

FINANCIAL SECTOR INTEGRATION IN THREE REGIONS OF AFRICA

**How Regional Financial Integration Can Support
Growth, Development, and Poverty Reduction**

TABLE OF CONTENTS

LIST OF TABLES	iv
LIST OF APPENDICES	v
LIST OF FIGURES	v
ABBREVIATIONS	vi
FOREWORD.....	viii
ACKNOWLEDGMENTS.....	ix
EXECUTIVE SUMMARY	x
1. INTRODUCTION.....	1
2. REGIONAL FINANCIAL INTEGRATION: A GENERIC ROADMAP	4
2.1 Introduction	4
2.2 Incentives toward Regional Financial Integration	5
2.3 The EU and ASEAN Experiences – Lessons for Africa.....	8
2.4 Stages of the RFI Generic Roadmap	10
3. THE COMMON MARKET FOR EASTERN AND SOUTHERN AFRICA	16
3.2 History of COMESA and the Path to Regional Integration	18
3.3 Obstacles to Regional Financial Integration	21
3.4 Structure of the COMESA Financial Sector	23
3.4.1 <i>The Banking Sector</i>	24
3.4.3 <i>Securities Markets</i>	28
3.4.4 <i>Non-banking Financial Institutions, Pensions and Insurance</i>	31
3.5 Status of the Supporting Financial Infrastructure	32
3.5.1 <i>Supervision and Regulation of the Banking Sector</i>	32
3.5.2 <i>Supervision and Regulation of the Non-banking Sector</i>	33
3.5.3 <i>Legal Supervisory Framework for the Financial Sector</i>	34
3.5.4 <i>Payment and Settlement Systems</i>	35
3.5.5 <i>Information Systems for Regional Financial Integration</i>	36
3.6 Assessment of COMESA’s Progress toward Financial Sector Integration.....	38
3.7 Role of Development Partners Going Forward.....	43
4. ARAB MAGHREB UNION	50
4.1 Introduction	50
4.2 Macroeconomic Context	51
4.3 History of the UMA and the Path to Regional Integration	52
4.4 Structure of the Financial Sector.....	54
4.4.1 <i>The Banking Sector</i>	54
4.4.2 <i>Non-banking Financial Sector: Pension Funds and Insurance Companies</i>	55
4.4.3 <i>Securities Markets</i>	56
4.5 Status of the Supporting Financial Sector Infrastructure	57
4.5.1 <i>Supervision and Regulation of the Banking Sector</i>	57
4.5.2 <i>Supervision and Regulation of the Non-Banking Financial Sector</i>	60
4.5.3 <i>Supervision and Regulation of the Securities Markets</i>	60
4.5.4 <i>Reform and Regulation of Payments and Settlements Systems</i>	60
4.5.5 <i>Legal Supervisory Framework for the Financial Sector</i>	61

4.5.6	<i>Information Systems for Financial Sector Regulation</i>	61
4.6	Assessment of UMA's Progress toward Financial Sector Integration	62
4.7	Role of the Development Partners Going Forward.....	66
5.	CENTRAL AFRICAN ECONOMIC AND MONETARY COMMUNITY	74
5.1	Introduction	74
5.2	Macroeconomic Context	75
5.3	History of CEMAC and the Path to Regional Integration	77
5.4	Institutional Framework	78
5.5	Structure of the Financial System	80
5.5.1	<i>The Banking Sector</i>	81
5.5.2	<i>The Non-banking Financial Sector</i>	88
5.5.3	<i>Securities Markets</i>	91
5.6	Status of the Supporting Financial Infrastructure	91
5.6.1	<i>Supervision and Regulation of the Financial Sector</i>	92
5.6.3	<i>Regulation of the Information Systems</i>	92
5.6.4	<i>Payment and Settlement Systems</i>	93
5.6.5	<i>Legal Supervisory Framework</i>	93
5.7	Assessment of CEMAC's Progress toward Financial Sector Integration	94
5.8	Obstacles to Regional Financial Integration	95
5.9	Role of Development Partners Going Forward.....	96
5.9.1	<i>Coordination of National and Regional Strategies</i>	97
5.9.2	<i>Financing of Regional Operations</i>	97
5.9.3	<i>Technical Assistance and Capacity Building</i>	98
5.10	Conclusions and Recommendations	100
6	CONCLUSIONS AND RECOMMENDATIONS	118
6.1	Common Characteristics and Differences between the Three Regions	118
6.2	Implications of the Global Financial Crisis for Regional Financial Integration	119
6.3	Supporting the Process of RFI	120
6.3.1	<i>Areas of Intervention by Development Partners</i>	120
	EPILOGUE	122
	BIBLIOGRAPHY	130

LIST OF TABLES

2.1	Regional Financial Integration: A Generic Roadmap	12
3.1	COMESA: Selected Variables, 2005-07 Averages	18
3.2	COMESA: Intraregional Trade Flows, 2003-06	19
3.3	COMESA: Interlinked Relationships	22
3.4	COMESA: Banking Soundness, 2005	25
3.5	COMESA: Banking Sector Structure, 2005	26
3.6	COMESA: Representation of Major International Banks, 2007	27
3.7	COMESA: Stock Exchanges, 2005	29
3.8	COMESA: Exchange Controls	31
3.9	COMESA: Structure of Non-Bank Financial Institutions, 2004	32
3.10	COMESA: Selected Indicators for Information & Payments Systems, 2005	36
3.11	COMESA: Stages of Country Preparedness for RFI	40
3.12	COMESA: Implementation of Action Plan by RFI Stages	42
4.1	UMA: Selected Variables, 2005-07	52
4.2	UMA: Financial System Structure, 2006	54
4.3	UMA: Stock Markets, 2007	57
4.4	UMA: Financial Soundness of Commercial Banks, 2005	58
4.5	UMA: Compliance with Basel Core Principles	58
4.6	UMA: Stages of Country Preparedness for RFI	63
5.1	CEMAC: General Characteristics of Member Countries, 2006	76
5.2	CEMAC: Selected Macroeconomic Indicators, 2006	77
5.3	CEMAC: Importance of Oil to the Economies of the Region, 2006	77
5.4	CEMAC: Structure of the Financial System, 2006	80
5.5	CEMAC: Selected Indicators of the Financial System, 2006	81
5.6	CEMAC: Concentration of the Banking System, 2006	82
5.7	CEMAC: List of Approved Banks in Operation, 2006	83
5.8	CEMAC: Conglomerates and Financial Groups, 2006	84
5.9	CEMAC: Geographical Distribution of Banking Networks, 2006	86
5.10	CEMAC: Activity of MFIs at Dec. 31, 2006	87
5.11	CEMAC: List of NBFIs Operating at Dec. 31, 2006	89
5.12	CEMAC: Insurance Market – International Comparison, 2005	90
5.13	CEMAC: Insurance Premiums by Country, 2001-05	91
5.14	CEMAC: Geographic Structure of Trade, 2001-05	96
5.15	CEMAC: Indicative Position of Member States as Regards Convergence Criteria	96
6.1	RFI: Areas for Development Partners' Intervention	120

LIST OF APPENDICES

3.1	COMESA: Action Plan for Macroeconomic Convergence and Financial Sector Development	45
4.1	UMA: Action Plan of Reforms of the Maghreb Financial Sector	68
4.2	UMA: Exchange Rates and Prices, 2005	71
4.3	UMA: Financial Access, Stability, and Efficiency, 2005	72
4.4	UMA: Integration with the Global Economy, 2005	73
5.1.	CEMAC: Summary Action Plan	102
5.2	CEMAC: Regional financial integration in CEMAC	103
5.3	CEMAC: Matrix of Key Recommendations for Private Sector Development	114

LIST OF FIGURES

5.1	CEMAC: Distribution of Banks by Origin of the Main Shareholder, 2006	82
5.2	CEMAC: Distribution of Banks by Quotation in 2006	85

ABBREVIATIONS

AACB	Association of African Central Banks
AEF	French Equatorial Africa
AfDB	African Development Bank
AML	Anti Money Laundering
ASYCUDA	Harmonized Automated System for Customs Data
BAM	Bank Al Maghreb
BCP	Basel Core Principles
BDEAC	Central African States Development Bank
BEAC	Bank of Central African States
BERI	Business Environment Risk Index
BIS	Bank for International Settlements
BMICE	Maghreb Bank for Investment and Foreign Trade
BVMAC	Central African Stock Exchange
CAR	Central African Republic
CDVM	Conseil Déontologique des Valeurs Mobilières
CEEAC	Economic Community of Central African States
CEMAC	Central African Economic and Monetary Community
CET	Common External Tariff
CFAF	CFA Franc
CIMA	Conference of Inter-African Insurance Markets
CIP	Payment Default Center
CMF	Financial Markets Commission
COBAC	Central African Banking Commission
COMESA	Common Market for Eastern and Southern Africa
COSUMAF	Commission for Monitoring the Central African Financial Market
CPSS	Committee on Payment and Settlement Systems
CRCA	Regional Insurance Control Commission
CTN	Common Tariff Nomenclature
CU	Customs Union
DRC	Democratic Republic of the Congo
DSX	Douala Stock Exchange
EAC	East African Community
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
EFT	Electronic Funds Transfer
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign Direct Investment
FOGADAC	Central African Deposits Guarantee Fund
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
FTA	Free Trade Area
FX	Foreign Exchange
GDP	Gross Domestic Product
GNP	Gross National Product
HDI	Human Development Index
HIPC	Heavily Indebted Poor Countries Initiative
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IBAN	International Bank Account Number
IBRD	International Bank for Reconstruction and Development (WB)
IFC	International Finance Corporation

IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
JSE	Johannesburg Stock Exchange
MCPS	Maghreb Committee on Payment Systems
MD	Million Dinars (Tunisia)
MFI	Microfinance Institution
MFW4A	Making Finance Work for Africa
MNC	Multinational Corporation
MOU	Memorandum of Understanding
MSMEs	Micro, Small and Medium Size Enterprises
NBFIs	Non-Bank Financial Institutions
NEPAD	New Partnership for Africa's Development
NPLs	Non-Performing Loans
NTBs	Non-Tariff Barriers
OHADA	Organization for the Harmonization of Business Law in Africa
OMAC	Central African Electronic Banking Board
PESF	Financial Sector Evaluation Program
PPP	Private-Public Partnership
PRGF	Poverty Reduction and Growth Facility
PTA	Preferential Trade Area
PTA Bank	Eastern and Southern African Trade and Development Bank
REC	Regional Economic Community
REP	Regional Economic Program (of CEMAC)
REPSS	Regional Payment and Settlement System
RFI	Regional Financial Integration
RMC	Regional Member Country
ROA	Return On Assets
ROE	Return On Equity
RFI	Regional Financial Integration
RIASP	Regional Integration Assistance Strategy Paper
RTGS	Real Time Gross Settlement
SACU	Southern African Customs Union
SADCQ	Southern African Development Community
SCCO	Savings and Credit Cooperative
SMAC	Central African Electronic Banking Company
SMEs/SMIs	Small and Medium-sized Enterprises / Small and Medium-sized Industries
SMI	Inter-bank Electronic banking system
SPV	Special Purpose Vehicle
SSA	Sub-Saharan Africa
SYGMA	Automated large-value payments system
SYSTAC	Central African Teleclearing System
TARGET	Trans-European Automated Real-time Gross Settlement Express Transfer System
UBM	Union des Banques Maghrébines
UDE	Equatorial Customs Union
UDEAC	Central Africa Customs and Economic Union
UMA	L'Union du Maghreb arabe (Arab Maghreb Union)
UMAC	Central African Monetary Union
UNDP	United Nations Development Program
UNO	United Nations Organization
US	United States
WAEMU	West African Economic and Monetary Union
WB	World Bank
WTO	World Trade Organization

FOREWORD

Most African countries have undertaken financial sector reforms within the broader context of stabilization and structural adjustment programs to assist in promoting private sector development, economic growth and poverty reduction. However, given the small scale for financial market development in most African countries, national and regional authorities as well as international institutions have also focused on regional integration to address the scale issue.

While trade and real sector integration have proceeded at a sustainable pace within various African regional economic communities (RECs), financial integration has progressed more slowly. The successful implementation of the first generation of domestic financial sector reforms, coupled with the more recent studies, has however encouraged national authorities and international institutions to focus on how to promote regional financial integration in respective RECs. The present study complements two World Bank publications *Making Finance Work for Africa* (Honohan and Beck, 2007) and *Financial Sector Integration in Two Regions of Sub-Saharan Africa* (World Bank 2007). It reviews the experience and status of regional financial integration in three sub-regions in Africa, namely, those covered by CEMAC, COMESA and UMA. This study also develops a comprehensive generic roadmap, with defined stages along the road to fully integrated financial systems, setting out appropriate policies and institutions for each stage. It uses this generic roadmap to review the status of financial integration in each of these sub-regions to propose how further progress could be achieved. It also includes an epilogue which analyzes the implications of the ongoing financial crisis on the sub-regions concerned. It also contains noteworthy observations on the appropriate role that Africa's development partners, including the African Development Bank Group, might play in advancing regional financial integration.

I am pleased to note that the study has been carried out in a highly participatory manner, involving the RECs, several Regional Member Countries (RMCs), as well as the World Bank and the International Monetary Fund. ADB appreciates the opportunity for this collaboration. For the Bank's part, recent institutional changes and the revision of relevant strategies have enhanced our readiness to support African countries in their efforts to strengthen financial sector development and integration consistent with the objectives of our Medium Term Strategy (2008-2013).

I believe that this publication is a useful contribution to the literature and knowledge in this area and deserves wide readership and reflection.

Donald Kaberuka
President
African Development Bank Group

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EXECUTIVE SUMMARY

1. Introduction

African countries have been strengthening and modernizing their financial systems as part of their domestic reform programs, recognizing that strong financial systems will deliver dividends in terms of growth and poverty reduction. However, despite these efforts, African financial systems lack depth and deliver only a limited range of products, at relatively high costs; with the result that the expected benefits have not materialized to the full. Recent studies by the World Bank and others have demonstrated a positive and significant relationship between financial sector development, economic growth and poverty reduction. They have also concluded that the disappointing outcome in Africa reflects, inter alia, the small scale of the operations of most African financial systems, and that this deficiency could be corrected through promoting regional financial integration (RFI).

RFI's contribution to growth comes through four different channels: (i) it provides further powerful stimulus for domestic financial reforms; (ii) it increases the scale of operations and competition, thereby increasing the system's efficiency and productivity; (iii) it induces foreign direct investment (FDI) inflows; and (iv) it enables the African systems to grow into regional and ultimately global players in financial markets. It is of course possible that some countries, especially the "fragile" states and countries with relatively less developed systems, could lose out in the initial stages of RFI. However, this eventuality can be avoided through appropriate compensatory policies as part of RFI strategy, leading to a win-win situation for all the member countries. These reasons alone provide a sufficient incentive for policymakers to pursue RFI seriously. And yet, they also have another reason to move faster with RFI – the present revival of interest in Africa in fostering free trade areas (FTAs), and the current negotiations on Economic Partnership Agreements (EPAs) between the EU and African countries, where the latter are grouped into specific regional groups for the purposes of negotiations.

It is against this backdrop that the Bank has undertaken this study reviewing the status of financial sector development and RFI in three regions¹ covered by regional economic communities (RECs): the Common Market for Eastern and Southern Africa (COMESA); the Arab Maghreb Union (UMA); and the Central African Economic and Monetary Community. The World Bank, for its part, has undertaken similar studies for two other regions: the East African Community (EAC) and the Economic Community of West African States (ECOWAS).² The objective of both organizations has been to identify the challenges and constraints of implementation, and to forge proposals on the best policy and institutional mechanisms for the way forward. The study also suggests instruments and procedures for support from development partners.

The present study has reviewed the experiences of regional financial integration in both the European Union (EU) and in Asia, and has drawn some lessons for Africa. One of the lessons learned is that trade integration and financial integration should not be considered as sequential

¹ In conformity with the terminology adopted in the World Bank (2007) report, we refer to the areas covered by the RECs as "regions" rather than "subregions". This also harmonizes with the term "regional financial integration" to cover these same areas.

² World Bank, *Financial Sector Integration in Two Regions of Sub-Saharan Africa*, January 2007.

processes, but must be promoted simultaneously. Furthermore, FDI inflows can accelerate financial integration, while capital market development can facilitate these inflows. Market forces alone cannot ensure that financial integration will occur at a pace, or in a form, that meets the requirements of increasing trade and investment flows while protecting the economies from becoming financially vulnerable. Thus African countries need to take a proactive approach toward financial sector development and integration.

What are the conditions that favor regional financial integration, that can spur FDI, and boost intraregional and global trade? Macroeconomic stability is a necessary precondition for promoting trade and financial integration across regions and across the global market. However, in order to achieve macroeconomic stability, it is essential to ensure the stability, predictability, and transparency of the financial system. At the same time, governments need to adopt a liberal policy toward FDI inflows, which will enable foreign enterprises to exploit the comparative advantages of countries in the region and to locate their production facilities accordingly. Intraregional trade is unlikely to increase significantly in the initial stages of regional trade liberalization if countries share similar production structures; nor will they attract investment if domestic and regional markets are too small to support profitable commercial enterprises. Rather, the emphasis needs to be on exploiting export markets outside the region. Having a formal free trade area (FTA) or customs union in place, which does away with tariff and non-tariff barriers, will further enhance the attractiveness of the region for FDI. This approach will also make the region a more conducive business environment for the relocation of production facilities, not only because it will safeguard demand for the producers, but because it will also encourage upgrading and building physical infrastructures that could reduce production costs. Such a development may also short-circuit the ASEAN route to increase intra-regional trade in intermediate products by inducing enterprises not only to subprocess their production across the region, but also to locate their final production process there.

Based on these considerations, this report develops a generic roadmap for RFI, describing the various stages, their characteristics, and policy and institutional requirements. In this, it follows the example of the well-known roadmap formulated for trade integration, which starts with a preferential trade area (PTA) and ends with an economic community, although it differs in important respects. The RFI roadmap similarly traces five (ascending) stages of RFI, beginning with the preparatory stage of information-sharing, moving on to institutional and other arrangements, and ending with a monetary union in which countries share a common currency and a common central bank, as well as unified supervisory institutions. The report spells out certain core measures that the members would need to take for the region to reach that particular stage of integration. For example, one core measure of the first stage is the introduction of appropriate payment systems, while a core measure of the second stage is compliance with the Basel Core Principles of bank supervision and regulations. The final (fifth) stage of integration, monetary union, would entail members yielding their sovereignty in matters of currency creation and monetary policy by exchanging their respective currencies for a common currency issued by a common central bank.

While the transition from one stage to the next at the lower levels of integration is mostly technical, achievement of the final stage demands a higher-order reform of institutional and regulatory processes, especially if accompanied by the establishment of an economic community. It would, for example, require the setting up of concrete institutional arrangements to facilitate the transition from national currencies, exchange rates and central banks to the

unified monetary system. It would also involve close attention to the supporting institutional framework, including the role of the “summit” leadership, rules-making and decisionmaking. For example, it would demand the establishment of technical committees to provide inputs to the decisionmakers for the consideration of various issues. All this would have to be backed by strong political commitment at the highest levels, a dedicated civil service that believes in regionalism, and acceptance by the civil society.

The present report reviews the structure of the financial system in each of the three regions. It does this by first analyzing the status of the financial sector infrastructure (comprising regulation supervision and financial reporting systems, legal frameworks, payments systems, and accounting systems), followed by an assessment of the stage of integration achieved by each region, as well as the state of preparedness for integration on the part of each member country.

The report confirms that, with exception of some individual countries, the overall size of the financial systems, as measured by the ratio M2/GDP, is small: the average being 47 percent for COMESA, 29 percent for the Maghreb (UMA), and only 15 percent for CEMAC. The depth of the system, as measured by the ratio of credit to the private sector/ GDP, is also shallow, with an average of 21 percent for COMESA, 32 percent for UMA, and 8 percent for CEMAC. Data from a recent IMF study suggest two critical levels for the ratio of private sector credit to GDP: (i) GDP growth is positively (almost linearly) influenced with growth in private sector credit until that ratio reaches a value of around 1.1, after which the correlation is weakened considerably, and (ii) the resilience and flexibility of the economy remain weak (output volatility high) until the private credit ratio reaches around 0.4. Viewed from both these criteria, the average financial depth in the three regions is below the critical levels, though some countries (Egypt, Mauritius and Tunisia) have ratios above those levels.

This report also highlights the predominance of banks in the financial systems of these three regions, although more recently, microfinance institutions (MFIs) have begun to show rapid growth. Non-bank financial institutions, such as insurance companies and pension funds, control only a small portion of financial resources. Stock exchanges have been established in 14 countries within the three regions, with COMESA accounting for 9 exchanges, UMA for 3, and CEMAC for 2. With the exception of a few exchanges (Egypt, Kenya, Mauritius, Zimbabwe, Morocco, and Tunisia), other markets are characterized by a relatively small number of listed companies, few market participants, low capitalization, and low trading volumes. However, more recently, some exchanges (for example, in Zambia), have shown signs of significant growth. This report assigns a large role to the development of stock exchanges in fostering RFI, and this trend needs to be encouraged.

2. Common Market for Eastern and Southern Africa (COMESA)

The three regions have approached RFI in different ways. COMESA has taken a gradual and variable-speed approach to integration. It was initially established as the Preferential Trade Area (PTA) for Eastern and Southern Africa. The PTA transformed into COMESA in 1994, and formed a partial free trade area (FTA) in October 2000. In the case of FTA, firm timetables were not negotiated in advance, rather members were free to join whenever they were ready to reciprocate the terms of the arrangement. Initially 11 out of 19 members participated in the FTA, and subsequently additional members have joined, increasing the membership to 13 by June 2007. The remaining six members of COMESA have reduced intraregional tariffs by 60 to 90

percent. COMESA intends to launch a customs union in 2009,³ having already put in place an extensive program of trade facilitation through harmonization.

