a company's management and, by extension, its ability to ensure the implementation of corporate strategies and growth plans and the necessary follow-up. The level of corporate institutionalization is another intangible factor that has an impact on determinations of a company's expected performance and continuity. While it is difficult for research firms to probe very deeply into the details of corporate administration and supervision and to gauge management capabilities, especially with less institutionalized companies, such firms should ensure that the investing public has access to all available news and information and recent updates on corporate management, shareholder bases, and other non-financial aspects of corporate activity.

4. *Corporate governance*

Two essential factors that will strengthen the credibility of stock exchanges in the region are (a) transparent, accountable and standardized corporate disclosures from the companies that are listed or have applied for listing; and (b) reliable, professional and standardized analysis of listed companies and securities

[122] Ibid.

by research analysts. This information creates and sustains investor interest and confidence in the market in general. At a more fundamental level, however, potential investors will wish to know about the operational and financial performance capabilities and prospects of individual companies and the corporate sector as a whole. Corporate governance is instrumental in shaping corporate growth, profits and long-term potential, all of which influence cross-national demand for listed securities.

Arab companies should strive to institutionalize their systems of operation, management and shareholder base in order to improve their efficiency and productivity and ensure their continuity. In a region where strong family ties tend to take precedence over corporate interests, company owners and directors must make sure that all managerial decisions are taken for the sole benefit of their companies, and that their companies are independent, self-sustainable and growing institutions, regardless of their ownership structures.

Growth in turnover is another major factor affecting corporate performance and status. Without projected and actual growth in a company's total revenues, growth in the funds available for dividend distribution cannot materialize. Lower dividend growth expectations imply weaker potential with regard to the value of the security and therefore weaker investor demand. The attractiveness of a public company's listed security derives from proper corporate financial planning and profitability. Growth without profitability is goalless unless it proves to be a temporary phase without any long-lasting adverse effects on a company's financial soundness and solvency. As one Harvard Business School professor says, "Being big without profit doesn't get you anywhere".[123]

Corporate governance ethics are also essential for maintaining investor trust. As one of the Ford Motor Company's policy letters stresses, "A good reputation is a priceless business asset that can be earned only through consistently trustworthy behavior".[124] This entails the following:

(a) Ensuring that the company's internal and external financial data and other reporting and information are true and accurate in all material aspects;

(b) Maintaining honest and ethical conduct, notably with regard to conflicts of interest;

(c) Ensuring that the company is in full compliance with all applicable external regulations and with its own internal policies and regulations.

Stock market performance is a reflection of the attractiveness of the listed securities, which in turn derives from corporate transparency, financial standing and performance, and growth prospects. The Arab world is not short of investment funds; billions of Arab dollars are invested outside the region. The characteristics of capital are mobility, sensitivity and scarcity; Arab companies and investment projects therefore need to be well-equipped for capital hunting.[125]

C. EXPERIENCES OF OTHER COUNTRIES AND REGIONS IN STOCK MARKET NETWORKING

Although the "twin forces of globalization of investment and technology have largely destroyed unique local structures of stock exchanges and brought about more homogeneous trading systems and competition",[126] there remains a wide divergence between stock market networking arrangements and

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[123] Michael Porter, "Being big without profit doesn't get you anywhere", *The International Herald Tribune* (1 October 2002).

[124] Ford Motor Company, "Code of ethics for senior finance personnel", policy letter (5 May 2003) (www.ford.com/en/company/investor/information/companyFinancials/corporateGovernance.htm), p. 1.

[125] George Azar, "Arab companies in dire need of sound strategic financial planning", *The Daily Star* (Beirut, 6 February 2002).

[126] Stephen Wellis, "Price discovery and competitiveness of trading systems", report prepared for the Annual Meeting of the International Federation of Stock Exchanges (FIBV), Brisbane, 3 October 2000 (http://www.world-exchanges.org/WFE/home.asp?menu=118document=222).

experiences around the world, regardless of whether the markets are developed or emerging. The potential levels of cooperation and coordination among stock exchanges, from the most integrated to the least integrated networks, include (a) the harmonization of regulations and unification of clearing and settlement transactions; (b) the facilitation of foreign investment through cross-border trading; and (c) the joint listing of shares.

An example of the most integrated form of stock market networking is the union formed by the exchanges of Amsterdam, Brussels and Paris. In September 2000, these three countries launched Euronext, a pan-European financial market. Beginning in October 2001, all company shares listed on the three exchanges were traded on one platform. Euronext offers investors and publicly listed companies from each of the member countries unified trading rules, a single order book per listed company, a single clearing house, a single payment and delivery system, Internet trading of shares, and equal access to company and share price information in the three languages (Dutch, English and French). All companies are classified according to the FTSE Global Classification System, facilitating comparison and helping investors make sound investment decisions. The unified single trading platform for the Euronext member countries provides "both investors and issuers ... a broader, more diversified offering".[127] A single trading platform is the most integrated form of stock market networking and requires extensive standardization and harmonization of legislation, rules and regulations.

Another method of networking is the facilitation of cross-border trading, whereby foreign investors are granted access to domestically listed companies. Large, developed stock markets welcome cross-border trading, which attracts investment funds from all over the world. Investors can place orders in these markets from virtually anywhere, and major international newspapers publish vital stock information, reaching the widest possible investor base. Removing legislative restrictions on foreign ownership of domestic companies promotes cross-border trading and linkages between financial markets. This type of trading is also facilitated by authorizing foreign brokers to operate in domestic stock markets through branch offices, or by allowing them to cooperate with their domestic counterparts in placing orders for their investors. Legislation facilitating cross-border brokerage services eliminates the need for investors to contact brokers in each foreign market and thus lowers the costs of making cross-border trades. Modern communication technologies and the Internet are extremely useful in this context. Electronic links can be established between stock markets using state-of-the-art technology. Stock market web sites, providing information on listed companies, share prices and the movement of indices, facilitate cross-border trading.

A third form of stock market integration used throughout the world is the joint listing of companies. Companies from developing countries that are jointly listed inside and outside their countries or regions are aware of the benefits of listing in a mature market; not only are they able to raise more capital, but they are also compelled to improve their business practices, as they learn from first-hand experience that "firms listing on foreign stock markets are also in the jurisdiction of a superior legal system and higher disclosure standards".[128] Stock exchanges that wish to promote stronger links with regional and global financial markets but are unable to harmonize their rules and regulations or unify their clearing transactions with other exchanges can still engage in networking by allowing the joint listing of foreign-based companies. For the regulatory agencies and stock exchanges, joint listing is less costly than harmonizing financial regulations and transactions because the legislative and technology requirements are less stringent for joint listing than for the establishment of a common trading platform. Joint listing may present some challenges. Companies have to invest a certain amount of money and time in learning about and complying with the listing requirements in more than one stock market and pay multiple listing fees. This may not be feasible for medium-sized enterprises or regional businesses with limited experience in capital markets. Large, well-known companies will benefit most from a system of joint listings. Despite the added costs, listing in more than one market in the region can help companies raise much-needed equity capital that may be unavailable in the domestic market. Joint listings also benefit domestic investors by increasing the depth of the local

[127] Euronext, "From Amsterdam, Brussels and Paris exchanges to Euronext" (http://www.euronext.com), accessed on 1 August 2003.

[128] Graciela Kaminsky and Sergio Schmukler, "Short-run pain, long-run gain: the effects of financial liberalization", paper prepared for the World Bank in 2002 (http://www.worldbank.org/research), p. 26.

market and, at a more practical level, by providing them with readily available financial information on foreign companies and easy access to their shares. Joint listings of domestic companies outside the region can attract global investment funds, and joint listings of foreign companies on national and regional stock exchanges can add depth to the emerging market. Some examples of international joint listings include the following:

(a) Firms from developing countries are discovering the benefits of joint listing in mature stock markets; "in the new millennium, most of the trading of Latin American shares occurs in New York";[129]

(b) The London Stock Exchange claims to be the most international of all stock exchanges, with listed companies from over 60 countries.[130]

Although many stock markets around the world are seeking greater cooperation and integration with regional and global capital markets, a few stock exchanges in East Asia are dismantling financial linkages and reserving their markets for domestic companies to serve their capital needs; examples include the following:

(a) The Kuala Lumpur Stock Exchange in Malaysia and what was formerly the Stock Exchange of Singapore (now Singapore Exchange Securities Trading Limited) once shared joint listings of companies based in each of these countries; in 1990, they mutually delisted those companies;[131]

(b) The Stock Exchange of Thailand promotes itself as a market for domestic company listings and government bonds. Its web site quotes the country's Second National Development Plan, noting that "the market's most important role would be to mobilize funds to support Thailand's industrialization and economic development".[132]

The largest body facilitating cooperation and coordination among stock markets is the World Federation of Exchanges (WFE), whose members account for 97 per cent of all stock market capitalization.[133] The Federation was founded in 1961 by several European stock markets and today includes 56 exchanges worldwide.[134] Its goal is to promote the growth and development of national capital markets by providing a forum for communication, analysis, debate, the exchange of experiences, and the provision of assistance in the areas of standards, transnational issues, trading, and clearing and settlements. Standardization among WFE members is not required, nor does the Federation provide a harmonized trading platform.

Several regional stock market federations have been formed and engage in a similar range of activities. These regional associations function as sources of both information and technology transfer. They promote the development of their regional securities markets by facilitating cooperation in trading and the clearing and settlement of transactions and through the clarification of terminology. The following are examples of voluntary regional associations supporting cooperation between stock markets:

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[129] Ibid.

[130] London Stock Exchange, "About us" (http://www.londonstockexchange.com), accessed on 31 July 2003.

[131] Kuala Lumpur Stock Exchange, "About us" (www.klse.com.my/website/marketinfo/marketinfo.htm), accessed on 31 July 2003.

