Capital Market Development Needs Efficient Institutional Support

Maj Gen M A Matin (Retd)

A sound and efficient capital market is The Solution for resource-poor Bangladesh to combat poverty. World Bank recommends a twofold strategy for reducing poverty, and the first necessity is to promote broadly based growth that will generate income-earning opportunities for the poor. And rapid growth is possible only through rapid industrialisation.

Industrialisation is heavily dependent on the availability of investable surplus, and savings are the prime source of this investable surplus. A sound capital market ensures greater mobilisation of that much needed domestic savings.

Capital market development is largely affected by many factors, and some major ones are : country's political and economic conditions, regulatory and legal environments, proper institutions and instruments, supply and demand of securities.

Political and economic policy instability followed by inappropriate tax and regulatory incentives constrain capital formation and hinder market success. Since investors' demands are extremely sensitive to political uncertainties and changes in economic environment, and when these factors are not conducive to market development, they usually outweigh any fiscal and tax policies designed to encourage its growth. Political instability undoubtedly generates investor preference for highly liquid assets. Capital market development is thus hundred demand and supply of securities keep the capital market going, and enhance its growth/development.

Investors want to invest their surplus in investments, which offer safety, liquidity as well as attractive rates of return. Perception of investment media, of course, varies from investors to investors. To meet the needs of investors of all types, a wide range and adequate number of securities should be made available in the securities market.

Institutions and institutional supports are absolutely necessary for such capital market activities. Investment Corporation of Bangladesh (ICB) and Dhaka Stock Exchange (DSE) are the two major institutions in the country playing their significant roles in developing the securities market. They deserve a closer look. Securities market comprises primary market and secondary market. The primary market mobilise individual savings for productive activities of the public and private sectors, while the secondary market facilitates the exchange of securities among investors. The primary market cannot function properly without an efficient secondary market which, in turn, requires the efficient operation of the primary market.

ICB mainly deals with primary market, while DSE looks after the secondary market (stock market). ICB was established with the aims and objectives to : encourage and broaden the base of investment, develop capital market, mobilise savings, and cater for the institutional support to meet the equity gap of the industrial enterprises (having public company status). In the absence of such an institution the process of industrialisation, particularly in the private sector, had really stowed down. And in order to attain its aims and objectives, ICB started with a number of activities and they included underwriting/bridge finance, debenture finance, investors scheme, floatation of Mutual Funds and issue of Unit Certificates. Participation in Government disinvestment programme and joint-venture projects were also included in the list of activities.

To know more about ICB analysis of its performances in the field of its various activities is important.

Underwriting/Bridge Financing (Cumulative figures as on 30 June, 1989) Supports show : No. of projects sanctioned— 295; amount of commitment/disbursement. ICB-93.44 (81.04 in crores, others— 69.87/36.08 in crores; progress of projects in commercial operation— 261 Nos., in trial operation— 4 Nos., under implementation— 30 Nos., public issue (assisted by ICB) No. of companies— 57, size of issue— 36.53 in crores, public subscription— 50.91 in crores, recovery/recycling— 46.43 in crores. Figures relating floatation of shares in the securities market (an essential step for securities market development) and recovery/adjustment of bridge loans give a very dismal picture. On the country demand of securities is very encouraging.

Apart from underwriting support, ICB extends financial assistance to public limited companies by purchase of corporate debentures. The ultimate aim is to create a bond market in the country. No appreciable progress has so far been made towards that.

By underwriting/bridge finance and debenture finance assistance ICB and ICB Consortium members (Sadharan Bima Corporation, Bangladesh Shilpa Bank, Bangladesh Shilpa Rin Sangstha and nationalised/private local and foreign Commercial Banks) are, of course, playing the role to create more and more securities through industrialisation and enlistment of new companies for public issue (a primary market operation).

To mobilise domestic savings and broaden the base of investment, ICB uses an array of instruments : Investors' Scheme, Mutual Funds and Unit Fund. Cumulative figures on Investors' Scheme (as on 30 June, 1989) show : No. of accounts opened— 40,240, deposits received— 33.95 in crores, loans sanctioned— 63.22 in crores, and investment made— 66.89 in crores. Of all ICB's operations, this scheme deserves a second look. Complaints on opening of accounts, portfolio management, investment counselling etc were afloat.

