WIDER

STUDY GROUP SERIES
No. 5

Foreign Portfolio Investment
in Emerging Equity Markets

WORLD INSTITUTE FOR DEVELOPMENT ECONOMICS RESEARCH
OF THE UNITED NATIONS UNIVERSITY

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Foreign Portfolio Investment in Emerging Equity Markets

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12 March 1990
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WIDER STUDY GROUP REPORT NO. 5

FOREIGN PORTFOLIO INVESTMENT IN EMERGING EQUITY MARKETS

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PREFACE

WIDER's second Study Group Report presented a five year plan for the recycling of Japan's surplus to developing countries at an annual rate of $25 billion a year for a total of $125 billion. A key rationale for that plan was to start the process of offsetting the deflationary impact of US savings adjustment on the world economy, in the face of the obstacles in the way of major surplus economies undertaking additional domestic expansion. Since substantial resources could not be expected to come out of government budgets, and since today's surpluses are in the private sector, the plan envisaged tapping these surpluses under one form or another of government guarantee. For example, with government budgets subsidising the difference between borrowing at market rates and the concessional terms of lending required, poorer developing country recipients could benefit from recycling (as they had done under the earlier Third Window approach evolved in the World Bank).

Publicly supported flows of this kind will only serve to accomplish a part of the task of recycling involved. If for example the required turn around in the US current account external deficit is set at around $150 billion then this amounts to as much as 7-1/2 per cent of the exports of the rest of the world and corresponding amounts of annual recycling to developing countries would be needed to offset the deflationary bias of US adjustment if there is no scope for domestic expansion. Publicly supported flows would need to be supplemented by substantial private flows. There is a further consideration that non debt creating flows have a particular priority when so many developing countries are having extreme difficulties servicing loan capital. Indeed the Study Group Report No. 3 (Debt Reduction) chaired by former IMF Managing Director Dr. Johannes Witteveen concluded that "it needs to be recognised that creditors and debtors will be better served if a significant amount of new inflows take the form of non debt creating capital, namely private direct investment and portfolio capital."

This latest WIDER Study Group Report therefore complements the work of earlier Study Groups on officially supported flows by analysing the obstacles to flows of private portfolio capital. The analysis distinguishes between factors limiting the availability of suitable stock in developing countries and the supply of portfolio investment and also analyses the other barriers that inhibit portfolio investment by fund managers.

I would like to thank Sir Kenneth Berrill for chairing this group and steering its report to completion. Many have helped in its compilation, including the staff of the Capital Markets Department of the IFC whom I would also particularly like to thank.

Lal Jayawardena
Director

INTRODUCTION BY THE CHAIRMAN OF THE GROUP

It is increasingly appreciated that improved markets for investment in equities can help promote faster economic growth. Such improvement also allows the ordinary saver to share in that growth. The past decade has seen quite extraordinary expansion in equity markets in a whole range of countries and cross border investment has expanded even faster than investment in domestic equities.

One important purpose of this report is to address the question as to whether developing countries can expect to attract net flows of private portfolio capital in any significant amount to their emerging equity markets. The answer of this report is clearly affirmative. As part of the rapid development of a global securities industry, a wide range of developing countries including low income and highly indebted countries can expect to be able to attract a portion of the flows invested in foreign markets by investors from the world's major financial centres. But to do this successfully, each country will have to compete for investor attention with other markets; that is, address a critical shortage of suitable stock, reduce obstacles to access and take actions to support the development of their markets; development which is in any event required for sound domestic reasons. The report focuses on these questions and makes a number of recommendations to the developing countries themselves and to the international community.

The issues which developing countries have to address in fostering the growth of their capital markets and in creating conditions attractive for foreign investors as well as for domestic investors are by no means unique to developing countries. On the contrary, many of the issues apply to varying degrees to the markets in developed countries. The difficult and long standing nature of some of the problems is apparent from the fact that developed countries continue to grapple with them — not necessarily always with success.

I would like to thank those who have joined me in this WIDER Working Group. I hope the report will make a modest contribution to the renewed attention being paid by the international community to private long term capital movements and the role that private portfolio capital can play in mediating global savings imbalances in a non-debt creating form.

Sir Kenneth Berrill

EXECUTIVE SUMMARY

1. Equity markets can play an important role in stimulating faster economic growth by encouraging savings, by directing savings into more productive channels and by making managers more publicly accountable for the performance of their companies. All countries need to improve the efficiency of their capital markets but understandably the deficiencies are much greater in developing countries.

2. The emerging equity markets, mainly in developing countries, with a capitalisation of $620 billion in 1989[1], have quintupled in size over the last five years and provide an important mechanism for mobilising domestic savings and for attracting foreign capital in non debt creating forms.

3. Foreign investor interest in emerging equity markets is one facet of the internationalisation of the global securities business. Out of more than 30 such markets, foreign investors are mainly attracted to around 20 by the perceived long term appreciation potential. Markets that are attractive to foreign investors include those in low income countries such as India as well as middle income countries such as Thailand and Malaysia, and include markets in highly indebted countries such as Brazil and the Philippines.

4. The supply of funds for investment in equities is not regarded as a constraint by investment managers. Currently about $15 billion of equities, equivalent to about 1/4 of 1% of the total pool of institutional funds in the major markets, are held by non-residents in emerging markets.

5. If developing countries succeed in attracting a modestly growing proportion of the funds placed by investment managers in foreign markets, the net inflow of portfolio investment into developing countries could expand from an annual level of around $1 billion a year in the second half of the 1980s to a potential level of around $5-10 billion a year in the 1990s and thus help replace net flows of loan capital from banking sources which are unlikely to increase on a voluntary basis for some time ahead.

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[1] As of end September 1989.

6. To achieve this potential, developing countries need to lower barriers to access to their securities markets for the foreign investor. The rationale for these barriers is not well founded in prevailing circumstances. Specifically,

* Restrictions which limit investment to approved country funds should be reconsidered;

* Limits related to domestic ownership and control of the corporate sector need to be reviewed and the role of non-voting shares possibly expanded as a way of reconciling foreign investor interest with domestic control;

* Taxation disincentives should be removed; capital gains taxes for non-resident investors and withholding taxes on dividends should be reduced to internationally acceptable levels;

* Protection afforded for domestic financial intermediaries, for example, mandated managerial roles in respect of foreign investor funds, are of doubtful necessity and should be re-examined.

7. The restrictions which have been placed on portfolio capital are part of a broader pattern of foreign exchange controls affecting capital movements. Given the importance of private capital flows in mediating savings imbalances, the presumption in the articles of agreement of the IMF that condones such restrictions (for example, Article VI, Section 3) needs to be also reviewed. In the meantime, the IMF could use the provisions of Article IV, Section 3 (b) to encourage member countries to make progress on the elimination of controls on capital movements.

8. Potential investors in emerging markets, domestic and particularly foreign, are also limited by a shortage of suitable stock. Although over 7,000 companies are listed in 30 emerging markets only about 900 stocks have the features required by foreign investors in the markets of greatest interest to them and two thirds of these are in just three markets (Korea, Taiwan and India).

9. Measures to increase the supply of stock in the short run should focus on encouraging additional issues of stock by removing discriminatory aspects of tax regimes as well as distortions in monetary regimes that favour borrowings rather than equity financing.

10. Measures to increase the supply of stock over the longer run include accelerating programmes of privatisation and encouraging family owned companies to issue stock.

11. The further development of emerging markets requires a combination of fiscal, monetary, technological, legal and supervisory measures. The Capital Markets Department of the IFC has played an important role in promoting these developments. This role might be expanded if the

IFC increased its investments in domestic financial institutions in emerging markets and undertook an enlarged technical assistance role funded by transfers from IBRD. Official bilateral agencies could also fund technical assistance for equity market development.

12. A strengthened regulatory framework is important to build the confidence of domestic and foreign investors in emerging markets and to help ensure that such markets attract a growing share of global portfolio flows. As the capital markets of developing and developed countries become more closely linked internationally and as portfolio diversification continues to lead to larger capital flows, confidence would be strengthened by the adoption of international regulatory standards. International supervisory efforts, therefore, need to be reinforced. A committee parallel to the Committee on Banking Supervision of the B.I.S. might provide an appropriate forum for examining international efforts in this area and encourage the carrying forward of the work undertaken by IOSCO[2] and others.

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[2] The International Organisation of Securities Commissions.

FOREIGN PORTFOLIO INVESTMENT IN EMERGING EQUITY MARKETS

I. INTRODUCTION

1. In the post war period, finance for development has overwhelmingly taken the form of loan capital. Non debt creating capital flows have been modest in size.[3] Reliance on loan capital has resulted in an accumulation of debt which now constrains economic management in a wide range of developing countries - both low income as well as middle income developing countries. This debt has also become a major problem for lending institutions in the developed countries as well as a source of friction between North and South. Accordingly, there is renewed attention being given to non-debt creating capital flows. This report focuses on one such form - private portfolio investment.

2. The need to attract foreign capital in non debt creating forms is only one reason, and not the most important reason, why developing countries should wish to foster their emerging equity markets. Equity markets are a vital part of economic development - they encourage savings, help channel savings into productive investment and encourage entrepreneurs to improve the efficiency of investments. This report therefore, puts the role of the foreign investor within the context of the general desirability of the growth of equity markets for domestic resource mobilisation reasons as well as for tapping foreign savings and know-how on market organisation and technology.

3. The report covers the following topics:

   i) the size of equity markets in developing countries and the perceived advantages to host countries of encouraging their further development;

   ii) the motivation, range and scope of foreign investor interest and the economic and market conditions which encourage or constrain it;

   iii) the attitude of the domestic authorities to foreign portfolio investment, the obstacles and the issues surrounding access for the foreign investor;

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[3] Non debt creating capital takes the following forms:
- official bilateral grants (mainly to low income developing countries) averaging $14 billion a year 1985-88 (excluding technical cooperation);
- private direct investment, averaging $14 billion a year 1985-88;
- private portfolio investment, averaging about $1 billion a year 1985-88.

iv) measures to increase the supply of suitable stock which constrains the growth of markets and which is perceived by the foreign investor community as the principal limiting factor on their activities;

v) measures to support market development, including regulatory aspects.