COMESA's long-term objective is to create a single market in financial services in support of regional integration. In 2003, the Council of Ministers adopted a framework and an action plan for harmonizing bank supervision and regulation, emphasizing that all member states should adopt the Basel Core Principles (BCPs). The areas of harmonization included legal framework, licensing, accounting and disclosure standards, consolidated supervision, internal and external audits, and IT systems. In 2007, the Council adopted another report on *Effective Harmonization of Financial System Development and Stability*, which guides the current RFI efforts of the region. This report includes a number of recommendations within the context of a detailed Plan of Action.

Significant progress has been made in modernizing national financial systems, though the degree of reform has varied among countries. For the COMESA region as a whole, further measures need to be implemented to make the system compatible with international standards. Overall, the conclusion from this report is that financial integration is indeed taking place within COMESA, but the process still has a long way to go. The reason for this is twofold: (i) some countries have yet to achieve macroeconomic stability, which is an essential precondition for integration into a regional financial system, and (ii) the modernization and harmonization process between member countries is at different stages of implementation. Progress in achieving financial system soundness and development has been uneven across the COMESA membership. In those cases where the member state has benefited from a joint IMF/World Bank Financial Sector Assessment Program (FSAP), the country in question has been able to draw up detailed financial sector development plans, which have helped to strengthen and develop their financial systems (e.g. Egypt, Kenya, Madagascar, Mauritius, Rwanda, Uganda, and Zambia).

In terms of the generic roadmap referred to above, and subject to the caveats mentioned in the following chapters and the need for further discussions with officials in the region, COMESA member states fall into four distinct categories of readiness to enhance financial integration: (i) six countries (Burundi, Democratic Republic of the Congo, Eritrea, Libya, Seychelles, and Zimbabwe) have yet to meet the preconditions for entering into RFI; (ii) three countries (Comoros, Ethiopia, and Sudan) have fulfilled the preconditions and could move to Stage I of RFI; (iii) five countries (Djibouti, Madagascar, Malawi, Rwanda, and Swaziland) could move to the second stage of RFI, and (iv) five countries (Egypt, Kenya, Mauritius, Uganda, and Zambia) have taken sufficient measures to move to the third stage of RFI.

Based on this categorization, these five countries (Egypt, Kenya, Mauritius, Uganda, and Zambia), having fulfilled the requirements of COMESA FTA, could become the first “sub-regional” group to advance RFI by joining the COMESA customs union launched in June 2009. These countries would need to undertake the measures indicated under Stage III of the roadmap, which are also included in the COMESA Plan of Action for financial sector development. Simultaneously, these countries would also need to review whether there are any measures under the previous stages that they have not yet taken and which should be implemented. This group

³ The COMESA Customs Union (CU) was launched at the 13th Summit of the COMESA, which was held in Victoria Falls, Zimbabwe, in June 2009.

would then serve as the “beacon” for other countries and encourage them (including through technical assistance) to take the necessary measures to progressively integrate into that group.

The COMESA Action Plan details a number of measures and a timetable for their implementation that appears appropriate for the specified objectives of RFI. Nonetheless, the Action Plan could benefit from stronger prioritization, especially at country levels, and from more realistic timetables. For example, priority should be given to achieving and maintaining exchange rate stability, as this will encourage cross-border investment and development of securities market and products. Liberalizing intraregional exchange controls and strengthening the regulation and supervision of securities markets would also attract FDI into the region. COMESA should, though, move at a considered and appropriate pace and not be in a hurry to move to Basel II, since there are significant risks if this move is not well prepared. Experience has shown that in a sophisticated banking market, and even with a strong and well-resourced supervisor, it can take 4-5 years to introduce Basel II. At the current stage of development, the focus should be on ensuring that banks are on a sound footing and fully implementing the Basel Core Principles. The proposed categorization in this report of RFI into different stages, and the delineation of measures to be taken at each stage, could assist in this prioritization exercise. As an illustration, Table 3.12 in Chapter 3 indicates various components of the COMESA Action Plan that could be implemented during each stage of RFI by the member states.

3. The Arab Maghreb Union (UMA)

The Arab Maghreb Union (UMA), established by a Treaty in 1989 between the five countries of Algeria, Morocco, Tunisia, Mauritania and Libya, aimed at creating an economic union. Its objective was to progressively establish an FTA, harmonize customs duties and regulations, and create a Common Market. The Union also envisaged financial integration, based on: the harmonization of monetary and fiscal policies, financial and legal regulations, supervisory systems, and the monetary systems. These efforts were to be complemented by the creation of a common bank (Bank of Maghreb) for investments and trade. However, for various reasons described in Chapter 4, little progress was made under the Treaty, although unilateral financial sector reforms in individual countries, particularly in Morocco and Tunisia (including the introduction of international financial and accounting standards) resulted in some harmonization of regional financial systems.

Overall, there is not much depth in the financial sector of UMA, with the ratio of credit to the private sector varying from about 70 percent in Tunisia (this includes credit to state enterprises) and Morocco, to 20 percent in the other three countries. There is a substantial presence of foreign banks in the region, especially in Morocco. Conversely, Moroccan and Tunisian banks have expanded beyond their borders by establishing branches in the EU, while some Moroccan banks have a presence in other African countries. Specialized banks, insurance companies, and pension funds are quite well developed in Morocco and, to a lesser extent, in Tunisia.

The four components of the financial sector infrastructure are fairly well developed in the region.⁴ The overall soundness of the UMA banking system has improved considerably in recent years, with all five countries having undertaken comprehensive bank restructuring measures, and

⁴ These four components are: regulation supervision and financial reporting systems; legal frameworks; payment systems; and accounting systems.

having adopted international standards and principles. There is convergence among the five countries in terms of compliance with the Basel Core Principles. Although banking supervision can be rated as satisfactory overall, performance and enforcement in some cases is somewhat uneven. For example, the frequency of supervision is insufficient to ensure adequate oversight and offsite monitoring, and the sanctioning powers of supervisors need strengthening in Algeria, Libya, and Mauritania.

Currently, Algeria, Morocco, and Tunisia have implemented an RTGS (Real Time Gross Settlement) system; and Libya is in the process of introducing one in the near future. Algeria has introduced an automated clearing house for large volume payments, and similar systems are in place or underway in the other countries. Reforms have also been implemented to remove other deficiencies in the payment systems, such as poor integration between central and commercial banks and long settlement lags. These systems are in line with international standards and reduce settlement risks. However, most payments are still cash-based, and checks and credit cards are only developing at a slow rate in the region. There are still delays and large floats in the domestic payments systems, particularly in Algeria, Libya, and Mauritania. Thus, the payment system is an area that will require considerable resources to develop further in the UMA countries.

Good progress has also been made in some Maghreb countries since the 1990s to modernize the laws and regulations governing financial intermediation. However, some countries do not conform entirely to best practices and international standards, and in others further reforms may be needed. In particular, there is a need to: accelerate the speed of court proceedings relating to bankruptcy and foreclosures; reduce the high costs of enforcing decisions; and enhance the training of the judiciary in commercial matters.

Both Morocco and Tunisia require the application of International Financing Reporting Standards (IFRS) by enterprises and financial institutions, except that in Tunisia the requirement applies only to conglomerates. On the other hand, all five countries have a public credit registry, though the quality and accessibility of information could be improved. Morocco is planning to introduce a private credit bureau in 2009 by placing the credit information database under private management.

The importance of stock markets in promoting RFI has been emphasized in this report. In UMA, stock markets operate in Algeria, Morocco, and Tunisia. The Moroccan exchange is the largest, most active and dynamic, doubling its level of capitalization in the three-year period 2005-2007, and registering a 40 percent increase in the number of listed companies in the same period. The Tunisian exchange has also registered significant progress in these years. The rapid growth of the Moroccan and Tunisian markets sends a powerful signal that there is a strong demand for active capital markets in the region. According to the Moroccan authorities, after taking account of the potential exchange rate risk, there has been a convergence between the interest rates in securities in Morocco and Tunisia. Opening up the two markets would certainly encourage further capital integration. In this context, Morocco and Tunisia could electronically link the two exchanges to broaden the development of capital markets in UMA. There are, however, obstacles to this development because current capital controls inhibit residents from investing abroad, including in the Maghreb region.

Building on these developments, and with encouragement from the IMF, Maghreb authorities have reinvigorated their efforts to foster regional financial integration. The authorities are now

adopting a new approach, which is being implemented under three broad headings: financial sector; trade and commerce; and the private sector. Following the Morocco meeting on Financial Sector Integration in 2006, experts from the five countries met under the chairmanship of Morocco, the lead country in this area, and developed an *Action Plan for Reforms of the Maghreb Financial Sector* (see Appendix 4.1) to be implemented by all the member countries. The Action Plan has five main components: (i) financing of external trade and investment in the Maghreb; (ii) harmonization of the payment systems and technical platforms; (iii) harmonization of banking and financial supervision regulations; (iv) strengthening cooperation and coordination between institutions and operators of the banking and financial sectors; and (v) opening up a window of information on regulations and information in the financial sector, trade and commerce.

For each of these five components, a lead country has been designated to promote regional integration. Thus, Algeria is the lead country for trade and commerce, Morocco for the financial sector, and Tunisia for the private sector. Annual conferences taking each of these components as their themes, were held in Algeria (November 2005), Morocco (December 2006), and Tunisia (November 2007). A fourth meeting on the theme of “Regional Integration and Joint Ventures” was held in Libya in November 2008. The authorities are cognizant of the mutual interdependence of the three areas identified for integration, and will strive to seek parallel development in each.

The overall Action Plan is comprehensive enough and takes into account practically all the steps needed to further financial integration. In keeping its aims modest, the Plan is perhaps more realistic than the original objectives of the UMA Treaty. It is also clear in terms of leadership in each area. Thus the Action Plan, developed by the lead country (Morocco) and approved by the five countries, is more achievable, provided that the designated lead country demonstrates appropriate leadership, and provided effective evaluation and monitoring mechanisms are put in place.

Despite its many merits, the financial sector Action Plan lacks prioritization among its components and does not prescribe clear benchmarks for achievement and timelines for the objectives to be realized. In that sense, the Plan lacks a sense of urgency, especially as the globalization process elsewhere is proceeding at a rapid pace. The Maghreb countries, if they attain a higher level of financial integration, could become an attractive destination for European and other FDI, and for manufacturing relocation. Furthermore, as the Action Plan has mainly to be implemented at the country level, it is important that the authorities simultaneously develop national action plans consistent with the regional plan in terms of the objectives and timelines.

The generic RFI roadmap proposed in this report could be useful tool to help sharpen the UMA Action Plan. In Chapter 4, three countries (Algeria, Libya, and Mauritania) are classified as ready to undertake measures appropriate to Stage II of the roadmap, while Morocco and Tunisia could move on to Stage III. The roadmap could also be used, following the illustrated example for the COMESA Plan, to prioritize measures under the authorities’ Action Plan. Some indications of those priorities are given in the relevant section of Chapter 4.

4. Economic and Monetary Community for Central Africa (CEMAC)

CEMAC's journey on the roadmap has been to take a leap straight to Stage V, by adopting a common currency and a common central bank, which is a modified and expanded arrangement from its colonial days. Its ultimate objective is the creation of a Common Market. It has a comprehensive structural and institutional framework, and a series of policies and measures have been put in place to promote regional economic and financial integration among its member states. However, the financial system of CEMAC is still relatively underdeveloped, insufficiently diversified, and largely dominated by the banking sector, which holds over 85 percent of the financial assets and liabilities. The non-bank financial sector is very small and operates almost exclusively at a national level. The banking system is also unevenly distributed among member states, with nearly one-third of banks located in Cameroon, and another half in three other countries. It is also dominated by foreign banks, which control two-thirds of bank assets. Only a few financial conglomerates and groups handle the bulk of region's financial transactions.

A review of the workings of the main components of the financial infrastructure in the CEMAC region reveals some gaps and deficiencies. The regulation and supervision of the financial system is assigned to the common Banking Commission of Central Africa (COBAC), with the Governor of the central bank, BEAC, as its President. Its mandate has been expanding to cover other areas, including the supervision of NBFIs (including MFIs and excluding the insurance companies). In the past, the efficiency of supervision has suffered from several constraints: namely, the limited independence of the COBAC; some divergence of prudential norms from international standards; poor enforcement of regulations; and inadequate resources. To address these limitations, COBAC has recently recruited additional staff members and has implemented reforms to reinforce its effectiveness and independence.

The payments system to be put in place is still not completed, but significant progress has been made in this area. The SYGMA component is operational throughout CEMAC (since November 2007), while the CIP⁵ component has been shelved since December 2006. An internal select committee was established by the Governor of the BEAC in January 2009 to consider the relaunching of this component. In the case of the legal system, CEMAC countries have signed the OHADA Treaty and legal issues relating to credit are governed by a uniform regional legislation. CEMAC's information system is functioning well. The system relies on the *Centrale des risques*, which is prepared by the central bank for each country, and the information is published in the *Centrale des risques* in electronic format.

A relatively successful regional institution is the regional development bank, BDEAC, which has provided substantial infrastructure and other loans across the regional membership. Under its medium-term (2008-2012) strategic plan, it aims to become a major market player in the region's financial markets.

CEMAC faces a serious policy dilemma in managing excess liquidity. This is because five out of its six member countries are oil-producing countries, and oil revenues have produced large fiscal deposits that the governments have not always deposited with the central bank (although there is now a movement toward a single Treasury account, to be held with the central bank).

⁵ CIP =Payment Default Center.

In 2007, the Summit of the Heads of State approved a series of reforms which, if implemented effectively, should help to boost regional integration (including RFI). But these reforms need to be properly prioritized, furthermore the capacity of implementing institutions such as the COBAC and BEAC needs to be reinforced and their independence properly guaranteed. Moreover, an effective and mandatory system of monitoring and evaluation should be installed within the Secretariat, together with international technical assistance. The support of development partners would be beneficial and could cover three main categories: (i) coordination of regional and national strategies, (ii) technical assistance and capacity building at both national and regional levels, and (iii) financing of regional financial infrastructures.

5. Conclusions and Recommendations

This report's overall assessment is that progress in RFI in the three regions has been slow and needs to be accelerated through a more proactive policy stance. The reasons for this slow progress are many and vary across regions and across countries. Some common obstacles to RFI include: divergent initial macroeconomic situations and an uneven level of bank soundness across member countries; a lack of political commitment to RFI; a lack of adequate (human and financial) capacities; overambitious and ill-defined objectives and timeframes; weak regional institutions charged with managing the integration process; lack of coordination between national and regional strategies; and conflicting regional obligations due to multi-organization membership of some countries.

While some progress has been made in overcoming these obstacles, other constraints and shortcomings continue to hinder the regionalization process, including: lack of prioritization in action plans; lack of realistic timetables for their achievement; inadequate preparation of consistent national action plans; and capacity shortages. Policymakers need to bear in mind that RFI is a long process that needs careful calibration of policy and institutional actions, a dedicated leadership, and coordinated national implementation. The development partners could help regional organizations to overcome these and other obstacles through appropriate technical and financial assistance.

Donors could help advance RFI by providing assistance in three broad areas: RFI strategy framework, financial infrastructure, and financial institutions and policies. For the Bank, financial integration is an important part of overall regional integration, which is an objective of its Medium Term Strategy 2008-2012. The Bank's interventions in RFI should be guided by its Financial Sector Policy, approved in 2003, and by its new Regional Integration Strategy, approved in 2009. The AfDB must also take into account that it is a relative newcomer to this field and that other institutions, such as the International Monetary Fund (IMF), the World Bank, and the Bank for International Settlements (BIS) have longer experience in this area. Given the Bank's experience, expertise, and reach, it could add value in areas of financial sector infrastructure, governance (including capacity building, institutional establishment, and financial standards), and regionalization strategy frameworks. Possible areas of intervention would be to help prioritize measures under the regional action plans, assisting regional member countries (RMCs) in the development of their RFI strategies, providing technical support to regional secretariats in the monitoring and evaluation of developments in RFI, assisting in capacity building, and conducting training and ad hoc workshops.

6. Impact of the Financial Crisis on the RFI Process

The current global economic crisis has seriously affected African economies, especially through its impact on export earnings, fiscal balances, remittances and access to foreign capital. However, the initial global financial crisis had a limited impact on financial sector in Africa compared to those of the United States and Europe. Indeed, the limited financial integration of African economies shielded the African financial system from collapsing, as no banks or other non-bank financial institutions verged on bankruptcy. This may tempt some to advocate a slowing, if not total abandonment, of regional financial integration. However, this would be a gross mistake. Such an insular approach would deprive the countries of economies of scale, and other advantages elucidated in this report. African governments should rather accelerate their efforts to foster RFI. Regional integration is critically important for the continent's ability to withstand future shocks and facilitate integration into the global economy, notably through market expansion, economies of scale, and improved competitiveness. The present crisis, in fact, points to the need for accelerating financial integration initiatives to move more quickly on the roadmap to fuller integration of the financial systems.

1. INTRODUCTION

The financial systems in most African countries lack depth; they serve only a small proportion of the growing population and provide a limited number of services at relatively high cost. This situation has persisted despite the fact that over the past decade, these countries have implemented financial sector reforms as part of their overall macroeconomic policy reform agenda. Research has increasingly indicated a causal connection between financial sector development on the one hand and economic growth and poverty reduction on the other.⁶ There is also a general consensus that the causes for the continued underdevelopment of African financial systems must be addressed in order to realize their potential contribution to sustainable growth and poverty reduction. Recent studies on this issue include the two reports by the World Bank: *Making Finance Work for Africa* (2007),⁷ and *Financial Sector Integration in Two Regions of Sub-Saharan Africa* (2007).⁸ Their overarching message is that regional financial integration (RFI), by creating economies of scale and competition among financial institutions, is a principal way to achieve those objectives.

Underdeveloped financial markets are regarded as one of the “soft” constraints to regional integration. The Bank is mandated to promote regional integration in Africa, which is a central pillar of its Medium Term Strategy 2008-2012; another is to promote financial sector development in its regional member countries (RMCs). To this end, the Bank is exploring how, with the support of its development partners, it might assist its member countries’ efforts to promote RFI and strengthen their financial sectors. A first step in that direction is to take stock of the present status of national financial systems and of RFI implementation plans of member countries. The World Bank has already conducted such studies for two of the regions in Sub-Saharan Africa, namely the East African Community (EAC) and the Economic Community of West African States (ECOWAS). The present study focuses on three other regions; namely the Common Market for Eastern and Southern Africa (COMESA), the Arab Maghreb Union (UMA), and the Economic and Monetary Community for Central Africa (CEMAC).

This reports takes as axiomatic the two principles underpinning the aforementioned World Bank reports, namely that (i) financial sector development promotes economic growth and poverty reduction, and (ii) regional financial integration will strengthen financial system development.⁹ The analysis, conclusions, and recommendations presented in this report are the result of intensive fieldwork and discussions by a team comprising Bank staff and consultants, with government officials, representatives of the regional bodies and financial institutions in the respective member countries of the three regional economic communities (RECs). The team’s scope of work, as defined in its terms of reference, was as follows:

- i. List and map (including overlaps) regional monetary and financial arrangements in Africa and describe their governing contracts and strategies;

⁶ Ross Levine (2005) “Finance and Growth: Theory and Evidence,” in P. Aghion and S. Durlauf (eds), *Handbook of Economic Growth*, vol. 1, chapter 12, Elsevier.

⁷ Patrick Honohan and Thorsten Beck, (2007), in *Making Finance Work for Africa*, World Bank.

⁸ World Bank (2007), *Financial Sector Integration in Two Regions of Sub-Saharan Africa*, January.

⁹ The rationale for these axioms is well discussed in the World Bank studies (2007)

- ii. Identify the specific regional financial sector integration programs, in particular those that would support trade and private sector development (for example, payment systems, cross-border provision of financial services, regional financial and capital markets, access to credit information, and cooperation in financial institutions supervision);
- iii. Review progress in the implementation of the identified regional financial sector integration programs and identify the challenges and constraints of implementation;
- iv. Make proposals on policy and institutional mechanisms for the way forward;
- v. Suggest instruments and procedures for support that the development partners could lend to the programs.¹⁰

After this introductory first chapter, Chapter 2 briefly describes the role of the financial sector in promoting growth and reducing poverty. It suggests additional reasons and incentives for policymakers to take a proactive stance in promoting RFI. The chapter then delineates a generic roadmap for RFI that includes five (ascending) stages of integration and required policy actions and institutions for each stage. The transition mimics that of real sector integration, whereby the latter proceeds in ascending stages from Preferential Trade Area (PTA) to Free Trade Area (FTA) to Customs Union (CU) and to Economic Community (EC), each with its own characteristics.