Six closed end Mutual Funds provide investment opportunities to small investors. Return on these funds had been quite encouraging so far. Pattern of income return shows that the supply base is very small, and hence no worthwhile shuffling or readjustments of portfolios ever look place. Total (cumulative) size of funds is 9.50 in crores, and total subscriptions (received by ICB) went up to 31.68 in crores, as per ICB annual report (1988-89).

ICB operates an open-end Unit Fund since April '81. From the annual report we see its phenomenal growth and the size has reached over 200 crores in the recent past. High dividend payouts in our slow market has made this instrument very popular and attractive to individual investors and also to several institutions. Unit certificate has proved that despite our very low national savings rate (about 2%), large funds could easily be mobilised from our investors far and near only if the investment opportunities were there. Annual report reveals that on the average 45% of the portfolio is invested in securities (Shaves, Stocks, Debentures) and the rest 55% deposited in short-term money market funds, and this is due to unavailability of investment opportunities.

ICB's array of instruments show growing investor awareness, that is the demand is there.

ICB innovated many more instruments to broaden the base of its activities in the country and outside for many useful purposes.

85% of the population live in villages, and growth of population has been identified as nation's number one problem. For survival of the nation this problem ought to be tackled effectively. Family Planning, of course, is the only way to do so. Save the Children Fund (USA), operating in 30 villages of the country, identified the barriers, which make family planning unacceptable/unpopular in the village : economic insecurity, child mortality, poorhealth and nutritional status of children, girls considered as economic burden. ICB's innovated Gram Bangla Unit Scheme envisaged to provide that much needed economic security through capital market activities.

A formula was worked out in matters relating selection of destitute families for adoption of permanent family planning measures, and through Gram Bangla Unit Scheme Operation each such destitute family would get in return a low cost house, an income generating venture (agricultural/fisheries/cattle farming/poultry trade/transportation etc), a lump sump amount or units on termination of a calculated period. Poverty to prosperity, despondency to solvency were what this scheme planned for, and no security was required and no repayment was to be made. And acceptability of this scheme would purely be on voluntary basis. With the enhancement of family purchasing power more economic activities would ensure in the rural areas and would thus promote market success.

There is a relationship between 'housing and security' and 'housing and health'. And solution of the habitat problem in the rural areas would certainly ensure more security for the family and better health care for mother and children. And Gram Bangla Unit Scheme envisaged to solve this national problem also.

Wage Earned Unit Fund and Bangladesh Fund (other two instruments) envisaged mobilisation of savings of Bangladeshis working in the Middle East, UK and the USA, and an entry into the international securities markets respectively.

All these instruments/schemes did not receive presidential blessings (1988-89), when they deserved a try-out.

Dhaka Stock Exchange (DSE) is the pivot around which the entire securities market (secondary market) revolves. Like most other exchanges in the world, DSE is a self-regulated, non-profit member organisation. It is the only stock exchange in the country.

Stock market of Bangladesh started functioning from mid 1976 when DSE was revived. DSE has at present 195 members, and unfortunately no more than 20% of them are active, and about 90% members are dependent on other professions for their livelihood.

DSE is playing a significant role to develop the country's stock market, and careful attention must, therefore, be given to strengthen the activities of this institution.

There are about 134 listed companies and 4 listed debentures, and DSE publishes a daily list of traded scrips with their prices.

Both DSE and ICB played very significant roles in developing country's stock market. Growth of stock market is assessed taking into considerations : trend of increase in the member of enlisted companies, the amount of issued capital, and the market capitalisation.

In 1989 and 1990 the securities market had been very sluggish; and widespread declines in the overall economy, poor corporate performances and the natural calamities of 1988 could be the possible reasons. Many companies openly violated Stock Exchange and Company Act rules and regulations. Very few companies declared dividends,

and those who did rarely paid out within time. The multinationals had been the best performers, but their shares were hardly available.

Foreign consultants and committees, formed with the local experts, were engaged time to time to examine country's capital market, and DSE and ICB affairs, and suggest ways and means to improve the situation. But has the situation improved?