[132] Stock Exchange of Thailand (http://www.set.or.th/en/about/set/history_p1.html), accessed on 1 August 2003.

[133] World Federation of Exchanges, "A brief history", members section (http://www.world-exchanges.org), accessed on 6 August 2003.

[134] Originally known as the International Federation of Stock Exchanges (or Federation Internationale des Bourses de Valeurs [FIBV]), the organization's name was changed to the World Federation of Exchanges in 2001.

(a) The Federation of European Securities Exchanges (FESE) is the trading association for the securities exchanges of the European Economic Area and Switzerland; the market organizations in Central and Eastern European countries are eligible for associate membership;[135]

(b) The Federation of Euro-Asian Stock Exchanges (FEAS) was established in 1995 with 12 members and has expanded to include 24, including four exchanges in the ESCWA region.[136] The role of the FEAS is to promote the development of regional stock markets and to encourage the integration of these markets through joint listing and cross-border trading;[137]

(c) The South Asian Federation of Exchanges (SAFE) has 12 members. Its goals are to promote the development of stock markets in the region, to encourage the application of International Accounting Standards, to facilitate cross-border listing and technology transfer, and to guide its members towards regional and global integration;[138]

(d) The East Asian and Oceanian Stock Exchanges Federation (EAOSEF) was established in 1982 to facilitate the exchange of information between members; currently there are 15. The Federation changed its charter in 1998 to sanction a shift from country-based to stock-market-based memberships. The Federation examines ways to enhance cross-border trading and other market linkages among its members;

(e) The Istanbul Stock Exchange (ISE), which has existed since 1866, signed memorandums of cooperation with other stock exchanges in the region in 1999. This limited form of federation links the Istanbul market with the emerging exchanges in the republics of Kazakhstan, Kyrgyzstan and Uzbekistan;[139]

(f) The UASE, established in 1982, seeks to facilitate intra-Arab investment flows through the establishment of an Arab regional stock market.[140]

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[135] Federation of European Securities Exchanges, "Members & associate members" (http://www.fese.be), accessed on 6 August 2003.

[136] The Amman Stock Exchange, Cairo and Alexandria Stock Exchanges, Muscat Securities Market, and Palestine Securities Exchange.

[137] Istanbul Stock Exchange, "Internal recognitions and memberships" (http://www.ise.org/about/recog.htm), accessed on 1 August 2003; and Federation of Euro-Asian Stock Exchanges, "History of FEAS" (http://www.feas.org).

[138] South Asian Federation of Exchanges (http://www.safe-asia.org/aboutsafe.htm), accessed on 31 July 2003.

[139] Istanbul Stock Exchange (http://www.ise.org/about/majordev.htm), accessed on 31 July 2003.

[140] Union of Arab Stock Exchanges and Securities Commissions, *The Basic System…*

III. STOCK MARKET NETWORKING IN ESCWA MEMBER COUNTRIES: CHALLENGES AND OPPORTUNITIES

The emerging stock markets of the ESCWA member countries must address the key factors that prevent them from playing the vital role in development that capital markets in other parts of the developing world have played. In the new era of globalization, the region's stock markets have the opportunity to attract international capital. However, they also face increased competition from developed markets. There is no guarantee of success for newly emerging stock markets: "Not all formal markets prosper, as investors gravitate to certain markets and leave others underutilized. The busier ones, generally, have important attributes that smaller markets often lack".[141] The attraction of international capital and efficient utilization of regional funds are essential for economic development in the Arab region. Lessons can be learned from the phenomenal development of certain economies in East Asia: "The experience of Hong Kong, South Korea, Malaysia and Singapore has indicated that long-term economic growth is dependent on the provision of funds to finance domestic capital formation".[142]

The attributes of a successful stock market include liquidity, transparency, reliability, investor protection, appropriate legal procedures, and low transaction costs. The stock markets in the ESCWA region, like other small emerging markets, lack many of these important features. In an age when the world is moving towards greater financial integration—especially after the signing of the General Agreement on Trade in Services (GATS), and particularly in the light of the Agreement's fifth amendment, calling for financial liberalization—Arab stock markets have yet to establish significant regional linkages. This has hindered the effectiveness of Arab stock markets as a mechanism for mobilizing capital for regional growth and development, and has created a vacuum leading to the transfer of Arab funds outside the region (capital flight). However, research on stock market volatility in the area indicates that "Arab markets [are] characterized by low correlations with each other and with international markets",[143] and with other emerging financial markets, making them an especially useful source of risk reduction for portfolio investors.[144] Stock prices that move independently from global capital market activity are an attractive feature for risk-diversifying international investors. There is growing demand for broader financial markets with a greater diversity of financial instruments in the Arab world, as many Arab investors have extensive experience in developed asset markets and require similar levels of diversity and quality in their domestic markets before they will invest. Despite recent efforts to vitalize the Arab stock markets, they remain underdeveloped and underutilized, lacking depth and adequate trading volume.

A strong financial market "can make access to international capital easier, to the extent that the market develops into an efficient and liquid security exchange".[145] At present, stock market thinness in the Arab world hinders investment opportunities for regional savers; much of the Arab capital that would otherwise be available for regional development is invested in the more lucrative markets of Asia, Europe and North America. In some cases, government investors such as pension funds are restricted from participating in domestic stock markets because their high volume relative to market size would influence stock prices. Since the Arab stock markets are underdeveloped, large investors often rely on direct investment in unlisted securities to build their regional portfolios, further inhibiting market development. Over-the-counter trading reduces the market capitalization and liquidity of the Arab stock markets. One recent trend has been for Arab investment groups to disinvest in some of the region's markets owing to a lack of confidence in reporting standards, inadequate enforcement of regulations, and the weakness of certain local economies. Because there is surplus capital chasing a limited volume of listed shares in some of the region's stock markets, IPOs can be greatly oversubscribed. Large strategic investors in both the private and government sectors frequently purchase blocks of IPOs and hold them for long periods of time, leaving few alternatives for

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[141] Marc Levinson, *Guide to Financial Markets*, 3rd ed. (Princeton, New Jersey, The Economist/Bloomberg Press, 2003), p. 11.

[142] Kamal Naser, op. cit., p. 2.

[143] Riad Dahel, "Volatility in Arab stock markets", working paper (Kuwait, Arab Planning Institute, 2003), p. 19.

[144] Henry Azzam, "Positioning the region's capital markets to attract repatriated Arab funds from abroad"...

[145] Kamal Naser, op. cit., p. 3.

smaller investors. Investors who would like to purchase shares on the domestic stock market are often unable to obtain them at any price. Low trading volumes and market thinness result in informational inefficiency and long memory.[146] Informational inefficiency is evidenced by persistent price differentials between stocks listed jointly on various markets in the region. Low trading volumes contribute to high share price volatility, reflecting regional failure of the efficient market hypothesis, which is based on the assumption that share prices "always fully reflect available information".[147] High volatility of share prices can have a "negative effect on risk-averse investors, and ultimately on the economy".[148]

The region's stock exchanges and regulatory bodies face a number of challenges that constrain their efforts to promote market development. The private sector must assume responsibility for some of the factors contributing to market growth, including the adoption of international accounting practices, timely and accurate financial disclosure, and the use of equity capital to finance family-owned enterprise development. Governments, regulatory bodies and the stock markets themselves are responsible for ensuring the transparency and harmonization of regional stock market rules and regulations, equitable treatment of foreign and domestic investors, the enforcement of relevant laws, the privatization of State-owned enterprises, the implementation of sound macroeconomic policies, and the provision of education programmes for family-owned companies. The sections below identify the key challenges and opportunities facing those involved in the region's stock markets and efforts towards networking.

A. AT THE REGIONAL LEVEL

1. *Challenges and opportunities facing the private sector*

Building investor confidence in company management is a universal challenge. It is the responsibility of the management in any type of company, be it a small domestic enterprise or a multinational corporation, to do the necessary market research to ensure the viability of the business and to make this information available to shareholders. To compete effectively for investor trust, Arab companies must maintain a certain code of ethics. A particularly critical element is the application of International Accounting Standards. Global investors have been stung by accounting scandals over the past decade, even in developed stock markets; they have become wary of company claims and are more conscious of the possibility of accounting tricks and inaccurate financial reporting. Companies that apply sound international accounting practices and fully disclose all pertinent financial information will be in the best position to attract investment funds. This is true regardless of the disclosure requirements of the stock markets or regulatory agencies. Internationally accepted accounting practices are a requirement for doing business in the globalized world economy of the twenty-first century. Experienced Arab investors have "a large base of assets under management in different markets. ... It is estimated that almost US$ 800 billion of private money is invested in Western markets."[149] To choose between investing in a developed stock market or an emerging Arab stock market, the Arab investor must have reliable information about the value and earning power of the listed companies. This comes down to a matter of trust in the accuracy of corporate financial statements. Companies can "cook the books", even if they are required to follow International Accounting Standards. An analysis of each of the companies listed in Standard and Poor's S&P 500 Index over the past 11 years showed that actual company earnings were approximately 18 per cent lower than the earnings reported to shareholders when adjustments were made for questionable accounting practices relating to special charges, stock-option grants and pension assumptions.[150] Investors take risks when they purchase stocks, which is why expected returns are higher than returns from bonds or bank accounts. Smart investors will do their homework, making sure they know about the risks associated with equity market participation, but private company managers must play their

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[146] Imed Limam, "Is long memory a property of thin stock markets? International evidence using Arab countries", Working Paper (Kuwait, Arab Planning Institute), p. 3.

[147] Ghassan Omet, Mohammad Khasawneh and Jamal Khasawneh, "Efficiency tests and volatility effects: evidence from the Jordanian stock market", *Applied Economics Letters*, vol. 9, No. 12 (October 2002), p. 818.

[148] Riad Dahel, op. cit., p. 1.

[149] Clare Woodcraft, loc. cit.