4. Based on this review, the report concludes with recommendations both to host countries with emerging equity markets as well as to the international institutions concerned with capital flows. The recommendations focus on three areas:

- the reduction of restrictions on access for the foreign investor;

- actions required to increase the supply of suitable stock;

- measures to promote market growth.

The report and recommendations reflect, not only the views of the practitioners that comprise this Study Group, but also extensive discussions in the market with investment managers.

II. EQUITY MARKETS IN DEVELOPING COUNTRIES

1) The Range of Markets

Most developing countries have equity markets although many are embryonic or dormant. Some have a considerable history with, for example, the informal trading of shares in Bombay dating back to the 1830s. The International Finance Corporation (IFC) monitors some 19 emerging markets on a weekly basis and keeps a less detailed track of a further eleven. Together the market capitalisation of the 30 markets totals about $620 billion with over 7,000 companies listed. Just two markets in East Asia (Taiwan and Korea) dominate this picture, accounting for $384 billion of the total market capitalisation (62%) while a further four (India, Malaysia, Brazil and Mexico) account for another $145 billion in market capitalisation (23%). The same six markets account for almost 4,200 of the companies listed, with India (Bombay) alone accounting for over 2,000. The number of stocks, however, that have the characteristics most desired by overseas investors is a small fraction, subjectively estimated at about 15% of the total listed.

Table 1: 30 Emerging Markets
End of September 1989

	Market Capitalisation $ billion	%	No. Listed Stocks
Korea, Taiwan	384	62	753
Brazil, Mexico India, Malaysia	145	23	3,436*
Other 24 Markets	91	15	3,241
Total	620	100	7,430

* of which listed in Bombay 2,344.
For further details, see Statistical Annex.

Market characteristics vary widely. At one end of the spectrum, Taiwan's market is speculative and dominated by the individual retail investor (turnover of $275 billion in 1988) while by contrast other markets may be dominated by passive holders of stock, frequently family owners, banks and institutional, including government, holders.

Taken together, emerging markets account for about 4% of the capitalisation of securities markets globally. The same developing countries account for 11% of the GNP of this group of countries and the lower weight of their securities markets in the total as compared with their GNP is sometimes taken as an indicator of the potential of emerging markets to increase their relative share in world markets as well as indicating the scope for equity markets

to play a larger role in the financing of economic growth in developing countries.

Table 2: Market Capitalisation and GNP
(end of 1988)

	GNP		Capitalisation		
	$ trillion	%	$ trillion	%	% GNP
Emerging Markets	1.8	11	0.4	4	21
Developed Markets	14.5	89	9.4	96	65
Total	16.3	100	9.8	100	

2) The Case for Stronger Equity Markets

Developing countries have frequently had an ambivalent attitude towards their equity markets. Neglect has reflected in part, a frequent bias against the private sector, an association of the market with income inequalities, financial sector distortions in favour of borrowing (partly reflecting a desire to finance the public sector cheaply) and in some markets, a concern about foreign investors or the status of expatriate owned companies. Attitudes are, however, changing as part of an overall shift in favour of private sector led development as well as by the need to attract foreign capital in non-debt creating forms.

Developing countries stand to gain a number of advantages from encouraging the growth of their emerging equity markets. From the domestic point of view, a well functioning equity market:

- provides an additional channel for encouraging and mobilising domestic savings;

- fosters the growth of the domestic financial services sector and the various forms of institutional savings;

- provides savers with better protection than most debt instruments against inflation and currency depreciation and thus alleviates two of the major reasons encouraging the flight of domestic capital to abroad as well as providing a vehicle to attract back earlier flight capital;

- facilitates the transfer of enterprises from the public sector to the private and thus helps reduce the size of public sectors;

- assists in the transformation of the private sector from 'ownership capitalism' to managerial capitalism;

- improves the efficiency of capital by providing market measures of returns on capital and a market mechanism for management

changes as compared with the administrative or political mechanisms of public sector corporations;

- improves the 'gearing' of the domestic corporate sector and helps reduce corporate dependence on borrowings;

- provides an incentive for high standards of accounting and disclosure which will both improve management performance and facilitate the eventual entry of domestic enterprises to the international capital market.

3) Equity Markets and Financial Strategy

In their assessment of these different factors and the role that equity markets can play in development, the authorities in developing countries have two very different examples from the experience of industrialised countries. In the case of Germany and Japan, fast economic growth has been associated with bank directed credit flows, while capital markets have played a more prominent role in investment financing in the United States and United Kingdom (although in the recent period the corporate sector in the United States has been a net withdrawer of equity from the market).

Despite the lack of a clear connection between economic growth and the development of equity markets, in present financial circumstances four considerations would appear decisive for developing countries. First, many developing countries face a pressing need to improve the efficiency of their investments. Capital markets can be helpful because public exposure of company performance focuses attention of corporate management on the return on capital, and encourages higher standards of accounting, financial planning and corporate disclosure. There is a market valuation of management and the potential for more transparent measures of efficiency in the corporate sector.

Secondly, government financing creates a severe strain on domestic credit markets in many developing countries. Greater reliance on equity financing can help insulate the private sector from the difficulties of public sector financing and the administrative allocation of credit and help mitigate cases where private sector investment would otherwise be crowded out by public sector claims on credit flows.

Thirdly, investment in domestic equities provides an alternative to investment in real estate. This encourages public savings and directs them into more productive uses.

Fourthly, from the perspective of attracting external finance, many developing countries face poor prospects of attracting net new flows of banking credit. On the other hand, the willingness of investment managers in the major capital markets to consider the acquisition of foreign assets has been growing rapidly in recent years and equity markets in developing countries have good prospects of obtaining a proportion of these flows. It is estimated

that international equities trading has exceeded $1 trillion in recent years, equivalent to about one out of every ten trades.

Table 3: International Equity Market Trading Values

	An. Average 1979-1981 $ trillion	An. Average 1986-1988 $ trillion
International Equity Trading Value	0.1	1.1
Total Trading Value	N/A	9.5

Source: Salomon Brothers, *International Equity Flows,* 1989 Edition.

III. THE ATTRACTION OF EMERGING MARKETS FOR FOREIGN INVESTORS

1) Portfolio Diversification

Foreign investors in the emerging markets of developing countries are asset managers in the industrial countries for institutions such as pension funds, insurance companies, mutual funds and for wealthy individuals. The pool of institutional and other funds at the disposal of asset managers is huge - approximately $7.5 trillion in institutions in the main markets of the United States, Europe and Japan. The assets of such institutions are estimated to be growing at about 15% a year.

Estimates of how much of this pool of investment funds have been placed in emerging markets are not precise. OECD/DAC does not monitor such flows as a separate category, and there appears to be under-recording in balance of payments statistics reported to the IMF. Outstanding assets of funds which specialise in emerging markets currently stand at about $8 billion but some investments have occurred outside the framework of such funds and there is anecdotal evidence of non-resident investments being 'fronted' by residents or expatriates with investment or tax privileges. In round terms, a figure of $15 billion for the stock of non-resident investments in emerging markets is given below, equivalent to less than one quarter of one per cent of total funds at the disposal of asset managers in the major markets and equivalent to about two per cent of that part of these funds that appears to be placed in foreign markets. Assuming that most of this investment has taken place in the last five years, a net flow of investment to emerging markets of about $1 billion a year is implied on a balance of payments accounting basis (excluding valuation changes).

Table 4: Assets in Emerging Markets

		1989 $ billion (Estimated)	2000 $ billion (Illustrative)
A)	Total Assets of Institutional Investors	7,500	20,000
B)	Of Which Assets in Foreign Equities	750	3,000
	(as a percentage of total assets (A)	(10%)	(15%)
C)	Assets of Non-residents in Emerging Markets	15	100
D)	Total Capitalisation of Emerging Markets	620	1,800

Memo:

Assets of non-residents in emerging markets as a percentage of:

i)	total assets of institutional investors (A)	0.2%	0.5%
ii)	foreign equities (B)	2.0%	3.3%
iii)	total capitalisation of emerging markets (D)	2.4%	5.6%

For further detail, see Statistical Annex.

Private flows cannot be forecast. The table above however gives some illustrative benchmarks for the next decade. One key assumption is that asset managers will continue to increase their holdings of foreign equities as a share of their total assets (shown rising from 10% to 15%). A second key assumption is the share of assets that diversification into emerging markets might represent. In the table above, this ratio is shown as rising from 0.2% of the total assets to 0.5% (equivalent to just over 3% of their foreign equity holdings). On this basis the stock of foreign investment in emerging markets is shown to rise from $15 billion to $100 billion by the year 2000. If, however, the relevant authorities for emerging equity markets take the steps discussed later in this report, to reduce barriers for foreign portfolio investors, to foster their markets and to increase the supply of stock then investment in these markets could become to be seen as part of normal diversification strategy for international asset managers. As a result, the ratio of assets placed in them could increase further than shown above and come into line with the share of emerging equity markets in global equity market capitalisation. This share itself could rise from 4% (end of 1988) if the growth of emerging markets is encouraged so that they grow more rapidly than developed markets. In short, a combination of increased investor diversification together with rapidly growing emerging equity markets could lead to the figure of $100 billion outstanding in emerging markets by the year 2000 being exceeded by a large margin.