From the total picture of the country's securities market the following points emerge :

- In view of growing investor awareness, the demand for good securities/investment opportunities will increase, and a tremendous potential for investment in securities market exists with Life Insurance Companies, Pension Funds, Provident Funds, etc.
- The only problem that hinders the growth of the securities market is short supply of securities, and inadequacy of investment opportunities.

Supply side appears to be the Achilles' heel in the whole system; and rapid industrialisation, privatisation, unloading of securities from Government Portfolios and restoration of investor confidence in the institutions would improve the situation tremendously. Most of the projects set-up in the last two decades have not yet been able to operate profitably to qualify for public issue.

There may be as many as 200 projects in such conditions. Measures for immediate resuscitation of these projects must be taken by the Government to build up the country's debenture/bond market, the Government must look in to the problems of high costs of stamp duty and registration fees etc.

Man behind the gun the institutions (ICB and DSE) are vital for capital market development. Any great planning will not matter unless it is implemented efficiently and honestly. Foreign consultants and local committees recommended radical changes in structural and operational matters for DSE, and exhaustive training for ICB, and Government must look in to these affairs for implementation.

To reduce poverty and to give an acceptable standard of life to our millions of rural people, living below the poverty level, we must develop our capital market, the market that helps promote democratic capitalism. By distributing the ownership of securities more widely, a securities market assures that the ownership of the business is not confined to a small number of wealthy families or to big industrial-financial conglomerates. ICB's activities in the country and outside must be extended/expanded, of course, based on return-risk considerations.

Savings Mobilisation and Capital Market-II

Khurshid Alam

MONEY in itself really is useless. But as a medium of exchange it has value. The value is what the money can buy. Ten years ago one Taka could buy a pencil and today one Taka can buy a chalk only. Ten years after, it might buy more or less or the same. The Taka itself does not change. But it will buy, how much it will buy does vary.

When a Taka does not buy as much as before, its value goes down. We call it inflation. It hurts many people. Those receiving fixed incomes find that their Taka buys-less and people with savings funds of accounts find that inflation reduces the value of their savings. As such, inflation, has a close bearing on savings performances. In an inflationary situation when the value of Taka falls in larger proportion to the rate of return (interest rate) on deposits, those who save this little incentives to do so.

Level of Savings in Bangladesh

Bangladesh has one of the lowest savings rate in the developing world. The investment performance of the economy has also been very low as a result. Investment have however exceeded the gross domestic savings over the years. The gap between investments and savings has been met by foreign assistance.

Domestic savings as a percentage of GDP have thus not increased at all. There has on the other-hand a declining trend on savings mobilisation over the latter half of the eighties. The growing budget deficit of the government or dis-savings (negative savings) in the public sector accounted for this. While savings remained at a stagnating level investment did not pick-up. Investment as a proportion of GDP declined from 13.00 per cent in 1984-85 to 11.19 per cent in 1989-90 while savings dropped from 4.21 per cent to 3.70 per cent over the same period.

Foreign AID as a proportion of FDP recorded also a drop from 7.91 per cent in 1984-85 to 5.93 per cent in 1989-90. World Development Report 1990 by World Bank presented a dismal savings performances in Bangladesh over the years. In its development indicators gross-do-mestic Savings in Bangladesh as a proportion of GDP were shown at 3 per cent in 1988 reflecting marked decline from 8 per cent in 1965. This deteriorating savings performance explains the reasons for low operational performance of the Bangladesh economy.

The domestic savings rates in other south Asian countries are much higher than that of Bangladesh. In India, it stood at 21 per cent of GDP in 1988.

The savings rate in Pakistan and Sri Lanka were at per at 13 per cent whole that in Nepal at 10 per cent in 1988.

In a wider comparative context, the situation in Bangladesh is all the more a very discouraging one. For low-income economies as a whole (excepting India and China) the gross domestic savings rate averaged 14 per cent of their aggregate GDP in 1988, according to the World Development Report. The same rate stood at 12 per cent in 1965.

Savings and investment gap has been the major constraint for Bangladesh in furthering economic growth and development. In order to address this constraint what is needed is to increase savings both in the public as well as in the private sector. This will also call for efficient use of resources, both in public (or government) and private sector and maximised returns, direct and indirect, on investments. Sustained growth with increase in per capita real income can then be promoted efficiently. Higher per capita real income will help generate more savings in the process.

