THE IMPACT OF CAPITAL MARKET DEVELOPMENT ON ECONOMIC GROWTH AMONG MENA REGION COUNTRIES

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DEDICATION

I dedicate this work to the soul of my father and to my beloved mother

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ABSTRACT

Middle East and North African (MENA) region is home to nearly 60% of the 1.4 trillion barrels of proven crude oil reserves and 46% of the 192 trillion standard cubic meters of natural gas reserves (OPEC, 2010). Although the capital market plays an important role in economic development in many countries, (MENA) region the role is not so clear. The region has participated less in the globalization and integration of international capital markets than have Asian and Latin American countries. Capital flows into the MENA region have been small. Countries in the region have had almost no direct access to the capital markets of industrial countries. The region has made only limited use of market-based income-hedging devices (such as product insurance and forward markets) despite its vulnerability to international price developments. Accordingly capital markets in the region are assumed to have not effectively utilized to generate economic growth due to structural and cultural factors albeit their potential prospects. Hence this study analyses and measures the historical impact of capital market development on the economic growth of four leading countries in the MENA region; Egypt and Tunisia (as non-oil driven economies); and Saudi Arabia and Kuwait (as oil exporter economies). In order to achieve the research aim, a quantitative method approach is adopted. Using 13 time periods (years) from 2002 to 2014 as the annual time-series data of the four countries, this study focuses on indicators that reflect the state of development of the capital market. This study used four variables as a General Index proxy for capital market development; (1) market capitalization ratio to GDP, (2) value of shares traded, (3) Number of shares traded, and (4) number of transactions, while gross domestic product (GDP) was used as a proxy for economic growth. In addition, the study used six macroeconomic variables as control variables, including (GDP/capita), saving rate ratio to GDP, investment rate ratio to GDP, interest rates, inflation, and exchange rates. The data of this study were analysed using Ordinary Least Squares (OLS) regression to examine the capital market development and economic growth relationship for the four countries. Pooled OLS regression analysis was adopted to examine the effects of development of the capital market on the economic growth of the countries as a group. The results of OLS regression indicate that the Egyptian capital market development had significant effects on economic growth, although there were mixed results when different proxies of capital market development indicators were used. In Tunisia, Saudi Arabia, and Kuwait, the level of capital market development had little influence on economic growth, and most of the results were insignificant when different proxies of capital market development indicators were used. However, using the OLS regression analysis model for the four countries combined showed that the development of the capital market had a significant impact on the economic growth of these countries. This study concluded that economic policy options consistent with maximizing economic performance and aiming at elevating economic growth should be developed through the integration of capital markets of the region. Therefore, policy makers should provide incentives to integrate the capital markets and unify economic structures where possible, by diverting funds to investment to further stimulate the growth of their economies.

Keywords; Capital market development, Economic growth, Egypt, Tunisia, Saudi Arabia, Kuwait, MENA region

ABSTRAK

Timur Tengah dan Afrika Utara (MENA) terbukti mempunyai hampir 60% daripada 1.4 trilion tong rizab minyak mentah dan 46% daripada 192 trilion meter padu standard rizab gas asli (OPEC, 2010). Walaupun pasaran modal memainkan peranan penting untuk pembangunan ekonomi di kebanyakan negara di rantau MENA, peranan tersebut masih belum begitu jelas. Rantau ini juga kurang mengambil bahagian dalam globalisasi dan integrasi pasaran modal antarabangsa berbanding dengan negara-negara di Asia dan Amerika Latin. Aliran modal ke rantau MENA juga adalah kecil dan negara di rantau ini hampir tiada akses terhadap pasaran modal luar. Ini menyebabkan rantau MENA hanya menggunakan sumber pendapatan lindung nilai terhad yang berasaskan pasaran seperti insurans produk dan pasaran hadapan. Walaupun rantau MENA mempunyai prospek yang tinggi, perkembangan pasaran modal antarabangsa di rantau ini didapati lemah untuk menjana pertumbuhan ekonomi disebabkan oleh faktor struktur dan budaya. Justeru itu kajian ini menganalisis dan mengukur kesan sejarah pembangunan pasaran modal ke atas pertumbuhan ekonomi di empat negara utama dalam rantau MENA; Mesir dan Tunisia (sebagai ekonomi yang berasaskan bukan minyak); dan Arab Saudi dan Kuwait (negara-negara pengeksport minyak). Untuk mencapai matlamat kajian, pendekatan kaedah kuantitatif telah diguna pakai. Menggunakan 13 tahun tempoh masa dari tahun 2002-2014 sebagai data siri masa tahunan empat negara, kajian ini memberi tumpuan kepada petunjuk yang mencerminkan keadaan pembangunan pasaran modal. Kajian ini menggunakan empat pembolehubah sebagai proksi Indeks Umum untuk pembangunan pasaran modal; (1) nisbah permodalan pasaran kepada KDNK, (2) nilai saham yang diniagakan, (3) Jumlah saham yang diniagakan, dan (4) Jumlah transaksi keluaran dalam negara kasar (KDNK), digunakan sebagai proksi untuk pertumbuhan ekonomi. Di samping itu, kajian ini, menggunakan enam pembolehubah makroekonomi sebagai pembolehubah kawalan, termasuk (GDP / kapita), menjimatkan nisbah kadar kepada KDNK, nisbah kadar pelaburan kepada KDNK, kadar faedah, inflasi, dan kadar pertukaran. Data kajian ini telah dianalisis menggunakan Ordinary Least Squares (OLS) regresi untuk mengkaji pembangunan pasaran modal dan hubungan pertumbuhan ekonomi bagi empat negara. Analisis OLS regresi pula telah digunakan untuk mengkaji kesan pembangunan pasaran modal kepada pertumbuhan ekonomi negara-negara sebagai satu kumpulan. Keputusan OLS regresi menunjukkan bahawa pembangunan pasaran modal Mesir mempunyai kesan yang signifikan ke atas pertumbuhan ekonomi negara tersebut. Didapati juga pelbagai kesan berlaku apabila proksi petunjuk pembangunan pasaran modal dianalisis. Tahap pembangunan pasaran modal tidak mempunyai pengaruh yang signifikan kepada pertumbuhan ekonomi bagi negara Tunisia Arab Saudi dan Kuwait. Malah tiada keputusan signifikan apabila analisis proksi petunjuk pembangunan pasaran modal dijalankan. Walau bagaimanapun analisis Regrasi model OLS bagi empat-empat negara pula menunjukkan pembangunan pasaran modal mempunyai kesan yang signifikan ke atas pertumbuhan ekonomi. Kajian ini merumuskan bahawa pilihan dasar ekonomi bagi memaksimumkan prestasi ekonomi untuk meningkatkan pertumbuhan ekonomi boleh dibangunkan melalui integrasi pasaran modal di rantau ini. Oleh itu, pembuat dasar perlu menyediakan insentif untuk mengintegrasikan pasaran modal dan menyatukan struktur ekonomi dengan mengalihkan dana untuk pelaburan untuk terus merangsang ekonomi mereka berkembang