[150] Gretchen Morgenson, "Quality of earnings: bubble lives on", *The International Herald Tribune* (14 July 2003), p. 10.

part, providing full disclosure of accurate information. To attract well-informed investors, Arab companies should provide the same quality and quantity of financial information as the companies listed on competing stock exchanges around the world.

Achieving and maintaining corporate financial transparency represents an important challenge in efforts to promote the successful development and networking of Arab stock markets. "In emerging markets in general, and Arab ones in particular, requirements for financial information are minimal and many companies are young. This leaves investors with limited information, possibly resulting in inappropriate or misinformed decisions".[151] As emphasized previously, Arab companies that are listed or have applied for listing on the region's markets should provide the high-quality, comprehensive and timely information required by investors, offering full and equal access to financial reports and other pertinent data and analyses, preferably through Internet web sites. Companies must be willing to go beyond minimum legal obligations if necessary. For example, the Bahrain Stock Exchange may require company financial reports every six months and the Beirut Stock Exchange every three months, but it is up to the company management to supply financial reports as often as investors need the information to make sound investment decisions. Company web sites are extremely useful for providing open and immediate access to financial reports; if the required financial information is not available, investors will take their funds elsewhere.

The traditional sources of funding for small and medium-sized Arab enterprises are lending institutions (a more expensive option than equity funding) and family-owned assets (which may limit the growth of a company). The situation is similar in other regions: "In most developing countries, banks are used as the major source of finance".[152] However, many of the "Arab countries follow Islamic *Sharia'* principles, which prevent the paying or receiving of interest and encourage the principles of profit and loss sharing. ... Dealing in shares complies with the spirit of Islam".[153] Private sector companies in the region should familiarize themselves with the most cost-effective sources of capital available for business development, as the cost of obtaining capital funds affects the competitiveness of companies operating in the global marketplace. An Arab bank recently announced that it had signed a seven-year loan agreement with a cement company for nearly US$ 8 million in financing to replace a higher-interest loan; however, equity financing might have been a less expensive alternative.[154] Arab companies that limit themselves to bank financing face higher capital costs than do companies with access to equity resources. Arab companies participating in equity markets have been successful at attracting regional capital through the public listing of shares. However, many more promising Arab companies remain out of the reach of investors because the company owners or managers lack the knowledge or the desire to go public. Ultimately, this can affect employment in the region. "Stock exchanges help promote employment by providing finance for small businesses", and in the Arab region, "small businesses ... have proven that they produce more jobs, more innovation and more tax revenue relative to investment than do large firms".[155] Arab company managers should educate themselves about the various sources and uses of capital, the benefits and risks of public listing, and the requirements for participation in the region's stock markets. An IPO is a way for companies to raise capital "just as [they] would with a bank loan but they don't have to make monthly interest payments".[156] A big difference is that equity capital is available for an unlimited time, unlike debt capital, and thus increases a company's flexibility in terms of financial decisions. Private company owners in the Arab region may fear that offering shares to the public will rob them of control over their businesses, or they may feel uneasy about financial disclosure requirements. By choosing not to participate in equity markets, however, these companies forego opportunities to expand their businesses, improve their international

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[151] Kamal Naser, op. cit., pp. 4-5.

[152] Ibid., p. 4.

[153] Ibid., p. 3.

[154] "$7.8 million OAB loan for Raysut Cement Co.", *Oman Observer*, Business News (24 August 2003) (http://www.omanobserver.com).

[155] Kamal Naser, op. cit., p. 3

[156] Arab Financial Markets Network, "Learning about IPOs" (http://www.alshabaca.com/mefn/education), accessed on 6 May 2003.

competitiveness, and optimize their financial structures by broadening their equity base.[157] Companies that are publicly listed also improve their public image and become more attractive to top-quality employees and managers. Because they must meet listing and disclosure requirements, investor and consumer confidence is enhanced. Public listing is a form of free advertisement for the company. The benefits from increased capital market participation by Arab companies include the following: (a) more effective capital market performance; (b) more efficient regional capital utilization; (c) private sector development and employment; and (d) increased consumer awareness of regionally produced products.

Family-owned businesses account for between 45 and 70 per cent of both world gross national product and employment.[158] The rapid development of the Arab economies in connection with the discovery and exploitation of oil resources in the past century has given rise to a large number of successful family-owned companies. The prevalence of family-owned businesses in the Arab countries represents a challenge for the development and networking of the region's stock markets, as these types of businesses tend to resist public listing. According to a study by the Emirates Center for Strategic Studies and Research, "Only with difficulty can family firms in the [Middle East and North Africa] be persuaded to go public, much less to submit to the fuller disclosures required by international investors."[159] Research has shown that for family-owned businesses in general, "only 3 per cent survive through the end of the third generation".[160] In the Arab region the large size of traditional families ensures that there will be too many third-generation descendents to efficiently manage an inherited business. By publicly listing, these vital companies could survive beyond the third generation and continue to provide dividend income to the shareholding descendants. The proclivity of Arab family-owned businesses to avoid equity markets limits their options to acquire funds, especially long-term capital, thereby reducing their potential for growth and increased international competitiveness. Public listing would provide access to the financing necessary for updating and expansion, allowing these companies to remain competitive and able to meet the demands of the growing regional and international markets. Regional investors stand poised to benefit financially from participation in these successful companies. Education programmes and examples of thriving family companies participating in the stock markets should be provided to change the negative attitude of Arab family-owned businesses towards equity financing.

Arab investors face challenges in the region's stock markets. As mentioned previously, the limited availability of investment opportunities in the area results in too much Arab capital chasing too few publicly listed companies. IPOs are usually oversubscribed as investors jump at any opportunity to put their surplus money to work by taking advantage of the limited instruments available to them. The predominance of large pension fund and government investors in the region contributes to low trading volumes and a lack of share liquidity. There is statistical evidence that long memory is exhibited by most of the Arab stock markets. Long memory, in which stock price movements do not exhibit a random walk, is found in developing stock markets characterized by "thin trading and [the] dominance of individual investors, attributed to the lack of [an] equity culture".[161] Experts from the region's stock markets, investment groups and regulatory agencies recommend that the base of financial instruments offered on these markets be expanded to serve the diverse capital needs of the region, since competing "international markets have an increasingly wide range of investment products such as alternative investments and private equity structures".[162] Greater diversification of instruments on the Arab stock markets would improve their ability to compete for global capital and attract Arab capital invested abroad.

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[157] Stock Exchange of Thailand, "How the market operates" (http://www.set.or.th/en/about/how/how.html), accessed on 1 August 2003; and Deutsche Boerse Group, "Going public overview" (http://deutsche-boerse.com), accessed on 1 August 2003.

[158] World Economic Forum, "Family businesses: entrepreneurial management from one generation to the next", summary of World Economic Forum Annual Meeting, 1 February 1999 (http://www.wef.org).

[159] Clement M. Henry, op. cit., p. 8.

[160] World Economic Forum, "Family businesses: entrepreneurial management from one generation to the next"...

[161] Imed Limam, op. cit., p. 16.

[162] Clare Woodcraft, loc. cit., p. B1.

2. *Challenges and opportunities facing the public sector*

Long memory can be caused not only by a lack of company transparency and insufficient financial disclosure, but also by regulatory weaknesses and limits on foreign investors. The Amman Stock Exchange is an exception in the Arab region, exhibiting short memory primarily as a result of financial reforms in the 1990s that opened the stock market to foreign investors, guaranteed investments, improved transparency, and established international standards of financial disclosure.[163] The public sector has an important role to play in addressing the challenges faced in the development and networking of Arab stock markets; within the context of ongoing financial reforms, attention must be given to the following: (a) requiring good corporate governance, financial disclosure, and observance of International Accounting Standards from listed companies; (b) improving the transparency of government regulations; (c) ensuring the fair treatment of companies, whether domestic or foreign-owned, in compliance with international and bilateral agreements; and (d) eliminating corruption linked to unaccountability in State-owned enterprises or to nepotism. Arab Governments have signed a number of bilateral and multilateral trade agreements that require the reduction or elimination of a wide range of import duties; consequently, alternative sources of revenue will be required. Corporate and income taxes can provide legitimate State revenues but require the existence of a strong formal private sector. In most Arab countries, a high percentage of market activity takes place outside the formal sector. Reforms should be undertaken to address the lack of transparency in regulations and discriminatory business practices if the formal private sector is to flourish and lead the Arab economies down the path to economic growth, development and prosperity.

Arab Governments can use the region's stock markets in their efforts to privatize State-owned enterprises. Allowing these emerging markets to serve as conduits for selling off government-owned companies will simultaneously benefit the public budget and increase market depth. An article published in the *Middle East Economic Survey* affirms that the "privatization and listing of utilities and major industries will help improve market depth and liquidity".[164] The stock market can be utilized in the privatization of government-owned companies to "overcome political resistance to market reforms ... because it establishes a broader-based ownership".[165] Workers in these companies may resist privatization owing to the natural employee redundancy that occurs when inefficient State enterprises are transformed into profit-seeking private companies,[166] but using the stock market to facilitate this transition may benefit workers if they receive shares of the stocks issued by the new publicly listed companies. Stock market networking efforts will also be strengthened if IPOs of these companies are offered on more than one stock exchange in the region.[167]

A solid framework for financial market development requires "legislation to reduce regulatory and legal uncertainty, greater protection of investors, removing restrictions on foreign ownership and competitive entry, and a reduction in the bias historically favorable to public sector borrowing; the real test is, of course, the proper enforcement of such rules".[168] To attract investors, the region's financial markets must ensure that the transparency of their legal infrastructure matches that of the global financial markets: "Capital will always go to where the rules of the game are the clearest."[169] Investor confidence in the fairness and equitability of the region's financial markets is an important element in promoting market development and growth. Building trust in the region's capital markets is the responsibility of both Arab companies (through financial disclosure) and the government bodies and other agencies in charge of market regulation. Legislation that protects investors generates investor confidence in the stock market. The Governments of

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[163] Imed Limam, op. cit., p. 16.