Management of the economy both at macro and micro levels along more efficient lines is an urgent need for this.

This managers of our enterprises, whether in the field of industry or other business organisation or utility management, whether in the public sector or private sector, must become cost-conscious, otherwise it will not be easy to reach the target of higher savings and investment performance. (To be concluded)

MFN Status and Why It Means Much to China

China's recent economic progress has been assisted by the MFN (Most Favoured Nation) status it has enjoyed in trade with the United States — an advantage now under threat of suspension. by Alan Chalkley.

HONG KONG : Over 40 years ago, a group of world leaders got quietly together to prevent a catastrophe. They recalled with horror what had happened in the 1920s and 1930s, when foreign trade had been choked back by high customs duties and other barriers.

In those decades, manufactured goods — including clothes, footwear and electrical products — hardly moved between the richer nations. All over Europe and North America, you rarely saw a foreign car; as for Japanese cars — well, they were just a dream in the mind of a family called Toyoda.

In contrast, in British and French and Dutch colonies you would find plenty of manufactured goods from the mother countries. That was the result of "preferences."

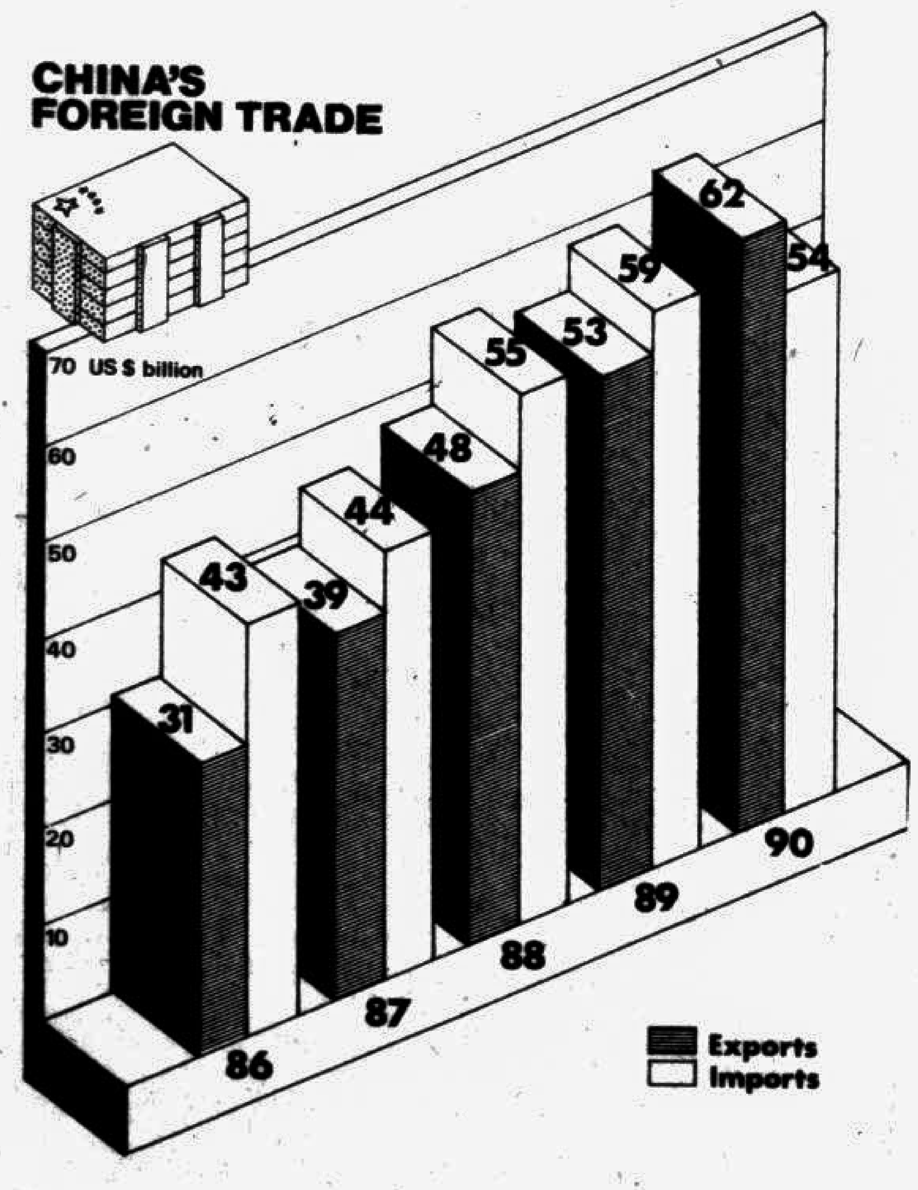
A British article would be taxed very low, or not at all, if it was sold to India or Australia. This was called "Empire Preference," until "Empire" came to be regarded as a nasty word and the phrase was changed to "Commonwealth Preference."