An essential precondition for embarking on the RFI roadmap is that the countries should have achieved macroeconomic stability and bank soundness. Chapter 2 includes some discussion about the costs and benefits of RFI, particularly as they impact on fragile states and countries with relatively less developed financial systems. The chapter concludes that, while the costs of trade integration are upfront and benefits are late in coming, in the case of RFI, the benefits generally precede the costs; consequently RFI reform is less likely to meet with social resistance than efforts to liberalize trade. Nonetheless, fragile and less developed members of the group may need compensatory measures initially to offset some of the perceived starting costs.¹¹

Chapters 3-5 provide a description of the financial sector and the programs of financial integration in each of the three regions. An assessment is made as to (i) the stage of integration currently reached by each region in relation to the roadmap delineated in the first chapter, as well as (ii) the preparedness of each member country as compared to the requirements of each stage of integration. As is to be expected, the three regions are seen to be at different stages of RFI; which is also the case for the preparedness of individual member states. This analysis of the status of each region and member state in relation to the RFI roadmap is followed by some practical proposals setting out the sequence of measures to be followed by each region and member state in order to implement their action plans. Given the wide disparity in the initial

¹⁰ These would include assistance to governments and regional organizations in the following areas: (i) *policy dialogue* – to understand the dimensions of their problems and share with them lessons learned in other countries that faced similar problems; (ii) *strategic advice* – to develop strategy, policies and institutional arrangements for promoting financial stability; (iii) *expertise mobilization* – bringing in outside experts and firms that can immediately offer practical advice and support in dealing with urgent priorities, and (iv) *capacity building* – to effectively address their immediate problems while strengthening their capacity to prevent future problems.

¹¹ As an example, in the first East African Community established in the 1960s, the arrangement included the establishment of the East African Development Bank, which was mandated to invest 40 percent of its annual loans in Tanzania and Uganda each, and only 20 percent in Kenya.

prevailing conditions among members in some regions, a “variable geometry” approach to RFI is suggested.¹²

Chapter 6 draws broad conclusions from the three regional studies, listing similarities and differences among them. It also delineates potential areas for intervention by key development partners.

As the study was finalized before the full impact of the global financial crisis had been fully felt, an Epilogue has been added to cover the most recent developments. This analyzes the impact of the current global crisis on Africa, including its ramifications for regional financial integration in the three regions, and suggests a harmonized approach for scaling up financial sector integration and macroeconomic stability across the continent."

¹² The idea of “variable geometry” is that each member need not subscribe to every policy of the regional organization simultaneously, but that a degree of flexibility be retained to allow for the individual conditions and varying development stages of member states.

2. REGIONAL FINANCIAL INTEGRATION: A GENERIC ROADMAP

2.1 Introduction

As a part of their overall stabilization and structural reform programs, many African countries have sought to implement reforms of their financial and monetary systems. These generally aim to liberalize and open up the financial services sector and thereby increase foreign and domestic investment; improve the robustness and depth of the banking sector; expand access to credit (particularly for SMEs); and improve the overall effectiveness of monetary policy. Within this context, regional monetary and financial integration is generally considered an important component of domestic financial sector reforms. Consequently, monetary and financial integration programs and arrangements are being introduced in many African countries at the continental and regional economic community (REC) levels. The motivation behind these reforms has been the widely shared conviction that strong financial systems help to scale up productive growth, and to create direct and indirect benefits across the income distribution chain.¹³

As a result of such efforts, indicators of financial development have steadily improved for most African countries over the past decade, while financial systems have been strengthened. Nonetheless, economic growth in Africa over the same period has remained below expectations, and the performance of financial sectors still falls well short of their potential.

Although financial integration in Africa has been progressing both as a result of market pressures and government initiatives, the two forces often react at different speeds and with little coordination. Consequently, policy-level financial integration initiatives are being realized at different speeds in the different regions covered by their respective organizations (RECs).¹⁴ RFI is led mostly by foreign and transnational banks and insurance companies that have entered African markets; these tend to follow liberalization moves as part of domestic financial reforms. Often these foreign enterprises enter the domestic market by purchasing or establishing local subsidiaries and they position themselves as regional institutions.

Financial regulators in Africa are making a number of moves: beginning to implement harmonized regulations and financial reporting systems for banks and insurance companies; fostering information-sharing agreements; organizing cross-border participation in supervision; and introducing in some instances single-license regimes for financial services firms. However, “progress in developing policies which support financial sector integration is very patchy overall, and even within some regions (such as ECOWAS and SADC) progress with the implementation of policies is at the very [best] mixed.”¹⁵

The continued shallowness of the financial sector and limited access to credit, both in terms of amounts extended and percentage of population served, have led policymakers and economists to examine whether “a low degree of financial depth, efficiency, and access [is] simply a question

¹³ Honohan and Beck, *op. cit.*

¹⁴ *Ibid.*

¹⁵ *Ibid.*, p. 12. African attempts at integration have tended to follow the process of “regionalism,” whereby countries have entered into formal arrangements by setting up regional organizations.

of economic development, or can other factors explain Africa's lower score?"¹⁶ The general consensus identifies two main causal factors: (i) the small size of the financial system of most African countries, which prevents them from exploiting scale economies that accrue from bigger financial institutions, and (ii) the small number of financial intermediaries, which limits competition and reduces the efficiency¹⁷ of those institutions. As the World Bank report (2007) points out, financial services in small systems tend to be more limited in scope, more expensive, of poor quality, and lacking in appropriate components of financial infrastructure. The report's authors, Honohan and Beck, also point out the relevance of the ownership of financial institutions, as it relates to public vs. private ownership, and the relationship between these institutions and major borrowers of credit.

To make finance work for Africa, Honohan and Beck propose a comprehensive set of policies and measures to improve the banking system's ability to intermediate funds, and to develop non-banking financial institutions (NBFIs) as providers of long-term finance. Primary emphasis is placed on domestic policies and institutions, such as improving information and contract enforcement (effective legal system), upgrading prudential regulation systems, improving and ensuring banks' soundness, improving governance arrangements, and fostering pension funds, housing finance, and securities markets. While endorsing these recommendations, the present report acknowledges the role of RFI in promoting financial sector development, with the attendant benefits in terms of economic growth and poverty reduction.

2.2 Incentives toward Regional Financial Integration

Financial integration implies an increase in capital flows, and a tendency for the prices and returns on traded financial assets in member states of the integrated region to equalize on a common denominator basis.¹⁸ In that sense, integration is a complex process that stretches from initial collaboration and cooperation through to unified financial markets and services. As we have already seen, effective financial integration cannot take place in isolation of domestic macroeconomic stability and financial sector reforms. Integration efforts are pursued in various forms and stages across a whole spectrum of the financial sector, comprising *financial policies* (financing of the public sector, trade, and investment policies), *financial infrastructure* (regulation, supervision and financial reporting standards; payment and settlement systems; legal frameworks; and counterparty /credit information), and *financial institutions* (banks and NBFIs such as pension and insurance organizations, credit and capital markets).

The above-mentioned World Bank publications place specific emphasis on fostering regional collaboration, suggesting that any initiative in that area must answer three key questions:

- Will it reduce transaction costs?
- Will it increase effectiveness and confidence by increasing the independence of regional institutions?

¹⁶ Honohan and Beck, *op. cit.*, p. 25.

¹⁷ Cf. David Hauner & Shanaka Peiris (2005), *Bank Efficiency and Competition in Low Income Countries: The Case of Uganda* (IMF WP/05/240). The authors found that following privatization of UCB, the level of competition increased significantly and has been associated with a rise in banking efficiency. However, smaller banks seem to have recently fallen back in efficiency relative to larger banks.

¹⁸ Asian Development Bank (2005), *Asian Economic Cooperation and Integration*.

- Which countries should be included?

At the regional level, the general consensus is that RFI reduces transaction costs and increases the effectiveness of financial institutions. RFI could benefit countries in four different ways: (i) it provides further powerful incentive for domestic financial reforms; (ii) it increases the scale of operations and competition and, hence, the efficiency of the financial system; (iii) it induces FDI inflows; and (iv) it enables local financial institutions to grow into regional, continental, and eventually even global players in financial markets.

A major new circumstance favoring RFI is the renewed, and credible, efforts toward fostering free trade areas (FTAs) among groups of African countries. Almost everywhere, in developed as well as developing world, countries are entering into regional trade arrangements, and individual countries do not wish to be excluded from those arrangements and the economic growth that they seek to create. The New Partnership for Africa's Development (NEPAD) is actively encouraging RECs to promote FTAs. As a consequence, there have been measures adopted such as the reduction/removal of intraregional tariffs, infrastructure development, etc. to make FTAs effective. Increased intraregional trade requires a higher level of financing and increased access to financial services and products, which may be more efficiently provided by regional institutions, services, and products. A further stimulus is provided by the current negotiations between Africa and the EU for concluding Economic Partnership Agreements (EPAs). Unlike in the past, the EU is conducting these negotiations on a regional basis (West Africa, Central Africa, Eastern and Southern Africa, and SADC), which should further encourage RFI efforts in these areas. The expected progress in the implementation of FTAs and other trade liberalization measures will also increase the demand for financial services and may, thus, induce a demand-led RFI within the regions.¹⁹ According to the received wisdom, in the private financial sector, banks and NBFIs will follow their clients and spread their activities regionally.

As the State gradually recedes from direct engagement in productive activities, development activities are being increasingly entrusted to the private sector. Private sector development is influenced by the business climate, which in turn is closely related to the maturity and depth of the financial system. There are various types of risks that influence the business environment and doing business in the private sector. A commonly used measure of risk is the Business Environment Risk Index (BERI), which is shown to have a strong correlation with private investment in Africa.²⁰ The index includes various risk factors, including "financial ethics" measures, security of property rights, and strength of institutions (including financial), which are all relevant for private investment. Thus the quality and scale of the financial sector are important to any development strategy aimed at improving economic growth via private sector development. Empirical studies, cited by the World Bank report (2007), have also demonstrated that both financial intermediation and the market play a key role in economic growth, and that financial systems do not merely respond to economic growth but also have a causal effect in

¹⁹ Some have argued that the size of the financial sector is limited by the size of demand, which itself is subject to economy of scale technology. In this case, financial liberalization (and presumable RFI) would fail to bring about development of the financial sector. This view regards improvement in the demand side of financial services as a precondition for improvement on the supply side. Although this report does not subscribe to this viewpoint, it does emphasize the importance of intraregional free trade and services flows to increase the demand for financial services. In addition, as mentioned later in this report, there exists a substantial amount of unmet demand from SMEs and the "missing middle" that needs to be matched by an increased supply of financial services.

²⁰ Vijaya Ramachandran, (2000) *Investing in Africa*, Overseas Development Council.

stimulating economic and productivity growth. They do this by producing relevant information for the market at reduced costs, by monitoring firms, exerting good corporate governance, diversifying and mitigating SSA investors' risk over time,²¹ mobilizing and pooling savings, and by facilitating the exchange of goods and services.²²

According to a World Bank survey,²³ African entrepreneurs consider access to and cost of credit as major constraints on the operation and growth of their firms. African firms finance about two-thirds of their investment needs with internal funds, which is a higher proportion than in Asia and Latin America. To put it another way, they finance less investment with equity funds or with trade finance than do firms in other parts of the world. Micro and small enterprises (MSMEs) in Africa are less likely to use formal external financing arrangements than the larger firms. A substantial number of MSMEs are denied full or partial credit; or they may simply not apply for it, because they feel their requests would be denied, often because of a lack of collateral. In addition, the same World Bank survey highlights the phenomenon of the “missing middle” firms that are not large enough to qualify for formal credit services, but not small enough to benefit from the services offered by microfinance institutions (MFIs). The largely unmet demand for credit deprives economies of untapped growth that could be realized if appropriate financial services were available. Modernizing and encouraging the establishment of appropriate financial intermediaries, together with the issuance of appropriate collateral criteria, could thus contribute significantly to growth and poverty reduction.²⁴

The private sector looks to scale economies and, therefore, cross-border activities as essential prerequisites for profitable investment. For this purpose, they need to access cross-border financial resources and services, including an efficient payments system, to carry out their activities profitably. Private sector development in Africa is intrinsically linked to FDI inflows from abroad – and regional financial institutions, with their larger reach and efficiency, are vital in attracting and channeling such inflows. Harmonizing “soft financial infrastructure” within a region will also enhance the funding base for intraregional flows of savings and investment by offering a larger market for financial investments. Moreover, increased trade under FTAs in Africa presupposes the development of physical infrastructure. This could be financed through the floating of infrastructure regional bonds and the formation of intraregional private-public partnerships (PPPs), which could be facilitated if RFI were well developed. RFI might also represent the more assured, domestically generated route to Africa's integration into the global economy, whereby large regional financial institutions would participate on an equal footing with other global institutions in providing financial services to their citizens.

For African countries, regional financial integration – and ultimately continent-wide integration – would also preserve a viable indigenous financial system. The continent has already opened its markets to the entry of foreign banking and financial institutions. Domestic banks, if they remain isolated and operate only in their domicile countries, are unlikely to survive the heightened competition that foreign entrant banks will introduce. Thus, there is a stark choice: domestic

²¹ For example, portfolio equity flows play a crucial role in broadening economic activity and sharing risk; cf. Ramachandran, *op. cit.*, p. 31.

²² World Bank (2007), *op. cit.*, pp. 4-5.

²³ World Bank (2008), “Finance for All? Policy and Pitfalls in Expanding Access,” A World Bank Policy Research Report, The World Bank, Washington, DC.

²⁴ This paragraph summarizes the findings reported by Honohan and Beck, *op. cit.*, pp. 61-65.

African banks must either increase the scale of their operations and their competitiveness through regional integration, accompanied by other measures to modernize their systems, or face extinction or absorption by foreign institutions.

2.3 The EU and ASEAN Experiences – Lessons for Africa

When analyzing the optimal path to regional integration, economists have generally focused on the experience of the European Union (EU). The usual path has been to start with some form of regional trade agreement (RTA), moving to a customs union, introducing elements of a common market, and only then moving from financial collaboration to financial integration. The EU experience would suggest, as the World Bank report (2007) notes, that regionalization is a slow and difficult process, and can evolve at different speeds for different sectors. However, the EU experience also suggests that the initial impulse toward regional integration (in that case, emanating from the coal and steel industries) was more policy-driven than market-driven.

For African policymakers, it may be more relevant and more instructive to look toward the Asian experience rather than that of the EU. While the Asian experience confirms that of the EU, namely that the integration process is slow and difficult, its initial impulse to integration and the sequencing process were very different. The East Asian region, which has proved the most successful in fostering regional integration, has experienced market-driven, rather than policy-driven, integration. This has been effected through trade and FDI flows that followed unilateral domestic liberalization measures. These were accompanied by multilateral (as opposed to regional) import liberalization, as a result of the lowering of tariff and non-tariff barriers during the decade of 1980s. As a result, East Asia experienced substantial inflows of FDI, initially from Japan but later from the USA and the EU. FDI inflows emanated mainly from the international business of multinational corporations (MNCs).

Japanese MNCs were actively engaged in vertical, intra-industry trade in East Asia between their home partners and foreign affiliates, or between their foreign affiliates. These MNCs formed supply chains and production networks in East Asia, based on each country's comparative advantage.²⁵ As Mr. Basu²⁶ noted, the initial pattern of specialization varied across the East Asian countries: Japan specialized in the manufacture of human capital and technological-intensive manufactured goods; the newly industrializing economies (NIEs) produced unskilled labor-intensive manufactures; and the poorer ASEAN countries specialized in producing natural resource-intensive products. Later, as ASEAN countries developed their human capital and technological capacities and Japan became a relatively costly end-product assembly country, MNCs moved that stage of production also to ASEAN countries, depending upon their comparative advantage in various products, thus paving the way to greater intraregional trade. As long as these final products were essentially for export out of the manufacturing country, intraregional trade could continue to flourish without the need to lower intraregional tariffs. However, as the regional demand for those products and other domestically produced finished products increased, the authorities realized the need for lowering intraregional tariff and non-

²⁵ This paragraph is based on an article by Masahiro Kawai (2005), "Trade and Investment Integration and Cooperation in East Asia: Empirical Evidence and Issues," in *Asian Economic Cooperation and Integration: Progress, Prospects, and Challenges*. Manila: Asian Development Bank.

²⁶ A. Basu (2008) "*The Challenges of Regional Integration in Africa and Policy Options*", Background Paper, Africa Emerging Markets Forum.

tariff trade barriers. Thus was launched the PTA in 1992 that graduated to an FTA and the customs union in later years. However, even then there were few, if any, policy-driven moves toward RFI.

It was only in the aftermath of the financial crisis of the mid-1990s that the authorities realized the importance of regional financial sector cooperation. This led to the launching of several initiatives, including: the Chiang-Mai Initiative (pooling of part of external reserves); the establishment of the Asian Bond Market; formal regional surveillance; and the Asian Cooperative Dialogue (ACD) mechanisms. Currently, steps are underway to link other countries of Asia to ASEAN, and a lively debate is taking place in academic and policy corridors on whether, and how quickly, Asia should proceed to accomplish monetary union in the context of a common market and Asian Community.²⁷

To summarize the principal lesson from the Asian experience: substantial trade integration can take place without explicit, policy-driven efforts at financial integration. However, this can only happen if the countries achieve and maintain macroeconomic stability, introduce a modicum of financial sector reforms that ensure relative soundness of the system, liberalize their investment regimes to encourage foreign investment, liberalize intraregional trade regimes allowing free flow of goods, and adopt an export-oriented policy framework. However, in the absence of a proactive policy stance, relying on market forces alone to drive RFI may also expose countries, as the ASEAN experience suggests, to increased financial vulnerability.

Taken together, the EU and Asian experiences provide some valuable lessons that need to be borne in mind when seeking to delineate a roadmap for financial integration in Africa. Trade integration and financial integration should not be considered as sequential but rather as processes that must be encouraged simultaneously. Furthermore, FDI inflows can accelerate financial integration, and capital market development may facilitate FDI inflows. Market forces alone cannot ensure that financial integration will occur at a pace, or in a form, that meets the requirements of increasing trade and investment flows while protecting the economies from becoming financially vulnerable. Thus African countries need to take a proactive stance toward promoting financial sector development and integration.

What steps need to be taken in the African context to create a secure foundation for RFI? Macroeconomic stability is a necessary precondition for promoting trade and financial integration across regions and across the global market. Financial sector stability, together with transparency of the financial system, are essential elements of macroeconomic stability. Simultaneously, countries need to adopt a liberal policy toward FDI inflows to encourage foreign enterprises to exploit the comparative advantages of countries in the region, and to locate their production facilities accordingly. Intraregional trade is unlikely to show a significant increase in the initial stages of regional trade liberalization if countries exhibit similar production structures. Another constraint to intraregional trade occurs where domestic and regional markets are too small to support profitable commercial enterprise; the emphasis in these cases will be to exploit export markets outside the region.

²⁷ Thurman Shanmugaratnam (2006), *Asian Monetary Integration: Will It Ever Happen?* Bern, Switzerland: Per Jacobsson Foundation.

Another development that will encourage FDI inflows is for countries to establish a formal FTA, or customs union, that does away with tariff and non-tariff barriers. This will increase the attractiveness of the region, not only because it will provide a safety margin of demand for the producers, but also because it will encourage the upgrading and building of physical infrastructure, which could reduce production costs. Such a development may also short-circuit the ASEAN route to increased intraregional trade in intermediate products by inducing enterprises not only to subprocess their production across the region but also to locate the final production process there.

2.4 Stages of the RFI Generic Roadmap

Regional financial integration is the culmination of a long process that begins with gradually increasing information sharing, extending this to cooperation (or collaboration) and harmonization, which ultimately can lead to unification across the entire spectrum of financial policies, financial infrastructure, and financial institutions. However, unlike the trade integration process, which can be defined and described in precise and progressive stages of integration – i.e. Preferential Trading Arrangement (PTA), Free Trade Areas (FTAs), Customs Union (CU), and Common Market (CM) – the stages of RFI are not open to such clear-cut categorization. Nonetheless, some categorization is necessary to evaluate the measures that countries need to take to reach a particular stage. Just as trade integration stages have defined characteristics and requirements, so too do RFI stages.

In the following paragraphs a generic roadmap is sketched out, with five (ascending) stages of integration.²⁸ The roadmap, in the present African context, envisages appropriate linkages between integration in the real sector (trade and investment) and integration in the financial sector. Thus the process along the five stages of RFI is linked with the process in fostering trade and services integration along the sequential FTA–Customs Union–Economic Community route. Conceptually, each stage is a stepping step to the next, and their formal classification serves to indicate policies and institutions that the member states of that group need to establish at the national and regional levels in order to progress further along the path. In practice, of course, such a rigid stratification of policy and institutional establishment may not be entirely feasible. Consequently, some policies and institutions may be implemented at an earlier or a later stage, while not departing from the implementation timetable of the core policies and institutions. It is hoped that such a roadmap will help policymakers to focus on the needed actions at national and regional levels to enhance RFI, which should enable their development partners to calibrate their assistance accordingly.

The roadmap, described fully in Table 2.1 below, adopts a policy-driven, as opposed to a market-driven approach. It is worth recalling here the finding of the World Bank report (2007), as noted in the introductory part of this chapter, that *for RFI to progress satisfactorily, both market-driven and policy-driven integration need to be coordinated*, and that in the past the latter has tended to

²⁸ These Stages should be distinguished from the “degrees” of RFI. Kawai and Motonishi (2005) use three aggregate measures for financial integration: *price-based measures* (interest rate parity, P/E ratios in securities markets), *quantity-based measures* (savings and investment correlations, current account dynamics, trade and investment flows), and *regulatory and investment-based measures* (financial infrastructure, exchange controls). Integration between countries may also be assessed on the basis of the “economic distance” between them in terms of, for example, inflation differentials, fiscal deficit differentials, the relative degree of financial sector depth, etc.

lag behind and made only a patchy progress. This finding explains the policy-driven approach of the roadmap. The roadmap, however, also aims at providing an appropriate environment for market-driven RFI to progress in tandem.

So what are the five stages that countries need to achieve in order to forge integration of their domestic financial systems into a regional one?

