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Concluding Remarks

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It is an honor for me to rap up the proceedings of this conference. Summarizing all papers in 30 minutes is not an easy task but I will try to focus on the main contributions of each paper presented here.

The theme of this conference was 'Fixed Income Market Development in Emerging Market Economies'. With this, the conference focused on the importance of bond markets in emerging economies and addressed the following questions:

i. What are the prerequisites to the development of a bond market?
ii. How to further deepen and impact liquidity to the bond market?
iii. What role a central bank can play in the development of a bond market?
iv. How to diversify the product of fixed income securities and exploit Islamic financial instruments?

The aim of this conference was to identify the main constraints in developing a domestic bond market with a focus on Pakistan. The discussions and deliberations of the conference were expected to benefit the State Bank of Pakistan to help devise a policy strategy for the development of a market for domestic bonds. I believe that the papers presented in the conference met those expectations. It was no surprise that all the papers presented in this two-day conference had a consensus that bond markets play an important role in the development of the overall financial sector; in the efficient allocation of savings and investments, and in an effective monetary policy. In these concluding remarks I will highlight the major issues presenters have discussed, and challenges the State Bank of Pakistan may face in implementing certain policies.

The conference started with an opening address by Shamshad Akhtar, the Governor, State Bank of Pakistan. The Governor highlighted the benefits of fixed income markets with a special reference to the state of fixed income securities in Pakistan. She rightly observed that a bond market is essential to provide financial stability by mitigating rollover risk and interest rate risk for the borrowers, providing an alternative source of finance to firms, and thus reducing the

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monopoly of the banking sector. She observed that the main obstacles in promoting and developing a market for fixed income securities in Pakistan include (i) a large number of companies are unlisted; (ii) family-owned businesses are reluctant to issue corporate bonds; (iii) the lack of a strict disclosure requirement; (iv) an ineffective taxation structure; and (v) an illiquid secondary market for bonds. The Governor also stressed that commercial banks could play an important role in the development of a bond market in Pakistan through their active participation. Comparison with other East and Southeast Asian countries showed that Pakistan has a long way to go. There are many lessons to be learnt through the experiences of these relatively more developed economies. The areas of special concern for Pakistan are the growth in primary government debt, promoting rating agencies, encouraging commercial banks in credit transfer and allocation and most importantly, developing a market for derivative securities.

The first paper of this two-day conference was presented by Jacob Gyntelberg, titled '*Developing Asian Pacific Non-Government Fixed Income Markets*'. He observed that Asia and the Pacific region have experienced remarkable growth in the securitization of domestic assets. Residential mortgages and consumer finance assets are believed to be the main contributor to this high growth, which has also helped to enhance liquidity. The paper asserted that factors responsible for secondary market illiquidity include diversity of investor base, market microstructure, transparency of trading activity and flow of timely information. Jacob argued that policy measures to develop market microstructure, e.g. diversifying the investor base and strengthening the institutions to improve the flow of information could be more effective, if pursued simultaneously.

Papers by Suresh Menon, '*Development of Bond Markets in Emerging Market Economies*' and by Ahmed Khalid, '*Bond Market Development in Emerging Markets: Prospects and Challenges for Pakistan*' discussed the prerequisites for developing a market for domestic bonds in emerging economies. Both papers also detailed the stages of development of a bond market. Using Malaysia as a case study, Suresh observed that Malaysia has passed stage II of the development. Malaysia's experience could be used as a model to develop a bond market in Pakistan. Ahmed's paper also provided a comparison using three sub-samples of representative countries from global markets, namely, the early reformers, the emerging economies and the developed economies. A variety of social and institutional indices were used to compare bond market development in South Asia with a particular reference to Pakistan. The main message in these comparisons was that Pakistan needs to do a lot more to reach the level of emerging economies. Besides specific bond market related measures, there is a need to focus on certain macroeconomic policies and for good communication and coordination among policy makers.