This system severely restricted all trading and protected special sets of manufacturers in favoured markets. One consequence was the world's worst economic depression, which lasted from about 1928 to 1945. After World War II, it was obviously time to rethink the world's trading system.

So the group of leaders, meeting in the same circles as those who founded the United Nations, the International Monetary Fund and the World Bank, dreamed up a "General Agreement on Tariffs and Trade," or GATT.

At the heart of the agreement is a very simple idea. Why not persuade all countries to grant "preferences" to every other country? Well, if not at once, then gradually over time?

The idea was that all import duties and trade barriers would shrink to the level of the "most favoured nations" of the past — the colonies and political allies. Thus arose the initials "MFN," the promise of freer trade for all, for both rich and poor countries.



The GATT was opened for signature in 1947 and 23 nations joined at once. In 1991 there are more than 100 members.

Not every country has joined yet. Most Communist coun-tries and a few others still thoroughly control their foreign trade; and even the signatory members haven't freed their total trade.

But the general level of import duties has dropped heavily from the 1930s; over much of the global trade these taxes are only a small percentage of the value of the articles.

Thus would trade is much freer than it was — and this is very visible in living standards which have soared in dozens of poor countries. But trade is still a battle ground, and a political one.

In Asia, the biggest question is over China. Beijing wants to be allowed to benefit from the GATT; it wants to sell its exports more freely, and participates in the global investment market.

In particular, it wants to retain the MFN status accorded by the United States following China's opening up of its economy, as part of its modernisation policies, in the late 1970s and early 1980s. China's MFN privileges were renewed last year for a further twelve months — but only after a vocal debate in Washington on the case for withdrawing them as a mark of displeasure at the bloody crackdown on the student-led reform movement in June 1989.

This year the debate was fiercer. President Bush has announced his intention to renew the MFN arrangement.

But the outcome will depend on whether he can muster enough votes in Congress to defeat moves to attach conditions to the renewal. Those conditions would place a heavy emphasis on the need for the People's Republic to improve its human rights record and Beijing might reject them as an unacceptable "interference" in its internal affairs.

As in the United States, so among other GATT members there are opposed schools of thought. One maintains that if China is to continue to enjoy MFN advantages, it must make convincing moves to liberalise its political, as well as its economic, system. At this, Beijing's leadership has balked so far.

Other members — notably Hong Kong, which has almost as much to lose as China itself if the PRC loses out on MFN — turn the argument around.

They say, in effect: "Let's take it one step at a time. Give China a chance to liberalise its economy further — and it will probably liberalise its politics soon afterwards."

Meanwhile, how has China — with the assistance of MFN status — been doing in its foreign trade? Its economic reforms began as long ago as 1978, when it abandoned a 30-year isolation. Progress towards freer trade and freer enterprise has been hard and hesitant, but has not ceased.

Beijing's eighth five-year plan (up to 1995) shows intentions to boost domestic investment, upgrade industry, improve roads and railways and power and get rid of loss-making state corporations.

More effective tax, price and income systems are being introduced — with much agonising. And foreign trade and investment are strongly needed in all activities.

Several countries have now removed their curbs on investment in China (notably Japan) and Hong Kong is an ever-open door for foreign investment anyway. Last year 7,290 foreign-funded enterprises were set up in China, involving over US$10 billion of incoming funds.

China's total foreign trade was valued at US$115 billion last year, as exports were up 18 per cent. The domestic output is expected to grow by a very satisfactory 5 per cent or 6 per cent this year and foreign trade should rise even higher. And price inflation has been low.