Stage I – Preparatory Stage First, countries need to fulfill certain preconditions relating to establishing macroeconomic stability and bank soundness. In the preparatory stage, the main responsibility falls on domestic policymakers to modernize domestic financial systems, especially the payments systems. At the same time, countries should enter into a formal agreement to gradually establish FTA covering the region. Substantial exchanges of information and other forms of interaction between the countries would be needed to make them aware of the reforms being undertaken in partner countries.

Stage II – Harmonization Stage At this stage, modernization of the financial sector in individual countries would be further extended by the introduction of and compliance with various international standards and practices in the financial sector to ensure regional harmonization. Intraregional exchange controls would be abolished, and foreign investment inflows would be liberalized, in tandem with the strengthening of the stock exchanges. At this stage, countries would also establish fully effective FTA that could propel the private financial sector to expand their activities cross-border.

Stage III – Cooperation Stage The achievement of harmonization in areas of financial institutions, rules and regulations would lay the foundation for the third²⁹ stage of integration. At this point, countries would cooperate in implementing agreed convergence criteria, to be monitored and evaluated by a regional ministerial council. They would also complete the full harmonization process relating to regulatory, supervisory, and accounting procedures began under Stage II, and would cooperate in cross-border regulation and supervisory activities. Arrangements would also be made to link domestic securities markets. Building on an effective FTA, countries would enter into an agreement to establish a customs union over a specified period. Legal systems would be reformed to enable cross-border enforceability of contracts. This stage would also see enhanced cooperation in the areas of monetary and exchange policies.

Stage IV – Integration Stage This shifts the focus of action to the regional level. This stage would be characterized by an operational customs union, the effective integration of various financial institutions, and the exercise of regulatory and supervisory functions, including single bank licensing, a single regulatory agency, and increased cross-border presence of financial institutions originating in member countries. The core measure in this stage would be a partial pooling of external reserves to meet balance-of-payments difficulties of member countries, the establishment of regional bond markets, and possibly a unified regional stock exchange. Following the strengthening and linking of national capital markets, new regional financial products, such as regional bonds, would also emerge to tap local savings.

²⁹ The word “cooperation” characterizing the second stage should be construed as *enhanced cooperation*, since some form of cooperation would already have begun at the preparatory stage.

Stage V – Unification/Monetary Stage This final stage would see the introduction of a common currency and a common central bank on the financial side, and possibly the launching of an economic community on the real side. Introducing a common central bank would mean that individual countries would yield their sovereignty in monetary matters to this supranational entity. The operationalization of this stage, especially if accompanied by the creation of an economic community, entails the establishment of concrete institutional arrangements to facilitate the transition from national currencies, exchange rates and central banks to the unified monetary system. It would involve detailed attention to the supporting institutional setup, including the role of the “summit” leadership, rules-making, and decisionmaking. It would also necessitate setting up technical committees to provide inputs to the decisionmakers for the consideration of various issues, etc. Achievement of this stage is not easy – it demands strong political will at the highest levels, a dedicated civil service that believes in regionalism, and acceptance by the civil society. In that respect, transition from Stage IV to Stage V is different in kind from transitions at the lower stages of integration.

Table 2.1: Regional Financial Integration: A Generic Roadmap

Stage of RFI	Domestic measures	Regional measures
Preconditions	Macroeconomic stability Bank soundness	
Stage I: Preparatory Member countries begin to take steps to modernize their financial systems by implementing parts of international financial standards and initiating exchange of information among themselves	Improve national payments systems (RTGS) to reduce payment delays and transfer costs Strengthen bank supervision and regulatory framework ('partial' compliance with BCPs) Improve accounting standards (IFRS) Improve core elements of legal system (land and corporate registries, property rights, contract enforcement)	Agreement to establish FTA Regional secretariat to advance and implement regional agenda Exchange of information and regular meetings between monetary and financial authorities Regional committees to delineate areas and modalities of the integration process Bilateral and regional agreements to offer technical assistance to 'less developed' members to upgrade their financial systems
Stage II: Harmonization Member countries to modernize their financial system. Steps should be taken to harmonize and link regional financial policies, institutions, and rules and regulations	Expand payments systems to include electronic fund transfers, security deposit systems, and payment switches Devise cost-effective systems for small transfers Further strengthen bank supervision and regulation by 'large' compliance with BCPs, IAIS, & IAS Remove intraregional exchange controls	Fully effective FTA Agreement on relevant convergence criteria (voluntary compliance) Establishment of (advisory) surveillance and monitoring mechanism Regular meetings between country regulators and supervisors Harmonization of policies regarding inward capital flows

Stage of RFI	Domestic measures	Regional measures
	Liberalize foreign capital inflows Strengthen stock exchange (if it exists) rules and regulations, and implement supervision ((IOSCO) principles Substantially complete the modernization of the financial systems, making them market-based; Central bank autonomy and reinforced supervisory authority Remove barriers to entry of regional and foreign banks to improve competition Develop national credit information systems.	Liking national payments systems (REPSS< TARGET) Establish private financial sector consultative bodies (association of bankers, accountants, stock exchanges, etc.) Establish regional physical infrastructure development bodies
Stage III: Cooperation Members make substantial cooperative moves towards harmonizing and linking their financial sector policies. They also strengthen and make more operative the regional surveillance and monitoring mechanism	Gradually liberalize exchange controls vis-à-vis the rest of the world Implement regionally agreed comprehensive convergence criteria Coordination of monetary and exchange rate policies	Agreement to establish customs union Regional FDI regime Establishment of comprehensive convergence criteria (mandatory) and its monitoring with MDBs/IFIs support Full harmonization of regulatory, supervisory, and accounting standards Single bank licensing, cross-border participation of regulators and supervisors in bank supervision Development of a centralized credit information system Development of region-wide securities market infrastructure and regulations
Stage IV: Integration Members move to unify their institutions, rules and regulations, as well as financial products.	Adapt/modify domestic legislative and regulatory requirements and institutional set-up to conform to the requirements of this stage of RFI.	Fully effective customs union Unified stock exchange Adoption of broad legal system (e.g. OHADA treaty by WAEMU countries) Partial pooling of reserves Regional bond market

Stage of RFI	Domestic measures	Regional measures
Stage V: Unification In this stage members yield sovereignty in monetary policy to a regional authority	Exchange local currency for a regional currency Reserves in common currency	Regional central bank Regional common currency

The roadmap sketched above in Table 2.1 involves a number of detailed measures to be implemented at various stages of the integration process. However, each stage also implies one or two *core measures* that must be undertaken. Thus in Stage I, the emphasis is on developing national payment systems. In Stage II it is on modernizing the financial system by adopting international banking and other standards, abolition of intraregional exchange controls, and liberalizing foreign investment inflows, combined with strengthening stock exchanges. Core measures in Stage III would include effective implementation (monitoring and evaluation) of convergence criteria, cross-border regulatory and supervisory mechanisms, and linking of national stock exchanges. In Stage IV the emphasis would be on unifying stock exchanges, and development of regional financial products such as regional bonds.

An ultimate objective of RFI is to facilitate financing of larger real transaction activity among the member countries of the region.³⁰ In that sense, RFI is a complementary process to trade and services integration among those member countries. However, it is not suggested that there has to be a one-to-one mapping of trade integration and RFI. Instead what is implied is that each process should support the other, and that both processes are interdependent. For example, the RFI process in the absence of increased intraregional real transactions would prove to be anemic and would contribute only marginally to growth and poverty reduction. Similarly, trade integration would be facilitated and accelerated if the financial sectors of member countries were well developed and integrated.³¹

Box 2.1: Definition of Some Financial Terms

In this report, the phrases “macroeconomic convergence,” “financial integration,” and “monetary integration” are frequently mentioned and it may be worthwhile at this point clarifying their meanings.

Convergence criteria are aimed at enabling member states to align their financial systems for regional and economic integration. Thus, besides some financial sector criteria, macroeconomic convergence criteria include inter alia the rate of inflation, fiscal balance, public debt, balance of payments, savings and investment ratios, etc. Not all these criteria are relevant to achieving financial or monetary integration, nor do they include all the preconditions that need to be fulfilled. The concept of “convergence” should not be confused with “equality,” in the sense that the convergence criteria generally provide a quantitative range expressed as “no more than” or “no less than” a particular quantitative target.

The term **financial integration**, on the other hand, does not imply any common quantitative criteria but rather an increase in intraregional capital flows and a tendency for the prices and returns on trade’s financial assets in member

³⁰ “The path from cooperation to integration is a continuum of actions, a process not an event, starting with sharing information to sharing processing facilities, to harmonizing laws and regulations, and eventually to unified licensing and inspection of institutions and the introduction of common currency, with the ultimate objective of achieving a single financial space”. World Bank (2007), p. 8.

³¹ It is perhaps worth noting that while market forces will lead to at least a partial RFI following trade integration, the reverse causation (RFI leading to trade integration) is not assured.

states to equalize on a common currency basis. As pointed out by de Brouwer:³² “Integration of markets implies an increase in transactions in those markets and a tendency for prices to converge in common currency terms; integration can also radically change the dynamics of this process. Financial integration is simply the application of this process to markets in financial instruments.” It should be noted that this equalization of prices does not have to take place at any target level, unlike in the case of convergence criteria, where certain targets are prescribed.

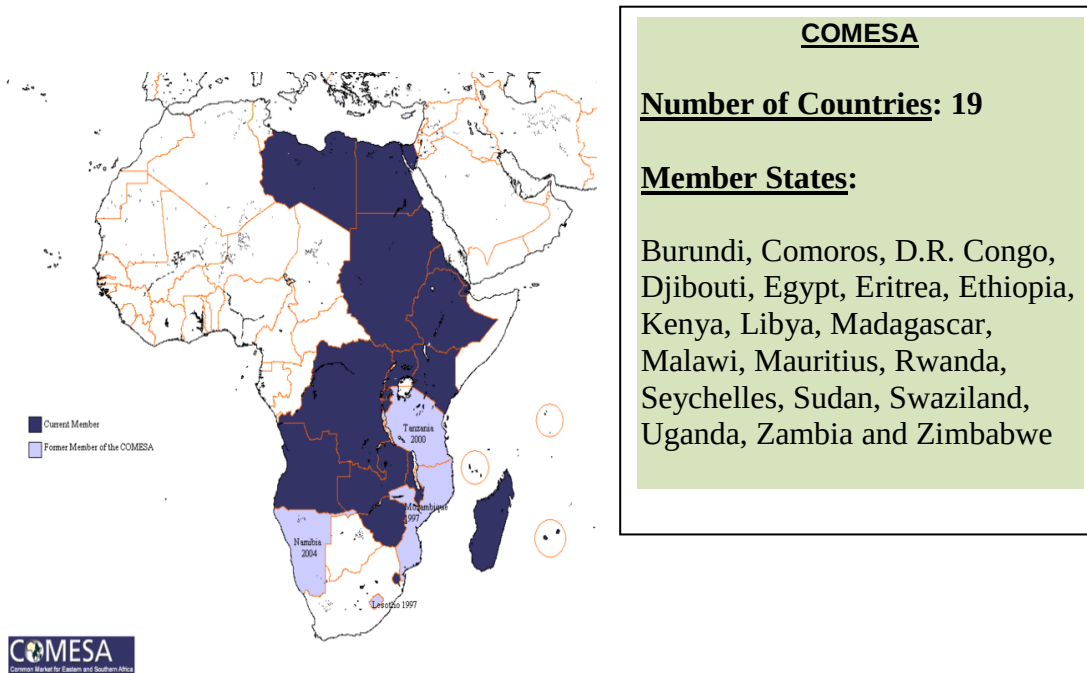
Monetary integration is a step beyond financial integration, in that member states establish a common currency and a common central bank and thereby cede their sovereignty in monetary and exchange policies that are now exercised by a supranational central bank. Here a main issue is to determine whether member states together form an optimal currency area, and whether other prior conditions for a successful monetary union have been established. In terms of the proposed roadmap, these prior conditions include implementation of most, if not all, of the measures included under the earlier stages of integration. Without them, monetary union will remain just that, a common currency and a common central bank that concentrates essentially on preserving the external balance of the union through the exercise of credit and monetary controls.

The above categorization of the RFI roadmap has emphasized that the path to integration is a continuous one. The benefits from regional integration result from the combination of policy, institutional, and regulatory actions, as well as market-driven extension and deepening of the financial system. The World Bank (2007) has summarized these benefits as accruing from economies of scale, efficiency gains from increased competition, and increased access to financial services. It also recognizes that there are a number of costs and difficulties, such as gradual loss of national control over monetary and exchange rate policy. In addition, there may be costs special to “fragile states” and states with relatively less-developed financial systems that may need to be addressed through compensatory measures at the outset to gain region-wide acceptance of the integration process.

Compensatory measures could include, for example, preferential investment policies of the regional development banks (as was done in the first EAC arrangement cited above), financial grants to meet the adjustment costs (such as the EU’s assistance to meet the social costs of adjustment), and time-bound exemptions from certain regional requirements for those countries to build up their capacities, combined with technical assistance from the more developed members (as is done within ASEAN arrangements). However, in general, these costs for other member states are likely to occur in the later stages of financial integration. In the initial stages, benefits outweigh the costs, and therefore integration policies in the financial sector are unlikely to meet with political opposition – in fact, they are more likely to be welcomed. This may explain why despite African governments’ and policymakers’ explicit emphasis on fostering trade integration, financial integration has proceeded at a more rapid pace and without the social protests that have accompanied trade liberalization efforts.

³² Gordon de Brouwer (2005), “Monetary and Financial Integration in Asia: Empirical Evidence and Issues”, in *Asian Economic Cooperation and Integration*, Manila: Asian Development Bank.

3. THE COMMON MARKET FOR EASTERN AND SOUTHERN AFRICA



3.1 Introduction

COMESA, with its 19 members and a total population of 400 million, is the largest of Africa's regional economic communities (RECs). It encompasses a broad range of countries, with wide differences in terms of geographical size and population, resource endowments, political and economic systems, and stages of development. Population ranges from less than 100,000 in Seychelles to more than 80 million in Ethiopia. Similarly, real per capita income ranges from US\$ 91 for the Democratic Republic of the Congo to US\$ 7,986 for Libya. The African Development Bank characterizes six of the members as middle-income countries (Djibouti, Egypt, Libya, Mauritius, Seychelles, and Swaziland), 13 countries as low-income countries (Burundi, Comoros, Democratic Republic of Congo, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Rwanda, Sudan, Uganda, Zambia, and Zimbabwe), and four countries as "fragile states"³³ (Burundi, Comoros, Democratic Republic of Congo, and Zimbabwe).

In the UNDP 2006 Human Development Index, Seychelles ranked 47th, while Ethiopia ranked 170th. Resource endowment varies greatly among the COMESA member countries; most are commodities exporters of either agricultural or mineral products (Burundi, DRC, Malawi, Rwanda, Zambia, and Zimbabwe), some rely to a great extent on tourism (Kenya, Mauritius, Seychelles, and Uganda), one is a hydrocarbon exporter (Libya), and one is relying on services associated with its strategic harbor (Djibouti). To some extent, Kenya also acts as a hub for

³³ Mainly because of postconflict status or ongoing political difficulties.

development in the East African region. Most members have liberal economies, although a few are still tightly controlled or just at the beginning of the liberalization process.

Despite this diversity, COMESA's members have made good progress toward forming an FTA since 2000, albeit effectively joining at different speeds. Over the past seven years, most of them have adopted reform measures, focusing on the gradual transformation of isolated national markets into a single regional market in Eastern and Southern Africa. Good progress has been achieved in trade liberalization and facilitation through reductions and elimination of trade and non-trade barriers between member states. COMESA's intraregional trade nearly doubled between 2003 and 2006 (Table 3.2). However, seen in relation to total trade flows, and adjusting for the effects of the sharp increase in petroleum product prices, the picture is more mixed although still positive. As a percentage of total trade, intraregional trade remains modest at only 5 percent. COMESA markets, nevertheless, are particularly important for Burundi, Djibouti, Kenya, Malawi, Rwanda, and Uganda whose exports to the COMESA region amounted to between 16 and 30 percent of their respective total exports.

Since 2000, COMESA's real GDP has been growing at an average rate of 5.5 percent per annum. The growth performance picked up over 2006-07, but needs to be accelerated further to enable the region to attain the Millennium Development Goals in 2015, as well as COMESA's macroeconomic convergence criteria of 7 percent growth. In particular, the situation in the fragile member countries must be turned around (Zimbabwe has experienced negative GDP growth over the last eight years). Continued reform efforts, including a further strengthening and integration of financial systems, could help in this regard. Economic indicators over the period 2005-07 for each of the COMESA member states are provided in Table 3.1 below.

Table 3.1: COMESA Selected Variables 2005-07 Averages
(as % of GDP unless otherwise noted)

COMESA member country	Real Growth %	Inflation %	Fiscal Deficit	Current Account	Reserves (Months of imports)	M2	Private Credit	Population (mn)
Burundi	3.2	8.2	-20.0	-32.2	3.7	30.6	19.6	8.2
Comoros	1.5	3.1	-7.0	-5.4	4.2	21.0	6.2	0.8
Congo, Democratic Republic of	6.6	17.1	-7.3	-11.8	0.7	10.4	2.9	60.6
Djibouti	4.4	2.8	-1.9	-12.7	4.1	78.6	20.2	0.8
Egypt	6.1	1.3	-8.4	1.8	10.4	97.2	50.3	74.2
Eritrea	1.0	12.3	-19.6	-8.0	-1.6	125.7	29.9	4.7
Ethiopia	11.9	11.6	-8.2	-12.6	2.2	35.8	17.9	81.0
Kenya	6.3	11.6	-3.6	-13.8	3.7	39.2	25.6	36.6
Libya	6.3	2.7	34.3	46.2	48.8	29.3	7.8	6.0
Madagascar	5.2	13.2	-10.0	-12.6	2.9	19.4	10.4	19.2
Malawi	5.9	12.5	-14.4	-19.1	1.5	14.9	5.8	13.6
Mauritius	3.8	7.1	-5.2	-5.7	3.8	147.1	85.6	1.3
Rwanda	6.2	9.1	-12.1	-16.1	7.1	17.9	11.4	9.5
Seychelles	3.9	1.7	-2.9	-29.3	1.0	116.1	39.4	0.1
Sudan	9.4	-3.0	-3.1	-12.6	3.4	21.2	11.3	37.7
Swaziland	2.5	5.4	1.9	-17.6	2.5	23.2	23.2	1.1
Uganda	6.1	7.1	-8.1	-9.9	7.6	18.8	8.5	29.9
Zambia	5.6	12.0	-7.1	-7.2	2.8	20.6	10.1	11.7
Zimbabwe	-5.2	61.7	-8.6	-6.7	0.8	36.6	13.5	13.2

Sources: IMF World Economic Outlook and other published data.

3.2 History of COMESA and the Path to Regional Integration

COMESA was initially established as the Preferential Trade Area (PTA) for Eastern and Southern Africa. The PTA was transformed into COMESA in 1994. COMESA formed a partial free trade area (FTA) in October 2000, with the participation of 11 out of the total number of 19 members. Subsequently, additional members have joined the FTA, reaching a membership of 13 by June 2007; the remaining six members of COMESA have reduced intraregional tariffs by 60 to 90 percent.

COMESA has taken a variable-speed approach to integration. Thus, in the case of the FTA, firm timetables were not negotiated in advance, but members were free to join whenever they were ready to agree to the terms of the arrangement. Similarly, COMESA intends to launch a customs union in 2009. The Secretariat has established a four-category, common external tariff (CET), with the limited possibility for excluding some goods for a specified time. Significant tariff adjustments are required by most members to align their tariff structures with the proposed CET. As in the case of the FTA, COMESA envisages a variable-speed approach; although at this stage it is unclear how many members will join the customs union at the time of its launch.

COMESA has put in place an extensive program for trade facilitation through harmonization and cooperation in customs procedures and documentation. A draft Customs Management Act to govern customs operations and procedures has been developed. Additionally, the region has

adopted a Common Tariff Nomenclature (CTN) and a single customs declaration document (the COMESA – CD). A “yellow card” uniform vehicle insurance scheme to facilitate the movement of goods and people across the region is also in place, as is a Customs Bond Guarantee Scheme (CBGS) for the same purpose. The COMESA Secretariat has also assisted member countries in adopting newer versions of the Harmonized System, Automated System for Customs Data (ASYCUDA), and the WTO Valuation system.

Table 3.2: COMESA Intraregional Trade Flows, 2003-06

COMESA member country	EXPORTS				IMPORTS			
	2003		2006		2003		2006	
	US\$ mn	%	US\$ mn	%	US\$ mn	%	US\$ mn	%
Burundi	4.0	6.3%	23.4	16.8%	47.5	27.3%	68.3	15.3%
Comoros	0.2	3.6%	0.7	6.4%	4.5	11.7%	15.2	14.1%
Congo, Democratic Republic	174.1	12.7%	68.8	3.0%	143.1	9.0%	350.2	12.5%
Djibouti	27.5	74.3%	14.5	16.0%	100.9	42.4%	10.4	1.0%
Egypt	239.0	3.9%	505.7	3.2%	229.8	2.1%	266.4	1.2%
Eritrea	0.5	7.1%	2.6	26.0%	7.8	1.8%	26.6	6.7%
Ethiopia	95.1	18.7%	100.0	9.9%	90.8	3.4%	391.1	7.7%
Kenya	430.1	23.5%	911.2	28.8%	144.6	4.0%	243.3	3.4%
Libya	42.4	0.3%	105.3	0.3%	121.3	2.8%	211.9	2.6%
Madagascar	13.5	2.0%	22.1	2.5%	65.3	6.0%	71.7	4.4%
Malawi	68.9	15.2%	76.3	11.6%	83.8	11.9%	180.9	14.1%
Mauritius	58.6	3.8%	57.1	3.8%	89.7	3.9%	99.1	3.2%
Rwanda	20.8	48.5%	36.2	29.5%	11.9	11.5%	336.9	51.8%
Seychelles	0.5	0.3%	0.5	0.2%	13.7	3.9%	23.7	3.2%
Sudan	77.4	3.6%	87.7	1.6%	422.5	15.1%	651.0	7.3%
Swaziland	116.0	6.9%	162.6	8.9%	2.0	0.1%	10.8	0.7%
Uganda	95.2	24.2%	234.2	28.8%	301.0	24.7%	450.4	17.6%
Zambia	84.6	9.0%	276.7	7.5%	266.7	16.8%	310.7	10.1%
Zimbabwe	121.9	3.6%	83.3	6.5%	26.0	1.2%	50.2	2.9%
Total	1,670.2	4.6%	2,769.0	3.6%	2,172.9	5.8%	3,769.2	5.2%

Note: The percentages in the above table denote for each country the percentage of imports/exports that are received from/sent to COMESA countries.