[164] Clare Woodcraft, loc. cit., p. B2.

[165] Enrico Perotti and Luc Laeven, "Confidence building in emerging stock markets", working paper (Washington, D.C., World Bank, March 2002), p. 38.

[166] Khalid Dalal, "Union expresses fears over privatization of JPMC, APC", *The Jordan Times* (24 August 2003).

[167] A.E. James, "Al Maha Petro divestment plan gains momentum", *Oman Observer*, Business News (24 August 2003).

[168] Enrico Perotti and Luc Laeven, op. cit., p. 37.

[169] Clare Woodcraft, loc. cit.

Jordan and Kuwait recently instituted safeguards to protect the rights of both local and foreign investors and improve the investment climate. Reforms must be undertaken to ensure the establishment of a sound legal framework for the Arab stock markets;[170] this constitutes an urgent priority, as trust in the legal system is crucial for attracting investors. Research has shown that "countries with common-law legal systems treat investors well, and their companies have an easy time raising capital".[171] Corruption and a lack of enforcement hinder market development. "Insider trading is [one] problem that may prevent a stock exchange from achieving its objectives. ... This practice allows a few investors to make systematic gains based on information made available to them, at the expense of others."[172] Modernizing legal frameworks and enforcing existing laws and regulations will improve investor trust in the Arab financial markets.

Sound financial markets are largely a product of effective macroeconomic governance. A stable foreign exchange rate reduces the level of foreign exchange risk for outside investors, an essential component for attracting portfolio investment.[173] Uncertainty about the future value of the Egyptian pound adversely affected foreign investment on the Cairo and Alexandria Stock Exchanges prior to the adoption of the free float system in late January 2003. Under the new system, foreign investors faced exchange-rate risks as the local currency struggled to find its level and eventually lost 30 per cent of its value relative to the United States dollar.[174] The monetary union between the GCC States will support market linkage efforts, as share prices in the subregion's seven stock markets will be quoted in a unified currency. Companies will be able to list shares on any of the GCC markets, and one element of risk will be reduced for investors. High interest rates on alternative financial instruments such as bonds and Treasury bills make equity markets less attractive for investors. A writer assessing some of the challenges Lebanon faced after it reopened its stock market in 1996 contends that "one of the fundamental drawbacks to a successful market was that interest rates on deposits and Treasury bills were high. ... Short term interest rates needed to fall to a maximum of 10 per cent before investors would become interested in the equity market".[175] Recent events suggest that the Government's efforts to lower interest rates through Paris II[176] have had a positive impact on the Beirut Stock Exchange, "prompting some investors to buy more local stocks".[177]

Financial liberalization leads to lower domestic capital costs and higher levels of investment. Nevertheless, some ESCWA member countries continue to restrict foreign investment in key sectors of the economy or require that a specified percentage be held by domestic investors. Such constraints limit participation in the Arab stock markets by reducing the investor pool. Low trading volumes and illiquidity are linked in part to the limitations placed on foreign investors; inactive pension funds account for the largest share of Arab investment in regional stock markets.[178] There are a number of reasons why foreign investors are extremely important for capital market development in the region. Research has shown that "financial market liberalizations are associated with higher real growth, in the range of 1 per cent per annum".[179] The link between financial liberalization and enhanced growth is possibly a "liquidity/efficiency mechanism".[180]

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[170] Ibid., p. B3.

[171] "The law of the market", *The Economist*, Finance and Economics Section (19 April 1997), p. 89.

[172] Kamal Naser, op. cit., p. 5.

[173] Clement M. Henry, op. cit., p. 7.

[174] Jordan Investment Trust Plc. (Jordinvest), "Weekly analysis: Will Arab stock markets maintain their upward trend in the second half of the year?", *Weekly Review & Analysis*, vol. III, No. 23 (6 July 2003).

[175] "Stuck market", *Lebanon Opportunities…*, pp. 98-101.

[176] The "Paris II" summit of international donors was held in late November 2002.

[177] Osama Habib, "Stock exchange yet to hit a real high", *The Daily Star* (Beirut) (http://www.dailystar.com.lb/business), accessed on 13 August 2003.

[178] Clare Woodcraft, loc. cit., p. B3.

[179] Geert Bekaert, Campbell Harvey and Christian Lundblad, "Emerging equity markets and economic development", NBER Working Paper Series, No. 7763 (Cambridge, Massachusetts, National Bureau of Economic Research, June 2000), p. 19.

[180] Ibid.

As mentioned earlier, the emerging Arab stock markets suffer from a lack of liquidity and informational inefficiency. To improve liquidity and market efficiency and enhance regional growth, Governments should review policies on foreign ownership of publicly listed companies within the context of their financial liberalization efforts. Some Arab stock markets, including the Amman Stock Exchange and the Cairo and Alexandria Stock Exchanges, are already fully accessible to foreign investors, while others are in the process of liberalization. The GCC States are moving towards greater market openness to investors from other GCC countries and have taken steps to establish a unified GCC capital market.[181] These liberalization policies should increase investment flows within the Gulf subregion; however, other Arab investors will continue to face the same restrictions applied to non-Arab investors in the GCC States. Governments should continue their efforts to open up their capital markets, as the liberalization of foreign investment in Arab stock markets will "increase the quality, pricing, and ... availability of products and services".[182]

Developing countries generally prefer foreign investment that brings in the expertise and technology needed to achieve national development goals, and often take steps to ensure that ownership of the companies modernized through such investment remains in the hands of citizens. A number of capital-surplus Arab economies invite foreign investment not because they lack funds but simply because they wish to benefit from the experience of seasoned international companies. Unfortunately, these capital-surplus economies continue to restrict foreign investment. Oman, Saudi Arabia and the United Arab Emirates limit foreign ownership of most domestic companies to 49 per cent. In Kuwait, Law No. 8 of 2001 stipulates that "the Council of Ministers shall determine the economic activities and projects that the foreign investor is allowed to undertake ... in conformity with the State's general policy and approved economic development plans".[183] Foreign capital participation is often accompanied by investor expertise that may be utilized to improve regional management practices, as foreign investors may have "better skills and information that enable them to monitor management in ways local investors cannot".[184] An excellent example of this is venture capital investment, whereby an experienced international company obtains a controlling share of a young company it believes is not reaching its full potential, then utilizes its technical expertise to improve operations and modernize the company. When the enhancements have been completed and the value of the company has increased sufficiently, the venture capitalists sell their controlling interest and leave the business. Venture capital is an especially attractive option for sensitive domestic sectors of developing countries, because these types of investors want to sell out after the industry becomes successful and their share values have risen, which coincides with the desire of developing country Governments to retain domestic ownership of profitable businesses.

Programmes providing educational materials and workshops on the use of equity markets should continue. With comprehensive information on the different funding sources and options, Arab companies will be better equipped to make decisions that lead to the efficient use of debt and equity capital. Bahrain offers workshops specifically for domestic family-owned businesses, bringing speakers from Kuwait, Saudi Arabia and the United Arab Emirates who have successfully listed their family-owned enterprises. Educating Arab companies—especially those that have remained in family hands—about the uses of equity capital should be a high priority for the region's stock markets and government regulatory agencies. The AFMN provides educational materials on IPOs through its web site.[185] Such efforts need to continue if regional entrepreneurs are to obtain maximum benefit from the area's equity markets.

Facilitating the participation of Arab women in capital markets as both entrepreneurs and investors will open up a largely untapped development resource. "Women still comprise a minority of managers in the

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[181] Hemu Gorde, "Call for 'unified' AGCC market to woo investors", *Khaleej Times* (5 February 2003).

[182] Nicola Fuchs-Schündeln and Norbert Funke, "Stock market liberalizations: financial and macroeconomic implications", IMF Working Paper, No. WP/01/193 (Washington, D.C., International Monetary Fund, December 2001), p. 5.

[183] Kuwait, Ministry of Finance, "Law No. 8 of 2001 regulating direct foreign capital investment in the State of Kuwait", chapter 1, article 2 (http://www.mof.gov.kw/lawno82001.doc).

[184] Graciela Kaminsky and Sergio Schmukler, op. cit., p. 26.

[185] Arab Financial Markets Network (http://www.alshabaca.com/mefn/education).

Arab world and mostly do not fill top positions at companies".[186] Empowering women through education campaigns will allow this segment of the population to contribute more fully to the development and diversification of the Arab economies. Training should be sponsored through women's associations, the media, the region's stock markets, and regulatory agencies, and might focus on such topics as raising equity capital for small to medium-sized enterprises, launching an IPO, and managing an investment portfolio. The Kuwait Stock Exchange is making an active effort to attract women to the stock market and has opened a separate trading floor for them, staffed entirely by females.[187] Women investors can use this venue or communicate their requests over the telephone without compromising their cultural traditions. Women brokers operate on the main trading floor as well, and there are no market restrictions based on the gender of brokers, investors or owners of publicly listed companies. Women are also active in the Egyptian stock market; the first woman was admitted to the trading floor in 1992.[188] Participation in the region's stock markets is a valuable mechanism for empowering women entrepreneurs and capital owners. Arab businesswomen are poised to make a vital contribution to the economic development of the region, and the stock markets are excellent venues for such activity. Female-owned enterprises can benefit from the region's stock markets, as they typically have difficulty obtaining bank financing. Equity finance is an excellent source of capital for small to medium-sized enterprises, especially as the decline in ODA worldwide is drying up microfinance opportunities for women.