In looking at the balance of payments implications of such assumptions about investor behaviour, account has to be taken not only of the sensitivity of the result to key assumptions about diversification but also some adjustment must be made to exclude valuation gains. A rough adjustment suggests that the difference between the 1989 stock of assets in emerging markets of $15 billion and a figure for the year of 2000 of $100 billion would be consistent with net inflows averaging $5 billion a year by the mid 1990s and $10 billion a year by the end of the decade on a balance of payments transactions basis. Balance of payments inflows of portfolio investment at these or even higher levels will hinge on the willingness of countries with emerging markets to link them to the global securities business so that foreign investment in emerging

markets is seen by foreign investors as part of their normal diversification strategy.[4]

2) Risks and Rewards

Emerging markets are not yet seen as part of 'normal' investor diversification strategy but rather as markets where higher risks (relative to developed markets) need to be offset by the possibility of above average gains. Thus, apart from an interest in portfolio diversification, the main motivation for investors to enter emerging markets is the possibility of above average long term capital appreciation. For investment managers there is also the fear of missing a market development and a perceived need to be in a market early - particularly if there is a shortage of stock. The experiences of foreign investors with Japan in the 1960s and subsequently in Taiwan and Korea provide the main incentive. The investor community also took note that in the 'crash' of 1987 some emerging markets performed better than the major markets. Comparative performance is illustrated in the table below.

Table 5: Relative Performance of Emerging Markets,
Changes in IFC Price Indexes (Per cent)
(in US Dollar Terms)

	End of 1980 to End of Sept. 1987	End of 1987 to End of Sept. 1989
Argentina	-71	302
Brazil	-3	161
Mexico	50	236
Korea	165	105
Malaysia *	36	57
Taiwan *	528	296
Thailand	74	95
Developed Markets		
U.S.A., S & P 500	137	40
U.K., FT-Actuaries (500)	207	23

* Period from end of 1984 to end of September 1987.

For further detail, see Statistical Annex.

It can be seen from the table above that the sample emerging markets did not on the average perform better than the markets of developed countries in the 'bull market' period leading up to October 1987 but that Korea and

[4] The note in the Statistical Annex illustrates the impact of alternative assumptions about investor behaviour and valuation gains.

Taiwan did perform better. Since October 1987, emerging markets have performed better on average partly because Korea and Taiwan have been joined by other fast growing markets in East Asia while emerging markets in other regions (particularly in Latin America) have also registered exceptional gains.

There are few developing countries that can expect to replicate the performance of Japan, Korea and Taiwan. However, not only can individual stocks and individual equity markets perform well even in less promising country circumstances and offer the prospect of exceptional capital appreciation, but also investment managers stress the fact that in some emerging markets, stocks have been undervalued when measured by the yardsticks used in developed markets (such as price/earnings ratios). The table below shows selected market averages. Such conventional indicators should be interpreted with caution as providing only a starting point in assessing values. However, it can be seen that rising ratios in emerging markets in the most recent period (partly reflecting foreign investor activity) have offered opportunities for substantial gain.

Table 6: Value Indicators in Emerging Markets

	End of 1986		End of September 1989	
	Price/ Earnings Ratio	Price/Book Value Ratio	Price/ Earnings Ratio	Price/Book Value Ratio
Asia				
Japan	45.7	3.9	50.6	4.6
Korea/Taiwan	18.9	2.1	44.7	5.0
Other Emerging Markets [1]	11.6	2.0	18.2	4.5
Western Hemisphere				
U.S.A.	14.1	1.8	13.4	2.1
Emerging Markets[2]	10.2	0.7	13.9	2.4

[1] includes India, Philippines and Thailand
[2] includes Argentina, Brazil and Mexico.

For further detail, see Statistical Annex.

The market averages shown above obscure differences in individual market values and more importantly the differences in individual company values which can be striking even for companies in comparable lines of activity. Some asset managers therefore stress the importance of 'stock selection' rather than 'portfolio diversification'.

The table below shows differences in conventional market yardsticks for the value of stocks of companies in roughly comparable sectors. It can be seen that the relevant ratios differ widely and the question for investors is whether such differences are indeed justified by different stock prospects or whether there are undervalued stocks that offer the possibility of good gains even if the overall market in which they are listed does not perform exceptionally.

Table 7: Individual Stock Value Indicators
End of September 1989
(Comparable Sectors)

Sectors	Price/Earnings Ratio	Price/Book Value Ratio
Transport/Communication/ Utilities (23 stocks)		
Average of 6 highest	21.9	4.34
Median	5.8	0.91
Average of 6 lowest	2.9	0.27
Wholesale/Retail Trade (20 stocks)		
Average of 6 highest	25.4	6.27
Median	12.9	2.17
Average of 6 lowest	5.5	1.11

For further detail, see Statistical Annex.

In attempting to assess the risks that accompany the potential rewards, most investment managers, including those emphasising 'stock selection' rather than 'portfolio diversification' will look to certain general country economic and political considerations to inform their decisions. On the political front, a generally favourable attitude to the private sector, or a willingness to see the private sector play a larger role in economic development is one litmus test. Prospects of reasonable economic growth, in real terms, is another general criterion.

The attitude of foreign investors towards inflation rates and exchange rate depreciation is more complex. Investors measure their returns in a foreign currency unit - usually the U.S. dollar. Equity markets are generally expected to hold their value against inflation measured in domestic currencies and thus the rate of domestic price increase is not regarded as a primary risk except as an indicator of the quality of general economic management. Thus there is a willingness to invest in countries where internal economic management (as evidenced by a high rate of inflation) has not been very effective. However, high rates of inflation (as in Latin America) can make balance sheets difficult to interpret and in the case of East Europe the problem is compounded by the difficulties of evaluating companies in non-marketised economies where price reforms are in process.

Exchange rate depreciation reduces capital appreciation when measured in an external currency but the early market experience with Korea and Taiwan has been that gains in the market have far outweighed exchange rate losses in the times (until recently) when currencies such as the Won were not regarded as appreciating currencies. In addition, investment managers take the view that a depreciating currency may not be harmful to a country's economic prospects but, on the contrary, be necessary for faster economic growth. They hope to see faster economic growth translated into equity market gains that more than compensate for exchange rate losses. Furthermore by selecting stocks of companies that are in the export sector, or in utilities and services with foreign exchange earnings, they can expect their investment to benefit from currency depreciation. The significance of the exchange rate factor is illustrated in the table below.

Table 8: Gains in Local Currencies and US Dollars in 1988

	% Change in Exchange Rate	% Change in IFC Total Return Index in Local Currency	% Change in IFC Total Return Index in US $
Korea	16.1	86.0	115.8
Taiwan	1.1	96.6	98.8
Argentina	-78.5	553.5	40.3
India	-14.2	60.3	37.6
Malaysia	-8.2	40.7	29.2
Portugal	-11.5	-15.4	-25.1
Turkey	-45.3	12.5	-36.6

Source: IFC

The view that exchange rate risk can be benign, is, however tempered by two important qualifications. First, a rapid currency depreciation may be symptomatic of more far reaching balance of payments weaknesses such that there is a risk of exchange controls effecting the repatriation of profits and principal. Secondly, transactions efficiency becomes of crucial importance. In one East Asian market there is said to be a 3-4 day delay between a decision to sell and the clearing of the stock transaction and a further 30 days before the foreign exchange transaction is cleared. Such delays can be of paramount importance if the currency is unstable.

The fact that foreign investors will look beyond the immediate negative impact on their returns of a depreciating currency to the other possibly positive effects, helps account for the willingness of foreign investors to consider markets such as those of Brazil and Mexico. However, non-convertibility (as in Eastern Europe) is likely to be a serious barrier to the foreign portfolio investor. Those funds established for Eastern Europe have had to address this problem by offering either an exchange rate and convertibility guarantee or the prospect of investments in exporting companies from which a return can be generated in foreign exchange. Such arrangements are difficult to frame

because equitable sharing of exchange rate risk (between investor and host country) is difficult to achieve through administrative mechanisms.

The general economic and political assessment of a markets prospects appears crucial before investors will consider more specific market features. In some countries the adoption of stabilisation and appropriate macro economic policies is vital for investors. The possibility that insurance might be available to cover some of these general risks, for example interruptions to profit and principal repatriation, does not seem to be a consideration. Insurance is not seen as a factor that might encourage additional flows. On the contrary, the view appears to be that investment decisions have to be taken on the economic and political fundamentals, not because insurance might be available.

In addition to these general risks, investment managers cite a number of more specific risks which foreign investors must face and which in most cases also confront domestic investors. Those risks most frequently cited are as follows:

- accounting standards are frequently poor and the quality and timeliness of company and market information frequently inadequate;

- the underlying worth of securities is difficult to estimate, not only because of unreliable company information, but also because of distortions in some markets of flotation pricing (India) because of the speculative nature of some markets (Taiwan) because of lack of trading in others (for example where family or government holdings predominate) and because of the intricacies of inter company accounting in the case of quoted affiliates of holding companies that are controlled by family interests;

- insider trading is often endemic, corruption is also a factor and political interference can also add to risks in the market;

- transactional efficiency in stock markets is widely regarded as improving but supervisory standards are uneven and lack of price transparency (i.e. immediate publication of the true price at which significant deals are currently being struck) is another risk factor.

3) Markets of Interest

Broadly speaking, foreign investors appear to regard the risks cited above as 'facts of life' to be set against the prospects of above average gains and the advantages of portfolio diversification. The net result is investor interest in a wide range of emerging markets as shown in the table below.

Table 9: Main Markets of Interest

East Asia	South Asia	Europe & Mid. East	Africa	Latin America
Indonesia	India	Greece	Nigeria	Argentina
Korea		Hungary	Zimbabwe	Brazil
Malaysia		Portugal		Chile
Philippines		Turkey		Mexico
Taiwan				Venezuela
Thailand				

Acute political instability is a deterrent (Sri Lanka, for example) and in some markets of potential interest, actual investment cannot be realized because of lack of stock (Hungary) or prohibitive barriers to entry (Nigeria). Nevertheless, two features of this spectrum of investor interest are particularly important. First, there is a willingness to consider equity investment in highly indebted countries such as Brazil, Mexico and the Philippines and in Eastern Europe as well as in those countries such as Korea, whose external indebtedness has been well managed. Secondly, there is a strong investor interest in a low income developing country such as India, and to a lesser extent, some other low income developing countries as well as in the middle income developing countries. The two major constraints cited by asset managers are barriers to access and a shortage of 'suitable' stock. These aspects are considered next.