Imran Usmani's paper on '*Fixed Income Securities: Shari'a Perspective*' provided a detailed overview of the role of financial market instruments under Islamic finance. The paper also discussed and explained different forms under Islamic financial systems parallel to the conventional financial system. An interesting feature of this paper was the inclusion of three case studies, (i) WAPDA Sukuk bonds, (ii) Musharaka term finance certificates issued by the Sitara Group and (iii) Sukuk al-Salam issued by the Bahrain Monetary Agency. The paper by Imran Usmani concluded that the issuance of Islamic instruments of financing will help to develop an efficient and diversified capital market institution.

Here I would like to make a few comments. It is a documented fact the Government of Pakistan initiated policies to establish an Islamic financial system as early as 1982. However, it is mind boggling that the country still has not achieved anticipated targets. The evidence suggests that during most of the last 25 years, Pakistan used the name of Islamic finance and Islamic banking by simply providing a parallel 'Islamic Window' in the banking system. It is even more surprising and unfortunate to note that with all the academic and institutional efforts, as well as the enormous resources employed by many countries and institutions to promote Islamic finance, we only see just a handful of countries where Islamic banking is in operation (at least in parallel to conventional banking). There is a need to increase and improve the understanding of Islamic banking and Islamic finance for both the customers and more importantly, the practitioners. The need is to implement the system with sincerity and determination, not just to please certain groups of society.

I have even more important questions here. Given the high level of outstanding debt that Pakistan has, and the continued reliance on grants and loans for new or rescheduled loans, how long will it take to transfer the economy to a completely Islamic financial system (if that is something we can ever achieve)? A related question is how will we continue to be part of the global financial world if this happens? I believe we need to initiate some brainstorming sessions on these issues as well.

Jamshed Uppal in his paper '*Role of Securities Law in the Development of a Domestic Corporate Bond Market*' considered the role of the securities laws needed to develop a domestic corporate bond market. The focus of his empirical investigation was corporate governance factors and securities law features needed to promote an effective corporate bond market. His empirical findings based on questionnaire survey data from 40 countries and using a TOBIT model confirmed the view that securities laws play an important role in the development of bond markets. These findings are consistent with the debate on financial market reforms and sequencing. The important lesson that was learnt during the 1997 Asian crisis was the fact that some East Asian countries liberalized and deregulated the financial sector without implementing a legal framework to cater for the needs of a liberalized financial market. The regulatory system should be part of the initiatives to develop a market for domestic bonds in any emerging economy. Interestingly, this was the only empirical paper presented at this conference. There is need to put more effort into empirical analysis alongside policy analysis. While descriptive policy analysis is important to devise certain strategies to help develop a bond market, empirical analysis leads to certain important policy implications and helps to identify factors that determine the effectiveness of the market.

The paper by Marshall Mays on '*The Importance of Domestic Institutional Investors in Pakistan's Growing Bond Market*' looked into the challenges faced by the financial system as it moves from a bank-centric model to a model where bond markets operate as a companion for credit intermediation. Basically this paper examined the importance of the demand-side of the domestic bond market in Pakistan, with a focus on the role of domestic institutional investors. Marshall argued that a tight regulatory system would reduce incentive for market participants. On the contrary, a loose and soft regulatory system with inefficient supervision may result in highly volatile portfolio returns and thus could lead to big losses. In either case, the market will face excess demand or excess supply leading to disequilibrium. Thus, there is a need to maintain effective balance in regulating the buyers of domestic bonds. Good risk-management practices are an important argument of such a balance strategy. During the transition period, efforts should be made to develop a mechanism that improves the understanding of the risk and return target of fund managers and should help them realistically evaluate the risk factors and variations across different types of investments, he suggested. In the second half of the paper, Marshall provided a comparison of bond market development in Pakistan vis-à-vis other Asian countries. He observed that Pakistan has implemented some bold structural changes in the domestic market such as the introduction of voluntary private pension funds and new Sharia-compliant products in the insurance and mutual funds sub-sectors. However, the most pressing need at this point is the establishment of risk-based supervision such as the adoption of Basel II.