3. *Arab bilateral agreements, the Greater Arab Free Trade Area, and stock market networking*

Negotiations for the establishment of the Greater Arab Free Trade Area (GAFTA) were revitalized in 1997. These ongoing negotiations are aimed at effecting the elimination of tariff and non-tariff barriers to intraregional trade of industrial products over a 10-year transition period, which began in January 1998. GAFTA coverage does not extend to financial services or capital markets, so the changes are unlikely to affect financial markets or the networking of Arab stock exchanges directly. However, intraregional trade liberalization may have an indirect impact on Arab stock markets, intra-Arab investment flows and FDI by stimulating regional economic growth and industrialization. Liberalizing trade among the GAFTA members will create opportunities for regional entrepreneurs and foreign investors, increasing the need for capital to finance Arab enterprises to serve growing regional and export markets. Several ESCWA member countries have recently negotiated interregional trade agreements and are poised to enter the huge consumer markets of the EU and North America. The Arab region has a comparative advantage with its low labour costs and is centrally located between the markets of Asia and Europe. Regional production-sharing and industrial clusters are forming as a result of Arab trade liberalization, freeing inputs to move among GAFTA members and allowing industries to benefit from economies of scale. Access to the North American market through the Jordan-United States Free Trade Agreement and to the EU through the Euro-Mediterranean association agreements will stimulate demand for equity capital financing through the region's stock markets. New market access will also encourage strategic foreign investment in the region's industries through both foreign acquisitions and the purchase of shares on the region's stock exchanges. Increased economic activity in the Arab countries as a result of regional trade liberalization is expected to have a positive impact on the trading volume and market capitalization of the Arab stock exchanges. Financial sector liberalization and stock market networking among the Arab countries can contribute positively to export-driven growth.

B. AT THE INTERNATIONAL LEVEL

1. *Financial services liberalization under the General Agreement on Trade in Services and regional stock market networking*

The General Agreement on Trade in Services, which emerged from the Uruguay Round, represents the first multilateral effort to establish rules governing trade in services, including financial services, and to provide a framework for multilateral negotiations on improved market access for foreign suppliers of

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[186] Ali Al-Shamali and Kenneth Wild, "Customer information exchange, ethical frameworks and gender in the Arab business world", Occasional Paper No. 46 (Abu Dhabi, Emirates Center for Strategic Studies and Research, 2002), p. 11.

[187] Arabicnews.com, "Women are segregated in Kuwait bourse", Kuwait, Culture Section (30 January 2003).

[188] Arabicnews.com, "1,000 Egyptian women in the Egyptian stock market", Egypt, Business Section (20 May 1999).

services. All branches of economic activity today are dependent on access to financial services. It is the diversified intermediation and risk-management services provided by the financial system that have made the development of modern economies possible. GATS provisions cover all types of financial services, including banking, securities and insurance. It is important to note that the GATS allows members to take prudential measures to protect investors and to ensure the integrity and stability of the financial system. It also permits the use of temporary non-discriminatory restrictions on payments and transfers in the event of serious balance-of-payments and external financial difficulties.

(a) *The General Agreement on Trade in Services and how it applies to financial services*

The GATS comprises the first set of multilateral, legally enforceable rules governing international trade in services. It covers all services sectors and all forms of trade in services. There are three components of the Agreement with direct relevance to financial services. First are the general GATS obligations, disciplines and other provisions, which apply to all WTO members and to all services sectors; these relate to issues such as most-favoured-nation (MFN) treatment, transparency and dispute settlement. Second are the GATS annexes on financial services, in which some of the general GATS rules and definitions have been modified to reflect the special characteristics of the financial sector. Finally, the individual member schedules set out specific commitments regarding market access and national treatment provided to foreign suppliers of financial services. In addition, WTO members have the option of scheduling their commitments pursuant to the Understanding on Commitments in Financial Services. This document, which forms part of the schedule of those members that have adopted it, provides a standardized list of commitments relating to the liberalization of financial services.

A majority of WTO members have undertaken financial services commitments. The scope of these commitments varies significantly from one country to another. In general, developed countries have complied with the requirements of the Understanding and have allowed foreign financial services suppliers to access their markets on terms largely similar to those granted to domestic firms. The situation is less homogeneous among developing countries.[189]

(b) *The role of the General Agreement on Trade in Services in liberalizing financial services*

Governments often impose trade restrictions aimed at preventing the domestic establishment of foreign services providers or the foreign supply of services on a cross-border basis. It is the reduction and elimination of these measures that constitute the primary focus of GATS trade liberalization efforts. A basic precept of the GATS, elucidated in article XIX,[190] is the principle of progressive liberalization, to be attained

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[189] Canada, Department of Finance, "Consultation paper for the World Trade Organization negotiations on financial services, June 2000" (http://www.fin.gc.ca/toce/2000/wto2000_e.html).

[190] Article XIX of the General Agreement on Trade in Services, under the heading "Negotiation of specific commitments", states the following: "1. In pursuance of the objectives of this Agreement, members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement and periodically thereafter, with a view to achieving a progressively higher level of liberalization. Such negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. This process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations; 2. The process of liberalization shall take place with due respect for national policy objectives and the level of development of individual members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing country members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in article IV; 3. For each round, negotiating guidelines and procedures shall be established. For the purposes of establishing such guidelines, the Council for Trade in Services shall carry out an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of this Agreement, including those set out in paragraph 1 of article IV. Negotiating guidelines shall establish modalities for the treatment of liberalization undertaken autonomously by members since previous negotiations, as well as for the special treatment for least-developed country members under the provisions of paragraph 3 of article IV; 4. The process of progressive liberalization shall be advanced in each such round through bilateral, plurilateral or multilateral negotiations directed towards increasing the general level of specific commitments undertaken by members under this Agreement" (see General Agreement on Tariffs and Trade, *Uruguay Round: Final Act (Marrakesh, 15 April 1994)*, pp. 298-299).

through successive rounds of negotiations. The aim of progressive liberalization is to gradually reduce or eliminate the adverse effects of government measures on trade in services in order to ensure increased market access and national treatment. The liberalization process is to take place with a view to promoting the interests of all participants "on a mutually advantageous basis, and to securing an overall balance of rights and obligations". Article XIX also stipulates that "the process of liberalization must be undertaken with due respect for national policy objectives and the level of development of individual members, both overall and in individual sectors". Appropriate flexibility is to be given to individual developing countries to open fewer sectors, liberalize fewer types of transactions, and progressively extend market access in line with their development situation.

It is important to understand that liberalizing trade in financial services and relaxing restrictions on capital account transactions are two distinct issues. The GATS focuses on improving the terms and conditions of market access and ensuring non-discriminatory treatment for foreign suppliers of financial services, and not on expediting the liberalization of capital account transactions. It is true that members are required to allow international transfers and payments for transactions relating to their specific commitments under the GATS, some of which may involve capital account transactions. However, the Agreement permits any member to take prudential measures aimed at preserving the integrity and stability of its financial system. Moreover, if a member faces "serious balance-of-payments and external financial difficulties or [the] threat thereof", it is entitled under article XII of the GATS to maintain temporary restrictions on trade in services in respect of which it has assumed commitments, "including restrictions on payments and transfers for transactions related to such commitments".[191]

Some countries are not yet ready for comprehensive liberalization; allowing foreign participation in an undeveloped financial sector that suffers from credit controls or negative interest rates might not produce the desired effect. Interest rate restrictions "often make financial intermediation unprofitable and result in poor portfolios and weak capital bases in banks".[192] Under such circumstances, few foreign banks would be interested in establishing themselves in a local economy. "If banks are forced to call in credits, poor portfolios could expose unsound banks and lead to a systemic crisis. Should capital inflows increase, the increase in liquidity may lead to imprudent lending and further worsen the quality of existing portfolios. Any (external) shock to the system could again expose the poor portfolios and lead to a crisis."[193] Opening a weak banking sector to stronger and more solid foreign banks and capital, easing controls on credit or interest rates, or replacing them with indirect monetary instruments (such as the open market operation of central banks) could rapidly lead to bank failures unless some restructuring has already taken place, as unsound banks with non-performing portfolios will be more vulnerable. Unsound banks are more likely to fail in a market in which there is strong foreign competition, as high operating costs associated with large, poorly performing portfolios can undermine competitiveness. The Governments of many countries are reluctant to allow banks "to restructure their portfolios for social or political reasons".[194] However, gradually allowing foreign banks or capital increased access can help launch or accelerate this process and force national policy makers to undertake domestic financial reforms.

The information presented above suggests that "commitments in the various modes of supply in the GATS could be linked to the state of development of a country's financial sector. Binding financial sector reform in ... mode 3 (commercial presence) would make sense during the later stages of internal financial sector reform, and mode 1 (cross-border) liberalization in the context of capital account opening. Commitments under mode 2 (consumption abroad) can be a way of increasing competition in local financial markets in the context of gradually [easing capital account restrictions]."[195] In sum, those countries in which the financial sector is less developed should first ensure that basic policies on internal reform are in place.

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[191] Ibid., pp. 293-294.

[192] Piritta Sorsa, *The GATS Agreement on Financial Services: A Modest Start to Multilateral Liberalization*, IMF Working Paper, No. WP/97/55 (Washington, D.C., International Monetary Fund, 1997) p. 20.

[193] Ibid.

[194] Ibid., p. 21.

[195] Ibid.