Kata Kunci: Pembangunan pasaran modal, Pertumbuhan ekonomi, Mesir, Tunisia, Arab Saudi, Kuwait, dan Rantau MENA

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MENA	Middle East and North Africa
MCR	Market Capitalization Ratio
NT	Number of Transaction
VST	Value of Share Traded
NST	Number of Share Traded
IDX	General Index
EG	Economic Growth
GDP	Gross Domestic Product
INC	Real Income (GDP/Per Capita)
SR	Saving Rate
INV	Investment Rate
IR	Interest
INF	Inflation Rate
ER	Exchange Rate

CHAPTER 1

INTRODUCTION

1.1 Introduction

Capital markets are closely related to economic growth, and a strong economic growth is always related with buoyant capital market performance (Phang, 2006).Their performance provides a bridge through which the savings of surplus units may be transformed into medium and long-term investments in the deficits units, which enhances economic growth and the prospects of the economy (Anigbogu & Nduka, 2014). Traditionally, capital markets are considered to be the main predictors for economic growth and, in order to determine stock prices, investors estimate future earnings of the firms that are closely linked to the economic environment (Har, Ee & Tan, 2008). The capital market develops the economy by stimulating specific financial market conditions, providing risk capital and direct subscription, encouraging new industries, encouraging export promotion and import substitution industries and the development of regions (Gurusamy, 2009). Hence, many emerging market economies have taken major steps to improve their macroeconomic performance by strengthening their monetary and budget policies. They have also managed to create a favorable environment by balancing and developing a stable domestic market. International financial institutions (IFIs) and advanced economic authorities have a major role to play in integrating the emerging market countries into the world capital market (Lipsky, 2007).

A “Capital Market” is defined as a market for borrowing and lending long term capital funds required by industries (Gurusamy, 2009). It offers an excellent source of external finance and represents all the facilities and the institutional arrangements for borrowing and lending medium term and long term funds (Gurusamy, 2009). The capital market is comprised of a primary market which deals with the trading of new securities when a company issues securities for the first time (Jalloh, 2009), and a secondary market for existing shares that are traded. Thus, it facilitates the buying and selling of securities that are already in the hands of the general public (investors) (Osinubi & Amaghionyeodiwe, 2003).

1.2 Background of the Study

This section provides the background of the MENA region countries and a general review of capital market development in the MENA countries and economic development in the MENA region.

1.2.1 Country classification

The Middle East and North Africa region (MENA), as defined by Regional economic Outlook (2015) comprises Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates, and Yemen.
Countries in the MENA region share several cultural, historical and geographical traits but also many marked differences, being two of the most notable the availability or lack of hydrocarbon resources in their territories and the size of their native populations. MENA economies can be classified in three main groups:

1. Resource rich, labour abundant countries are producers and exporters of oil and gas and have large native populations which represent almost the totality of their residents. This group of countries includes Algeria, Iraq, Syria and Yemen.
2. Resource rich, labour importing countries are producers and exporters of oil and gas and have large shares of foreign or expatriate residents which represent a significant percentage of the total population and even the majority in some

cases. This group of countries includes the Gulf Co-operation Council (GCC) members (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE) and Libya.

3. Resource poor countries are small producers or importers of oil and gas. These countries comprise Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Tunisia and the Palestinian Territories (Mendez, 2011).

The MENA region is home to nearly 60% of the 1.4 trillion barrels of proven crude oil reserves and 46% of the 192 trillion standard cubic meters of natural gas reserves (OPEC, 2010). However, the distribution of hydrocarbon wealth is uneven across countries, with only six countries (including Iran accounting for 94% of proven oil reserves, and Saudi Arabia taking the lion's regional share of 31% (OECD, 2011). The resource rich countries members of the Gulf Co-operation Council (GCC) and Libya have vast oil resources, are home to small populations (except Saudi Arabia) and are important magnets of foreign workers, both skilled and unskilled. These resource rich, labour-importing countries are home to only 15% of the total population in the MENA region yet they account for nearly half of its total GDP and register high levels of GDP per capita. GDP per capita in this subgroup of countries is significantly above the regional median of US$8,300, ranging from around US$15 000 in Libya to a very high US$88 000 in Qatar (OECD, 2011). The rest of the resource rich countries host comparatively larger populations (37% of the total in the MENA region) and account for a lower share of regional GDP (less than 20%). These countries' average GDP per capita of US$4 600 is significantly lower, even compared to the resource poor countries, which account for above 46% of total population and 32% of total GDP.

1.2.2 Capital market development in MENA region

The history of capital market development in the MENA region is interesting as very few stock exchanges have been established in the past ten years, from 2007 to 2015 (OECD, 2012), while some stock exchanges have been active since the 18th century and had emerged from different economic contexts (OECD, 2012). Egypt's capital market is an excellent example of a long-established market that has received a lot of investor attention over the last few years. Established in the late 18th century, it is the oldest market in the region, but its operations were suspended for a number of years during the 1950s and the 1960s (Billmeier & Massa, 2007), Other markets, such as those in the Gulf Cooperation Council (GCC) were established late in the 1980s and 1990s (OECD, 2012).

Stock exchanges in the region remain focused on attracting domestic listings and many bourses do not especially aim to attract foreign companies (OECD, 2012). Some countries, such as Jordan, have restrictions on foreign investor's for certain sectors, but other markets, like those of Egypt, Morocco and Turkey, have no restrictions on foreign participation (Assaf, 2006). GCC markets have varying degrees of openness to foreign investment; for example, Saudi Arabia is mostly inaccessible to foreign investors, whereas Dubai and Bahrain are relatively more open to foreign capital flows(Balcilar, Demirer, Hammoudeh, 2013).

In most MENA markets, the presence of foreign issuers remains marginal or non-existent. Only NASDAQ Dubai and the Dubai Financial Market have attracted considerable foreign issuers relative to the size of their overall market. Other markets in the region, such as the Kuwait Stock Exchange, have some foreign issuers, but their presence is limited: of the 229 companies listed at the end of 2010, only 13 were foreign-owned (OECD, 2012). Despite their openness, the MENA region's market capitalization is still small in proportion to its overall GDP. The main reason for the underdevelopment of the MENA region's capital markets is that they still attract only a small proportion of the world's foreign cash flow (Assaf, 2006). MENA countries, in particular Libya, Egypt, Tunisia, Jordan and Saudi Arabia, have all begun similar reform programmes aimed at achieving the stabilisation of their economies (Masoud, 2009).