Source: COMESA Secretariat

The COMESA Agreement calls for the elimination of non-tariff barriers (NTBs) which are reported to the Secretariat from time to time. Some observers believe that additional work is required in this area. Although a formal dispute settlement mechanism is provided for through the COMESA Court of Justice, so far this has not been invoked in trade disputes between member states. The normal route for handling such disputes is through an informal process of diplomatic consultations and the good offices of the COMESA Secretary General.

COMESA has established various structures in support of trade liberalization, including a COMESA Fund, to channel development funding from Aid for Trade, the EU, and other

financial assistance. The Fund has two windows: an Adjustment Facility and an Infrastructure Facility. The Adjustment Facility will provide donor (mainly EU) grant funds to member countries to meet the social costs of adjustment consequent upon the liberalization of trade. Work is also underway to set up a COMESA Infrastructure Development Company, with majority equity participation from the private sector and multilateral development banks (MDBs), which will facilitate private investment in the development of trade-related infrastructure projects in the COMESA region (PPP and SPV). The Eastern and Southern African Trade and Development Bank (PTA Bank), which was established in 1985, also provides project and trade financing to COMESA members.

Realizing the importance of macroeconomic stability to its regional integration objectives, COMESA established macroeconomic convergence criteria as early as 1993. In line with the African Monetary Cooperation Program, spearheaded by the Association of African Central Banks (AACB), the Council of Ministers at its meeting in December 2004 adopted revised macroeconomic criteria aimed at underpinning macroeconomic stability, enhancing growth, and supporting financial integration. In furtherance of financial integration, the secondary convergence criteria include the adoption of all the Basel Core Principles for Bank Supervision and Regulation by 2010, thereby ensuring harmonization of supervision within the region.

Most COMESA members are still a long way from achieving the convergence criteria for macroeconomic stability. Only seven countries meet the criteria for the fiscal deficit (Djibouti, Kenya, Libya, Mauritius, Seychelles,³⁴ Sudan, and Swaziland). Another four countries meet the criteria for inflation (Comoros, Djibouti, Egypt, and Libya), and six countries meet the criteria for external reserves (Comoros, Djibouti, Egypt, Libya, Rwanda, and Uganda). Only Djibouti and Libya meet all three criteria.

Nonetheless, most COMESA members have made some progress toward macroeconomic stability. Macroeconomic stability plans have in many cases been developed with support from the IMF and the World Bank under the Poverty Reduction and Growth Facility (PRGF) and some countries benefit from debt forgiveness under the Heavily Indebted Poor Countries (HIPC) initiative. In all the remaining cases, the lack of macroeconomic stability can be explained by political difficulties and/or postconflict status (Burundi, Democratic Republic of the Congo, Eritrea, Seychelles, and Zimbabwe).

COMESA intends over time to create a single financial services market in support of regional integration. Banks authorized to operate in one member state will be able to export their services to any other COMESA member state and will also have the right to establish branches and subsidiaries. As a first step, at the second meeting of banking supervisors in 2003, agreement was reached on establishing a framework and action plan for harmonizing bank supervision and regulation in the COMESA region. These were subsequently adopted by the Council of Ministers, which further emphasized that all countries should adopt the Basel Core Principles as a minimum standard. According to the action plan, the harmonization of banking supervision was slated for completion at the end of 2004.

³⁴ The reliability of the Seychelles figures is not certain.

The subcommittee on Financial System Development and Stability undertook a study in 2006 of the degree and extent of financial system development and stability of individual COMESA member countries. *The Report and Proposed Guidance on Effective Harmonization of Financial System Development and Stability in COMESA* (henceforth “the Report”) is based on a detailed study of existing financial systems and regulatory/supervisory frameworks.³⁵ The report suggests that while good progress has been made in some areas, harmonization of financial regulation and the achievement of macroeconomic convergence are far from achieved. The study established a detailed Action Plan for financial system development and stability for the COMESA region. This Action Plan was subsequently adopted by the Council of Ministers, and is included at the end of this chapter as Appendix 3.1.

COMESA countries now have a well-established track record of cooperation. In this, the membership may have been helped by the absence of a single dominant country that could dictate policy. A few of the members have emerged as being more active in advancing trade, economic, and financial integration (Mauritius) and have gained international credibility. The COMESA Secretariat has been relatively proactive, while COMESA members are also active in negotiating an economic partnership agreement (EPA) with the EU. Nevertheless, progress towards meeting convergence criteria and other objectives has on occasion been slower than anticipated. Given the wide divergence of countries, and the complexity of steps to be undertaken, it is perhaps not surprising that deadlines, at times overly ambitious, not been met. For example, the FTA should have been fully in place by 2004, but as of mid 2007, only 13 countries had implemented it fully. The financial sector harmonization is also behind also schedule, and, reportedly, non-tariff barriers still cause significant problems.

3.3 Obstacles to Regional Financial Integration

The wide divergence among COMESA member states is a major obstacle in the medium term to full RFI for all the members. Some countries (Burundi, Ethiopia) have less sophisticated financial systems and less developed regulatory and supervisory frameworks. They have further to go, and at the same time have fewer resources to implement the requisite actions. Other members (Democratic Republic of Congo, Sudan, and Zimbabwe) are held back by intractable political difficulties. Others have yet to fully commit themselves to an open and liberal system, which is a prerequisite for RFI. In the meantime, COMESA’s strategy of variable-speed adoption by member states to specific objectives may be appropriate, as it may “fast-track” financial integration among those ready and equipped to do so, while helping others to upgrade their systems to integrate with them. Successful integration among fast-trackers could also encourage others to accelerate the reform of their financial systems.

Delayed action is facilitated by the lack of clear reporting requirements and effective enforcement mechanisms. The COMESA Secretariat should be strengthened so that it can follow up forcefully on reporting requirements. Individual members should be encouraged to draw up their own time-bound action plans, setting out precisely how they intend to conform to the COMESA Action Plan. As early as feasible, COMESA members should undertake financial sector assessment programs (FSAPs) and/or FSAP updates to help them identify priorities to be

³⁵ Participation in the study was far from complete: only 14 members responded to the detailed questionnaire that formed the basis for the study and in many cases left sections blank.

tackled in their individual action plans. Delays should be clearly communicated to the Council of Ministers and a mechanism for enforcement should be developed. COMESA may look to the AfDB to strengthen its surveillance and monitoring activities, and to take a proactive role in organizing and conducting those activities, similar to the role adopted by the Asian Development Bank for its member countries.

Table 3.3: COMESA Interlinked Relationships

COMESA	EAC	SADC	SACU	UMA	ECCAS
Burundi	Burundi				Burundi
Comoros					
Congo, Democratic Republic of		Congo, Democratic Republic of			Congo, Democratic Republic of
Djibouti					
Egypt					
Eritrea					
Ethiopia					
Kenya	Kenya				
Libya				Libya	
Madagascar		Madagascar			
Malawi		Malawi			
Mauritius		Mauritius			
Rwanda	Rwanda				
Seychelles					
Sudan					
Swaziland		Swaziland	Swaziland		
Uganda	Uganda				
Zambia		Zambia			
Zimbabwe		Zimbabwe			
Other members	Tanzania	Angola, Botswana, Lesotho, Madagascar, Namibia, South Africa, and Tanzania	Botswana, Lesotho, Namibia, and South Africa	Algeria, Mauritania, Morocco, and Tunisia	Angola, Cameroon, Central Africa Republic, Chad Republic of Congo, Equatorial Guinea, Gabon, Sā Tomé and Príncipe

Source: Websites of listed organizations.

Integration is also complicated by multiple memberships in various regional groupings. Of the 19 COMESA members, 12 are members of two or more groupings (see Table 3.3). In addition to being members of COMESA, four states are also members of the EAC, seven are members of SADC, one of SACU, one of UMA, and two of ECCAS. Burundi, DRC, and Swaziland are members of three different groupings. However, multiple memberships may also help in forging harmonization of standards and procedures of different RECs, provided that a common member country agrees to take the lead in this process.

COMESA members are conscious of the potential for conflict that may arise from multiple group membership. As a result, COMESA, EAC, and SADC have established regular high-level meetings attended by their Chief Executives, to discuss matters of common interest, in particular trade integration, customs unions, and infrastructure development. The intention is to ultimately form a larger regional integration encompassing the three RECs. Thus, at their third meeting at year-end 2006, they agreed on areas of harmonization that included FTA (tariff elimination, competition policy, and trade in services), customs union (CTN, valuation, free circulation and revenue sharing, structural funds to address asymmetries in member countries' economic development), etc. They are also cooperating in their negotiations with the EU on Economic Partnership Agreements (EPAs).

Nevertheless, matters should come to a head with the launch of the COMESA customs union, the EAC customs union, and, subsequently, the SADC customs union since, by definition, each member can only be member of one customs union. Reportedly, the EAC common external tariff (CET) is very close in its provisions to the proposed COMESA CET. It may therefore be possible that with minor modifications to tariffs, both customs unions could operate in the interim period, assuming the enforcement of strict rules of origin. However, in the longer run, members will need to consider how to rationalize memberships since, as the World Bank report (2007) pointed out, the problem of multiple membership is broader than its impact on CET. Both COMESA and SADC cover many issues besides trade, from the issuance of international vehicle insurance to harmonization of banking regulations, regional payments systems, etc.

Multiple memberships also impose administrative burdens. Frequent international meetings and the development of multiple coordination plans use up scarce administrative resources, often at quite high levels. The task of unwinding membership from one group may, therefore, not only be time consuming but also costly. In the event, countries may find it more practical to merge the three groups into a single integrated region.

As indicated above, with few exceptions, COMESA member states have made progress in achieving macroeconomic stability, which is a prerequisite for regional integration. The sections below assess the current structure of the financial sector, its institutional and infrastructure development, the status of regional integration, and what further steps may be necessary for full achievement of RFI. The final section analyzes the role that the development partners could take to advance this process.

3.4. Structure of the COMESA Financial Sector

Financial Depth In general, the financial sectors in COMESA countries are characterized by the dominance of banks, which between them control the bulk of total financial assets. However, market access to financial institutions remains very low, the insurance sector is relatively small, securities markets are established in only 9 of the 19 countries, and these raise relatively little funding.

Reflecting the divergent circumstances of COMESA members, the size of their financial sectors differs greatly. The overall size of the financial system, as denoted by the ratio M2/GDP which averaged 47 percent for the years 2005-2007, is relatively small. The financial depth, as measured by the ratio "private sector credit to GDP", averaged only 21 percent during the same

period, well below the SSA average, particularly when high ratios for Eritrea, Djibouti and Seychelles are excluded due to their special circumstances. These averages mask wide variations between member countries, ranging from a low of 10.4 for M2 and 2.9 private credit ratios for DRC, to a high of 147.1 and 85.6 respectively for Mauritius (see Table 3.1). Data available from a recent study³⁶ by IMF staff suggest two critical levels of the ratio of private credit to GDP: viz. (i) GDP growth is positively (almost linearly) influenced with growth in the private sector credit, until that ratio reaches a value of around 1.1, after which the correlation is weakened considerably, and (ii) the resiliency and flexibility of the economy remains weak (output volatility high) until the private credit ratio reaches around 0.4. On both these criteria, the average COMESA financial depth is below the critical levels, although some countries (Egypt, Mauritius) register greater depth.

3.4.1 *The Banking Sector*

Banking systems in COMESA, and in Africa more generally, have undergone significant reforms over the past decade. With a few notable exceptions (Eritrea, Ethiopia, Libya, and Sudan), banking systems reveal a strong presence of foreign-owned banks, and regional banks are also starting to spread across borders. While conditions differ significantly across countries, as a general rule, concerted efforts have been made to enhance the strength of banking systems by liquidating and/or restructuring those banks that find themselves in difficulty and by enhancing banking regulation and supervision. As a result, non-performing loans (NPLs) have been reduced, and profitability has increased. At the same time, state control of banks has been reduced in most countries, in recognition of the fact that, in general, state-owned enterprises tend to be less efficient and experience more difficulties in ensuring appropriate loan quality.

The banking sector in most COMESA members shows a high level of capitalization and liquidity (Table 3.4). Only one country (Madagascar) registered capital adequacy below the Basel I recommendation of 8 percent. Moreover capitalization has increased in line with banking reform projects in a number of countries. Profitability, as measured by aggregate numbers for return on assets (ROA) and return on equity (ROE) is in general quite high (in excess of 50 percent in the cases of Democratic Republic of the Congo, Djibouti, and Zimbabwe), reflecting what some perceive as high interest rate spreads, fees and charges.

³⁶ A.Tahari et al., (2007) *Financial Sector Reforms and Prospects for Financial Integration in Maghreb Countries*; IMF WP/07/125.

Table 3.4: COMESA Banking Soundness, 2005
(%)

COMESA Country	Capital/ Assets	NPLs	ROA	ROE	Overheads/ assets
Burundi	...	20.1	...	...	6.7
Comoros	...	...	...	...	...
Congo, Democratic Republic of	10.5	3.0	2.7	51.6	10.2
Djibouti	17.4	21.4	1.9	52.4	...
Egypt	15.1	24.7	0.6	17.4	2.0
Eritrea	...	...	...	...	...
Ethiopia	11.4	14	2.8	41.1	1.0
Kenya	16.5	10.3	3.2	28.6	6.2
Libya	118.2	...	...	...	1.6
Madagascar	6.2	10.1	...	...	3.7
Malawi	22.5	4.0	...	...	11.1
Mauritius	15.8	3.0	1.9	21.1	1.9
Rwanda	15.0	34.1	1.8	23.9	8.6
Seychelles	...	...	...	...	...
Sudan	19.7	19.4	3.6	35.4	4.7
Swaziland	20.0	4.0	6.0	52.0	7.5
Uganda	16.5	2.9	3.4	...	10.0
Zambia	20.4	11.3	5.1	30.6	9.6
Zimbabwe	10.8	9.0	13.4	78.7	14.3

Source: IMF and World Bank data.

Despite a substantial number of banks in most countries, the data could point to a lack of effective competition, with a relatively small number of large banks acting as price setters and smaller banks unable to compete because of high costs and lack of sufficient scale. However, banks stress that fees and charges reflect the high cost of doing business in the COMESA region (and in Africa more generally). Indeed, the nature of banking in Africa does appear inherently more risky because of information deficiencies, the vulnerability of customers to exogenous shocks, and weak judicial systems. As a result (but also reflecting poor lending decisions by state-owned banks in particular), banking systems still exhibit very high levels of NPLs, which adds to the cost of loan provisions. Relatively high levels of unremunerated reserve requirements also act as an implicit tax and add to business costs.

In an attempt to drive down the cost of financial services and enhance competition, most countries have opened up access to their financial markets. Furthermore, as a result of privatization efforts, the foreign ownership of banks is increasing. There is a wide divergence in the banking sector structure among member states, and in most cases there is also a sizeable domestic banking presence (see Table 3.5). In three countries, 100 percent of the banking system is foreign owned (Comoros, Djibouti, and Madagascar). With the exception of three other countries (Eritrea, Ethiopia, and Libya), all countries have a subsidiary of at least one major foreign banking group (see Table 3.6).

Table 3.5: COMESA: Banking Sector Structure, 2005

	Assets US\$ mn.	Total No. of Banks	State-owned No.	Foreign owned No.	Foreign owned % of assets
Burundi	364.9	8	...	2	20.0%
Comoros	56.8	1	0	1	100.0%
Congo, Democratic Republic of	494.1	11	2	9	...
Djibouti	592.9	4	0	4	100.0%
Egypt	117,332.0	43	7	20	23.8%
Eritrea	1,237.2	3	3	0	0.0%
Ethiopia	8,730.6	9	2	0	0.0%
Kenya	8,581.8	49	3	3	40.0%
Libya	25,019.8	9	8	0	0.0%
Madagascar	1,016.5	6	0	6	100.0%
Malawi	680.6	9	1	5	53.8%
Mauritius	15,416.5	18		...	66.6%
Rwanda	233.1	6	2	2	37.5%
Seychelles	1,089.2	6	...	3	50.0%
Sudan	6,036.7	21	10	1	7.6%
Swaziland	...	5	2	3	82.0%
Uganda	2,040.7	15	...	11	73.3%
Zambia	1,691.4	13	1	...	63.5%
Zimbabwe	3,259.9	14	2	3	12.9%

Source: COMESA Secretariat and published IMF data

Note: ellipsis (...) indicates data not available.

A common theme across COMESA members (and Africa in general) is the very low access to banking services. Some estimates (Honohan and Beck, 2007) place access to the formal banking system in SSA at less than 20 percent of the population. According to a comprehensive 2006 survey of financial access in Kenya, 26.4 percent of the population had access to formal financial services, 35.2 percent to informal financial services, while 38.4 percent had no access to financial services. However, anecdotal evidence indicates that banks are starting to focus more on broadening access to retail banking. For example, Barclays Bank, which had earlier retrenched its branch network in Zambia, has changed its business strategy, and is now in the process of adding to its network, including through mobile banking operations. Equity Bank in Kenya has as its business model a focus on low-end customers, and is now branching out into Uganda. Other banks are also focusing on broadening their branch network. This trend can also be seen in a pick-up in private credit in several countries in the region.

Table 3.6: COMESA: Representation of Major International Banks, 2007

	Barclays	Belgolaise	BNP Paribas	Citibank	Stanbic	Stanchart
	(UK)	(Belgian)	(French)	(USA)	(South Africa)	(UK)
Burundi		X				
Comoros			X			
Congo, D R				X	X	
Djibouti						
Egypt	X			X		
Eritrea						
Ethiopia						
Kenya	X			X	X	X
Libya						
Madagascar					X	
Malawi					X	
Mauritius	X				X	X
Rwanda		X				
Seychelles	X					
Sudan						
Swaziland					X	
Uganda	X			X	X	X
Zambia	X			X	X	X
Zimbabwe	X				X	X

Source: Websites of commercial banks

Microfinance Institutions Many COMESA countries have also seen an increase in the number and operations of microfinance institutions (MFIs). This is a welcome development since it provides a potential source of financing for small and medium size enterprises (SMEs). MFIs come in a variety of forms, sometimes benefiting from donor financing. There is no internationally agreed standard on which governance and business model works best, and results may well differ according to divergent conditions among countries. The regulation of MFIs also varies greatly across COMESA member states, and in some cases is not covered by legislation (Democratic Republic of the Congo, Comoros). Also it is of concern that some MFIs charge very high interest rates, in some cases reputedly more than 100 percent per annum. With the proliferation of new MFIs, it would seem desirable to draw up COMESA-wide regulations for their licensing and supervision. In this context it should be considered whether increased transparency requirements will be sufficient to address the very high interest rates and fees, or whether countries will need to consider additional measures (more competition, educating customers, etc.)

The PTA Bank The Eastern and Southern African Trade and Development Bank (PTA Bank) was initially established in 1985 as the financing arm of the integration arrangement. Its objective is to provide development capital to the region, mainly mobilized from international capital markets. PTA Bank provides both trade finance and project finance. In the case of project finance, it focuses on agro-industry, infrastructure, transportation, communications, microfinance mining, services industry, and tourism. PTA Bank favors projects that are export-oriented and

that have a regional perspective. In trade finance, it supports activities that augment the economic and social development of the region, focusing on petrochemical products, agricultural commodities, minerals, and critical raw materials. Since its establishment, PTA Bank has provided total financing of US\$ 2.5 billion, of which 15 percent has targeted infrastructure development, 22 percent to banking and finance, 7 percent to tourism, and 66 percent to other sectors. It provides its assistance in a variety of ways, including loans, lines of credit, and guarantees, and its lending products include letters of credit, pre-shipment and post-shipment loans, syndicated lending, finance for capital equipment, and bills discounting. Most countries in the region have benefited from PTA Bank lending, with Tanzania having received 25 percent, while Kenya, Zambia, and Uganda have each received more than 10 percent of total approvals.

COMESA Infrastructure Development Company As part of liberalizing their economies, COMESA has decided to establish a majority-owned, private sector regional infrastructure development company. This aims to promote regional integration by financing the development of regional infrastructure projects. The company will have a capitalization of US\$ 1 billion, though the paid-up capital would initially be much smaller. The COMESA Fund will invest in the equity of the company the “base” contributions (around US\$ 30 million) it receives from member countries. The Company will operate on a strictly commercial basis and tap capital markets for regional infrastructure projects through the mechanism of special purpose vehicles (SPVs) and private-public partnerships (PPPs). COMESA expects to launch the prospectus for the company in the near future and will explore with prospective private investors their participation in the equity capital of the company. The company will also seek funds from local investors. The proposed company has attracted the interest of MDBs, including the World Bank and the African Development Bank.