IV. HOST COUNTRY ATTITUDES AND MARKET ACCESS

1) The Reasons for Host Country Caution

Despite the interest of the foreign investor in a wide range of developing country markets, and the foreign investors' professed long term perspective, the authorities in many developing countries have taken a cautious attitude to the foreign investor. The first major concern of the developing countries is that foreign equity investment represents an unstable inflow which could reverse if the country encounters economic difficulties and leave the country at the precise moment when the balance of payments is likely to be weak. The second important concern is the fear that equity investment will provide foreign investors with an avenue of control over domestic corporations. The third concern (related to this perception of the power of the foreign investors) is that foreign investors may simply come to dominate the market, key sectors of industry and the financial services sector. Fourth, the mirror image of investor interest in offsetting high risks by above average rewards is a host country concern that portfolio investment is a particularly costly form of inflow when taking into account both dividends and future redemptions (outflows of principal). These general concerns have found their reflection in a fairly widespread pattern of barriers erected in the way of foreign portfolio investors. Five main types of barrier can be distinguished:

- general restrictions limiting aggregate inflows, for example, by confining access to approved country funds;
- restrictions related to foreign exchange controls on remittances;
- restrictions relating to the preservation of domestic ownership;
- restrictions relating to protecting the domestic financial sector;
- taxation disincentives that can effectively turn away foreign investors;

These main types of barriers (which in practice overlap) are illustrated in broad terms in Annex 1 attached. The more specific considerations related to each are discussed below.

2) Barriers to Access

Among the general restrictions on foreign investor access are those which limit investments to approved country funds (for example for Brazil, Korea, Taiwan and India). The rationale behind this kind of restriction is simply for the authorities to be able to control the volume of funds flowing in and out of the country. It has an appeal to some investment managers, since in marketing the funds to clients, the risks and rewards can be defined in terms of a single market. However, there are disadvantages for a country to limiting direct access for principals. Unsatisfied foreign demand will reflect in premia

on the funds (to net asset value) rather than flowing through to market prices and thus to the benefit of domestic sellers, there will be evasion (through resident or expatriate nominees) and investment decisions will be concentrated in a few hands rather than stock valuations benefiting from a multiplicity of investment decisions. At the same time, foreign knowledge of the market, of benefit both to the country and to the corporate sector, will similarly be restricted.

Concern about the foreign exchange impact of transactions is reflected in the frequent need for the registration of purchases with a central monetary authority and an authorisation procedure for remittances. Where these authorisations are accorded automatically such procedures will not inhibit investors. However, if they involve delays extending beyond transaction delays in the purchase and sale of stock, a separate currency risk is added for the investor. Such deterrents cannot be in the interest of host countries wishing to attract capital. Moreover, in cases of high currency risk, it simply encourages the use of parallel exchange markets for stock transactions.

A third type of barrier is that related to retaining domestic ownership and control of the corporate sector. A basic issue is whether domestic ownership as such should be protected. Leaving this fundamental issue aside (which is a politically sensitive issue in most developed countries as well as in developing markets), the issue is whether a desire to protect domestic ownership and control can be reconciled with attracting non-resident portfolio inflows. As far as ownership is concerned, one approach is to set limits on foreign ownership but not at too low a level. Concerns over foreign control can be met by the use of non-voting stock for foreign investors or for voting rights to be non-exercisable by foreigners. While the use of different classes of stock raises questions relating to price differentials, equitable treatment in take over situations and the protection of minority shareholders, on the other hand ceilings on foreign holdings of a single class of stock can give rise to administrative manipulation, the enforced unwinding of transactions and the evasion of registration requirements through the use of nominees. It appears that foreign investors tend to regard voting rights as a distinctly secondary concern and thus the use of non-voting stock or different classes of stock with limited or non-exercisable voting rights may be appropriate ways of reducing access barriers related to domestic ownership.

Particular sensitivity about domestic ownership is sometimes found with regard to the financial sector and separate measures may be used to protect domestic financial intermediaries. The need for approved country funds to be associated with a restricted group of local managers is one form of protection. Tax treatment may also steer management functions into particular domestic management arrangements. On the whole such protectionist measures would appear of doubtful value. Because of lack of familiarity with markets, and above all because of the need to develop reliable research based sources of corporate information and to tap into local sources of knowledge, foreign investors have the strongest possible incentive to seek local partners. It would seem best to leave the choice and type of association to the market.

A final barrier is that imposed by the levying of taxes, usually in the form of withholding taxes on dividends and less usually on capital gains. The motivation behind such taxes is to place the foreign investor on the same footing as the local investor. Equal treatment is, however beyond the control of the host authority since, amongst other reasons, the use of tax credits cannot be monitored. More important, high taxes act as a disincentive to investors compared with markets where such taxes are not levied. Some asset managers will not enter markets where taxes are levied on the investment fund rather than being passed on to the individual investor. Insofar as developing countries wish to attract rather than deter non-debt creating capital, tax disincentives should be carefully reviewed to see whether their reduction to a more internationally accepted level would not be beneficial.

3) The Rationale for Dismantling Barriers

Leaving aside the specific issues relating to particular types of barriers, there is a more fundamental issue relating to the general concerns that have provoked the barriers in the first place. The suspicion about the stability of portfolio inflows and the possible way in which they may aggravate a balance of payments weakness runs counter to the important role that such inflows have played in recent years in both market development and balance of payment terms. Market weakness and balance of payments weakness may not be correlated and in times of market weakness, investors may stay in place in part because market liquidity is unreliable. While emerging markets cannot compete in depth and liquidity with the United States and other major markets, they still respond to a basic investor demand for portfolio diversification and as discussed earlier, this trend could be encouraged and is unlikely to be reversed. Emerging markets whose growth is encouraged by the authorities are likely to be able to attract net new inflows on a sustained basis.

In addition, any perceived disadvantages of portfolio inflows have to be set against the availability of private portfolio capital as compared with the poor prospects for net new loan capital. Private portfolio inflows do not create debt and they represent a desirable shift away from the sovereign obligations of developing countries towards individual credit risk taking. Unlike debt which gives rise to service obligations regardless of the success or not of the investment, the costs associated with portfolio investment in the form of dividends and capital gains only arise if investors make successful choices with investments that are returning such gains. Finally, it would appear that concerns which relate to foreign ownership can be reconciled with portfolio inflows through various alternative arrangements relating to voting rights. Thus the general concerns that have led in emerging markets to the imposition of barriers in the way of foreign investors do not seem well founded given the nature of capital flows in current and prospective world market conditions.

4) Restrictions on Capital Movements

The restrictions on portfolio capital discussed above are in part a

reflection of a long standing pattern of foreign exchange controls affecting capital movements. In the immediate post war world, the main focus of the international community was on freeing current transactions; large scale movements of private capital were not envisaged and as part of the emphasis on achieving balance in the current accounts of balance of payments position, it was accepted that restrictions on capital movement might be justified. This historical condoning of exchange restrictions affecting the capital account is still reflected in the IMF Articles of Agreement where the provisions of Article VIII 2 (a) which operates against restrictions on current payments can be contrasted with Article VI Section 3 which states that "members may exercise such controls as are necessary to regulate international capital movements".

The presumption in the IMF articles that controls are legitimate in respect of the capital account does not appear to reflect the role of private capital in today's markets. In today's globally linked financial system, attempts to limit private capital flows are subject to widespread evasion, (particularly by rich individuals in emerging economies) and result in incentives for parallel exchange markets. It would be quite possible in a particular developing country that the lifting of exchange control could lead in part to a return of flight capital if there were legitimate avenues. Capital efficiency could improve and additional new flows be attracted. The foreign exchange rate would more accurately reflect both current and capital account transactions.

At the most recent meeting of the Interim Committee in September 1989, the Committee agreed on the need for a further study of international capital flows. In this context, it would appear appropriate for the IMF to receive a mandate to play a more active role in encouraging the dismantling of barriers to capital movements. Pending the amendment of Article VI which appears anachronistic, the provisions of Article IV Section 3 (b) would appear to provide a basis for the IMF to discuss the removal of barriers to portfolio flows and other capital movements with its members.

V. THE SHORTAGE OF STOCK

1) The Existing Supply

In addition to barriers to access, foreign investors face an acute shortage of stock which they regard as the main constraint on their activities. Although some 7,000 companies are listed in the 30 emerging markets followed by the IFC, only a small fraction are regarded by the foreign investor as 'suitable' stock. While investors will look to a number of different indicators of quality in defining 'suitable' stock, among the key qualities is tradeability (liquidity). There is a widely perceived shortage of stocks that meet this criterion. This partly reflects the neglect of equity markets in general. It also reflects the fact that, among the stocks listed in the markets, many are not in fact traded or tradeable. The requirements on the minimum amount of stock which has to be publicly available to obtain a listing on stock exchanges are uneven, public sector or bank holdings or family ownership may restrict turnover, while thinly traded stocks may be regarded as liable to manipulation. Liquidity is not the only consideration, particularly where the investor is a potential long term holder. A crucial consideration is also the reliability of underlying company information, its timeliness and whether insiders, rather than the public, have first use of it.

Estimates of the number of stocks with the desired characteristics in markets of primary interest to the foreign investor, must be somewhat subjective. For the main markets of interest they appear to run in the order of 900-1300 — Korea, Taiwan and India together account for around two thirds of this total. Illustrative figures are given in the table below. They should be regarded with caution and are likely to represent an overestimate in a falling market. For this reason the lower end of the range may give a more accurate picture of availabilities. Since the same considerations apply to domestic investors, they too suffer from the same constraints. If market development is to be encouraged, a critical area therefore, is to increase the supply of stock with the desired twin features of tradeability and reliable underlying company information.