A privatization program initiated in 1990 and enhanced in 1996, which utilised IPOs as one of its preferred methods of divestment, was key to reactivating the MENA stock exchanges not only by increasing listings and attracting foreign investment, but also by encouraging other private firms to raise capital through the stock market (OECD, 2013). The privatization program encouraged foreign investors to put their money into MENA countries, clearing the linkage between privatization and capital market volatility. In 2001, the MENA region managed to attract only US$10bn of foreign direct investment, compared to US$50bn for Latin America and US$70bn for Asia (Assaf, 2006). Furthermore, until recently the MENA region did not show a rising trend of privatization, as occurred in other developed and emerging markets. Stock exchanges are mostly state-owned or organised as public institutions. Very few exchanges in the region are listed or mutually-owned. Currently, out of the 18 bourses in the region, 14 are owned by the state and 3 are structured as mutual organisations. Only 2 exchanges in the region, namely the Palestine Stock Exchange and the Dubai Financial Market, are owned by private investors and are not mutualized (OECD, 2012). The majority continue to operate as state owned organisations, either as incorporated government-owned companies or as unincorporated state administrative entities. For this reason, Arab exchanges remain somewhat anomalous in a world of increasingly privately owned and self-listed exchanges (OECD, 2013).

The MENA capital markets are generally perceived as less developed, suffering from a number of institutional underdevelopments, and limited by several structural and regulatory weaknesses. The lack of institutional development is a powerful obstacle to increased access to MENA by international fund. For example, first, derivatives are not available, and foreign access to the market was liberalized only in the last decade. Second, market makers are missing due to the considerable involvement of governments in economic activities. Third, short selling remains illegal, and information disclosure requirement are lax (Lagoarde-Segot & Lucey, 2008).

MENA capital markets, then, are thin and tightly regulated, government ownership is prevalent and market forces play a limited role in most of these countries (Saif & Yaseen, 2006). Capital markets in the MENA region are embryonic and generally lag behind other emerging markets, such as those of Asia and Latin America, with regard to the level of development indicators (Naceur, Boubakri, & Ghazouani, 2008). As of December 2012, the total stock market capitalisation of the world's exchanges was almost USD 55 trillion, of which 26% was from Europe, Africa, and the Middle East, 23% from the Asia-Pacific region, and the rest from the Americas (OECD, 2013). Table 1.1 provides comparative information on the percentage from of the total world of market capitalization for held by MENA countries (over the period 1993- to 2012).

Table 1.1: Percentage of Total World Market Capitalization held by MENA countries (1993-2012)

Region	1993	2003	2010	2012
East Asia & Pacific	32.44%	19.35%	27.64%	25.82%
Europe & Central Asia	22.64%	28.31%	24.85%	24.40%
Euro area	10.93%	15.52%	11.64%	11.87%
Latin America & Caribbean	2.97%	1.72%	5.10%	4.80%
Middle East & North Africa (MENA	0.92%	1.42%	2.27%	2.17%
North America	38.97%	47.33%	35.63%	38.91%
Sub-Saharan Africa	0.00%	0.92%	1.37%	1.40%

Sources: (World development indicators, 2012)

Table 1.1 indicates that the percentage of total world Market Capitalization held by MENA countries increased by 1.3% from 1993 to 2012, but at the end of 2011, the market capitalization of the MENA countries was still very low compared to other developed and emerging markets. The comparative underdevelopment of the MENA capital market has encouraged many MENA governments to address the situation, and several capital markets in the region are working on upgrading their infrastructure and technological systems for trading. For example, Egypt utilized computer based trading system through revitalizing its capital market laws. Other initiatives, such as the implementation of circuit breakers since 1997 to increase the stock market volatility were also involved. Between 1996 and 2000, the market went through volatile and sluggish periods due to the initiatives of the privatization program. The market peaked at a record new high in early 2000, but the outstanding performance did not continue and the market sloped down to new record lows due to deterioration in monetary indicators and tension in the foreign exchange markets. Figure 1. 1: shows Market capitalization of listed companies in MENA from 1993 – 2012.

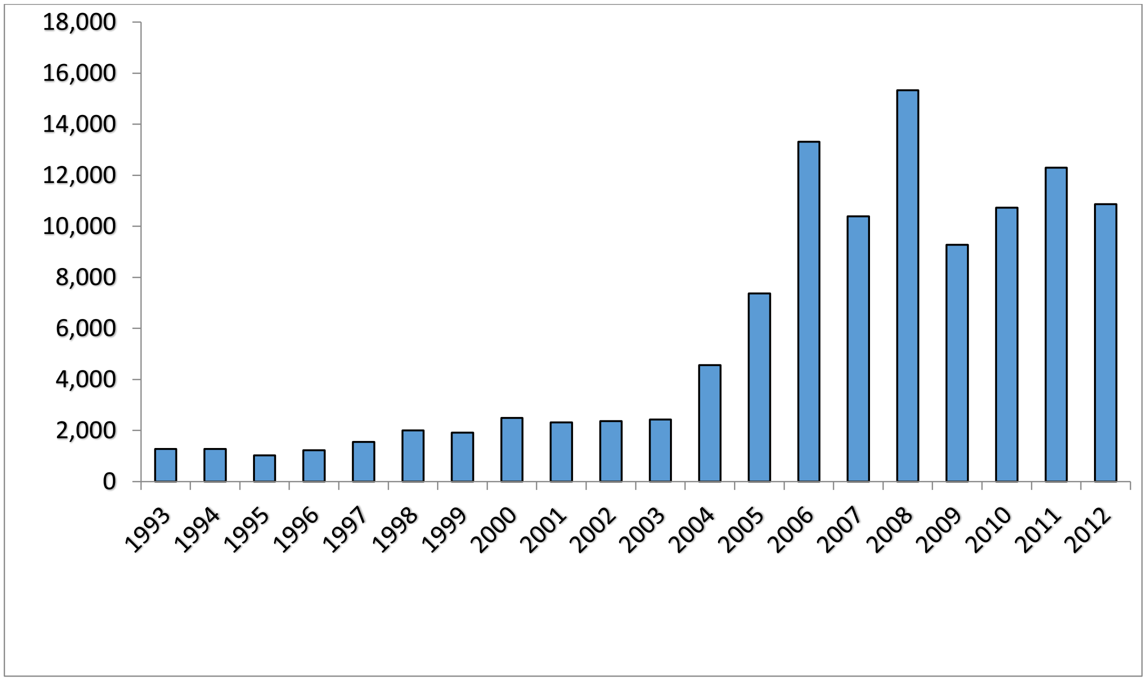

Figure 1.1: Market capitalization of listed companies in MENA (million current US$) (1993 – 2012)
Source:(World Development Indicators, 2012)

Figure 1.1 shows that there was a significant increase in market capitalization in MENA in the middle of the 2000-2010 decade. The peak was reached in 2008, with 1.5 billion US dollars equivalent invested in the capital markets of the region. However, market capitalization declined sharply after the global financial crisis in 2009, before recovering in the following years up to 2012.

