Globalization of Finance and Fintech in the MENA Region

Franklin Allen

Imperial College London

March 30, 2022

ERF 28th Annual Conference, 2022

Macroeconomics and Finance in the Digital Age

1. Introduction

- Finance plays an important role in economic growth, employment, and the alleviation of poverty (e.g., Allen, Gu, and Kowalewski (2018) and Senbet (2019) for MENA region.

- Focus on countries in table on the next page – don't consider Syria, Libya, Palestine or Yemen because of conflict or Mauritania, Somalia, Sudan, or Eritrea because of limited information.

- Focus on two groups according to GDP per capita

Group 1	International $
Bahrain	47,003
Kuwait	52,060
Oman	28,508
Qatar	94,029
Saudi Arabia	49,040
UAE	70,089
Group 2	
Algeria	12,020
Egypt	12,284
Iraq	11,363
Jordan	10,517
Lebanon	15,196
Morocco	7,826
Tunisia	11,232

2. MENA Financial Systems and Infrastructure for Fintech

- Financial systems are overwhelmingly bank-based (Arezki and Senbet 2020)
- Firms are either large and state-owned or politically connected and have access to banks or are SMEs and do not
- Stock and other financial markets are at an early stage of development in most countries
- For oil producing countries (countries in Group 1 and Algeria and Iraq in Group 2) problem of "stranded assets" means new industries need to be developed but usual VC and IPO won't work

2. MENA Financial Systems and Infrastructure for Fintech (cont.)

- Mobile telephony is reasonably advanced in most MENA nations including many of those that are quite poor - mobile phone penetration is at rates between 70-200% and mobile coverage 80-100%

- Internet access is close to 100% in the Group 1 countries and is 45-80% in Group 2 countries

- E-banking is doing well in the Group 1 countries, but in Group 2 countries the affordability of the internet is rather low and financial services over the internet have less than average use

3. Fintech and Financial Inclusion

- Financial inclusion particularly a problem for Group 2 countries
- Important for economic growth
- Example of Kenya
  - M-PESA
  - Equity Bank
- Example of China
  - Alibaba and financial of inclusion of SMEs

4. Credit Scoring, Digital Banking, and Peer-to-Peer (P2P) Lending

- Credit scores have served as the primary factor in lending decisions for many years but there is good evidence AI and ML can do better particularly if information such as digital footprint is included (e.g. Alibaba and Tencent systems)

- Digital banking more of interest to Group 1 countries given requirement of good internet access – evidence is that large banks are able to provide these services

- P2P lending is designed to cut out financial intermediaries – substitute for banks for intramarginal borrowers but complement for small scale loans

5. Distributed Ledger Technology (DLT), Blockchains, and Cryptocurrencies

- Recent development of DLT, blockchains and cryptocurrencies are changing the financial services industries in many countries and this transformation is likely to continue
- DLT and blockchains are becoming more and more important for recordkeeping
- While cryptocurrencies such as Bitcoin have obtained huge publicity they are not very practical for their original purpose of transactions except for a special class of these such as drug dealing but those that are used in ICOs or as CBDCs are likely to be important

6. Initial Coin Offerings (ICOs)

- Typical sequence of events:

  1. The promoters issue a “White Paper” describing the nature of project

  2. Possible investors ask the promoters questions about the project

  3. Initial sale of coins to raise funds for the project with promoters keeping enough coins to incentivize them to complete the project

  4. Coins can be used on the platform to buy and sell the product the firm produces. These transactions are recorded on a blockchain.

  5. The coins can be bought and sold for conventional currencies on cryptocurrency exchanges

6. Initial Coin Offerings (ICOs) (cont.)

- Advantages and disadvantages of ICOs:
  - ICOs enable borderless online sales with low costs by enabling promoters to bypass usual legal hurdles by directly selling to worldwide investors
  - Liquidity is high because global cryptocurrency exchanges provide continuous access to trading ICO tokens from the start as opposed to VC where money is tied up for several years
  - The main disadvantage of ICOs is the lack of regulatory oversight and legal recourse to the promoters but investments in coins are on average profitable

7. Central Bank Digital Currencies (CBDCs)

- Private cryptocurrencies caused some worries in central banks as in the long run they might have the potential to lessen effectiveness of conventional monetary policy – this has led many countries to consider implementing a CBDC

- One of the most advanced countries in doing this is China

  - City level trials in 2021-2022 to introduce by Beijing Winter Olympic Games

  - Withdraw e-yuan from state-bank ATM machines to smart phone e-wallets

  - Pay by holding phone close to point of sale device that all vendors will have

  - In the long run will help internationalization of the Rmb and for Group 1 countries that sell oil to China may be important to integrate into this system

8. Cybersecurity

- Cybersecurity is increasingly important for all firms but especially for financial services firms

- While Fintech improves many dimensions of financial services as discussed above, it also creates vulnerabilities

- Important problem for both Group 1 and Group 2 countries

    - A good example for advanced countries is the hack of the US SEC's EDGAR system that allowed the hackers to trade on non-public information

    - For less advanced countries the theft of $81 million from the Central Bank of Bangladesh is salutary

9. Regulation of Fintech

- A very important issue is how Fintech should be regulated
- Key issue is to allow innovation while at the same time safeguard financial stability and protect consumers
- A good example is the “Regulatory Sandbox” introduced by the UK FCA – this allows new Fintech products and services in a live environment with oversight but must be small in scale initially
- Other successful countries that have encouraged development of Fintech industries are Switzerland and Singapore
- Key issue for both Group 1 and 2 countries

10. Concluding Remarks

- Fintech and associated globalization can make many contributions to MENA countries

- There are some that are relevant for Group 1 countries, some for Group 2 countries and some for all MENA countries

- They have great potential for creating new industries, expanding employment, improving economic growth, and reducing inequality

- They should be carefully considered by all MENA countries

Bibliography

- Allen, F. (2021). Globalization of Finance and Fintech in the MENA Region, Economic Research Forum Working Paper No. 1489

- Allen, F., X. Gu, J. Jagtiani (2021). A Survey of Fintech Research and Policy Discussion, *Review of Corporate Finance* 1, 259-339.

- Allen, F., X. Gu, J. Jagtiani (2022). Fintech, Cryptocurrencies, and CBDC: Financial Structural Transformation in China, *Journal of International Money and Finance, forthcoming – published online.*

- Fuster, A., P. Goldsmith-Pinkham, T. Ramadorai, A. Walther (2022), Predictably unequal? The effects of machine learning on credit markets, *Journal of Finance* 77(1), 5-47.