Table 10: The Supply of Suitable Stock

East Asia	South Asia	Europe & Mid. East	Africa	Latin America
Indonesia (5-10)	India (300-500)	Greece (20-30)	—	Brazil (60-80)
Korea (250-300)		Hungary (—)		Chile (20-30)
Malaysia (40-60)		Portugal (20-30)		
Philippines (10-20)				Mexico (50-60)
Taiwan (100-150)		Turkey (20-30)		
Thailand (30-40)				

2) Encouraging New Issues of Seasoned Stock

The options for the authorities which can lead to an increase in the supply of stock in the short run are limited. The focus of measures which might increase the supply of stock in the short run has to be on encouraging companies that already are listed to issue more stock and/or to encourage immobile holders to trade. Rising markets are themselves likely to provide an incentive for companies to issue more stock. In addition, the authorities can review the impact of the tax system on the supply of stock.

Relevant tax considerations might include:

- reducing capital gains taxes may encourage family holders to sell part of their holdings;

- trading might also be encouraged by reducing distinctions between short and long term capital gains tax and new issues (as well as trading) encouraged by indexing capital gains taxes fully to remove gains which purely reflect rises in general price levels;

- measures which reduce the cost of equity issues may encourage companies to issue more stock;

- measures which reduce discrimination against 'unearned' (dividend) income or between capital gains and income may make stock purchases and issues more attractive;

In addition, in a number of markets there are distortions that enhance the attractiveness of borrowing relative to the further issuance of equity and

these distortions could be re-examined. They include interest subsidies and exchange rate risk guarantees.

These various tax aspects are part of a more generalised problem of structuring tax systems so that they are more neutral as between different forms of return on investor capital and discriminate less against savings. The incidence of taxes as they effect stock market development should be reviewed against this more general background.

3) Sources of New Stock

In addition to encouraging new issues of seasoned stock, the authorities can encourage the supply of new stock. A first source is through privatisation of public sector companies. Since a number of developing countries are taking steps to reduce the size of the public sector and in addition perceptions of what is appropriate for public sector ownership are also changing, privatisation offers one promising way of increasing the supply of stock for private investors. Certain public sector companies such as telecommunications and airlines have the advantage of deriving part of their earnings in foreign exchange and this adds to the attraction from the point of view of the investor.

However, for a number of reasons there is likely to be a considerable time lag in the process of privatising. The reasons include the following:

- the capital structure usually requires radical change; for example, the conversion of the balance sheet into a market related gearing structure, the write off of past government debt, and the write down of assets;
- the range of activities may need to be restructured and if monopolies are involved the company may need to be split, or a regulatory system set up, or provision made for freedom of entry;
- accounting practices frequently need overhaul and a period of proven profit may be required;
- management would typically need to be changed and employees shed, possibly on a large scale.

Although therefore it will take time for privatisation programmes to add to the supply of stock, a recent IFC paper[5] estimated that over 600 companies were targeted for privatisation in markets of interest.

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[5] Guy Pfefferman; IFC Discussion Paper No.1, *'Private Business in Developing Countries'*, 1988.

A second source of supply for new stock is through bringing privately held companies to the market. Three rather different types of situation can be distinguished. The first is of a mature company in family ownership; the second where a company is quoted on an unlisted market and third, is the venture capital type of situation of a new company starting up. Of these different types of situation venture capital has an appeal to a special class of investor and by definition there is likely to be a considerable time lapse between start-up situations and when the company can be listed. Even in the case of companies that have taken the step to the unlisted market there may be a considerable time lag before they are ready for listing.

Persuading family owned companies to issue stock may also take time. The process of going public may enable a true and higher value to be put on a family owned business and may enable the family to realise some part of these assets and to diversify. The market price may be higher than a private sell out. On the other hand, disclosure requirements will become more onerous and accounting will need to be transparent with consequential tax implications. While non family management can be accorded incentives through going public, the family's own management hold will be loosened. Family owned companies weighing the relative advantages of going public cannot be rushed. However the incentives for them to go public will be greater in buoyant market conditions where prices stand at a significant premium to book values. The authorities can influence this general market environment positively by taking steps to support the development of the market. These steps are discussed next.

VI. SUPPORTING MARKET DEVELOPMENT

The weight of foreign purchases in emerging markets (estimated at about 2 1/2%) is relatively small, and likely to remain so, but as some foreign investors are likely to be active traders rather than passive holders and their purchases may be focussed on a relatively narrow band of stocks, there are concerns in some markets that removing barriers to access could lead to destabilising price movements. These fears may well be exaggerated but in any event the fundamental response has to be to address the shortage of stock and to encourage market development more generally.

Strengthening the role of equity markets involves taking parallel action on several different fronts in an evolutionary process. Tax and monetary measures affecting savings flows, the development of a competitive structure of institutional intermediaries, the putting in place of improved market technology, (including that needed to link settlement, registration and custodial functions), legal and regulatory measures, all have an important role to play[6]. Within the scope of this report, the following points give selective illustrations of some of the issues involved in the evolution of markets.

- In a number of countries, tax and monetary policy combine to favour borrowings rather than equity financing. Table 6 in the Statistical Annex indicates that effective borrowing costs are negative in a number of countries while profits available for dividends can be said to suffer double taxation from corporate tax and individual dividend withholding tax.

- In most emerging countries, non-bank savings institutions and intermediaries such as pension funds and mutual funds need to play a larger role in attracting savings flows and in channelling them to equity markets. In some markets, institutional intermediaries suffer from investment restrictions on the purchase of equities which do not reflect prudential concerns as much as public sector financing claims. The role of public ownership amongst such intermediaries may also require review. If institutional investors are mainly public sector institutions, the sale of stock in privatisation programmes may simply change the nature of public sector ownership and it may inhibit the issue of shares by private companies. In addition, if institutional investors are in a privileged or non-competitive environment they may be regarded as holding excessive market power and this could also inhibit the supply of stock. Table 7 in the Statistical Annex indicates the relatively small role played by institutional intermediaries in a number of developing countries.

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[6] For example in Sri Lanka, 1990 budget proposals remove tax benefits for a company obtaining quoted status and may remove them from some companies already listed. Existing tax legislation does not provide any incentives for Unit Trusts.

- Market technology is important not only to enable larger volumes to be handled efficiently and to reduce transaction delays and errors, but it is also important as a means to improve the quality of market information for all investors and to improve fairness and market transparency. Table 8 in the Statistical Annex illustrates the current level of computerisation in a number of markets and the scope for further improvement.

- Supervision is weak in many markets and it is important to improve the confidence of domestic as well as foreign investors. It would be helpful for the authorities in developing countries if the process of putting in place international standards could be accelerated. At present, progress is being made mainly in one area — capital adequacy guidelines for institutions carrying out stock transactions - work which is nearing completion under the auspices of a subcommittee of IOSCO. There are, however, many other important supervisory aspects including, for example, those relating to key investing institutions (such as mutual funds), those relating specifically to the market (such as insider trading and procedures for disclosure of price sensitive information), and other areas where attempts to introduce international standards have hardly begun. Whether there is a need for a new international secretariat to support this work or whether IOSCO can provide the resources and umbrella is one question involved. In addition, in most countries authority for supervision of the securities industry is fragmented and this is reflected by an absence of overview at the international level. A committee parallel to that in the B.I.S. on banking supervision to encourage the spread of international standards of supervision in securities markets and the securities industry might be appropriate.

Among the international institutions, it is the Capital Markets Department of the IFC that has played the pioneering role in encouraging developing countries to foster their equity markets. In particular, by co-underwriting country funds the IFC has played an important part in bringing awareness of these markets to international investors. This particular role with the foreign investor community has now been achieved. But further market development in all its aspects remains to be fostered. In addition to expanding its investments in intermediary institutions in developing countries, the IFC might play a larger technical assistance role.

Technical assistance in respect of emerging markets is needed not only in areas such as market technology, clearing, settlement and custodial functions but also in the area of the supervision of securities markets and securities houses (as well as in respect of some other financial markets such as options and futures markets). Currently among the international institutions there is neither a clear locus for this kind of assistance nor the necessary funding. The Central Banking Department of the IMF is hard pressed to meet the most urgent needs for technical assistance in the area of bank supervision and has neither the financial nor human resources to move into the supervision of securities markets. The Capital Markets Department of IFC has a nucleus of relevant technical expertise but does not have the funding capacity to provide for a

major enlargement of free standing technical assistance. It would not make sense for IBRD to try to duplicate the expertise that is already established in the IFC but IBRD does have a funding capacity out of its administrative budget or net profits. Therefore, transfers from IBRD to the IFC to support a much enlarged technical assistance role would be one response. In addition bilateral official aid agencies fund little, if any technical assistance in the area of equity market development. This would appear a significant gap in their activities.

VII. CONCLUSIONS

Developing countries have strong domestic reasons to encourage the growth of their emerging equity markets. Equity markets can help improve the efficiency of investment, encourage savings flows and protect investment levels from the difficulties associated with public sector finances. In addition they can serve to attract non-debt creating capital from abroad.

In developed countries a willingness to invest in international securities has grown rapidly over the last decade and emerging markets in developing countries have attracted a small proportion of this movement towards portfolio diversification. Emerging markets are likely to continue to be seen as markets where higher than average rewards are needed to offset higher than average risks. If emerging markets continue to attract even a small proportion of the growing global securities business, it can represent a valuable source of net new capital in the 1990s at a time when new lending from foreign banking sources is likely still to be constrained by high indebtedness.

To attract these inflows, emerging markets will have to compete with other larger and deeper markets. To compete for the attention of the international investor, barriers to access need to be reduced, including tax disincentives. Measures are required to increase the supply of stock that is actively traded and where values can be assessed in the light of good quality underlying company information. Other measures such as improved market technology and settlement systems are needed to foster market development more generally both for domestic reasons as well as to attract external capital.

It needs to be stressed that many of these issues, for example, those relating to the tax and monetary environment, the attitude towards foreign shareholdings and the need to improve market organisation and supervision are by no means unique to developing countries. For developing countries the IMF and IFC are important sources of assistance in addressing these issues and could play even more active roles. In addition, developing countries would benefit from greater international attention to regulatory issues where an international approach to standards would provide additional confidence for investors. Such an underpinning is needed in a world where private capital plays an increasingly important role in international savings flows.