1.2.3 Economic development in MENA region

Following the sharp increases in petroleum prices in the early 1970s, growth and development indicators in the MENA region improved rapidly. The sudden increase in investment and growth rates in the oil-exporting countries spread to the rest of the region through increases in worker remittances and capital flows (Dahi & Demir, 2008). The single most important determinant of growth in MENA (where fuel products account for about half of the region's GDP, and around 90 percent of total exports in the oil rich countries) has been the fluctuations in international oil prices. In addition to growth volatility, as a result of high dependence on oil revenues, fiscal policy in the oil rich countries is also volatile (Dahi & Demir, 2008). In large part due to the collapse of oil prices in the 1980s and 1990s, growth rates in the region recorded marked declines. Low growth rates failed to provide the rapidly expanding labor force with sufficient employment opportunities and led to a deterioration of living standards and a rise in poverty rates. As a result, growth performance, GDP per worker, and total factor productivity levels in the MENA region since the early 1980s has been near zero and even negative, closer to the trends in Latin America and lagging far behind East Asia. Furthermore, despite substantial improvements since the gaining of political independence, the region lags behind both East Asia and Latin America in the UN Human Development Index (Dahi & Demir, 2008). The economic growth of Arab oil countries improved from about 1 per cent over the period 1982- 1991 to around 6 percent over the period 1992-1999. The enhanced real GDP growth of these countries is attributed to the economic reforms undertaken and the adoption of more market oriented policies in these systems (Saif & Yaseen, 2006). However, per capita economic growth in the MENA region has been relatively low, in part because of high population growth rates, and in part because many MENA countries still depend on oil exports for economic growth and oil prices remained relatively low throughout the 1980s, 1990s, and early 2000s (Saif & Yaseen, 2006). The region has a side effect on the direction of investment flow between the two categories. The spill-over effect when oil price moves higher or lower impacts both categories of economies, but with a lag. If the oil price moves higher it will have a direct positive impact on the oil exporters, but the effect will be felt much later in oil importing countries. At a later stage, oil importers will benefit from the investment flow from the oil exporter countries and will achieve higher rates of growth as well. Conversely, a decline in oil price would cause growth in the oil exporters to stagnate; however as a result of healthy investment that is not reliant on oil price in non-oil exporter’s growth will be relatively higher. Figure.1.2. shows real GDP growth rate patterns for oil exporters and oil importers from 2000 to 2014.

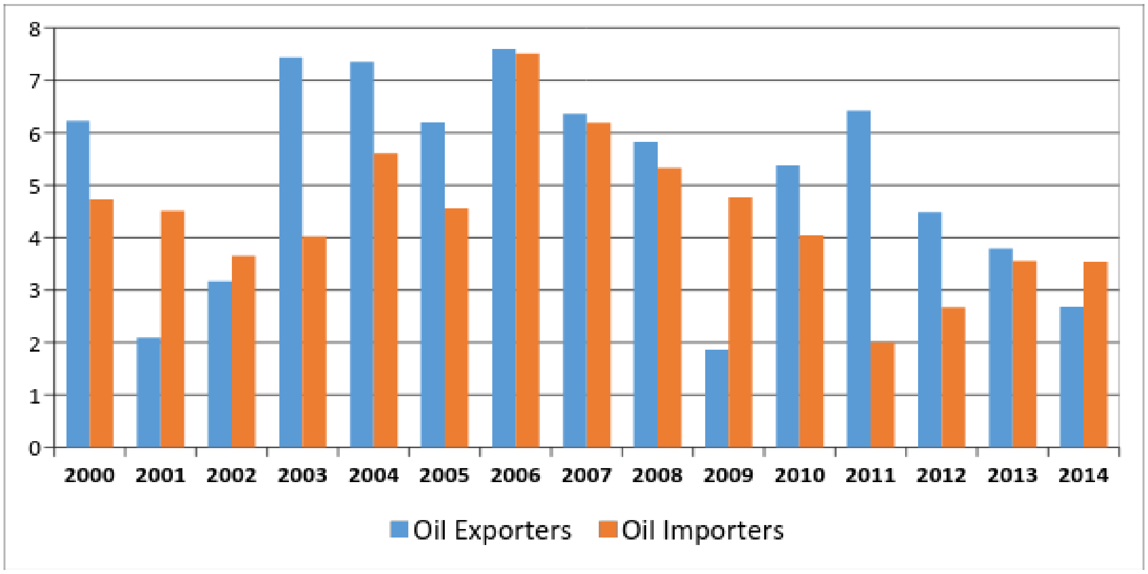

Figure 1.2: Real GDP %, Growth Rates Patterns for oil exporters and oil importers. Source: (World Economic Outlook Database, 2015)

Figure 1.2 shows a declining trend in real GDP for both oil exporters as well as oil importers after a peak in 2006. In the short term, the growth in the region's oil importers is expected to recover, but only at a moderate pace. It is projected to be close to 3 percent, a rate far below what is required to address these countries' high rates of unemployment. The overall business environment remains weak because of political uncertainty and social unrest across the Arab countries, and heightened security concerns. The region's oil-exporting countries showed strong growth of 5.7 percent in 2012, temporarily reversing the decline, which was due to an improvement in Libya's oil production. However, this did not last, and strong expansions were based on increased government expenditure in the Gulf Cooperation Council countries. Economic growth then declined to 3.2 percent in 2013 and to 2.4 in 2014, as oil production growth paused with reduced global oil demand. However, non-oil growth continues at healthy rates of about 4.5 percent, on average Figure 1.3 shows real GDP, Growth Rate, Year-on-Year from 1990 to 2014. Figure 1.3 shows real GDP growth rate, year-on-year, for five-year periods from 1990 to 2014.