The last two papers by Farhan Hameed and Mohammed Arif discussed the issues concerning the development of a bond market in Pakistan. Farhan Hameed in his paper '*Fostering the Corporate Bond Market in Pakistan*' provided a very detailed overview of the state of the corporate bond market in Pakistan. He observed that the corporate bond market in Pakistan is still at an early stage of development, with total public corporate debt issues accounting for just over 1% of GDP. This finding is basically echoed in most of the papers presented in this conference. The paper observed that a lack of benchmark rates, crowding-out by government borrowing, administrative impediments such as a supporting regulatory framework, and lack of liquidity in corporate bonds are the major constraints in the development of this market. Farhan suggested that the first step to have a well functioning domestic bond market is to develop a secondary market for sovereign bonds. The paper also listed some other measures which could help to improve the efficiency of the bond market in Pakistan.

Finally, the paper 'Developing a Bond Market in Pakistan' by Mohammed Arif focused on certain broad macro and monetary conditions, some of which are directly influenced by the monetary policy pursued by the State Bank of Pakistan. The paper observed that the size of the local currency bond market (percentage of GDP) is only 5.3 percent as compared to 93 percent in Malaysia, 83 percent in Korea, 71 percent in Singapore, 38 percent in Hong Kong and 35 percent in China. Arif discussed in detail the problems faced by the State Bank of Pakistan in achieving certain targets and suggested recommendations to overcome these problems. He also touched upon the important role of sequencing, an essential aspect of effective policy implementation. Arif, being affiliated with the State Bank of Pakistan, acknowledged that the SBP is fully aware of the needs to develop a bond market in Pakistan and hence could play a leading role in its development.

Arif also mentioned the recent interest of some major investors to invest in Pakistan. Arif seemed to be very upbeat on this news and considered this as acknowledgement of Pakistan's effort in implementing policies for financial market development. I do agree that a decision to invest in Pakistan by foreign investors is recognition of the achievement of the domestic market. However, we should have a cautious view of this development. One should not forget that some Asian experts and politicians blamed some foreign investors for exploiting the situation in 1997 that later lead to a worst crisis in Asia. Others may have a different view. And there are a few who believe that it was a combination of factors including both internal mismanagement and external exploitation that lead to the collapse of Asian markets in 1997. In any case, there is a consensus that foreign investment without a legal structure in place to monitor its movement could increase a country's vulnerability to external shocks. Although foreign investment is important for any country, the governments should not encourage investors to park their funds during good times and leave abruptly when the economic environment changes and expected profit margins start to decline. The country should have a good monitoring system and a regulatory structure in place before funds start flowing in. Policies such as the Tobin tax or restrictions to place funds for a certain minimum period could help to provide a more stable investment environment and reduce a country's vulnerability to shocks.

In summary, what did the State Bank of Pakistan achieve through these deliberations? A lot, I believe. On the first day of the conference, I said in reference to emerging economies, that the important question is not why to develop a bond market, but when to develop it. I believe the major outcome of this conference is that we have moved one step forward. We, in general, agree that it's time for Pakistan to take initiatives to develop a bond market. The next important phase (and a question) is how to develop it. The presentations, discussions and recommendations of this conference could serve to devise a strategy to develop a market for fixed income securities in Pakistan.

Finally, I commend the Governor of the State Bank of Pakistan to take the lead in this direction. However, as I stated yesterday, the Bank alone cannot do it. Efforts to develop a bond market should be designed and implemented as a package. This package should include policies to provide macroeconomic stability, stable monetary and financial market conditions and most importantly, fiscal discipline and reduction in debt. At micro levels, we need to implement measures to encourage market participants as well as provide a regulatory structure to cater for the needs of a newly developed market for fixed income securities. Thus, the country has a challenging task ahead. To achieve these goals, major players including the State Bank of Pakistan, the Ministry of Finance, the Planning Commission, the Central Board of Revenue, regulatory agencies, and fiscal authorities should have a well coordinated plan, and sincerity and commitment to implement it. The task to establish a well functioning bond market is challenging, but not impossible. In the interim period, the State Bank of Pakistan should encourage more research in this important area and take measures to improve the understanding of the essentials of a bond market in an emerging economy for policy makers, fund managers and market participants. This means a continuance of what we have observed during the last 2 days. I believe it is achievable.

Finally, on behalf of all speakers and foreign delegates and participants, I would like to thank the Governor and the staff of the State Bank of Pakistan in organizing this conference.

Thank you.