Annex 1: Access to Emerging Stock Markets: Illustrative List of Barriers

Annex 2: Statistics

ANNEX 1: ACCESS TO EMERGING STOCK MARKETS: ILLUSTRATIVE LIST OF BARRIERS*

	General Restrictions	Foreign Exchange Controls	Limits on Foreign Ownership	Protection of Domestic Financial Sector	Taxation
East Asia					
Korea	Non-residents can participate only through approved mutual funds. Subject to some restrictions, eligible Korean companies are permitted to issue to foreign investors bonds convertible into stock. The Government intends to permit direct foreign portfolio investments in 1992.	The overseas remittances of dividends and repatriation of capital are freely permitted.	Non-residents may own up to 10 % of the shares of any class of an issuer. Securities and Exchange Commission has powers to impose specific restrictions.	Korean trust companies must co-manage approved foreign investment funds.	25 % withholding tax on dividends, this may be reduced to 10-15 % when a tax treaty is in force. The sale of units in Korean trusts or shares in Korean companies is subject to withholding tax of the lesser of 10.75 % of the gross sales price or 26.875 % of any capital gain. Capital gains tax is normally eliminated in tax treaties.
Philippines	The common stock of many Philippine companies is divided into A and B shares. A shares may be acquired only by nationals while B shares may be acquired by any person, corporation or association. There are no distinctions between the rights, preferences, and limitations of A and B shares.	Central Bank registration of incoming portfolio investment is required to obtain repatriation and remittance of dividends. The policy adopted by the Central Bank is that dividends and capital can be repatriated in full at any time. However, foreign exchange shortages may cause significant delays.	Foreign ownership in companies that own land, exploit and develop natural resources, own educational institutions, or operate public utilities is limited to 40% of the capital stock. In advertising the limit is 30% of the capital stock. Foreigners may not own any shares of companies which engage in mass media, retail trade or rural banking. In other business activities prior approval of the Philippine Board of Investments is needed for foreign ownership exceeding 40 %.	In banking, foreign ownership is limited generally to 30% of the voting stock.	Tax treaty rate for withholding tax on dividends is generally 15%. The regular tax rate is 35%. There is a transaction tax of 0.25% on the gross value of sales of shares.
Taiwan	Foreign portfolio investment is permitted only through trust funds authorized by the Ministry of Finance.	Central Bank authorization is necessary for overseas remittance of proceeds from securities transactions in foreign currency.		Approval has been granted for a number of joint venture management companies to act as investment managers in Taiwan.	Dividend and interest income of country funds are subject to a withholding tax of 20%. Approved country funds have been exempt temporarily from capital gains tax. The regular tax on net gains is 35%.
South Asia**					
India	Investment in securities by non-residents (other than non-resident Indians) is possible only through investment trust funds established in India and authorized by the Reserve Bank of India. Secondary market purchases by non-residents are not permitted. Direct investments are permitted by non-resident Indians and by companies at least 60% of the equity of which is owned by such persons.	Each remittance of redemption proceeds to foreign investors requires the specific approval of the Reserve Bank of India.	The normal ceiling for foreign investment is 40%, but higher percentage of foreign equity can be considered in priority industries (sophisticated technology and export orientation used as criteria).	Investment fund managers may be from public or private sector, but private managers are subject to additional taxation.	Dividend income is subject to withholding tax of 25%. In respect of capital gains, for units held for more than one year, the tax rate is 45.5%. For units held for less than one year, the tax on the gain is 65%. If such gains are distributed as dividends, the 25% tax rate applies. For non-resident Indians a 20% capital gains tax applies.

* The information given in this table is intended to illustrate in broad terms types of investment barrier faced by foreign investors. Detailed regulations may be more complex.

** In Sri Lanka dividend income is subject to income tax (up to 40% maximum). A withholding tax at source of 20% is levied or where Double Tax Treaties are in effect a 15% rate is typical if recipient is resident of a Treaty country. The tax on capital gains is 25% but gains realised within two years of acquisition are treated as income. (i.e. subject to maximum 40% tax).

Indonesia	Foreign portfolio investment is possible without prior approval.	Currently there are no regulations on foreign exchange which would restrict remittances in or out of Indonesia.	The limit for foreign ownership is 49% of the listed share capital. In addition, the articles of association of some listed companies contain further restrictions.		The withholding tax on dividends is 20%. Capital gains on the sale of Indonesian securities by non-residents are not presently subject to withholding tax.
Malaysia	Non-residents are free to buy and sell stocks and bonds traded on the local market. First public offerings however are not available for non-residents.	Most of the authority for approving payments abroad is delegated to authorized banks. Repatriation is therefore normally automatic.	General limit for foreign equity is 30%. Foreign Investment Committee of the Govt. must approve the purchase of securities in excess of M$ 5 million or the equivalent of 15% or more of the voting power. Country funds are not required to seek these approvals.		Non-residents are subject to 40% income tax on gross dividend income. Taxes are paid by the distributing corporation. There is no capital gains tax, (except for shares in real property companies.)
Thailand	Registration of foreign portfolio investment is required.	Prior approval of the Central Bank is needed for outward transfer of foreign currency for any purpose. Provided that investment in securities is shown to have originated in an inward transfer of foreign exchange, duly registered with the Central Bank, permission for repatriation is given routinely.	Foreign ownership is restricted by law and by articles of association of most companies. These limits vary from company to company between 25 and 49% of the capital.	Foreign ownership of commercial banks is restricted to 25% of the capital.	The standard withholding tax on dividends is 20% and on interest and capital gains 25%.
Europe, Mid-East, Africa					
Greece	Transactions in listed and unlisted securities have been fully liberalized.	Repatriation is freely permitted, provided that foreign currency was used for the purchase of the securities.	There are no restrictions on foreign ownership, except in shipping and insurance companies.	Foreign participation in banking is subject to restrictions.	Regular withholding tax on dividends is 42% (registered) or 45% (bearer) for quoted shares. Tax treaty rates are 25-35%. No capital gains tax on securities.
Portugal	Purchases of listed securities by non-residents are free of restrictions. Foreign investors cannot participate in primary offerings without prior authorization.	Foreign exchange controls have been liberalized. Repatriation is free.	Foreign investments are permitted in all sectors except those which are closed to all private participation.		Withholding tax on dividends is 25% (no tax treaty) or 12-15% (tax treaty). There is no capital gains tax.
Turkey	In August 1989, regulations were revised to permit foreign investors to freely invest in listed securities. Investment in non-listed securities is subject to prior approval.	Restrictions on repatriation have been abolished.	There is no limit on foreign holdings of capital in listed companies, but exercise of voting rights by foreign investors is prohibited.	Purchases and sales of listed securities must be done through intermediary institutions such as brokers, unless special permission is obtained.	There is no withholding tax on dividends. Capital gains from the sale of securities by non-residents are not subject to taxation.

Kenya	Foreign portfolio investment is subject to prior approval.	Dividends and interest may be remitted abroad, but prior exchange control approval is required. Repatriation of capital is restricted to the original amount, the premium must be placed in a blocked account unless it is reinvested. Significant delays are reported.	A permission from the Central Bank is needed for entering non-residents as shareholders in any local company. Central Bank has power to limit foreign ownership (generally 49%).		Withholding tax on dividends is 15%. At present, there is no capital gains tax.
Nigeria	The approved status is not given for the purchase of shares on stock exchange unless it forms an integral part of an otherwise approved investment project.	Outward transfers must be approved by the Federal Ministry of Finance.	In the insurance, petroleum and mining sectors foreign ownership is limited to 40%	Foreign ownership of banks is restricted to 40%.	Withholding tax on dividends is 15%. Capital gains tax is 20%.
Zimbabwe	Foreign portfolio investment is subject to prior approval.	Prior exchange control approval is required from the Reserve Bank. Repatriation of capital is permitted after two years, subject to the requirement that the amount to be repatriated will be reduced by any profits remitted in the interim. Outward transfers of capital are allowed only through six-year external government bonds bearing 4% interest. Dividends are remitted on the basis of 50% of after tax amount. Significant delays are reported.			Withholding tax on dividends is 20%. Capital gains tax on securities is 30%.
Latin America					
Argentina	Foreign investment in publicly traded stocks is unrestricted provided that the investment per company does not exceed US$ 2 million or 2% of the stock capital. Prior approval is needed for the purchase of unquoted shares.	Repatriation of capital is allowed three years after investment. Remittances of dividends and capital are made via dollar denominated bonds (Bonex) purchased from the Central Bank. Official exchange rate applies to all transactions.	The total stock purchased by foreign investors is limited to 20% of the stock capital.	The purchase of shares by non-residents has to be made at a stock exchange through an authorized broker.	Dividends and capital gains can be remitted up to 12% of the investment per annum. Withholding tax on dividends is 17.5%. Excess profits tax of 15-25% is levied on remittances exceeding the limit. Taxation mechanism of capital gains of non-residents is not defined, but 36% tax may be charged.
Brazil	Foreign investors may invest only through funds approved by the Securities and Exchange Commission.	Remittances are not allowed without foreign investment registration certificate. Investment can be repatriated after having remained in Brazil for at least 90 days. Official exchange rate applies.	The aggregate investment by approved country fund in a single company must not exceed 5% of the voting capital or 20% of the total issued capital.	The manager of the approved fund has to be Brazilian investment bank or stockbroker. Foreigners can own half an investment bank's total capital, but only a third of the voting stock.	Dividends are subject to a 15% withholding tax (country funds, tax treaty in force). The non-treaty rate is 25%. Remittances of dividends over 12% of the capital base per annum are taxed 40-60%. Non-residents can repatriate the capital gain free of tax.