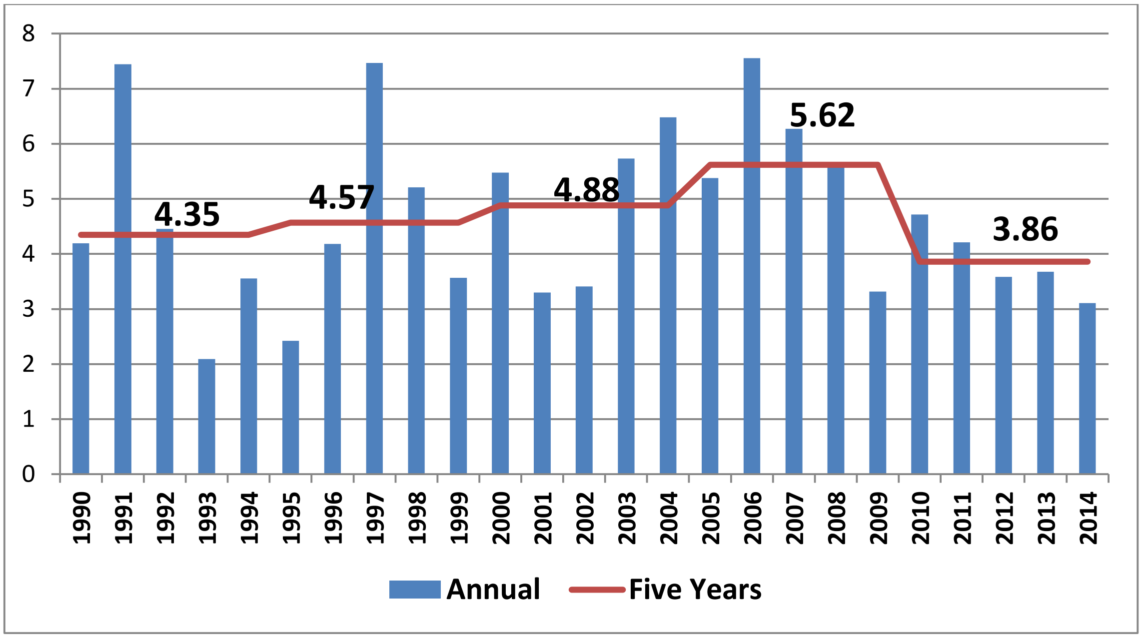

Figure 1.3: Real GDP, Growth Rate, Year-on-Year
Source:(World Economic Outlook Database, 2015)

The economic performance measured through real GDP growth as shown in Figure 1.3 above, as year on year comparisons for five-year periods, demonstrates that growth patterns vary through different periods. Averaging the growth rates for five-year periods shows that the peak performance of the region, 4.8 percent growth, was achieved in the 2000-2010 period. The slowing pattern of growth after 2010 is mainly attributed to the global financial crisis and political problems in the region. After year 2011, there was a declining trend in real GDP and it reached 2.4 percent at the end of 2014. Expanding and consolidating the capital markets in the region seem to be a focused solution to the investment problem. This is the main assumption driving this research. The study begins by accumulating knowledge about the relationship between capital market activities and economic growth in the MENA region through examining past performance; that is, the last two decades. The research then advances to test the impact of expanding those markets on future economic growth in the region.

1.3 Problem Statement

The problem addressed by the research is related to three main issues. The first is the assumption that capital markets in the region have a positive role to play in the economies of the region. However, based on past performance, it can be said that this role was very small and inefficiently related to economic growth. The second issue concerns the attempt to explain the source of such an inefficient situation. Many researchers have linked this inefficiency to the burgeoning stage of the markets in the region, the smaller size of them compared to other emerging economies, and the relatively illiquid status of those markets. The third issue is related to the most effective way to reform capital markets in order to improve their contribution to economic growth.

With regard to the first issue, which is the importance of capital markets; such importance is highlighted by the positive role of capital markets in the region, as large corporations in MENA have made considerable use of them to finance their growth. However, there are still many obstacles that hinder capital market development to promote the rate of economic growth in MENA. Hakura (2006) asserts that the under-developed capital market is one of many key factors that are weakening economic growth in the region[1].

Moving to the next issue, which is related to the inefficiency of capital market in contributing to economic growth, a critical approach is used in the discussion below. In order to explain the inefficiency from the short range perspective of the markets to stimulate growth. Ben Naceur, Ghazouani, and Omran (2007) have debated some of the problems causing such ineffectiveness. Most of the MENA countries were either not able to implement fully economic reforms on capital markets within the relatively short time since they were introduced, or the reform's results have not yet become fully apparent. Since their late entry to capital markets in the 1990s, the countries have failed to reorient MENA economies towards a market-led system that could facilitate automatic economic advancement. Reforms since the 1990s were ineffective due to the

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[1] Generally, the weak economic growth rate in the region has arisen from many key factors: dominance of the public sector, underdeveloped financial markets, highly restrictive trade regimes, rigid internal economic policies, inappropriate exchange rate regimes, and lack of integration in the world economy, less developed financial institutions, lack investment climate and inadequate human capital development.

faltering performance in developing efficient institutions. There are several factors that have created such a situation. Political uncertainty is one of the major factors, as it contributes to financial instability and volatility which in turn have significant negative impacts on investors and regulators of capital markets in the MENA countries (Chau, Deesomsak, & Wang, 2014). Next, there is a mismatch of adjustment between shares traded in MENA and world market shares, considering that shares in different MENA capital markets are not frequently traded, a typical situation with late arrivals. This has created a shortage of international investment flow to the region which implies that MENA region capital markets are less developed and consequently less efficient (Lagoarde-Segot & Lucey, 2008).

Another aspect of the inefficiency that was mentioned at the beginning of the section is related to the size and liquidity status of the markets. The lack of contribution of capital markets to the development process is mainly due to relatively new and generally small and illiquid capital markets in the MENA region when compared with other developing countries. If the size of some emerging economies, such as Brazil and South Africa, are compared to the size of individual countries in the region, it is clear that MENA markets are comparatively small in size. For example, all the MENA markets combined are smaller than the size of Brazil’s market (see: Figures 1.4 and 1.5)