Once this is done, mode 3 commitments are advisable. Mode 1 and 2 commitments seem more appropriate when some domestic access has been granted to outside parties and appropriate prudential regulations and monetary conditions are fulfilled. This should not, however, be used as an excuse to either delay reform or avoid making commitments in the multilateral negotiations.[196]

(c) *The Doha Development Agenda*

Negotiations on the liberalization of services were officially launched in early 2000 under the auspices of the Council for Trade in Services. "In March 2001, the Services Council fulfilled a key element in the negotiating mandate by establishing the negotiating guidelines and procedures. The Doha Declaration endorses the work already done, reaffirms the negotiating guidelines and procedures, and establishes some key elements of the timetable including, most importantly, the deadline for the conclusion of the negotiations as part of a single undertaking."[197] Mandated deadlines include the following: (a) "by 30 June 2002, members were [to have submitted] initial bilateral market access requests to their trading partners. This deadline, however, is considered to be only indicative, and members were expected to submit further requests"; (b) "by 31 March 2003, members [were to have responded] to the requests received with initial offers"; and (c) "by 1 January 2005, the mandated services negotiations are to conclude as part of the single undertaking agreed in Doha".[198]

"In the current bilateral—and thus confidential—request phase, virtually all WTO members have received initial requests from some 30 mainly developed and larger developing countries."[199] Some developing country members are concerned about the process's lack of transparency and the large resource capacities required within the framework of the bilateral market access negotiations, as well as the inequalities in bargaining power and the trend towards the "bilateralization" of horizontal issues such as domestic regulation and classification. More generally, many developing countries continue to question whether they have anything to gain from further multilateral liberalization of services.[200]

(d) *The General Agreement on Trade in Services and the Arab financial markets*

Although it is too early to predict the outcome of the most recent reforms being undertaken in financial services regulation and supervision by the Governments of the ESCWA member countries, there appears to be little doubt that the aim is to improve the functioning of the markets and to complete rather than reverse the process of liberalizing financial services. It should be noted, though, that the ESCWA members have a long way to go before their financial systems are able to handle foreign involvement in a manner benefiting all parties. Some require the gradual implementation of financial reforms before they can even consider the external liberalization of their financial systems. Others can easily start opening up their financial markets and benefit from the movement of international capital after improving their prudential regulations. Although the schedules of financial services commitments offered by the ESCWA region's seven WTO members vary in scope, coverage and degree of conditionality, additional modifications may be undertaken in all cases to produce better-drafted and more transparent policies. Future negotiations will likely facilitate further financial market liberalization, not only for the region's WTO members, but also among the other ESCWA member countries that have applied for membership.

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[196] Ibid., pp. 20-22.

[197] World Trade Organization, "The Doha Declaration explained" (http://www.wto.org/english/tratop_e/dda_e/doha explained_e.htm), p. 4.

[198] International Centre for Trade and Sustainable Development and International Institute for Sustainable Development, *Doha Round Briefing Series: Developments Since the Fourth WTO Ministerial Conference*, vol. 1, No. 3 of 13, executive summary relating to trade in services (February 2003), p. 1.

[199] Ibid., p. 2.

[200] Ibid.

2. *Financial services commitments under the Doha Development Agenda*

Seven of the thirteen countries in the ESCWA region are WTO members and have scheduled commitments to liberalize their financial services sectors in line with GATS rules and provisions (see tables 5 to 11).[201] As mentioned previously, the degree of financial system development varies from one country to another. Some require internal reforms before they are able to make full use of the multilateral framework provided by the Agreement, while others have achieved an advanced state of open market access in financial services. For this latter group, participating in efforts to liberalize trade in financial services on a global basis represents a new, unreserved commitment to comprehensive financial sector liberalization. For the other countries in the region, the schedules of specific GATS commitments are useful examples they may wish to consider should they decide to participate in future negotiations.

The schedule of specific commitments includes the following categories: (a) financial services; (b) modes of supply, (c) limitations on market access; and (d) limitations on national treatment. The modes-of-supply category comprises four subcategories, namely, cross-border supply, consumption abroad, commercial presence, and the presence of natural persons.[202] Member Governments may make commitments guaranteeing the right to supply services under any or all of these modes. For each of the services covered by a particular commitment, the schedule must indicate, under each of the four modes, any limitations on market access or national treatment that are to be imposed; limitations not declared in this manner become illegal. From an analysis of the schedules of financial services commitments it is possible to extract the following with regard to the ESCWA member countries:

(a) In terms of market access limitations relating to the commercial presence of financial services suppliers, restrictions on specific types of legal entities and joint ventures, as well as limitations on the participation of foreign capital in local financial institutions, are common;

(b) With respect to national treatment, special authorization requirements for foreign institutions, limitations on the ownership of land, and nationality and residency requirements are very common;

(c) Taxes also constitute a national treatment concern. Taxation is often a determining factor in decisions regarding the location of financial transactions and can substantially alter the conditions of competition between financial services suppliers;

(d) The most liberal offer, in general terms, is that of Qatar, followed by that of the United Arab Emirates;

(e) Qatar's offer is the easiest to read, followed by that of the United Arab Emirates;

(f) The most rigid offer is that of Kuwait, followed by the Egyptian offer;

(j) The most complex schedule is that of Egypt, in which activities have been reclassified, redefined, and redistributed among three types of banks (with different legal forms and structures) and the stock market. However, stock market activities have been greatly liberalized in the Egyptian offer;

(h) The most liberalized mode of supply is consumption abroad (mode 2), followed by cross-border supply (mode 1);

(i) The most closed mode of supply is the temporary movement of natural persons (mode 4), followed by commercial presence (mode 3).

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[201] These countries (in order of dates of membership) include Bahrain (1 January 1995), Kuwait (1 January 1995), Egypt (30 June 1995), Qatar (13 January 1996), United Arab Emirates (10 April 1996), Jordan (11 April 2000) and Oman (9 November 2000).

[202] For more detailed information see Piritta Sorsa, op. cit., p. 8; and Greg McGuire, *Trade in Services: Market Access Opportunities and the Benefits of Liberalization for Developing Economies*, Policy Issues in International Trade and Commodities Study Series, No. 19 (New York and Geneva, United Nations Conference on Trade and Development, 2002) (United Nations publication, Sales No. E.02.II.D.9), p. 3.

TABLE 5. SCHEDULE OF COMMITMENTS FOR BAHRAIN UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES

Sector and subsector	Limitations on market access	Limitations on national treatment
Services auxiliary to insurance (including broking and agency services)	(1) N (2) N (3) N (4) U	(1) N (2) N (3) N (4) U
Trading the following for own account or for the account of customers, whether on an exchange, in an over-the-counter market or otherwise: (a) Money market instruments (including cheques, bills and certificates of deposit); (b) Derivative products including (but not limited to) futures and options; (c) Transferable securities; (d) Other negotiable instruments and financial assets, including bullion.	(1) Unbound for equity and other securities listed on the Bahrain Stock Exchange (BSE). A licence is required from the Bahrain Market Authority (BMA) if the activity is undertaken in/from Bahrain for customers' account. (2) Unbound for equity and other securities listed on the BSE (3) Transactions on the BSE must be conducted through a licensed stockbroker. Transactions involving listed bonds and warrants can be done over the counter. Stockbrokers and market markers for securities on the BSE must be either Bahraini nationals (individuals or locally incorporated companies with a minimum 51 per cent Bahraini ownership) resident in Bahrain, or branches of foreign companies undertaking such business in international securities. A money broker must be locally incorporated with 51 per cent Bahraini ownership, and requires a licence from the BMA. (4) U	(1) U (2) U (3) N (4) U
Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues	(1) Unbound for equity and other securities listed on the BSE. A licence is required from the BMA if the activity is undertaken in/from Bahrain for customers' account. (2) Unbound for equity and other securities listed on the BSE (3) A licence is required from the BMA if the activity is undertaken in/from Bahrain. Unbound for equity and other securities listed on the BSE (4) U	(1) U (2) U (3) N (4) U
Asset management, including cash or portfolio management, all forms of collective investment management, pension fund management, and custodial, depository and trust services	(1) Unbound for BSE-listed equity and other securities (2) Unbound for BSE-listed equity and other securities (3) Licences are required from the BMA. For depository services in respect of BSE-listed equity and other securities, approval is required from the BSE. (4) U	(1) U (2) U (3) No limited-liability companies can undertake investments on behalf of third persons. (4) U

TABLE 5 (*continued*)

Sector and subsector	Limitations on market access	Limitations on national treatment
Settlement and clearing services for financial assets, including securities, derivative products and other negotiable instruments	(1) Unbound for cheques in Bahrain dinars (BD), must be through the BMA; for BSE-listed equity and other securities, must be through the BSE (2) Unbound for BD cheques, must be through the BMA; for BSE-listed equity and other securities, must be through the BSE (3) Unbound for BD clearing (4) U	(1) N (2) N (3) N (4) U

Source: World Trade Organization, "Bahrain: schedule of specific commitments" (GATS/SC/97) (http://www.wto.org/english/tratop-e/serv_commitments_e.htm).

Notes: The numbered items in the second and third columns correspond with the following modes-of-supply subcategories: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; and (4) the presence of natural persons. The letter designations signify the following: U = unbound in liberalizing an activity; N = no limitations; UE = unbound except; and NE = no limitations except.

TABLE 6. SCHEDULE OF COMMITMENTS FOR KUWAIT UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES

Sector and subsector	Limitations on market access	Limitations on national treatment
Trading the following for own account or for the account of customers, whether in the financial market, over-the-counter or otherwise: (a) Money market instruments (such as cheques, bills and certificates of deposit); (b) Derivative products including (but not limited to) futures and options; (c) Transferable securities; (d) Other negotiable instruments and financial assets, including gold bullion.	(1) U (2) N (3) UE (4) UE	(1) U (2) N (3) UE (4) UE
Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and the provision of financial services related to such issues	(1) U (2) N (3) UE (4) UE	(1) U (2) N (3) UE (4) UE
Management of assets, including the management of portfolio investments, liquid assets, all forms of collective investments, pension funds and investment trustee services	(1) U (2) N (3) UE (4) UE	(1) U (2) N (3) UE (4) UE
Settlement and clearing services for financial assets, including securities, derivative products and other negotiable instruments	(1) U (2) N (3) UE (4) UE	(1) U (2) N (3) UE (4) UE

Source: World Trade Organization, "Kuwait: schedule of specific commitments" (GATS/SC/49) (http://www.wto.org/english/tratop-e/serv_commitments_e.htm).