"The World Bank, in a special report entitled "China: Between Plan and Market," says that some of the setbacks evident in 1989-90 have been overcome. "Tourist arrivals are on the rise, there is renewed interest on the part of foreign investors, and industrial activity is picking up." The World Bank itself has resumed lending to China.

So, the trading world generally regards China as a good prospect. This confidence will continue and grow, except in the event of the MFN benefits being suspended. But that, for all the current uneasiness, remains for the time being a threat rather than a probability.

— Depthnews

Free Market Utopia

More poor countries are abandoning state control as a strategy for development in favour of old-fashioned free market economics. **Ramon Isberto** of IPS reports.

MANILA: The sight of socialist India, a champion of the South and stalwart of the Non-aligned Movement, sinking into a debt trap has dismayed smaller developing countries who believe it marks the end of an era for the Third World.

Desperately short of foreign exchange and US $71 billion in debt, India did the unthinkable last month — it turned to the International Monetary Fund (IMF) and Western creditors for help.

This is bitter medicine for India, which has long abhorred the IMF's free-market prescriptions. And for many policymakers in the South, it provided fresh evidence of how much economic thinking has changed in the Third World.

As countries emerged from colonial bondage 40 years ago, they thought that having a big, benevolent government would lift their peoples out of poverty.

Today, after the collapse of bureaucratic centralism in Eastern Europe, more and more poor countries are turning their backs to that notion. The new orthodoxy is old-fashioned free market economics.

The shift began in the early 1980's when stagnating economies, askewed international economic order and heavy foreign debt burdens brought many Third World nations to their knees.

Pressed by the IMF and other creditors, governments were pushed to rethink their strategies. Some, like Chile and Ghana, did so eagerly while others, like Peru and Brazil, proceeded fitfully.

After a frightful decade which saw Africa lose 30 years of development, the World Bank says it has detected a "consensus".

In its new world development report entitled, The Challenge of Development, the bank says countries must adopt "market-friendly policies", spur efficiency and productivity by getting government out of business and cut subsidies of state firms so private enterpise can flourish.

The bank says the state should focus on building roads, jailing thieves, collecting taxes and playing a broad regulatory role.

Even statesmen and scholars of the South say the developing world has begun to embrace the market and accept the need to trim state control over the economy.

In its 1990 report, The Challenge to the South, the 27-member South Commission chaired by former Tanzanian President Julius Nyerere said: "The state had underachieved precisely because it has tried to do too much, too soon"

It added: "The withdrawal of the state from some activities may well enhance its effectiveness as an instrument of development."

But Nyerere, who visited Manila recently, sees much irony in these trends. Asked about the World Bank report and its far-reaching advocacy of free markets, he said: "Listen to what they say, but don't do what they do."

He cited rising protectionist barriers that textile and agricultural exporters of the poor South face in the ostensibly free-market, free-trading nations of the wealthy North.

According to some estimates, Western protectionism such as the European Community's enormous subsidies for farm exports, costs the South nearly US $60 billion a year in lost exports.

The United States, long the most ardent proponent of free trade, is turning away from that creed. Plagued by a huge trade deficit, Washington has coaxed its trading partners to agree to over 60 voluntary export restraints on key manufactures like garments, semiconductor chips and automobiles.

After preaching free trade to the Third World of decades, the rich countries are setting up trade blocks that will lock them out.

Meantime, the Third World remains burdened with debt and the World Bank's critics say its actions do not match its rhetoric on Third World development.

"When the chips are down, when it comes to foreign debt, the bank goes along with the IMF," says former Philippine Economic Planning Secretary Solita Monsod, also a member of Nyerere's South Commission.

"Whenever there is a conflict between development and debt, development loses all the time, hands down," she adds.

Part of the problem is that the world economy has become less sympathetic to poor countries that open their economies and push their exports.

In a recent investment conference here, Nobel Prize-winning economist Lawrence Klein warned that the favourable conditions that allowed Asia's export tigers like Taiwan, South Korea and, more recently, Thailand, to flourish, have vanished.

Poor countries now face a more inhospitable world as they are pushed to adopt new economic doctrines that call for opening up their fragile economies.