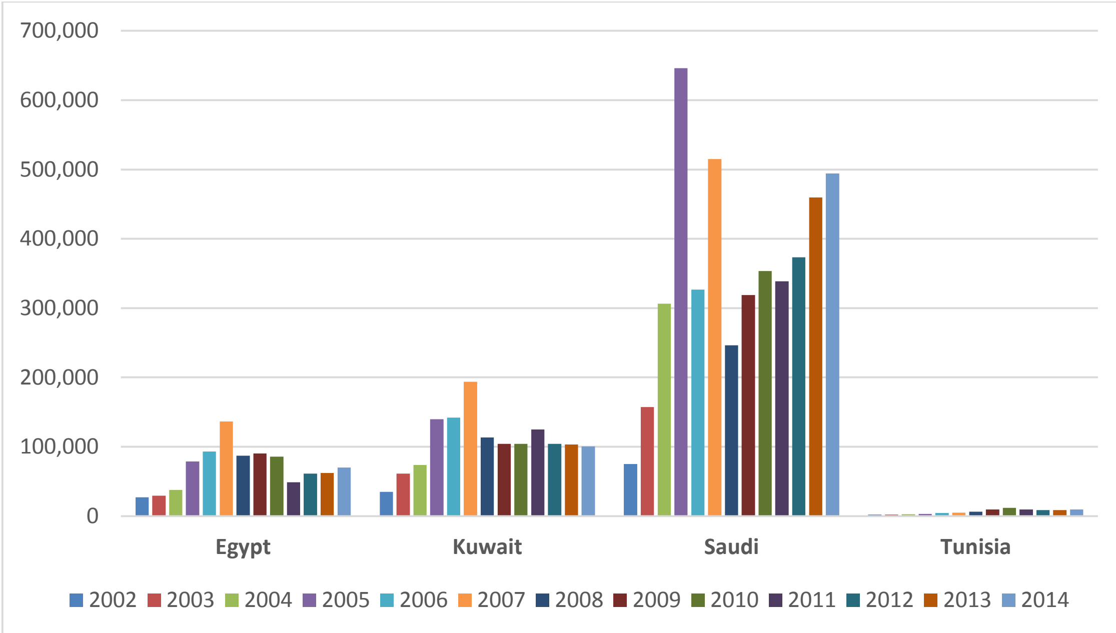

Figure 1.4: Market capitalization development for selected countries
Source:(World Bank, 2016)

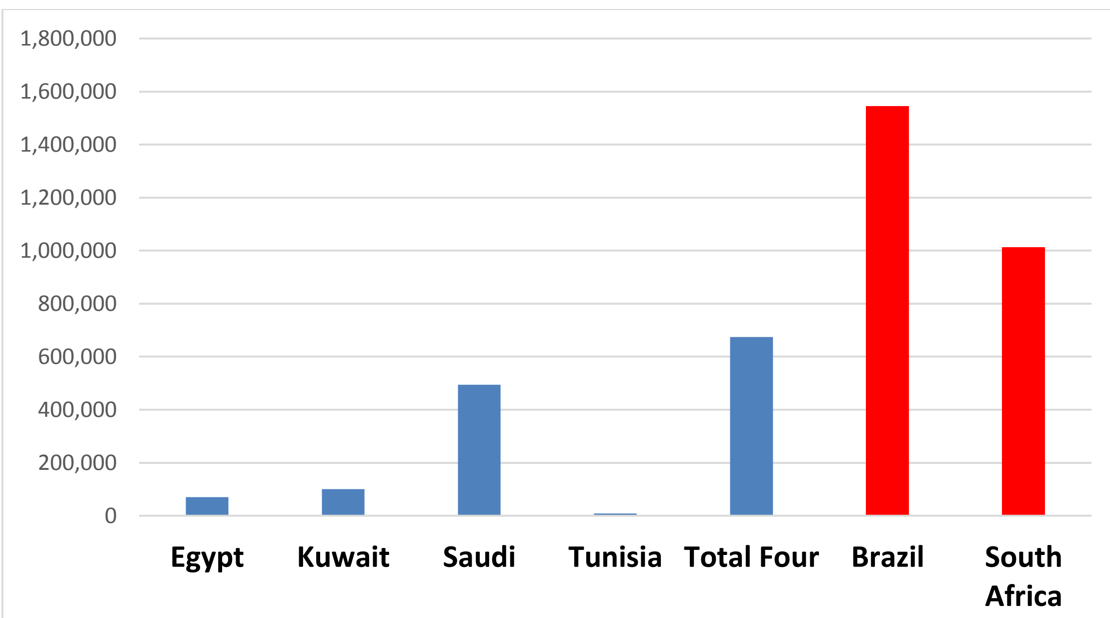

Figure 1.5: Market capitalization development for selected countries in 2014
Source:(World Bank, 2016)

Many studies have addressed specific issues of capital markets in MENA countries. According to Naceur and Ghazouani (2007) capital markets in MENA countries have not reached a threshold that enables them to contribute to economic growth.

The degree of capital market development have been too slow and is below the threshold level for economic growth. Another more recent study by Badr (2015) deduced that the Egyptian stock market is weak, inefficient and does not contribute to the economic growth process, because it is based on speculation rather than on investment. All the above factors contribute to inefficiency of the markets through reducing the investor base which eventually affects size and liquidity. The lack of size of these markets has very tangible ramifications; in particular, it limits the choice at the disposal of investors. When a small number of companies are listed on the stock market, it follows that a smaller number of shares will be available for trading. This initially deters investors from entering the market but, at a later stage, when trading is active, results in violent price movements.

MENA countries have large and growing populations, scarcity of domestic savings and an urgent need to generate employment (Cherif & Gazdar, 2010). MENA has participated less in the globalization and integration of international capital markets than have Asian and Latin American countries (Lagoarde-Segot & Lucey, 2007). Foreign direct investment (FDI) inflows to the MENA region have been lower than to other developing regions. During 1989-1994, foreign direct investment inflows to the region amounted to about $10 billion, compared with a total of about $212 billion to the developing countries as a whole. Portfolio flows into the region have remained low, because MENA countries have limited access to international capital markets and the region's capital markets are at the development stage (Omran & Bolbol, 2003). Private capital inflows have shown more diversity and response in countries that have made steady progress in macroeconomic and structural adjustment (such as Egypt, Israel, Jordan, Morocco, and Tunisia), as well as those recovering from domestic unrest (Lebanon). Other MENA countries have special characteristics such as small populations, high oil revenue, limited domestic diversification and foreign exchange revenues in excess of current needs (Omran & Farrar, 2006). Two specific observations can be made about these countries:

1) As with other MENA countries and indeed all emerging markets, a market-based system incorporating international best practices can advance the objective of utilising the oil resources windfall to stimulate growth in non-oil sectors.

2) These activities should be aspired to be international financial centres and seek to achieve economic diversification.