Notes: The numbered items in the second and third columns correspond with the following modes-of-supply subcategories: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; and (4) the presence of natural persons. The letter designations signify the following: U = unbound in liberalizing an activity; N = no limitations; UE = unbound except; and NE = no limitations except.

TABLE 7. SCHEDULE OF COMMITMENTS FOR EGYPT UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES

Sector and subsector	Limitations on market access	Limitations on national treatment
	Banks	
A. Joint venture banks (JVBs) Trading the following for own account or for the account of customers: (a) Money market instruments (cheques, bills and certificates of deposit); (b) Securities. Participation in share issues and the provision of services related to such issues through subsidiaries Safekeeping of securities	(1) U (2) U (3) The share of non-Egyptians in the capital of JVBs and private banks may exceed 49 per cent of the issued capital of any bank, without any ceiling. On a non-discriminatory basis, ownership of more than 10 per cent of the issued capital of any bank, except through inheritance, requires the approval of the Central Bank of Egypt's Board of Directors. (4) The General Manager should have banking experience in Egypt of no less than 10 years for banks established in Egypt other than branches of foreign banks.	(1) U (2) U (3) Foreign services suppliers, in the context of JVBs, are required to offer on-the-job training for national employees. (4) N
B. Foreign bank branches Same activities as specified under category A (above)	(1) U (2) U (3) Economic needs test shall be applied. (4) N	(1) U (2) U (3) Branches of foreign banks existing on 5 June 1992 (the date of enforcement of Law No. 37 of 1992) may be licensed to deal in local currency in addition to foreign currency subject to the satisfaction of the minimum capital requirement, adequacy of provisions and other prudential measures (article 13 of the executive regulations of said Law). (4) N
C. Representative offices of foreign banks (ROs)	(1) U (2) U (3) Foreign banks that wish to set up representative offices should not have branches in Egypt. The activities of ROs should be confined to conducting studies on potential investments, acting as liaisons with their head offices, and contributing to solving problems and difficulties that may be confronted by their head offices' correspondents in Egypt. (4) N	(1) U (2) U (3) U (4) N

TABLE 7 (*continued*)

Securities		
Sector and subsector	Limitations on market access	Limitations on national treatment
Underwriting	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N
Brokerage	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N
Trading in securities (purchases and sales by individuals or institutions on the stock exchange)	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N
Clearing and settlement	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N
Marketing and market promotion	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N
Portfolio and investment management	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N
Establishment of collective investment funds	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N
Venture capital	(1) N (2) N (3) N (4) N	(1) N (2) N (3) N (4) N

Source: World Trade Organization, "Trade in services—Egypt: schedule of specific commitments" (GATS/SC/30) (http://www.wto.org/english/tratop-e/serv_commitments_e.htm).

Notes: The numbered items in the second and third columns correspond with the following modes-of-supply subcategories: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; and (4) the presence of natural persons. The letter designations signify the following: U = unbound in liberalizing an activity; N = no limitations; UE = unbound except; and NE = no limitations except.

TABLE 8. SCHEDULE OF COMMITMENTS FOR QATAR UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES

Sector and subsector	Limitations on market access	Limitations on national treatment
Services auxiliary to insurance (including broking and agency services)	(1) N (2) N (3) The number of foreign insurance suppliers is frozen at the level existing on March 1995 (five firms) (4) U	(1) N (2) N (3) N (4) U

Source: World Trade Organization, "Qatar: schedule of specific commitments" (GATS/SC/120) (http://www.wto.org/english/tratop-e/serv_commitments_e.htm).

Notes: The numbered items in the second and third columns correspond with the following modes-of-supply subcategories: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; and (4) the presence of natural persons. The letter designations signify the following: U = unbound in liberalizing an activity; N = no limitations; UE = unbound except; and NE = no limitations except.

TABLE 9. SCHEDULE OF COMMITMENTS FOR THE UNITED ARAB EMIRATES UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES

Sector and subsector	Limitations on market access	Limitations on national treatment
Trading the following for own account or for the account of customers:	(1) N	(1) N
	(2) N	(2) N
(a) Money market instruments; (b) Derivative products; (c) Transferable securities; (d) Other negotiable instruments and financial assets.	(3) (a) No limitations on the establishment of representative offices; (b) Unbound for new licences for operating bank branches; (c) Unbound for the expansion of activities of existing financial entities.	(3) N
Participation in issues of all kinds of securities (underwriting) Asset management	(4) UE	(4) UE

Source: World Trade Organization, "United Arab Emirates—General Agreement on Trade in Services: schedule of specific commitments" (GATS/SC/121) (http://www.wto.org/english/tratop-e/serv_commitments_e.htm).

Notes: The numbered items in the second and third columns correspond with the following modes-of-supply subcategories: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; and (4) the presence of natural persons. The letter designations signify the following: U = unbound in liberalizing an activity; N = no limitations; UE = unbound except; and NE = no limitations except.

TABLE 10. SCHEDULE OF COMMITMENTS FOR JORDAN UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES

Sector and subsector	Limitations on market access	Limitations on national treatment
Trading the following for own account or for the account of customers, whether on an exchange, in an over-the-counter market or otherwise:	(1) NE, U (2) NE, U (3) Access restricted to:	(1) N (2) N (3) N
(a) Money market instruments (cheques, bills, certificates of deposit); (b) Derivative products including (but not limited to) futures and options;	(a) Banks; (b) Financial services companies constituted in Jordan in the form of a public shareholding company, limited liability company, or limited partnership in shares company.	
(c) Transferable securities; (d) Other negotiable instruments and financial assets, including bullion.	(4) UE	(4) UE

TABLE 10 (*continued*)

Sector and subsector	Limitations on market access	Limitations on national treatment
Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues Asset management, including cash or portfolio management, all forms of collective investment management, pension fund management, and custodial, depository and trust services	(1) U (2) UE (3) Access restricted to the following: (a) Financial services companies constituted in Jordan in the form of a public shareholding company, limited liability company, or limited partnership in shares company; (b) Licensed banks through affiliated companies or separate accounts. (4) UE	(1) U (2) UE (3) N (4) UE
Settlement and clearing services for financial assets including securities, derivative products and other negotiable instruments.	(1) U (2) N (3) Access is restricted to the Securities Depository Center at the Amman Stock Exchange for securities, and to the Central Bank of Jordan for all other financial instruments. (4) UE	(1) U (2) N (3) Access is restricted to the Securities Depository Center at the Amman Stock Exchange for securities, and to the Central Bank of Jordan for all other financial instruments. (4) UE

Source: World Trade Organization, "Trade in services—the Hashemite Kingdom of Jordan: schedule of specific commitments" (GATS/SC/128) (http://www.wto.org/english/tratop-e/serv_commitments_e.htm).

Notes: The numbered items in the second and third columns correspond with the following modes-of-supply subcategories: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; and (4) the presence of natural persons. The letter designations signify the following: U = unbound in liberalizing an activity; N = no limitations; UE = unbound except; and NE = no limitations except.

TABLE 11. SCHEDULE OF COMMITMENTS FOR OMAN UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES

Sector and subsector	Limitations on market access	Limitations on national treatment
Insurance intermediation, such as brokerage and agency services	(1) N (2) N (3) Foreign equity limited to 70 per cent (4) UE	(1) N (2) N (3) N (4) UE
Trading the following for own account or for the account of customers, whether on an exchange, in an over-the-counter market or otherwise:	(1) None for financial information services and financial advisory services; unbound for other services	(1) None for financial information services and financial advisory services; unbound for other services

TABLE 11 (*continued*)

Sector and subsector	Limitations on market access	Limitations on national treatment
(a) Money market instruments (cheques, bills, certificates of deposit); (b) Derivative products including (but not limited to) futures and options. Asset management, including cash or portfolio management, all forms of collective investment management, pension fund management, and custodial, depository and trust services Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments.	(2) N (3) (a) None. Upon accession, commercial presence is allowed for wholly owned branches of foreign banks; starting no later than 1 January 2003, commercial presence is allowed in the form of wholly foreign-owned subsidiaries and branches of foreign banks and other financial services suppliers; (b) The aggregate holding by (i) an individual and related parties, (ii) an incorporated body and its related parties, or (iii) a joint stock company or holding company and its related parties in a locally incorporated bank (other than wholly foreign-owned subsidiaries) shall not exceed 35 per cent of the voting shares of the bank; (c) The number of bank branches in Muscat is limited to four for each bank (whether local or foreign). (4) UE	(2) N (3) N (4) UE

Source: World Trade Organization, "Trade in services—Oman: schedule of specific commitments" (GATS/SC/132) (http://www.wto.org/english/tratop-e/serv_commitments_e.htm).

Notes: The numbered items in the second and third columns correspond with the following modes-of-supply subcategories: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; and (4) the presence of natural persons. The letter designations signify the following: U = unbound in liberalizing an activity; N = no limitations; UE = unbound except; and NE = no limitations except.

IV. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

The emerging Arab stock markets have a key role to play in providing Arab companies access to regional and international capital. Equity markets can provide lower-cost, longer-term capital than that available through bank financing, ensuring the international competitiveness of Arab companies in an age of globalization. Foreign investors holding shares in publicly listed domestic companies can bring additional benefits to the region in the form of international management skills and modern technology. Like other emerging stock markets around the world, the Arab stock markets lack many of the important features of the developed markets, including depth, liquidity, openness, accountability, transparency, appropriate legal procedures, investor protection, and low transaction costs. This undermines the effectiveness of the Arab stock markets as a collective mechanism for mobilizing capital for regional growth and development. It also creates a vacuum leading to the transfer of Arab capital outside the region. The factors hindering the development of the Arab stock markets differ from one country to another. However, all markets face common challenges that should be addressed before real progress can be made in establishing intraregional market linkages. Promoting the development and networking of the emerging Arab stock markets is important in facilitating intraregional investment flows.