3.4.3 *Securities Markets*

Nine of the 19 COMESA members have organized stock exchanges. With one notable exception (Egypt), these exchanges are generally characterized by a relatively small number of listed companies, few market participants, low capitalization, and low trading volume (see Table 3.7). Several factors contribute to the above picture. Honohan and Beck (2007) point firstly to the low levels of economic activity, which makes it difficult to reach a critical mass, and secondly to the state of company accounts and their low reliability. Also, they note that several African exchanges were established primarily by external influences (in part political) rather than by a perceived demand in the market. A related factor is the relatively low demand from institutional investors, as private pension funds and insurance companies have not yet built up significant capital stocks, and there are certain statutory limits on the composition of their portfolios that restrict investment in equity capital.

Table 3.7: COMESA: Stock Exchanges, 2005

Member Country	No. of listed firms	No. of listed bonds	No. of Brokers	Market Cap (% of GDP)	Value traded (% of GDP)	Turnover %
Egypt	603	...	...	87.0	44.2	55.2
Kenya	47	...	20	26.1	2.1	7.9
Malawi	10	0	2	9.2	1.3	14.1
Mauritius	41	1	32	36.0	1.6	4.4
Sudan	49	10	27	2.5	0.4	16.3
Swaziland	6	5	3	8.3	0.0	0.0
Uganda	5	2	7	1.4	0.0	0.2
Zambia	13	22	3	8.0	0.1	1.5
Zimbabwe	79	0	37	41.3	2.9	7.0

Sources: Honohan and Beck (2007) and COMESA Secretariat

There are, however, signs of a potential renaissance of some stock exchanges. Zambia's stock exchange attracted two new stocks in 2006, contributing to a 46 percent increase in capitalization in that year. Then in 2007, one of the smaller Zambian national banks was listed. Kenya's stock exchange is also showing positive signs of growth in investment capital; for example a recent IPO (Safaricom) was significantly oversubscribed. An interesting feature of that offering was that while 65 percent of acceptances were reserved for "locals" and 35 percent for foreigners, "locals" were defined to include nationals of all the EAC countries. Oversubscription was not confined to local bids but included foreign bidders also. This points to two conclusions: (i) that it is not a shortage of capital in the region that is the problem, but rather the lack of products to invest in, and (ii) that well-functioning securities markets will always attract foreign investors. Given excessive dependence on foreign savings to finance investments in Africa, this would indicate a need for African countries to be given priority in the development of capital markets at the start of their financial reforms.³⁷

Most observers agree that Africa's stock exchanges are too small individually to ensure efficiency and liquidity; consequently, they argue in favor of an integration of exchanges. This argument would seem to be supported by the trend among European stock exchanges toward market-driven integration. Indeed, given the small number of listed stocks and the fixed costs involved in setting up and running the exchanges, listing costs are relatively high in Africa. This has been cited as a contributing factor to the low number of listings. It should therefore be a goal to ultimately unify COMESA exchanges, although this may prove a difficult task, given concerns by some over a perceived loss of "sovereignty."³⁸ Meanwhile, efforts should be

³⁷ This recommendation goes against the conclusion of Hooper (2002), cited in the above-mentioned World Bank study, that Africa is the least likely candidate for regional integration of stock exchanges.

³⁸ The above-cited World Bank in its study of the EAC capital market wonders whether: "to attain the requisite scale, a regional exchange would have to include the JSE. [...] In the past countries in the SADC and EAC regions have resisted proposals for regional integration of stock exchanges in which JSA would take a leading role for political, cultural and historical reasons and due to a concern about the potential capital flight."

directed at eliminating barriers to intraregional investment and at facilitating cross-listing (see Box 3.1).

Box 3.1: EAC Cooperation for a Joint Stock Exchange

EAC members, most of which are also COMESA members, are fairly advanced in coordinating securities market regulation and in setting up a joint stock exchange. They have created an East African Member States Securities Regulatory Authority to serve as a coordinating body for capital market cooperation and integration. Partial capital account liberalization has been implemented and cross-listing has been encouraged. In November 2006, the Uganda Stock Exchange and the Nairobi Stock Exchange signed an agreement to cross-list over 35 blue-chip companies and to merge within two years. However, cost considerations seem to have prevented several companies from availing themselves of this cross-listing facility.

Source: World Bank, 2007.

SADC, six members of which are also COMESA members, is exploring an interesting form of cooperation to increase the scale of capital market activity. The intention is to link SADC stock exchanges in the region through a “hub and spokes” system.³⁹ A broker in one country would have real-time, screen-based access to trading on linked stock exchanges. The broker would need either to be local or to have an agreement with a local broker, as stock exchanges only acknowledge domestic traders. COMESA should explore how well this scheme functions and could possibly associate itself with the scheme.

An effective linkage of national stock exchanges implies intraregional liberalization of exchange controls, since the latter are an impediment to capital market integration. Of the 14 countries responding to the COMESA study, 10 of the 19 member countries have some form of capital exchange controls (Table 3.8). These will need to be eliminated, at least on intra-COMESA flows, to permit a COMESA-wide capital market. This is rightly recognized as a priority in the COMESA Action Plan (see Appendix 3.1) and an earlier lifting of these controls is highly desirable.

Honohan and Beck (2007) pose the question whether international (IOSCO) standards for capital market regulation are too “heavy” and costly for African stock exchanges. They suggest that perhaps lighter-tough regulation might be better suited to African conditions. In that context it is interesting to note that the Zambian Stock Exchange is exploring setting up a “second” board, along the lines of some existing in advanced economies. The second board would have less onerous requirements in terms of company governance and information requirements for new listings as well as listing fees. The Nairobi Stock Exchange has already established such a second board, and Egypt is also considering doing so. This approach requires further study by COMESA countries, and it could be helpful to draw up joint agreements on listing requirements across COMESA countries.

³⁹ This option is additional to the three mentioned in the World Bank study; i.e. (i) establishing a central clearing and settlement facility for trades in securities in national trading platforms; (ii) national exchanges form a single electronic platform and (iii) clearing and settlement system with specialist portals located in individual countries; strengthen the most efficient exchange in the region and merge that with other exchanges to form a single market.

When considering possible linkages of national stock exchanges, COMESA might also wish to explore the introduction of region-wide capital market products, such as a regional bond issuance. A case in point could be the finance to be raised by the COMESA Regional Infrastructure Development Company, which is currently being set up. It could issue infrastructure development bonds to be subscribed by residents across the COMESA membership. The proposed financing of individual projects via the SPV and PPP mechanisms would also contribute to the development of region-wide investment products. Further, as is being done in the EAC, if a part or whole of subscriptions to local IPOs in national markets is reserved for “nationals,” this could be expanded to include nationals of all COMESA member countries.

Table 3.8: COMESA: Exchange Controls

COMESA member	Exchange controls	Exchange controls on current account	Exchange controls on capital account
Burundi	X		X
Egypt			
Eritrea	X		
Ethiopia	X	X	X
Madagascar	X		X
Malawi	X	X	X
Mauritius			
Rwanda	X		X
Seychelles	X		
Sudan	X		X
Swaziland			
Uganda			
Zambia			
Zimbabwe	X	X	X

Source: COMESA report

Key: X = Exchange controls are in place

3.4.4 Non-banking Financial Institutions, Pensions and Insurance

Table 3.9 provides data relating to pensions, insurance, and other non-bank financial institutions (NBFIs), based on the (limited) information gathered by COMESA and other sources. In general, the insurance sector in COMESA is still very small, and the life assurance subsector in particular is highly underdeveloped. Of the 19 member countries, Egypt, Mauritius, Uganda, and Zimbabwe have a significant number of insurance companies (20 or more), while others have less than 10 companies each. It is only in Mauritius and Kenya that these insurance companies control a significant proportion (11.7 and 8.2 percent respectively) of total financial assets, and of GDP (18.1 and 6.8 percent respectively), based on 2004 figures (see Table 3.9). In Egypt, on the other hand, financial assets controlled by the insurance companies amounted to less than 3 percent of total financial assets and of GDP.

Table 3.9: COMESA: Structure of Non-Banking Financial Institutions, 2004

COMESA member	INSURANCE COMPANIES			PENSION FUNDS			OTHER NBFIs		
	No.	Assets as % of Total Finan. Assets	GDP	No.	Assets as % of Total Finan. Assets	GDP	No.	Assets as % of Total Finan. Assets	GDP
Democratic Republic of Congo	1	...	0.5	1	...	0.4	32	...	1.3
Egypt	31	2.2	2.9	...	...	...	...	...	...
Ethiopia	8	1.5	1.4	1	1.5	1.4	1,050	3.0	2.9
Kenya	44	8.2	6.8	781	...	13.2	2,689	15.0	12.6
Mauritius	24	11.7	18.1	1,007	18.9	29.3	275	7.6	11.8
Seychelles	2	2.1	3.4	1	5.0	8.3	3	5.8	9.6
Rwanda	4	4.3	1.5	1	20.6	7.1	5	7.1	2.4
Uganda	19	...	0.8	2	...	2.5	83	...	0.3
Zambia	8	3.5	1.6	190	16.7	7.0	42	23.1	9.7
Zimbabwe	23	3.6	4.1	28	2.0	2.3	171	10.2	11.4

Sources: Anne Marie Gulde et al., Sub Saharan Africa: Financial Sector Challenges, IMF (2006); and other published IMF data

Asset accumulation by pension funds is relatively limited in the COMESA region. While there are some private pension funds, they are relatively small. The public sector dominates the pension sector and pension schemes are frequently pay-as-you-go systems (Rwanda) and support the budget either directly or by acquiring government securities. Kenya and Mauritius appear to have a significant number of pension funds, with financial assets equivalent to over 13 and 29 percent of GDP, respectively. However, in terms of the percentage of total financial assets controlled by pension funds, Rwanda's sole pension fund controls nearly 21 percent, compared to 19 percent for Mauritius. Little information is available on the financial sustainability of these funds, though some are reported to be in a dire situation. Thus, a study on Democratic Republic of the Congo pension fund notes: "The Institut National de Sécurité Sociale (INSS) also faces serious difficulties. The INSS is not able to collect the premiums it needs to pay claims because of the large size of the informal sector and the number of public enterprises in distress. Moreover, much of its infrastructure has been mismanaged."

3.5 Status of the Supporting Financial Infrastructure

3.5.1 Supervision and Regulation of the Banking Sector

Efficient and independent systems of regulation and supervision are key to achieving and maintaining financial system stability, while rigorous standards for financial reporting improve the transparency of financial institutions and instill confidence in the solvency of the system.

Banking supervision and regulation vary across the membership. Episodes of bank difficulties in the 1990s and early 2000s have brought home the need for strengthening supervision, and most COMESA members are engaged in capacity building in this area, some with donor support. In 2003 agreement was reached on a Banking Supervision Harmonization Framework that would establish harmonized banking regulation across the membership. Data are not available to permit an assessment of overall progress toward this goal; a survey conducted by the COMESA

Secretariat in 2006 elicited responses from just seven members, and this indicated that not all of the harmonized standards had been implemented.

Evidence from published IMF documents also points to the same conclusion and stresses the need for continued capacity building in this area. In particular, risk-based supervision and consolidated supervision still need to be introduced in most member countries (only Mauritius and Zimbabwe conduct consolidated supervision) and the quality of monitoring and enforcement of existing regulations need to be enhanced. Nevertheless, the path forward is well defined by the COMESA Framework, and the quality of banking supervision in the majority of member countries appears to be adequate. Discussions with banks in Mauritius, Kenya, and Zambia indicated that banking supervision was functioning well in those countries. Banks would welcome further progress toward harmonization across COMESA, and in particular a standardization of reporting requirements, which differ significantly among central banks.

Full implementation of the COMESA Framework is hampered by a lack of capacity, human and material, in many countries. Capacity constraint is a real issue that would argue in favor of vesting scarce resources in a regional supervisor. Some African regional groupings have taken this approach. However, COMESA has opted to encourage coordination and harmonized standards, but it lacks an effective follow-up mechanism for enforcement. EAC countries, some of which are also members of COMESA, have taken a somewhat more proactive coordination stance. It would seem that COMESA is too large, and its members too varied, to realistically argue for one common banking supervisor. However, a greater commitment to coordination with proper monitoring and enforcement mechanisms is called for. At the same time, members could consider a flexible approach by establishing regional integrated supervisors, if considered efficient and cost-saving. Care must be taken to ensure that such a regional supervisory body does not become simply another bureaucratic layer; in other words, it must be assured appropriate independence and the authority to function.

Basel Core Principles are the internationally accepted standards and benchmark to judge the efficacy of bank supervision and regulations. The 2003 report on bank supervision concluded that many member countries suffer from various deficiencies in this regard. Problems that have been encountered in the implementation of the 25 Basel Core Principles include: inadequate legislative frameworks, inadequate human and technological resources, lack of skilled supervisory staff, and lack of adequate policies and procedures to implement effective off-site and on-site inspections. The 2003 report made several recommendations in the form of a Framework and an Action Plan for improving bank supervision. Although full recent information on compliance with those principles in each member state of COMESA is not available, the 2007 report on *Effective Harmonization of Financial System Development and Financial Stability* (FSDS) indicates that some progress has been made in improving bank supervision. Thus, most members were found to be compliant, or largely compliant, with 16 or more of the Basel Core Principles. Six countries were largely compliant with all the 25 core principles.

3.5.2 Supervision and Regulation of the Non-banking Sector

Typically, regulation and supervision of the insurance sector, as well as of the pension funds, is weaker than that of the banking sector, and in many countries the legal and regulatory framework needs to be strengthened. In some cases the insurance sector is still regulated by the Ministry of

Finance (Seychelles) rather than by an independent regulator. In some countries, the state has a monopoly on insurance (Eritrea, DRC) or plays the dominant role (Egypt). A recent Fund staff study on the Democratic Republic of the Congo notes: “The state owned Société Nationale d’Assurances (SONAS), which has a monopoly on the insurance market, faces serious financial difficulties. Its restructuring and opening the sector to competition is essential to improve the availability of insurance products at a reasonable cost.”

Stronger insurance and pension sectors will help capital markets and the economy by providing increased long-term investment funds. It is therefore important for member countries to: (i) strengthen the regulatory framework and oversight over insurance companies and (ii) reform pension funds to ensure their health. The sectors can benefit from an opening-up of borders to permit enhanced economies of scale. But in the short run, the focus should likely be on strengthening regulation and supervision in individual countries, where necessary through the establishment of independent regulators.

3.5.3 Legal Supervisory Framework for the Financial Sector

Most COMESA countries have adequate legal supervisory frameworks in place, but certain aspects need strengthening, particularly in respect to the effectiveness of implementation. In general, central banks and banking laws are in place. In 12 countries of the region, central banks regulate only the banking sector; in Ethiopia the central bank regulates all the banking and non-banking financial sector; while in Madagascar the Banking and Finance Supervision Committee regulates the banking sector, the microfinance sector, and the Bureau de Change. The national payment and settlement system is regulated by the central bank in eight countries, and in other countries by the Ministry of Finance. Legal systems that adequately support enforceability of transactions and the finality of settlement are in place in seven countries. Only five countries have a framework for netting arrangements and securities lending. In some countries, legal provisions for strengthening supervisory independence need to be put in place. The 2007 report on financial system development also emphasized the need to harmonize fragmented banking laws in some member countries.

As noted above, until the present, supervisors have enjoyed only limited independence. This has meant that they have sometimes lacked the means to take prompt corrective action when required, in particular when a state-owned bank encountered difficulties. As a result, weak banks have remained in the system for too long. A similar situation is likely to prevail in the insurance and pension sectors, although difficulties may stay hidden there for much longer. As the World Bank report remarked in the case of EAC, national legal problems need to be addressed first before any meaningful progress can be made toward regionalization.

Financial sector regulations are only as effective as the larger body of law and regulations supporting commercial transactions. Commentators generally agree that weak property rights and poor enforceability of contracts constrain financial market activity. One of the reasons for banks’ reluctance to lend is because of difficulties in securing collateral and seizing assets in the case of loan defaults. Shortcomings in the judiciary systems in COMESA countries, including lack of independence, add to enforcement difficulties.

The legal framework for the non-banking financial sector also needs to be strengthened in several countries. In some cases, framework laws need to be put in place for the insurance and pension sectors; in others the independence of supervisors needs to be strengthened; and in general, regulatory and supervisory practices need to be overhauled. Adoption of needed legislation can, though, be a time-consuming process. For example, in the case of Swaziland, the passage of three important pieces of legislation are reported to be still pending: the Securities Bill (1993), aimed at developing the securities market; the Financial Services and Regulatory Authority Bill (FRA 2003), aimed at consolidated supervision and regulation of non-bank financial institutions, including SCCOs, insurance and pension funds; and the National Clearing and Settlement Systems Bill (NCSS, 2004).

3.5.4 Payment and Settlement Systems

While most COMESA countries have in place adequate payment systems, not all these systems have been modernized and there is significant work to complete in this area. For example, not all countries have introduced real-time gross settlement (RTGS) systems. Out of the 14 countries responding to the COMESA questionnaire, only five countries indicated the use of an RTGS system (Malawi, Mauritius, Uganda, Zambia, and Zimbabwe). Kenya has also implemented an RTGS, and several countries (Egypt, Madagascar, and Rwanda) are close to making such systems operational (Table 3.10). While all countries have check-clearing systems, only about half have electronic funds transfer (EFT) systems (EFTS). Check-clearing system is still the most common method used within the region. Only four countries responded to the question on the speed for the settlement of transactions in equities, money, bond, and FX markets. Mauritius was the most efficient, with same-day settlement in all cases, whereas Zimbabwe was the most inefficient, with equities settling at T+7. While check-clearing systems are generally functioning adequately, in a few cases settlement is very slow (up to 30 days in the case of Democratic Republic of the Congo).

As in other African countries, SMEs experience high costs and delays for transfers and for foreign currency conversion. For example, at the airport in Zambia, banks and FX bureaux charge commissions of up to 20 percent; similar high commission charges are also common in Lusaka itself. There is need to develop payment systems geared toward low costs and accessibility needs, including establishing an appropriate low-cost regulatory framework for those systems.

Cross-border payments are currently conducted via banks' correspondent accounts with partner banks abroad or via banks with cross-border subsidiaries.⁴⁰ Such a system can function well and may be all that is needed, in particular if payment volumes are low. However, it may favor the large international banks, in part because smaller banks will have to establish trust before being accepted abroad as a correspondent bank. It has been found that linking payment systems into a regional group (such as the EU's TARGET system) can be a powerful tool in supporting financial integration and in complementing efforts to foster regional trading arrangements.

⁴⁰ A significant volume of cross-border trade, much of it unrecorded, is transacted on a cash basis, involving the physical transport of bank notes in domestic or foreign currency.

Table 3.10: COMESA Selected Indicators for Availability of Information & Payments Systems, 2005

COMESA member country	Credit Information Bureau	IFRS	Electronic Funds Transfer (EFT)	Real Time Gross Settlement (RTGS)
Burundi	...	...	...	no
Comoros	...	...	...	n/a
Congo, Democratic Republic of	...	...	no	no
Djibouti	...	...	...	...
Egypt	yes	yes	no	soon
Eritrea	...	no	...	...
Ethiopia	..	...	yes	no
Kenya	yes	yes	soon	yes
Libya	no	no	no	no
Madagascar	yes	partly	no	soon
Malawi	...	partly	yes	yes
Mauritius	yes	yes	yes	yes
Rwanda	...	yes	no	soon
Seychelles	...	...	no	no
Sudan	...	...	yes	no
Swaziland	...	partly	yes	no
Uganda	yes	yes	yes	yes
Zambia	...	yes	yes	yes
Zimbabwe	...	yes	yes	yes

Sources: COMESA. *Report and Proposed Guidance on Effective Harmonization of Financial System Development and Stability*; and published IMF documents.

As part of its drive toward a fully effective FTA and customs union, and to reduce costs of cross-border financial transactions, COMESA is setting up a Regional Payments Settlement System (REPSS), linking members' national payment systems (see Box 3.2). Unlike the EU's TARGET system, the REPSS is a netting system, which may be operationally easier and cheaper to set up, but it lacks some of the safety and finality features of an RTGS system. If REPSS proves to be cheaper to use than correspondence banking, it will be able to attract a larger volume of smaller transactions (including cash and carry), which will help to level the playing field for smaller banks.

3.5.5 Information Systems for Regional Financial Integration

Accounting Standards Accountancy practices vary across the COMESA region. While most members require the use of International Financial Reporting Standards (IFRS) for financial sector enterprises, there is no uniformity in their application. Only four out of 14 respondents to the COMESA study used all standards, while four did not use any standards. In addition, even when in principle applying full IFRS, assessments by the World Bank of the implementation of accounting standards have found that many companies are deficient in their application, in part because of lack of sufficiently trained personnel and the absence of enforcement mechanisms.

Box 3.2. COMESA: Regional Payment and Settlement System (REPSS)

The Regional Payment and Settlement System (REPSS) is at an advanced stage of completion. Software and hardware have been acquired with EU financing, the system is being tested, and training is being provided. It is as yet unclear how many COMESA members will participate from the outset. COMESA follows a variable speed approach, which allows those members who are willing and able to join immediately, whereas others may join when ready. It is also not clear whether, once a country decides to join REPSS, individual banks will participate or not. Zambia intends to make bank participation compulsory.

REPSS is a multilateral netting system with end-of-day settlement in a single currency (Euro or US Dollars). Under REPSS, the exporter's currency will be quoted on letters of credit; transactions will be settled at spot T+0, with value T+2, at the agreed spot exchange rate; a single currency will be used for net settlement; a single nostro correspondent will be used for the net settlement currency; the COMESA Clearing House will act as the agent of the central banks; and bilateral limits will be set by each central bank at the Clearing House. Agreement has been reached that the Central Bank of Mauritius will act as the settlement central bank, and it has accordingly set up settlement accounts in Euro and US Dollars.