Institutional savings are very small. Some countries, such as Saudi Arabia, Egypt and Jordan have fairly large funded pension schemes. However, even in those cases, investment in domestic capital markets is rather small. In all countries other forms of institutional savings such as insurance and collective investment schemes (CIS) represent low shares of national income. One of the reasons that MENA equity markets continue to diverge from global norms is that foreign participation is limited (Lagoarde-Segot & Lucey, 2007). Most countries have limitations on foreign investment in domestic equities and, with the exception of countries that are seeking to become international financial centres, there is limited participation by foreign intermediaries and investors in the domestic markets (ACHY, 2003). In addition to encouraging opening their financial markets to all countries, there is considerable scope to deepen regional cooperation among MENA countries (Lagoarde-Segot & Lucey, 2008).

Given these potential complementarities in economic structure, there are undoubtedly numerous possibilities for expanded intra-regional cooperation. Integration would enable investors throughout the region to achieve more portfolio diversification, while users of capital could improve borrowing terms. At the same time, deeper markets would enable more companies to move from bank to equity finance. One obvious possibility is for more cross-national listing and trading of investment instruments.

The question of how capital markets in MENA could contribute more efficiently to economic growth is one of the questions this research set out to answer. Many studies have suggested that, in order to improve efficiency, the policy makers should focus on widening the investors' base either (1) domestically, by increasing the participation of local private sector, or (2) internationally, by allowing global access to the markets. This study attempts to narrow the problem down by measuring the individual effects of the capital market on economic growth of selected MENA countries, and then to establish possible collective influence of the markets on the economic growth of the group, as a whole. This would achieve the target of the study, which is to examine the possibility of enhancing economic growth through increasing the efficiency of capital markets.

1.4 Research Questions

There have been concerns by individuals and even corporate bodies alike as to whether the capital market development in MENA region is actually achieving the goal of capital market-led-development. To this end, this research work seeks to answer the following questions:

1. Do the economic structures have impacts on capital market performances of the selected oil exporter counties and oil importer countries of the MENA region?
2. Does capital market development has an impact on economic growth in four countries of MENA?
3. Is capital Market development causes economic growth in MENA region?
4. What would be the best model for capital markets effects on the economic growth in four countries of MENA?

1.5 Objective of the Study

The general objective of the study is to analyse the capital market, and economic growth in MENA. Specifically the study aims to reach as follows:

1. To analyse the impacts of economic structures on capital market performances of the selected oil exporter counties and oil importer countries of the MENA region.
2. To evaluate the impact of capital market development on economic growth in four countries of MENA.
3. To propose the best model of capital markets effects on the economic growth in four countries of MENA.
4. To investigate the causal linkage between capital Market development and economic growth in four capital markets of MENA region

1.6 Scope of the study

This study focuses on analyzing the capital markets of four MENA countries by measuring quantitative indicators, in order to formulate policies that will positively affect the socio-economic development of the countries. This study applies econometric panel data analysis specifically for Saudi Arabia, Kuwait, Egypt and Tunisia. Annual country data that covers for 4 out of the 20 MENA countries is used, for 13 time periods (years) from 2002 to 2014.

1.7 Contribution of the study

The slow economic progress of these countries, despite possessing significant natural resources, and the weak function of their capital markets are among the main motivating factors for conducting this study. Potential contributions of the study can be divided into three main sub-sections, including contribution to the body of knowledge, contribution to policy, and contribution to practice.

1.7.1 Contribution to knowledge

This study makes a valuable contribution to the literature, because it provides a comprehensive insight and perspective on capital market development in the MENA region, and an assessment of their significance in contributing toward economic growth. This is achieved by considering the trends of macroeconomic indicators in the MENA region economies. Furthermore, it should be mentioned that there have been very few works carried out to investigate MENA capital market development, especially from an integrated regional perspective.

As it has been mentioned, a number of empirical studies have shown that there is a positive relation between capital market and economic growth. Others, however, have demonstrated a possible negative effect of capital market variables on economic growth under varying conditions. Hence, this study aims to determine whether capital markets in the MENA region have a positive or a negative effect, or mixed effects, on economic growth of this region. It can be observed that the results of this study show mixed relations (some positive and some negative effects) between capital market indicators and economic growth. Additionally, the empirical evidence provided by the analysis that first obtained results for each country individually, and then the four countries combined, has contributed new findings and insights to the literature by considering the capital market effect single and grouped economies.

1.7.2 Contribution to the Policy

Historically, economic growth has been the major focus of policy-makers in the MENA region, especially in Egypt, Tunisia, Saudi Arabia, and Kuwait, guided by centrally planned economic development models. Capital market development-led stimulated growth models were later introduced to economic based policies. It is proposed that an economic policy option consistent with maximizing economic performance aimed at elevating economic growth could be developed through the integration of capital markets in the region. Countries which are relatively closely linked together, such as these four MENA countries, could benefit from the effects of each other's economic policies. An economic policy which stimulates capital market growth in these countries could raise the prospects of higher economic growth, which would, in turn, strengthen the economic structure of these countries, either individually or as a group. The countries, adapting such policies will benefit in socio-economic aspects. Although this study focuses on likely linkages between capital market development and economic growth, it does not exclude consideration of other government financial measures which could provide parallel financial market incentives, such as interest rate. These kinds of government measures could provide incentives to the capital market and economic structure by diverting funds to investment, thereby stimulating the economy to grow.

This study, based on its results, introduces an efficient model for selecting policy to stimulate economic growth by means of capital market development in MENA regions. The results show that improving Number of shares traded, Number of transactions, and General index variables in the economies of these countries would subsequently elevate economic growth rates. Specifically, enhancing Value of shares traded, Number of shares traded, market capitalization ratio, and general index variables in the Egyptian economy; market capitalization ratio and general index variables in Tunisia; market capitalization ratio, and general index in Saudi Arabia; and value of shares traded, and number of transaction variables in the Kuwaiti economy would boost the economic growth of each country. This result could guide policy-makers in emerging economies in the rest of the MENA region that have similar economic structures to those of the four selected countries (Egypt, Tunisia, Saudi Arabia, and Kuwait) countries.

1.7.3 Contribution to practice

Furthermore, this study has policy implications for MENA Region economies and the results provide a suitable model for the MENA region in particular, and for emerging economies in general. As mentioned earlier, according to Adenuga, (2010), until recently, the literature has concentrated mainly on the role of financial and capital market variables as intermediaries in the process of economic growth and capital accumulation. Moreover, the majority of practitioners and academics have ignored the important role of capital markets in the economic growth. The results of this study confirm that this role not only should not be disregarded but that, in fact, it should be considered as a leading factor for improving the growth of the MENA economies. Specifically, market capitalization ratio and general index variables of capital market development can be the basis for an economic growth model for the MENA region countries in particular, and emerging countries in more generally.

1.8 Operational definitions

Definitions of key terms used in this research are listed and defined below.