Significant financial reforms have been undertaken in the ESCWA member countries over the past decade. However, the Arab stock markets have a long way to go to reach their full potential as a capital resource for regional growth and development. Since the late 1980s, most Governments in the region have taken steps to empower the private sector and enhance the role of the stock markets, having recognized their importance in the achievement of national development objectives. The interest these countries have exhibited in developing and reforming their financial structures has been evidenced by the rapid increase in the number of Arab stock exchanges. The public sector can play an active role in the development and networking of regional stock markets by increasing transparency, enforcing regulations, ensuring the fair treatment of companies, addressing corporate corruption, reducing the share of government-held equities, and privatizing government-owned companies through public listings. Arab Governments should continue to pass investor protection laws and remove restrictions on foreign investment. To achieve integration between the Arab stock markets, efforts to unify financial legislation, harmonize stock market rules and regulations, and ensure the compatibility of their financial infrastructures should continue.

At a time when the world is moving towards greater financial integration—especially with the signing of the GATS—Arab stock markets continue to lack significant regional and international linkages, with a few notable exceptions. The networking agreement between Egypt, Kuwait and Lebanon required the establishment of clearing and settlement institutions and securities depositories, as well as mechanisms to ensure the rapid completion of property transfers and to guarantee the rights of shareholders, whether national or foreign. Even with the availability of the necessary laws and institutions, these three countries were required to establish a minimum level of legislative harmonization and compatibility. Building a stronger stock market network through consolidation into a single trading platform (the most integrated form of networking) would require more rigorous regulatory harmonization among the networked countries. The Euronext is the only regional stock market network to have achieved this level of integration. Evidence from other parts of the world suggests that regional capital markets are not consolidating; on the contrary, the 1990s witnessed a massive increase in the establishment of new stock exchanges because domestic stock markets offer customized services and features that meet the particular needs of the local private sector. The networking of the Arab stock markets into an integrated regional capital market is more likely to be achieved through efforts to facilitate the joint listing of companies, electronic cross-border trading, and foreign investor access than through the establishment of a single Arab trading platform.

1. *The private sector*

The private sector can contribute to regional stock market development and networking efforts through the following:

(a) *Good corporate governance*. Companies that use sound international accounting practices will be in the best position to attract long-term strategic investors. The success of a stock market depends on the underlying assets of its publicly listed financial instruments. A stock represents the financial standing, performance and growth potential of a company, its liquidity and solvency, and investor expectations of financial and corporate growth; the attractiveness of securities to investors is therefore a product of the issuing companies' financial status and prospects. Without accountability at the senior management level, investors will not have the confidence to invest in the market. In a region in which family ties tend to take precedence over corporate benefit, company managers should make every effort to ensure that the managerial decisions taken are in the best interests of the company and the shareholders;

(b) *Transparency*. One of the thorniest issues faced in Arab stock market development is the corporate sector's ability and willingness to provide transparent financial disclosure on a regular basis. Investors require timely information to make sound investment decisions; if the necessary financial information is not available, investors will take their funds elsewhere. Disclosure is not limited to audited financial statements but should include any additional relevant information and analysis provided in a company's annual report. Financial disclosure for domestic and foreign investors is most effectively provided through corporate web sites;

(c) *Going public*. The large number of family-owned businesses in the Arab economies hinders the development of the region's stock markets. These businesses can reduce their traditional dependence on bank financing and obtain the lower-cost equity financing necessary for expansion and modernization to meet the demands of growing regional markets and increased international competition. Family-owned companies should be encouraged to learn about equity financing. The public listing of successful family-owned Arab businesses would improve stock market depth. Regional investors stand poised to benefit financially from participation in these companies. Some family-owned enterprises in the region have been publicly listed on the region's stock markets, but many more remain out of the reach of Arab investors;

(d) *Auditing*. Corporate laws are the cornerstone of the stock market. Most ESCWA member countries have revised their company acts to encourage the creation of joint stock companies. Auditing and supervisory operations have been developed in line with international standards. However, the absence of or deficiencies in auditing practices in some Arab markets, the shortage of accurate financial information, and the differences in executive regulations governing auditing are all factors that adversely affect the stock markets.

2. *Governments and regulatory agencies*

Government and regulatory agencies can contribute to regional stock market development and networking efforts through the following:

(a) *Asset diversity*. Many Arab investors have extensive experience in developed capital markets with wider coverage in terms of the types and characteristics of instruments available to investors. Similar diversity and quality is required in the Arab stock markets to attract these international investors, and to respond to the growing local demand for broader financial markets offering a greater selection of financial instruments;

(b) *Standardization*:

(i) Stock market rules and regulations should be harmonized with international standards—similar to what has been achieved through the World Federation of Exchanges—as a necessary condition for competing in the global financial marketplace. Arab Governments have yet to take any action in this respect;

(ii) Modern technological advances have standardized electronic trading operations in the Arab countries, raising the level of transparency and market efficiency and reducing clearance times for transactions. Further development is required in this area, particularly with regard to facilitating cross-border trading;

(iii) It is essential to standardize the terminology used in the Arab stock markets with that used in global financial markets. The AFMN web site offers assistance in standardizing terminology for UASE members. Standardized terminology improves transparency for investors. The standardization of analysts' reports reduces the prevalence of unsubstantiated profitability ratios, dubious security valuations, and buy and sell recommendations that mislead potential investors;

(c) *Electronic trading*. Linking the Arab stock markets through electronic cross-border trading is a viable option for regional stock market networking. The modern electronic trading systems in the ESCWA member countries make it possible to develop a stock market in cyberspace, eliminating the need for a physical trading platform. With a virtual stock exchange, each of the Arab stock markets would retain the individual features that satisfy the particular needs of the domestic private sector, while also giving Arab companies and investors access to a wider regional capital market;

(d) *Transparency*. Government legislation and regulations should be transparent to ensure equal access for stock market participants, including publicly listed companies and their shareholders. Transparency prevents nepotism, corruption, and the unintentional mistakes that can occur when rules and regulations are unclear or inaccessible. Transparent access to government legislation and regulations should be provided for foreign companies and investors, as well as for the domestic market, and the laws and rules should be compatible with regional and international agreements, including the GATS;

(e) *Financial services liberalization*:

(i) *GATS compliance*. Arab countries that are WTO members still need to achieve full compliance with GATS commitments. Steps must be taken to liberalize financial services by, for example, permitting foreign brokerage firms to operate in the region's stock markets. In the ESCWA member countries, limitations and restrictions still exist with regard to the commercial presence of financial services suppliers, the specific types of legal entities and joint ventures permitted, and the participation of foreign capital in local financial institutions;

(ii) *National treatment*. Special authorization requirements for foreign institutions, limitations on the ownership of land, and nationality and residency requirements are very common in the ESCWA member countries. Taxation also constitutes a national-treatment concern under the GATS, as this is often a determining factor in decisions on the location of financial transactions and can substantially alter the conditions of competition between financial services suppliers;

(f) *Macroeconomic policies*. Financial markets depend on sound macroeconomic policies. A stable foreign exchange rate reduces the level of foreign exchange risk faced by outside investors, an essential component for attracting portfolio investors and facilitating cross-border trading. The high regional interest rates on alternative financial instruments such as bonds make equity markets less attractive for investors;

(g) *Privatization*. In their ongoing efforts to privatize State-owned enterprises, Arab Governments can both support and benefit from the region's stock markets, using them as conduits for the sale of these companies while simultaneously enhancing market depth. Placing IPOs of State-owned companies on more than one exchange will improve regional networking;

(h) *Education*. Government programmes that provide educational materials and workshops on the use of equity markets for companies in the region should continue. With comprehensive information on the different options for raising capital, Arab company managers will be better equipped to make decisions leading to the efficient use of debt and equity capital in their businesses. The UASE, through the AFMN, is playing an active role in this respect, providing Internet access to educational materials on the pros and cons of public listing and how to participate in equity markets;

(i) *Women's participation*. The participation of Arab women in capital markets as both entrepreneurs and investors, will open a largely untapped development resource. Empowering women to participate in the

equity markets will allow this segment of the Arab population to contribute more fully to the development and diversification of the Arab economies. Equity financing is a potential source of capital for female-owned enterprises. Female entrepreneurs stand poised to make a vital contribution to the economic development of the region, and the stock markets are excellent venues for such activity.

B. RECOMMENDATIONS

The following recommendations are presented for consideration by those in the Arab private sector involved in the development of the emerging Arab stock markets:

(a) Adopt International Accounting Standards;

(b) Ensure that managers are accountable to shareholders for the business practices and profitability of listed companies;

(c) Provide transparent financial disclosure on a regular basis, mainly through corporate web sites;

(d) Reduce dependence on bank financing by increasing reliance on equity financing.

The following recommendations are presented for consideration by decision makers in the ESCWA member countries:

(a) Require companies to employ sound auditing practices in order to ensure transparency;

(b) Increase the diversity of the financial instruments available on the region's stock markets;

(c) Strive to harmonize stock market rules and regulations with international standards;

(d) Continue to support the development of the joint Arab institution for clearing and settlement as a mechanism for facilitating cross-border trading;

(e) Standardize financial terminology;

(f) Restructure weak banking sectors before opening them up to foreign banks and capital in order to limit bank failures;

(g) Facilitate the further development of domestic electronic trading and the adoption of cross-border electronic trading;

(h) Ensure transparent access to government legislation and regulations for foreign and domestic companies and investors;

(i) Honour GATS commitments (for the region's WTO members);

(j) Promote policies that strengthen macroeconomic stability; in this context, particular attention should be given to the management of interest rates and the foreign exchange market;

(k) Increase the use of public listings in the ongoing effort to privatize State-owned enterprises;

(l) Continue to provide educational materials and workshops on the use of the region's equity markets for family-owned small and medium-sized companies;

(m) Encourage women's participation in capital markets as both entrepreneurs and investors.

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