REPSS should lead to a reduction in transactional and operational costs. REPSS will bring about a reduction in: (i) settlement transactions; (ii) liquidity requirements to secure payments; (iii) exposure to foreign counter-parties; and (iv) foreign correspondent banking charges for covering confirmation/ drawing of LCs by correspondents. REPSS will also bring about a switching of relationships for trade transactions from commercial banks/foreign correspondent to commercial bank/central banks for intra COMESA trade.

REPSS links central banks' RTGS systems via an interface with the COMESA Clearing House. As noted above, not all countries have yet introduced an RTGS system. It is also feasible to develop a separate interface for those countries that have an electronic retail payment system, but this work is not yet completed.

Sources: COMESA and Bank of Mauritius

The situation is even more varied at the level of the customers of banks, where most countries use national standards. Indeed, it would likely be too onerous to require most enterprises to apply IFRS. IFRS was designed to meet the needs of equity investors in companies in public capital markets, and cover a wide range of issues, contain a sizeable amount of implementation guidance, and include disclosures appropriate for public companies. Users of the financial statements of SMEs, such as banks, do not have all those needs, but, rather are more focused on assessing shorter-term cash flows, liquidity, and solvency. Also, many SMEs have found that full IFRS imposes a heavy burden – one that has been growing as these standards have become more detailed and more countries have begun to use them. Furthermore, as noted by some regulatory agencies in other regions, enterprises are also required to prepare accounting statements to satisfy national fiscal requirements, and those standards do not correspond to IFRS.

The new International Financial Reporting Standard (IFRS) for SMEs, which are currently being developed by the International Accounting Standards Board (IASB) could be very relevant to COMESA members. IASB's twin goals in this respect are to meet user needs while balancing costs and benefits from a preparer perspective. The objective is to develop an IFRS expressly designed to meet the financial reporting needs of entities that (i) do not have public accountability and (ii) publish general-purpose financial statements for external users. Examples of such external users include owners who are not involved in managing the business, existing and potential creditors (banks), and credit rating agencies. The IASB plans to issue a final IFRS for SMEs in the fourth quarter of 2008. COMESA, with donor support, could take the lead in championing the new standards and in organizing appropriate training.

Credit Information Systems Transparency is key to expanding the availability of credit in COMESA. In addition to harmonizing accounting standards on the new IFRS for SMEs, and on international auditing standards, it is now generally accepted that a Credit Registration Bureau could play an important role in enhancing transparency. According to Honohan and Beck (2007), 80 percent of developing countries have now established such a credit registry, but data indicate that only five COMESA countries have put these in place. It would be desirable for COMESA members to implement the recommendation of the financial sector development report and put in place such registries (Credit Reference Bureaux) as soon as possible, in part because increased transparency helps compensate for, or obviate the need for recourse to, inefficient judicial systems.

3.6 Assessment of COMESA's Progress toward Financial Sector Integration

The above review of the status of the financial sector and supporting infrastructure across COMESA member states indicates that significant progress has been made in modernizing national financial systems, although the degree of reform differs between countries. Moreover, for the COMESA region as a whole, further measures are needed to make the systems compatible with international standards. Nevertheless, taking advantage of the reform measures being implemented at national levels, the region has also taken various steps to foster financial sector integration among its member states. This process has been led by the COMESA Secretariat, which has provided intellectual and technical input at the national and regional levels.

The first major internal impetus to RFI came with the adoption of the 2003 Banking Supervision and Harmonization Framework, which outlines areas of harmonization in the COMESA region and suggests minimum standards and timelines for these. The areas for harmonization include: legal framework; licensing, accounting and disclosure standards; consolidated supervision; internal and external audits; and IT systems, among others. This impetus was followed by the adoption, in 2007, of the Plan for the Effective Harmonization of Financial System Development Stability (FSDS) in COMESA, which includes a number of recommendations under a detailed Plan of Action (see below, and Appendix 3.1).

It appears that financial integration is indeed taking place at the ownership level of banks in most COMESA countries. This is encouraging, as enhanced integration will not only increase competition and efficiency through increased scale of operations, but will also facilitate cross-border payments in support of trade and economic integration. Discussions with commercial banks during this study indicated an interest on the part of domestically owned banks in expanding their networks into neighboring countries. This aim was in part to “follow their customers,” but also to increase scale and earnings potential. For example, Mauritius Commercial Bank has established subsidiaries in Seychelles and Madagascar and is considering further expansion into East Africa. They stressed, however, that they would move cautiously since it is very difficult to assess risk in Africa, partly because of corruption. Kenya Commercial bank has opened subsidiaries in Rwanda, Sudan, and Uganda; Fina Bank of Kenya has opened a subsidiary in Uganda; and Kenya Equity Bank has acquired a large microfinance bank that has several branches across Uganda. Finance Bank in Zambia also indicated advanced plans for moving into DRC, Uganda, and Zimbabwe.

With the exception of Eritrea, Ethiopia, and Libya, COMESA members allow liberal access to foreign banks. The increase in cross-border ownership of banks in COMESA states, both intra and extra regional, has been a major impetus to financial integration. Most COMESA countries host a subsidiary of one of the major international banks (Table 3.6). In particular, Barclays, Stanbic, and Standard each have networks in about half of the member states, and also outside the COMESA region. Most cross-border moves are, perhaps not surprisingly, initially directed toward neighboring countries and close trading partners. Discussions with commercial banks suggest that, while they would welcome uniform licensing rules and a “common passport,” they do not see current individual practices as major obstacles to establishing subsidiaries in other COMESA countries.

Notwithstanding the above developments, the integration process still has far to go. This is for two reasons: (i) some countries have yet to achieve macroeconomic stability, which is an essential precondition for integration into a regional financial system, and (ii) the modernization and harmonization process among member countries is at different stages of implementation. Progress in achieving financial market soundness and development has been uneven across the COMESA membership. In those cases when a member has benefited from a joint IMF/World Bank FSAP, the country in question has been able to draw up detailed financial sector development plans which have helped strengthen and develop their financial systems (Egypt, Kenya, Madagascar, Mauritius, Rwanda, Uganda, and Zambia).

In the absence of more detailed country assessments, and given the complexity of formulating and implementing various policies toward full integration, Table 3.11 provides some indications as to the preparedness of different countries for RFI. In this context, the table offers some preliminary guidance as to how the COMESA Action Plan for Financial Development and Stability could be prioritized in different member states to enhance RFI.⁴¹ This categorization needs to be confirmed by detailed country assessments (supported by the conduct of an FSAP for those countries that have not yet undertaken one, and an FSAP update for those whose assessment was undertaken some years ago) and by further discussions with the COMESA Secretariat.

⁴¹ It is even more difficult to make an assessment of how COMESA as a whole should be rated. As to the regional criteria, all criteria of Stage I have been met (except perhaps the one on technical assistance). Several, but not all of the regional criteria of Stage II have also been met. Some countries are not yet adhering fully to the FTA, intra-regional exchange controls have not yet been fully liberalized, and a regional surveillance and monitoring mechanism is not fully effective. Disregarding that some countries have not yet met preconditions, as a rough approximation, COMESA members on average are working toward fulfilling Stage II domestic conditions. ***Thus, overall, COMESA could be rated as being in Stage II of financial integration.***

Table 3.11: COMESA: Stages of Country Preparedness for Regional Financial Integration

	Pre-Financial Integration	Stage I (Preparatory)	Stage II (Harmoniz- ation)	Stage III (Cooperation)
Burundi	X			
Comoros		X		
Congo, Democratic Republic of	X			
Djibouti			X	
Egypt				X
Eritrea	X			
Ethiopia		X		
Kenya				X
Libya	X			
Madagascar			X	
Malawi			X	
Mauritius				X
Rwanda			X	
Seychelles	X			
Sudan		X		
Swaziland			X	
Uganda				X
Zambia				X
Zimbabwe	X			

Sources: consultants' estimates based on COMESA data and published IMF data.

Based on the above classification, COMESA member countries fall into four distinct categories of their readiness to achieve financial integration: (i) six countries (Burundi, Democratic Republic of the Congo, Eritrea, Libya, Seychelles, and Zimbabwe) that are yet to meet the preconditions for entering into RFI,⁴² (ii) three countries (Comoros, Ethiopia, and Sudan) that have fulfilled the preconditions and could move to Stage I of RFI,⁴³ (iii) five (Djibouti, Madagascar, Malawi, Rwanda, and Swaziland) that could move to the second stage of RFI,⁴⁴ and

⁴² In some of these countries (Eritrea and Libya), the authorities are yet to open up the banking system and have a long way to go in reforming their financial systems. Others (Burundi, Congo DRC, Seychelles, and Zimbabwe) have too fragile macroeconomic frameworks.

⁴³ These have not yet introduced RTGS systems and have some way to go in improving banking supervision and regulatory frameworks as well as core legal frameworks.

⁴⁴ Banking systems in these countries appear to be sound, and they have made good progress on supervision and regulation. They have also made good progress on improving payments systems and have already introduced, or are at an advanced stage of introducing, RTGS. They all meet the regional criteria required for Stage II.

(iv) five countries (Egypt, Kenya, Mauritius, Uganda, and Zambia) that have taken sufficient measures to move on to the third stage of RFI.⁴⁵

Kenya, Mauritius, Uganda, and Zambia, having fulfilled the requirements of COMESA FTA, could therefore become the first group of countries to form a “subregional” group to advance RFI. This would principally entail adhering to the COMESA customs union, launched in June 2009⁴⁶, and undertaking measures indicated under Stage III of the above categorization that are also included in the COMESA Plan of Action for financial sector development. Simultaneously, these five countries should also review whether there are any measures under the previous stages that they still need to undertake. This group would then serve as the “beacon” for other countries and encourage them (including through the provision of technical assistance) to take the necessary measures to progressively integrate into that group.

Some may argue, with a degree of justification, that the COMESA region is too disparate and geographically spread across the continent of Africa to form one regional financial union at the outset. Thus, as has happened within ECOWAS, RFI within COMESA may develop at different rates in two or three separate subgroups of countries, consistent with the “variable geometry”⁴⁷ approach COMESA has adopted for trade integration. This course of action would probably accelerate regional financial integration and ultimately the cohesion of those states into one economic community.

The COMESA Action Plan (see Appendix 3.1) details a number of measures and a timetable for their implementation, which appears appropriate for the specified objectives of RFI. But it could benefit in places from stronger prioritization, especially at country levels; it also needs more realistic timelines. For example, priority should be given to achieving and maintaining exchange rate stability, which would encourage cross-border investment and possible development of securities markets and products. Liberalizing intraregional exchange controls, and strengthening securities markets regulations and supervision, would also attract FDI into the region. COMESA should also not be in a hurry to move to Basel II, since there are significant risks if the move is not well prepared. Experience shows that in a sophisticated banking market, and even with a strong and well-resourced supervisor, it can take 4-5 years to introduce Basel II. At the current stage of development, priority should be focused on ensuring that banks are on a sound footing and on fully implementing Basel I and the Basel Core Principles.

The proposed categorization in this report of RFI into five different stages, and the steps to be taken at each stage, could assist in this prioritization exercise. As an illustration, Table 3.12 has been prepared to indicate how various components of the COMESA Action Plan could be implemented during each categorization stage of RFI. Again, it should be emphasized that the

⁴⁵ These have sound, well-regulated financial systems that are more diversified than those of other COMESA countries. Financial infrastructure is also relatively well developed. For example, all have in place RTGS systems and are advanced in developing, or have already introduced, electronic payments systems. All require IFRS for their financial systems. These countries also meet all the regional criteria.

⁴⁶ The COMESA Customs Union (CU) has been launched at the 13th Summit of the COMESA, which was held in Victoria Falls, Zimbabwe, in June 2009.

⁴⁷ The idea of “variable geometry” is that each member need not subscribe to every policy of the regional organization simultaneously, but that a degree of flexibility be retained to allow for the individual conditions and varying development stages of member states.

measures listed under each stage are an approximation and are intended solely to initiate discussions on how to prioritize actions under COMESA Action Plan.

Table 3.12: COMESA: Implementation of Action Plan by RFI Stages

Stage I	Stage II	Stage III	Stage IV	Stage V
Macro Stability: A (a-d) Strengthen financial system architecture, incl. elements of A Promote financial soundness, incl. adopting COMESA minimum criteria and work towards adopting international standards: B 1-2 Develop financial infrastructure, including sequenced action plan strengthening payment system and enhancing banking supervision and regulatory framework: C 1-4 Enhance legal and regulatory framework: D1-4 Meet Basel I capital requirement for banks: E1	Macro stability A (e-g) Strengthen financial system architecture, A A3, 4(a, b) Promote financial system soundness, incl. establishing credit bureaux and enhancing insolvency and banking laws: B 5-6 Further develop infrastructure, incl. introduction of RTGS and adopting IFRS C1-4 Enhance regulation of insurance and pension sectors: J 1-3 Develop and strengthen supervisory and regulatory framework for MFI: K 1-3	Further promote financial system soundness: B 3-4 Enhance anti-money laundering activities: D5 Further strengthen compliance with BCP Core principles: H 3 Introduce consolidated supervision: I 1-4 Complete overhaul of supervision of insurance and pension sectors: J 4-12	Establish deposit insurance scheme: D 6 Fully implement risk based supervision: F1 Establish roadmap for implementing Basel II: G1	Establish a common currency

* Note: Item numbers refer to Appendix Table Action Plan for Macroeconomic Convergence and Financial Sector Development.

The above classification implies, for example, that not all the convergence criteria listed in the Action Plan need to be satisfied to begin the process of regional financial integration, and that compliance could be spread over the first two stages. Similarly, the development of capital market infrastructure should be attended to once measures requisite to Stage I have been completed, and before new products, such as the derivatives, are introduced (Stage III). The rating of banks etc. by international rating agencies should, on the other hand, await the establishment of appropriate legal systems and harmonization of banking laws, which need to precede the establishment of deposit insurance schemes.

The COMESA report rightly stresses the need to develop country-specific, comprehensive Financial System Development Plans. Some countries have already done so with good results, following IMF/World Bank FSAPs, although timetables have frequently slipped because of difficulties in taking hard political decisions. Those countries that have not undertaken FSAPs should do so, while those with FSAPs may need to undertake updates to assess progress and reprioritize, if necessary.

Three vital issues need emphasis: *political commitment*; carefully developed, *country-specific action plans* with realistic deadlines and strong ownership; and *donor coordination* in support of

such action plans. Taking the first of these, political commitment and ownership are crucial for furthering economic integration. Also crucial is monitoring progress toward fulfilling commitments already undertaken. COMESA members would do well to examine whether their administrative set-up in support of economic integration could be strengthened. Integration cuts across many government ministries and regulatory agencies, so it may be necessary to set up a coordination commission, including all the parties involved, to develop members' positions and to ensure follow-up. The chairman would need to be of sufficiently high stature to move the process forward, and possibly would require cabinet status. A strengthened administrative set-up at the membership level would help avoid a situation where only two-thirds of members respond to a very important survey.

Commitment can be enhanced by accountability, and the COMESA Secretariat should be strengthened to ensure appropriate follow-up. Better monitoring mechanisms should be put in place to allow a better understanding of the situation in each member country. Periodic assessments of the follow-up required by each member should be prepared and discussed at the Council of Ministers.

3.7 Role of Development Partners Going Forward

Various areas have already been indicated where the development partners could assist COMESA in furthering RFI. In the first place, countries need to update FSAPs to assess the current status of their financial sector and identify the immediate areas for strengthening and modernizing. The obvious areas may be the payments systems, especially for small transactions and for cross-border payments, bank supervision, and regulation. This area of assistance falls squarely with the IMF and the World Bank, though the AfDB could be associated with those missions, especially if capacity building and technical assistance are anticipated. The EU has provided useful assistance to COMESA in funding software for REPSS and could continue to assist in that area.

This report has emphasized the urgency of developing capital markets by strengthening and modernizing securities markets and their regulatory framework, and by increasing their scale through linkages. The World Bank and the IFC could provide the necessary technical input into COMESA's efforts in this area.

COMESA is well advanced in implementing a fully effective FTA, and a customs union is scheduled to be launched in 2009. Integration in trade and services will provide further impetus to RFI. The EU and the World Trade Organization (WTO), could provide support in these areas through technical and financial assistance, especially under Aid for Trade provisions to meet the social costs of liberalization. This aid could usefully be channeled through the Adjustment Facility window of the COMESA Fund. The AfDB, along within the World Bank and the IMF, could assist in assessing the social costs of adjustment implied in a customs union arrangement, and provide policy advice and other assistance to meet those costs.

The COMESA region has very large needs for trade-related infrastructure development, which could be interpreted to include financial sector infrastructure. COMESA's innovative initiative to establish the COMESA Infrastructure Development Company, with majority private sector participation, is worthy of full support from its development partners, in the form of both

technical and equity participation. The technical work of developing appropriate projects for financing will be handled by the COMESA Secretariat (COMAID), which will require substantial technical assistance in at least the initial stages.

The COMESA Infrastructure Development Company also intends to raise project financing from capital markets through SPVs and PPPs. A part of that financing could be raised locally within the region. This, combined with possible development of a regional bond market in COMESA, could advance RFI. The AfDB can help this process through its private sector window, using products such as guarantees, loans, and grants.

Experience to date with COMESA's efforts to monitor the implementation of its harmonization framework has revealed weaknesses, including incomplete coverage of relevant statistical information, and a tendency to "paper over" deficiencies in implementation at the national levels, and in the monitoring system. As RFI advances, monitoring and evaluation will become more complex and more demanding. One way to meet this requirement, and to lend credibility to the process, may be to have a more impartial evaluation mechanism. The AfDB may consider taking a progressively leading role in assisting COMESA in the evaluation and integration process, along the lines taken by the Asian Development Bank.

**Appendix 3.1: COMESA Action Plan for Macroeconomic Convergence and
Financial Sector Development**

1. Macroeconomic Convergence

ITEM NO	POLICY OBJECTIVES	ACTION PLAN	OUTPUT	EXECUTING AGENCY	TARGET DATE
A	Ensuring Macro economic Stability	Member countries implement the following agreed upon COMESA macroeconomic convergence criteria: Primary Criteria: (a) Overall budget deficit/GDP ratio (excluding grants) of not more than 5%; (b) Annual average inflation rate not exceeding 5%; (c) Minimize the central bank financing of the budget towards 0% target; and (d) External reserves of equal to or more than 4 months of imports of goods and non-factor services. Secondary Criteria: (a) Achievement and maintenance of stable real exchange rates; (b) Achievement and maintenance of market based positive real interest rates; (c) Achievement of sustainable real growth rate of real GDP of not less than 7.0%; (d) Sustained pursuit of debt reduction initiative on domestic and foreign debt. i.e. reduction of total debt as a ratio of GDP to a sustainable level; (e) Total domestic revenue to GDP ratio of not less than 20%; (f) Reduction of current account deficit (excluding grants) as a % of GDP to sustainable level; and (g) Achievement and maintenance of domestic investment rate of at least 20%.	1. Sound fiscal and monetary policies to support growth, control inflation, and promote the strengthening and deepening of the financial sector. 2. Market determined exchange rate interest rates and price for goods and services 3. Tradable level of government private sector securities in all member countries to provide benchmark interest rates and control liquidity. 4. Coordinated macroeconomic policies leading to the smooth implementation of regional integration. 5. Increased FDI. Free movement of capital.	Governments and Central Banks	2010

2. Financial Sector Development

ITEM NO	POLICY OBJECTIVES	ACTION PLAN	OUTPUT	EXECUTING AGENCY	TARGET DATE
A	Financial System Architecture and Development	1. Establishing a sound framework for private sector development in the financial system 2. Relax exchange controls 3. Participate in developing a policy and institutional framework for rural financial inclusion 4. Promote capital market reforms and development. This will include the following: a. Establishing well-regulated and active	1. Reduce government ownership of the banking sector 2. Free movement of capital and labor 3.a. Enhanced access to financial services. This serves to integrate the formal and informal financial markets 3.b. Establishment of rural banks/ MFIs 4. Enhanced financial stability and diversification of financial services.	Governments and Central Banks	2010 2010 2008 2008 - 2010

ITEM NO	POLICY OBJECTIVES	ACTION PLAN	OUTPUT	EXECUTING AGENCY	TARGET DATE
		derivative markets. b. Enhancing framework capital markets securities regulation to: i. License, supervise and monitor activities of securities and capital market players. ii. To set standards of competence for the activities of brokers, dealers, advisors and traders. iii. To support the operation of orderly, fair and informed capital and securities markets. iv. To safeguard the securities markets from improper, illegal and dishonorable practices.			
B	Promoting Financial System Soundness	1. Adopt international best practice in supervision and regulation of the financial sector 2. Adopt COMESA minimum criteria for harmonization of banking supervision adopted in 2003 3. Encourage strategic alliances in the banking sectors 4. Encourage major banking institutions and regional banks to be rated by internationally renowned rating agencies 5. Establishment of Credit Reference Bureaux 6. Harmonize the administration of the insolvency and banking laws 7. Developing a transparent entry and exit framework for the banking sector 8. Adoption and enforcement of mandatory Prompt Corrective Action (PCA) system	1. Regional Memoranda of Understandings that require compliance with prudential regulations by member countries 2. (a) Harmonized Prudential standards, (b)Uniform surveillance and inspection procedures including standardization of reports submitted by banks 3. Emergence of strong banks 4. Increased market discipline. 5. Enhances credit culture in the region 6. Efficient insolvency and liquidation of banks 7. Encourages efficiency and financial deepening in the banking sector 8. (a) Improved transparency and predictability of regulatory practices (b)Minimizes regulatory forbearance	Central Banks/ banking Institutions	Ongoing Ongoing 2010 2008