Chile	Central Bank approval is needed for foreign portfolio investment.	Dividends and net realized capital gains can be remitted at any time. Remittances are made at official exchange rate via Central Bank. The capital may not be repatriated for three years after its entrance in Chile.	In general, there are no percentage limits on foreign ownership. However, foreign investment funds specifically may not own in the aggregate more than 25% of the shares issued by any company. Foreign investors are prohibited from owning TV stations and the ownership of other media entities is limited.	There is a legal requirement that a Chilean administrator should be appointed by country fund.	Dividends and capital gains above inflation rate are subject to a 35% tax against which a 10% tax paid by the portfolio management companies could be credited. There is no withholding tax on dividends or net realized capital gains that are reinvested in Chile.
Mexico	A trust account has been set up by the Nafin (the government development bank). Foreign investors may purchase any stock which brokerages are authorized to transfer into the trust account.	Foreign investments are subject to the free market exchange rate and no particular exchange control regulations are applicable.	Stocks purchased by foreign investors are converted to non-voting status. Limit on foreign ownership in classified business activities varies from 34 to 49%. Certain activities are excluded from foreign investment e.g. oil, basic petrochemicals, certain minerals, railways, basic communications and the non-bank finance sector.	Foreign investors are able to buy up to 34% of the non-voting C shares of state-owned commercial banks. In general, the financial sector as a whole remains protected.	Withholding tax on dividends is 35% if paid from untaxed profits, otherwise zero. Sales through the Mexico Stock Exchange of shares considered as available to the general investing public are exempt of withholding tax.
Venezuela	Foreign investors may acquire shares from other foreign investors by making public offers through the stock exchange, in which case they are subject only to registration requirement. Otherwise, the purchase of shares by foreign investors is subject to prior authorization.	Authorization is needed for remittance of dividends and repatriation of capital. Dividend remittances are restricted to 20% (plus LIBOR) of the investment.	Public utilities, radio and television broadcasting, publicity and local transportion are reserved for national companies (foreign ownership less than 20%).	In insurance, commercial banking and other financial institutions new foreign investments are not allowed and existing investments have been limited to 20% of the capital base.	No withholding taxes apply to shares of open capital companies.

Sources: International Finance Corporation;
A World Guide to Exchange Control Regulations, 1989/90 Edition, Euromoney Publications;
Corporate Taxes, A Worldwide Summary, 1989 Edition, Price Waterhouse; The GT Guide to World Equity Markets, Euromoney Publications and GT Management, 1989 Edition;
IMF, Exchange Arrangements and Exchange Restrictions, Annual Report 1989.

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Table 1: Market Size Indicators

	Market Capitalisation (US $ million) End of Sept. 1989	Number of Listed Stocks End of Sept. 1989	Market Capitalisation, % of GDP End 1988
Taiwan	243,768	167	118.3
Korea	139,676	586	71.4
Brazil (Sao Paulo)	43,770	592	8.4
Mexico	42,236	255	16.8
Malaysia	33,851	245	69.1
India (Bombay)	24,908	2,344	8.7
Thailand	17,787	159	16.8
Philippines	11,960	142	10.9
Kuwait	11,836 *	65 *	76.7 **
Portugal	10,029	176	19.5
Chile	8,024	213	33.8
Greece	6,790	119	8.8
Argentina	5,919	180	2.5
Turkey	4,272	50	1.6
Pakistan	2,425	429	6.7
Jordan	2,099	106	44.0
Egypt	1,760 *	483 *	9.2 **
Venezuela	1,239	60	6.7
Colombia	1,007	80	3.0
Zimbabwe	942	54	12.4
Nigeria	884	109	3.6
Peru	831 **	236 *	3.6 **
Jamaica	796 *	44 *	22.0 **
Sri Lanka	471 *	176 *	9.5 **
Morocco	446 *	71 *	2.0 **
Bangladesh	430 *	101 *	2.3 **
Trinidad-Tobago	268 *	33 *	8.8 **
Indonesia	253 *	24 *	0.1
Kenya	24 *	55 *	0.3
Costa Rica	N/A	76 *	N/A
	Total 618,701	Total 7,430	Average 21 %

* End 1988
** End 1987

Source: IFC Emerging Markets Data Base.

Table 2: Performance Indicators

Per Cent Change in IFC Total Return Indexes

	December 1984 — September 1987		September 1987 — September 1989	
	In U.S. Dollars	In Local Currency	In U.S. Dollars	In Local Currency
East Asia				
Korea	241	232	151	108
Philippines	938	982	144	152
Taiwan	574	413	119	86
South Asia				
India	64	73	44	82
Malaysia	46	53	14	21
Pakistan	46	66	26	51
Thailand	265	247	92	92
Western Hemisphere				
Argentina	50	2,002	351	109,837
Brazil	— 24	1,088	166	26,815
Chile	551	1,032	44	74
Colombia	267	720	— 2	59
Mexico	869	7,785	— 19	32
Venezuela	49	575	— 35	— 27
Europe/Mid East/Africa				
Greece	399	445	— 5	12
Portugal	2,247	2,087	— 48	— 43
Turkey	402	518	169	543
Jordan	29	11	— 15	59
Nigeria	— 60	109	8	57
Zimbabwe	345	405	99	157

Source: IFC Emerging Markets Data Base.

Table 3: Market Value Indicators

	Valuation at end of 1986		Valuation at end of September 1989	
	Price/ Earnings Ratio	Price/ Book Value Ratio	Price/ Earnings Ratio	Price/ Book Value Ratio
East Asia				
Japan	45.7	3.9	50.60	4.59
Korea	25.7	2.5	39.73	2.67
Philippines	4.4	0.9	19.61	4.67
Taiwan	12.0	1.7	49.65	7.38
South Asia				
India	18.0	3.5	16.75	3.11
Malaysia	32.7	2.3	31.57	3.29
Pakistan	8.2	1.9	8.96	1.87
Thailand	12.5	1.5	18.18	5.68
Western Hemisphere				
U.S.A.	14.1	1.8	13.40	2.14
Argentina	16.0	0.3	25.10	5.07
Brazil	4.2	0.9	6.97	1.22
Chile	5.3	1.0	4.46	0.93
Colombia	8.3	1.4	6.92	1.18
Mexico	10.5	1.0	9.68	1.04
Venezuela	9.4	3.6	5.65	1.35
Europe/Mid East/Africa				
France	19.0	2.2	12.90	2.06
Germany	14.7	2.7	16.20	2.14
United Kingdom	13.4	1.8	11.20	1.88
Greece	30.5*	3.2*	31.12	3.46
Jordan	12.9	1.8	14.14	1.69
Nigeria	5.8	2.8	6.41	1.47
Portugal	24.8	3.1	23.70	4.22
Turkey	4.3	N/A	11.99	4.50
Zimbabwe	4.2	3.7	5.24	1.07

* (1987)
Source: IFC Emerging Markets Data Base, Morgan Stanley Capital International.

Table 4: Individual Stock Value Indicators (September 1989)

Stocks in the transport, communications and utilities sector *

	Country	P/E Ratio	P/BV Ratio
1	Portugal	22.95	4.34
2	Portugal	17.95	3.39
3	Turkey	11.43	6.51
4	Brazil	2.30	0.25
5	Chile	4.30	1.07
6	Chile	6.33	0.85
7	Chile	5.28	0.84
8	Chile	4.57	0.66
9	Chile	3.88	0.29
10	Chile	4.45	0.76
11	Chile	3.47	0.39
12	Chile	5.77	0.85
13	Colombia	2.90	0.09
14	Mexico	5.17	0.94
15	Mexico	0.43	0.07
16	Jordan	20.06	0.91
17	Jordan	9.97	1.40
18	Korea	36.00	3.19
19	Malaysia	23.30	4.40
20	Malaysia	11.70	3.80
21	Pakistan	4.22	0.52
22	Philippines	10.20	3.61
23	Philippines	10.62	2.66

Stocks in the wholesale/retail trade sector *

	Country	P/E Ratio	P/BV Ratio
1	Greece	15.60	5.26
2	Greece	17.33	8.36
3	Greece	5.35	—
4	Brazil	6.90	1.51
5	Colombia	5.33	1.20
6	Mexico	11.04	1.93
7	Mexico	13.66	1.17
8	Taiwan, China	31.86	7.38
9	Taiwan, China	795.24	16.03
10	India	9.24	3.18
11	Korea	39.30	2.44
12	Korea	12.90	2.17
13	Korea	23.80	3.10
14	Korea	14.20	2.32
15	Korea	13.90	9.19
16	Korea	153.50	2.88
17	Pakistan	8.83	1.57
18	Pakistan	4.23	0.90
19	Thailand	24.69	4.22
20	Nigeria	5.30	1.20
21	Nigeria	9.50	1.70
22	Nigeria	5.80	0.66

* Stocks in the IFC Composite Index.
Source: IFC Emerging Markets Data Base.

Table 5: Selected Closed-End Country Funds for Emerging Markets
(Values in US$, as of End September 1989)