Middle East and North Africa (MENA): The Middle East and North Africa region (MENA), as defined by Regional economic Outlook (2015) comprises Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates, and Yemen. The MENA countries divided into two groups:

The first group is MENA oil exporters comprising Algeria, Bahrain , Iran , Iraq , Kuwait , Libya , Oman , Qatar , Saudi Arabia , the United Arab Emirates ,and Yemen , which include:

The six Gulf Cooperation Council (GCC) comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

The Non-GCC oil-exporting countries are Algeria, Iran, Iraq, Libya, and Yemen.

The second group is MENA oil importers comprising Afghanistan , Djibouti ,Egypt , Jordan , Lebanon , Mauritania , Morocco , Pakistan , Somalia , Sudan , Syria , and Tunisia.

Capital market: is defined as a market for financial investment in long term debt and equity securities, where business enterprises (companies) and governments can raise funds for long term investment (Rezaee, 2011)**.**

Capital market variables are defined as follows:-

Market capitalization ratio: is defined as the value of listed companies traded on the stock exchange relative to GDP (El Wassal, 2013).

Value of shares traded: is defined as the total value of shares traded from seller to buyer on the stock market during the period (Beck & Levine, 2004).

Number of shares traded: is defined as the amount number of shares that are traded from seller to buyer listed in the stock exchange over any given period of time. (Alghamedi & Misfer, 2012).

Number of transactions: is used to measure the extent of market development in a high institutional and regulatory framework (Alghamedi & Misfer, 2012).

General index: indirectly measures the development of stock market in general and it better expresses the stock exchange market (Vazakidis & Adamopoulos, 2011).

Economic growth: is defined as an increase in real gross domestic product (GDP) (Alshammary, 2014).

Real gross domestic product (GDP) is defined as market value of all the final goods and services provided within a country in a given time period (Colander, 2010).

1.9 Structure of the Thesis

The structure of the thesis is summarized in Figure 1.6, below:

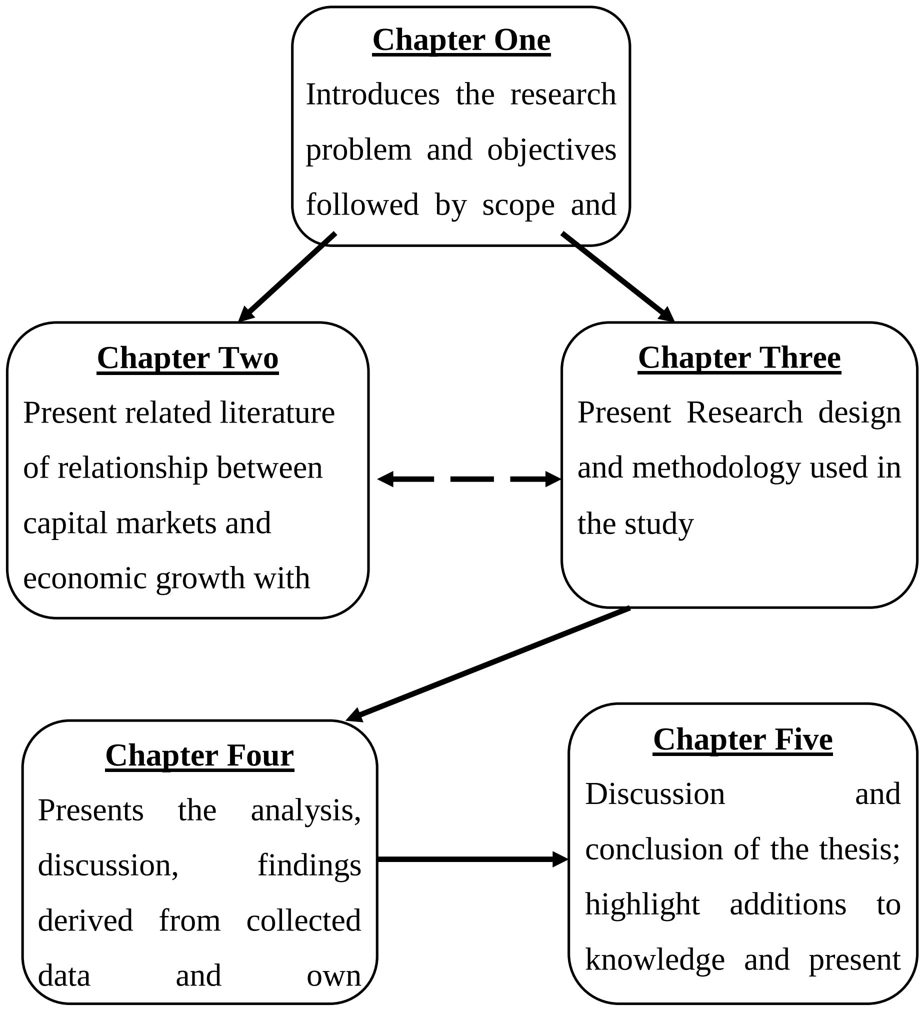

Figure 1.6: Structure of the Thesis

1.10 Summary

This chapter has provided an outline of this study, which sets out to analyse the impact of capital market development on economic growth in the MENA countries. It introduces the background and aim of the research, and lists the research questions which have guided the conduct of the study. The chapter discusses the justification for carrying out the study, indicating its significance and the contribution it can make to the body of knowledge concerning capital market development and potential initiatives for increasing economic performance in the MENA countries. The thesis reporting this research is organized into five chapters, as illustrated in Figure 1.6 above.

This study aims to analyse the question of whether and how the Middle Eastern and North African (MENA) countries could achieve higher economic growth rates as a group by expanding their capital markets. In order to fully investigate issues related to the economic and capital market in MENA, a wide range of interlinked matters need to be thoroughly addressed. First it must be determined if the current growth rate is adequate to maintain economic and political stability across the region. In this respect it is obvious that social problems that stem from rising unemployment in the region (that reflects the gap between economic expansion and demographic growth), would have a major destabilising effect on the region. Second, the question of whether capital markets can work as an economic growth stimulator must be addressed. Here the discussion should cover the capability of the capital markets to optimise the use of the region’s financial resources to increase the productivity of its economic resources. For a start, a highly promising area lies in mobilising savings that are currently locked in the region due to the discouraging investment environment.

This chapter provides an overview of the study covering eight (8) sections as follows:

1.1 Background of the study
1.2 Problem statement
1.3 Research questions
1.4 Objectives of the study
1.5 Significance of the study

1.6 Scope and limitation of the study

1.7 Structure of the Thesis

1.8 Summary

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