Fund Name	Offering Date	Gross Initial Size (million)	Total Market Value (million)
Regional Funds			
EMGF, Inc. (I, II)	May-86	133.00	310.50
Templeton E.M. Fund	Feb-87	115.00	153.81
EMIF, Inc. (I, II)	Feb-88	117.81	159.52
New World Investment Fund	May-89	62.50	66.81
Asian Devel. Equity Fund	Jan-88	100.00	132.30
Equity Fund of Latin America	Jul-89	114.50	120.19
Emer. Markets Investors Fund	Apr-88	24.50	86.70
Emer. Markets Strategic Fund	Jul-88	36.20	86.90
Genesis Emerging Markets Fund	Jul-89	250.00 *	250.00 *
Emerging Eastern Europe Fund	Oct-89	250.00 *	250.00 *
Brazil			
Equity Fund of Brazil	Sep-87	87.50	193.40
Brazil Fund	Mar-88	150.00	150.00
Chile			
The Chile Fund, Inc.	Sep-89	70.00	84.00
India			
India Fund	Jul-86	127.80	284.85
India Growth Fund	Aug-88	60.10	96.95
India Magnum Fund	Oct-89	157.00	157.00 **
Indonesia			
Indonesia Fund Inc.	Mar-89	20.80	57.38
Jakarta Fund	Aug-89	21.00	29.50
Korea			
Korea Fund (I, II, III)	Aug-84	150.00	905.35
Korea Growth Trust	Mar-85	31.50	256.92
Korea International Trust (I, II)	Nov-81	27.25	314.90
Korea Trust (I, II)	Nov-81	26.03	256.46
Korea Europe Fund (I, II)	Mar-87	63.71	268.45
Seoul International Trust	Apr-85	31.35	257.29
Seoul Trust	Apr-85	31.35	250.23
Malaysia			
Malaysia Fund	May-87	96.60	109.68
Malaysia Growth Fund	Apr-89	45.25	48.78
Malacca Fund	Jan-89	36.40	62.56
Mexico			
Mexico Fund	Jun-81	147.31	237.39
Portugal			
Portugal Fund	Aug-87	42.32	52.50
Oporto Growth Fund	May-88	37.10	42.00
Taiwan, China			
Formosa Fund	Mar-86	25.70	306.25
Taipei Fund	May-86	25.70	258.75
Taiwan Fund (I, II)	Dec-86	65.17	122.16
R.O.C. Taiwan Fund	Oct-83	42.13	453.90
Thailand			
Bangkok Fund (I, II, III)	Aug-85	44.17	163.75
Siam Fund	Feb-88	95.04	159.00
Thai Fund Inc.	Feb-88	114.96	225.13
Thailand Fund	Dec-86	31.14	82.50
Thai Euro Fund	May-88	80.25	105.94
Thai Prime Fund	Sep-88	155.00	235.60
Thai International Fund	Nov-88	80.03	120.94
Totals		3423.17	7966.24

Note: * Authorized capital
** Subscription Value

Source: International Finance Corporation, Batterymarch Financial Management, various prospectuses.

Table 6: Real Effective Interest Rates, 1988

	Lending Rate	Corporate Tax Rate	CPI Change	Real Effective Interest Rate
Indonesia	22.1	25.0	8.0	7.9
Thailand	15.0	30.0	3.9	6.3
Chile *	38.3	32.5	19.9	4.9
Malaysia	7.25	40.0	2.0	2.3
Philippines	15.9	35.0	8.8	1.4
Greece	22.9	40.0	13.5	0.2
Korea	10.1	30.0	7.1	0.0
India	16.5	50.0	9.4	— 0.1
Zimbabwe	13.0	50.0	7.0	— 0.5
Nigeria *	14.0	40.0	10.2	— 1.6
Colombia	28.2	31.0	28.0	— 6.6
Turkey *	50.0	46.0	38.8	— 8.5
Venezuela	8.5	35.0	29.5	— 18.5
Mexico	52.7	37.0	114.2	— 37.8

* 1987

Note: Real effective interest rates were calculated from lending rates — adjusted first for corporate tax rates — using the formula: $[(1+r) / (1+p) - 1] \times 100$, where r is the interest rate and p is the inflation rate.

Sources: IMF International Financial Statistics,
Price Waterhouse, Corporate Taxes — A Worldwide Summary, 1989 Edition.

Table 7: Distribution of Assets — 1985 Share by Type of Institution

									MEMORANDUM ITEMS: (includes Securities Held Directly by Individuals)	
Developed Markets *	Central Banks	Commercial Banks	Savings Banks & Thrifts	Specialized Lending Institutions	Provident & Pension Funds	Mutual Funds Trusts & Investment Banks	Insurance Companies	Total System Assets (% of GNP)	Lond-Term Debt Securities & Equities *** (% System Assets)	Equities (% System Assets)
U.S.A.	3%	30%	17%	12%	19%	6%	13%	207%	66%	28%
Canada	2%	35%	12%	3%	25%	11%	13%	208%	43%	24%
Sweden	6%	31%	10%	27%	13%	1%	12%	231%	54%	15%
Japan	3%	36%	29%	13%	1%	10%	8%	300%	43%	20%
Germany	6%	21%	37%	20%	0%	3%	13%	224%	42%	13%
Australia	7%	27%	20%	21%	11%	1%	14%	158%	50%	27%
France	7%	53%	13%	12%	1%	6%	7%	218%	19%	6%
U.K.	2%	37%	16%	1%	20%	5%	20%	211%	51%	32%
Singapore **	12%	42%	6%	6%	16%	17%	2%	399%	32%	14%
Emerging Markets										
Taiwan	21%	51%	24%	0%	0%	3%	2%	202%	11%	9%
Korea	10%	54%	5%	16%	0%	11%	4%	230%	11%	4%
Venezuela	22%	43%	8%	27%	0%	0%	1%	125%	9%	2%
Argentina	35%	47%	1%	12%	0%	0%	5%	125%	11%	4%
Brazil	35%	31%	11%	15%	2%	5%	1%	210%	30%	17%
Malaysia	10%	45%	5%	18%	16%	4%	3%	232%	48%	24%
Chile	20%	63%	0%	2%	11%	1%	5%	115%	40%	14%
Jordan	19%	59%	0%	21%	0%	0%	1%	221%	30%	24%
Thailand	19%	59%	7%	15%	0%	0%	1%	121%	20%	4%
Philippines	35%	40%	4%	16%	0%	3%	3%	120%	16%	3%
Nigeria	28%	57%	0%	2%	1%	9%	3%	83%	24%	5%
India	13%	55%	7%	8%	7%	1%	9%	74%	31%	12%

Notes:
- * Countries are listed in descending order of GNP per capita.
- ** Mutual Funds & Investment Banks include local and foreign merchant and investment banks' regional activities in Singapore.
- *** Long-term debt securities include Government, Agency and corporate securities with original maturities of one year or more, valued at par. Equities represent the market value of listed shares.

Comments:
The often unique roles some financial institutions play and differences in national and statistical reporting has required some judgement on allocating liabilities. The percentages shown here should therefore be viewed only as indicators of approximate degrees of relative size.

Source:
Batterymarch Financial Management

Table 8: Stock Exchange Automation in Selected Countries (Ranked by group alphabetically, roughly in order of overall degree of automation)

	Clearing & Settlement	Central Depository	Market Quotation	Company Financial Information	Order Execution	Linked Order Execution/ Clearing & Settlement
Group 1						
Brazil	Y	Y	Y	S	S*	S
Canada	Y	Y	Y	Y	S*	N
France	S	S	S	Y	S*	S
U.K.	Y	Y	Y	Y	N*	N
U.S.A.	Y	Y	Y	Y	N*	N
Group 2						
Chile	S	S	S	Y	N*	N
Taiwan	N	N	Y	S	Y	N
Denmark	Y	Y	S	N	N*	N
Japan	N	N	Y	Y	S	N
Hong Kong	N	N	Y	Y	(Y)	N
Korea	Y	Y	S	S	S*	N
Mexico	Y	Y	S	S	N	N
Norway	S	S	Y	S	S	N
Singapore	N	N	Y	Y	S*	N
Sweden	Y	Y	Y	N	N*	N
Group 3						
Argentina	S	S	S	S	N	N
Australia	N	N	S	S	S*	N
Belgium	N	N	S	S	N*	N
Germany	N	S	S	S	N	N
Italy	N	S	S	S	N	N
Netherlands	S	S	S	S	N	N
Spain	S	S	S	S	N*	N
Switzerland	S	S	S	S	N*	N
Group 4						
Malaysia	N	N	S	S	N	N
New Zealand	N	N	S	S	N	N
Philippines	N	N	N	N	N	N
Thailand	S	S	N*	N*	N	N
Venezuela	N	N	N	N	N	N

Footnotes:
In the ranking, significant extra weighting is given to decentralized automated order execution systems. If there is more than one stock exchange, the largest or a combination of the largest is used.

Y = Mostly automated
S = About half
N = None or negligible
(Y) = Centralized on the floor
* = Currently installing automated order execution systems, or expanding usage.

Source: Batterymarch Financial Management, IFC.

STATISTICAL NOTE ON TEXT TABLE 4

ASSETS IN EMERGING MARKETS

The figures shown in the text table 4 are at current prices and in current US dollars. The total estimated assets of institutional investors in 1989 have been projected to grow at 10% a year from 1989 (i.e. slightly faster than the nominal growth of GDP in the OECD area of 8% a year in the period 1980-88). The share of foreign equities in this total has been assumed to rise from an estimated 10% in 1989 to 15% in the year 2000. The share of total assets of institutional investors held in emerging markets is assumed to rise from 0.2% in 1989 to 0.5% in the year 2000, i.e. to $100 billion in the year 2000 from an estimated $15 billion in 1989. The GDP of emerging markets has been projected to grow at 9% a year (nominal growth) and the capitalisation of emerging markets has been shown to rise (expressed as a ratio to GDP) from 21% to 40%.

The difference between the stock of foreign assets outstanding in emerging markets in 1989 ($15 billion) and the stock outstanding shown for the year 2000 ($100 billion) can be looked at as a balance of payments inflow. However, from a balance of payments accounting perspective, net inflows are recorded as transaction values (purchases less realisations at the time when made). Valuation gains are excluded. Thus in order to derive an estimate about net balance of payments inflows from the difference between the stock of foreign assets in emerging markets in 1989 and the year 2000, a further assumption has to be made about what part of the difference represents valuation gains. For this purpose, it has been assumed that valuation gains are equal to the GDP price increases (6% a year) which underlie the market capitalisation projection. These valuation gains are calculated in relation to the annual outstanding balance of foreign owned equities during the projection period 1989-2000.

The table below indicates the effect of alternative assumptions about diversification and valuation gains on net inflows.

Portfolio Inflows into Emerging Markets

(Alternative Assumptions)

Equities in Emerging Markets % of Total Assets	0.5%	0.7%	1.0%
(% of Foreign Equities	3.3%	4.7%	6.7%)
Change in Outstandings 1989-2000, $ billion	85	125	185
A. Less Valuation Gains at 6% p.a.	27	33	42
Equals Net Inflows	58	92	143
B. Less Valuation Gains at 10% p.a.	45	56	70
Equals Net Inflows	40	69	115
C. Less Valuation Gains at 15% p.a.	68	83	105
Equals Net Inflows	17	42	80

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