ITEM NO.	POLICY OBJECTIVE	ACTION PLAN	OUTPUT	EXECUTING AGENCY	TARGET DATE
C	Developing Financial Infrastructure	1. Develop properly sequenced plans to modernize financial infrastructure, particularly the payment/clearing system, accounting and auditing system, credit system and the regulatory framework. 2. Establishing a framework for payment systems to cover the following: a. Promoting the use of electronic payment systems b. Enhance implementation of a Regional Payment and Settlement System. c. Adopt a modernized legal and regulatory framework for the payment system d. Educate the public on electronic payment system issues. 3. Harmonizing compulsory information Disclosures in financial statements as per international best practice. 4. Adoption of International Accounting and auditing standards, and ensuring their alignment with prudential requirements.	1. Adoption of electronic payment systems by all COMESA members including RTGS, POS, ATMS, STPS, etc . 2a. Efficient payment and settlement systems b. Facilitates the integration banking systems in the region. Enables members to use domestic currencies in inter-COMESA trade c. Legally enforceable rules, regulations, agreements and codes of conduct governing the payment system d. Effective usage of electronic payment systems 3. Enhanced market discipline 4. Enhanced market discipline	Governments, Central Banks, and banking institutions	2008 2010 2008 2008
D	Regulatory & Legal Framework	1. Empower central banks to execute their regulatory and supervisory functions 2. Ensure ongoing enhancement of legal and regulatory framework for commercial transactions, protection of property rights, enforcement of contracts and operation of financial institutions 3. Ensure ongoing enhancement of risk management and corporate governance practices 4. Enact legislation that offers consumer protection 5. Control anti-money laundering activities 6. Establish stand-alone deposit insurance schemes	1. Flexibility in central bank operations 2. Efficient legal system 3. Sound corporate governance and risk management systems 4. Consumer Protection 5. Safe and secure financial system 6. Efficient deposit protection scheme	Governments Governments Central banks Governments, lobbying groups and related agencies Government and Central Banks	Ongoing 2010 Ongoing 2010
E	Full Implementation of Basel I	1. Full compliance with Basel I	1. Enhanced financial stability	Central Banks	2008
F	Implementation of Risk-based Supervision	1. Fully implement risk-based supervision	1. Enhanced financial stability	Central Banks	2008

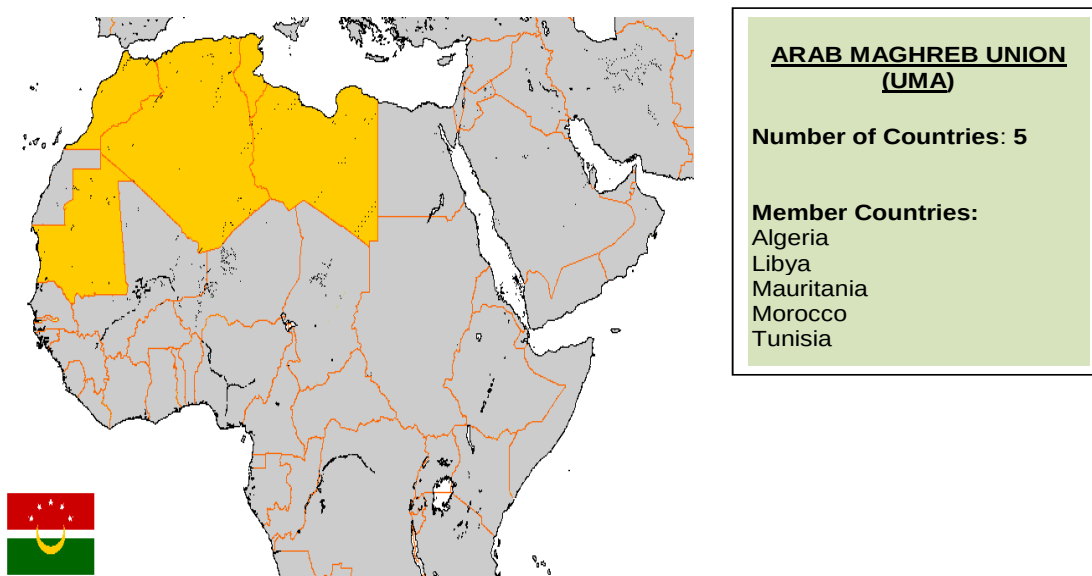
ITEM NO.	POLICY OBJECTIVE	ACTION PLAN	OUTPUT	EXECUTING AGENCY	TARGET DATE
G	Basel II Implementation	1. Establish a road map to implement Basel II i	1. Road map for Basel II implementation	Central Banks	2008
H	Full Compliance with the 25 Basel Core Principles for Effective Banking Supervision	1. Full adoption of the Core Principles for Banking Supervision 2. Undertake self evaluation of compliance with BCP and report to COMESA 3. Peer reviews on compliance with Core Principles for effective Banking Supervision	1. Enhanced financial stability 2. Facilitates regional harmonization	Central Banks / COMESA	
I	Consolidated Supervision	1. Developing a harmonized Consolidated Supervision Framework covering the legal and regulatory framework, quantitative and qualitative consolidated supervision. 2. Conduct workshops to put in place properly sequenced action plans for the implementation of consolidated supervision 3. Signing of MOU by regulatory agencies within states and externally spelling out areas of regional cooperation 4. Amendment of banking laws to provide for Consolidated Supervision where necessary 5. Capacity building for effective on-site and off-site supervision of financial sector	1. Regional Consolidated Supervision Framework, transcending cross-border issues 2. Clear road map for the implementation of CS covering activity, duration (target date) and official(s) accountable. 3. MOUs covering identification of lead supervisor, capital adequacy, MIS, information sharing, reports currency and exchange rate 4. An enabling regulatory framework 5. Competent and efficient staff at regulatory agencies	Central Banks	2007 2007/8 Ongoing 2008 Ongoing
J	Regulation of Insurance and Pension Sectors	1. Development and strengthening supervisory and regulatory framework for insurance sector 2. Enhance regulatory and supervisory standards to provide for ongoing supervision and surveillance and enforcement actions. 3. Build capacity of insurance regulators and supervisors 4. Review and enhance insurance laws to ensure they are up to date and in conformity with international best practice 5. Enhance transparency and stress higher standards of corporate governance 6. Limiting the extent to which insurers are able to enter into transactions with related parties 7. Introducing sophisticated and stringent minimum capital requirements e.g. Solvency II framework. 8. Review pension laws 9. Enhance regulatory and supervisory	1. Appropriate laws and prudential requirements 2. Laws, circulars and guidelines 3. Well equipped regulators and supervisors able to discharge their duties 4. Modern/appropriate legislation for the sector 5. Efficiently run companies 6. Limit insider abuse 7. Ensure adequate capitalization 8. Appropriate legislation	Governments	2010

		framework for pension funds 10. Build capacity of pension sector regulators 11. Facilitate establishment of voluntary or mandatory privately managed pension schemes 12. Enhance flexibility in choice of fund managers	9. Pension sector prudential guidelines and regulations 10. Expert supervisors 11. Alternative pension schemes 12. Enhanced choice and efficiency		
K	Regulation of Microfinance Institutions	1. Development and strengthening supervisory and regulatory framework for MFIs. This should adequately cover regulation and supervision without stifling competition 2. Development of a tiered approach to the supervision of MFIs 3. Embark on consumer awareness and education on regulatory framework governing MFIs. 4. Build capacity of microfinance institutions and supervisors	1. Laws and basic prudential guidelines creating an enabling environment for the development of MFIs and regulating their operations 2. Results in graduated supervision & surveillance of MFIs with incentives for graduating from one tier to the next. 3. Informed consumers 4. Well equipped regulators and market practitioners	Governments and central banks	2008

3. Financial Stability

ITEM NO.	POLICY OBJECTIVES	ACTION PLAN	OUTPUT	EXECUTING AGENCY	DATE
A	Financial Stability	1. Member countries to conduct annual financial stability assessments. a. Adopt Financial Stability Indicators b. Evaluate compliance with international best practices c. Conduct self and peer evaluation of financial stability 2. Implement macro-prudential analysis 3. Conduct stress testing of financial institutions at institutional level and system wide level 4. Adopt prompt corrective action systems	Enhanced stability, safety and soundness of financial system	Central Banks	2008

4. ARAB MAGHREB UNION⁴⁸



4.1 Introduction

The Arab Maghreb Union was established by a Treaty in 1989 between five Maghreb countries (Algeria, Libya, Mauritania, Morocco, and Tunisia). These countries are bound by a common heritage and are endowed with large natural resources. The economic structure of the countries is somewhat different but complementary. Algeria and Libya are naturally endowed with large oil resources, while Mauritania has a large mineral sector. These latter three countries have small and relatively less developed financial and manufacturing sectors. Morocco and Tunisia, on the other hand, have less-developed mineral and oil sectors but a much more developed and sophisticated financial and manufacturing sectors.

Considering that the five countries jointly have a population of about 81 million people, financial sector integration and active trade among them can only result in a major gain in terms of growth and development. However, although several bilateral trade agreements have been signed between these countries, they have rarely been implemented, and trade is hampered by a cumbersome list of trade and capital controls. Indeed, very little trade takes place among them, and there is very little financial integration within the Maghreb region. As a result, a considerable loss of resources and opportunities occur in the region.

⁴⁸ The authors of this section are grateful for the assistance in terms of documents and comments provided by the staff in the Middle East and Central Asia Department of the IMF. In particular, the basic data and other information on developments in the region, as well as some policy suggestions, have been derived from an IMF Working Paper by A. Tahari et al. (2007), *Financial Sector Reforms and Prospects for Financial Integration in Maghreb Countries*, IMF Working Paper /07/125.

Regional financial integration within Maghreb, as in other African countries, can yield benefits via three channels. First, it provides a powerful incentive for domestic financial reforms. Second, it increases the efficiency and profitability of the financial institutions by increasing their scale of operations. Third, it ensures the survival and growth of indigenous financial institutions into regional and global players by increasing their competitiveness in the face of competition from globalization. These benefits should translate in additional economic growth and poverty alleviation. It has been estimated that the lack of integration within the five Maghreb countries costs between 1 and 2 percent of GDP.⁴⁹ Considering the total GDP for 2005-2007 amounted to about US\$ 266 billion, it has been estimated that some US\$ 3-5 billion a year is lost as a result of the non-integration. In contrast, the Maghreb countries seem to be more open to trading with the EU and US than among themselves.

Despite different natural endowments, there are, however, a number of similarities between countries, and similar patterns in terms of moving towards globalization, modernization of the financial sector, compliance and observance of best practices and international standards, and international financial integration. This is evidenced in particular by the recent entry of foreign banks into Maghreb states.

In recent years, the five countries have made considerable progress in implementing financial sector reforms. Albeit to different degrees, all of them have improved their legal and regulatory framework, recapitalized banks, and enhanced financial sector soundness and efficiency. Taking advantage of these reforms, the authorities in the five countries in recent years have taken steps to revivify Maghreb integration, a plan that was launched almost 20 years ago. Indeed, a number of ideas, studies, and programs are in the pipeline (Appendix 4.1: Action Plan). For example, there are two major infrastructure projects being considered to link the five countries by train and road. If these projects materialize, they will certainly boost trade and financial integration.

To summarize, there is a lot of potential and renewed interest in the integration but a number of obstacles need to be removed in many areas; from trade and capital controls to the unsettled political situation between Algeria and Morocco. Given the divergent and complementary resource endowments of the region, and its geographical and historic relationship with the EU, an integrated Maghreb could attract large capital inflows from Europe, as well as becoming a relocation destination for European industries that are seeking low-cost production areas.

4.2 Macroeconomic Context

As shown in Table 4.1, there are both differences and similarities in terms of macroeconomic indicators among the five countries. Total GDP for the five countries amounted to some US\$ 304 billion in 2007, with a per capita income of about US\$ 3,650. However, the income distribution is much skewed across the five countries. Libya's GDP per capita is more than double that of Algeria and Tunisia, more than three times that of Morocco, and almost ten times larger than that of Mauritania.

⁴⁹ As mentioned by the Governor Jouahri of the Central Bank of Morocco in his speech at a meeting of the Africa Emerging Markets Forum in Rabat, Morocco, April 8, 2008.

Table 4.1: UMA: Selected Variables 2005-07, Average
(% of GDP unless otherwise noted)

UMA Member Country	Real Growth	Inflation	Fiscal Deficit	Current Account	Reserves Months Imports	M2 (%)	Private Credit* (%)
Algeria	3.9	3.5	13.1	23.1	29.0	60.0	8.4
Libya	6.3	2.7	34.6	46.2	48.8	37.3	7.8
Mauritania	5.9	8.6	...	...	2.1	31.0	25.2
Morocco	4.4	2.3	-3.3	2.5	7.9	100.0	56.6
Tunisia	5.1	3.2	-3.6	-2.0	5.0	59.9	64.0*

* Includes credit to public enterprises.

UMA member country	Population (mn)	GDP (US\$ bn)	GDP per capita (US\$)
Algeria	32.9	115.3	3,400
Libya	6.0	50.6	8,433
Mauritania	2.8	2.5	892
Morocco	30.5	65.3	2,171
Tunisia	10.2	31.9	3,124

Sources: IMF IFS- World Economic Outlook, and other published data.

Economic growth has varied across the five Maghreb countries over the period 2005-2007 with a range of between 4 and 6 percent, and with Libya and Mauritania recording the largest growth. Except for Mauritania, which has experienced a rate of inflation of over 8 percent during 2005-2007, all the other four countries have recorded a low annual rate of inflation of about 3 percent.

More differences are found in the fiscal positions, which record a surplus for the two oil-producing countries (Algeria and Libya), and a deficit for the others. In the case of Mauritania, the fiscal situation is unclear as a result of a large excess in 2006 and a deficit in 2005 and 2007. Similarly, as a result of the oil exports, the current account shows a surplus for Algeria and Libya and even a smaller one for Morocco (a non-oil country), and a deficit for Tunisia. Algeria and Libya have accumulated large external reserves, amounting to more than the equivalent of 2 years of imports for the former and more than four years for the latter. Morocco and Tunisia have external reserves equivalent of less than one year of imports.

Unemployment is one of the major concerns for the Maghreb authorities. The average unemployment rate in 2007 was estimated at about 11 percent in Algeria, 10 percent in Morocco, and 14 percent in Tunisia. Official data are not available for Mauritania and Libya. However, in 2006 the unemployment rate in Libya was estimated at around 30 percent.

4.3 History of the UMA and the Path to Regional Integration

The Maghreb Treaty to create the *Union du Maghreb arabe* (UMA) was signed by the five Heads of State on February 17, 1989 in Marrakech. As a follow-up, six summits took place between 1990 and 1994⁵⁰ to establish the main objectives and targets of the UMA integration. At these summits, the Maghreb authorities agreed on the UMA structure; signed some 36

⁵⁰ These summits were held in Tunis (January 1990), Algiers (July 1990), Ras Lanouf, Libya (March 1991), Casablanca (September 1991), Nouakchott (November 1992), and Tunis (April 1994).

conventions/agreements; and adopted an implementation program. One of the main objectives of the Treaty was the development of a common economic policy to favor the free movement of goods and services and capital among the five member states. In particular, at the summit in Ras Lanouf-Libya in 1991, a strategy for the economic and financial integration was launched. This aimed at creating an economic union by progressively establishing a free trade area (FTA), harmonization of customs duties and customs regulations, and the creation of a common market. The strategy also envisaged financial integration, based on: the harmonization of monetary and fiscal policies, financial and legal regulations, supervisory systems, and the monetary systems. These efforts were to be complemented by the creation of a common bank (Banque Maghrébine) for investments and trade.

Very little progress occurred after the signing of the Treaty, particularly until 2005. Of the 36 conventions, only a few have been ratified and even fewer implemented. After almost 20 years, there is no FTA, and exchange controls exist on capital transactions between the five countries, except that Libya and Tunisia have a bilateral currency convertibility arrangement. Some harmonization has taken place in the financial sector as countries have unilaterally introduced various international standards in banks and other financial and non-financial institutions as part of their domestic financial reform programs. Also, in the case of Algeria, Morocco, and Tunisia, some convergence in the real effective exchange rates has taken place (see Appendix 4.2).

There are several reasons for this slow progress. To start with, the Treaty did not prescribe a clear roadmap with benchmarks and timelines but only long-term objectives and targets. This provided little guidance (or incentive) for converting objectives into realities, or for pursuing / monitoring their implementation. The most important reasons for the lack of progress are: the lack of sufficient coordination and communication among the five countries; the lack of adequate regional physical infrastructure, such as roads; and as the political situation existing between Morocco and Algeria. It may also be the case that since the signing of the Treaty, national authorities have been very preoccupied with consolidating macroeconomic stability and pursuing structural reforms introduced during the 1980s, and thus regional integration has not ranked as a top priority among their immediate objectives.

This period also witnessed the authorities implementing domestic measures, such as financial liberalization and introduction of international principles and standards, to improve the soundness of the financial, especially the banking, sector. So again, the integration agenda was put very much on the backburner. It is also possible that the predominant role of oil in two of the five member states may have led these countries to minimize benefits that may have accrued to them from regional integration. As time has passed, and as mentioned by UMA officials, most of the conventions relating to the UMA Treaty have become obsolete and require a fresh examination. With macroeconomic stability well established, and financial sector reforms (see below) in place, the Maghreb authorities are now better placed to focus on promoting regional integration.

The authorities are now following a different approach towards fostering regional integration, which is being implemented under three different headings: *trade and commerce*, *financial sector*, and *development of the private*. For each of these components, a lead country has been designated to promote regional integration. Thus, Algeria is the lead country for trade and commerce, Morocco for the financial sector, and Tunisia for the private sector. Annual

conferences relating respectively to these subjects were held in Algeria (November 2005), Morocco ((December 2006), and Tunisia (November 2007). The fourth annual conference on the broader theme of “Regional Integration and Promotion of Joint Ventures in the Maghreb” took place in Libya in November 2008. The authorities are aware of the mutual interdependence of developments in the three areas identified for integration, and will strive to seek parallel development in all three.

The IMF has been a catalytic influence in prompting these countries to adopt a fresh approach to integration. Visiting the region in March 2005, the then Managing Director of the IMF, Mr. Rodrigo de Rato, proposed stepping up efforts toward integration and offered the institution’s active support. The IMF subsequently participated in the above-mentioned four high-level conferences, which were each co-chaired by the Management of the IMF.⁵¹ Each conference was followed by technical meetings between the country authorities and IMF staff.

4.4 Structure of the Financial Sector

4.4.1 The Banking Sector

In the UMA, banks represent the largest segment of the financial sector. Their importance, in terms of the proportion of financial assets controlled, varies from about 60 percent in Morocco (70 percent in 2008) to around 93 percent in Algeria. In Algeria and Libya, public banks dominate the banking sector while in Morocco and Tunisia there are both domestic private banks and foreign-owned banks (see Table 4.2). In Algeria and Libya, public banks control over 90 percent of total financial assets; while in Mauritania, most of the banks have been privatized to domestic investors.

Table 4.2: UMA Financial System Structure, 2006
(% of total assets unless otherwise specified)

UMA Member Country	Commercial Banks			Non-banking Financial Sector				Financial Sector Total Assets (US\$ mn)	Banks		
				Specialized banks	Insurance Companies	Pension funds	Other Institutions		Total No.	Public Banks No.	Foreign owned No.
Algeria	83.4	9.4	92.8	...	2.8	...	4.4	24,700	19	19	0
Libya	...	...	...	...	...	...	...	25,019	17	5	0
Mauritania	...	...	88.2	...	5.0	...	6.8	410	10	1	0
Morocco	35.3	24.4	59.7	11.0	10.6	15.6	3.1	38,810	16	5	5
Tunisia	30.6	39.1	69.7	3.0	3.4	6.5	17.4	20,538	24	...	5

Sources: National authorities; and Bank-Fund staff estimates.

⁵¹ The conferences on “Financial Sector Reform and Integration” in Rabat and Algiers were co-chaired by the Managing Director of the IMF, Mr. Rato, while the third conference in Tunis was co-chaired by the Deputy Managing Director, Mr. M. Portugal. The fourth conference in Libya was co-chaired by the MD of the IMF, Mr. Dominique Strauss-Kahn.

In general, there is not much depth in the financial sector in the UMA. In the period 2006-2007, credit as percentage of GDP varied from about 70 percent in Morocco and Tunisia to about 20 percent in the other three Maghreb countries. Similarly, the ratio of M2 to GDP varied from 8.4 percent in Algeria to about 60 percent in Tunisia.⁵² Also, the access to financial sector services is limited. Thus, in Morocco and Tunisia, the number of population per bank window is about 11,000 while in Algeria it is more than double, and in Mauritania is about 40,000 people per bank window.

There is a substantial presence of foreign banks in the Maghreb region, especially in Morocco and Tunisia, with five foreign banks in each country. Foreign banks account for some 26 percent of total assets in Morocco, followed by Tunisia at 19 percent, and Mauritania at 8 percent. Conversely, Moroccan and Tunisian banks have branches in the EU, and some Moroccan banks have branches in other African countries (such as in Senegal).

The process of regional integration of banks and financial institutions within the Maghreb is well established. For example, there are Moroccan bank subsidiaries in Tunisia (e.g. AXIS Capital, a subsidiary of the Banque Marocaine du Commerce Extérieur (BMCE) and Attijari Bank, a subsidiary of the Moroccan group Attijariwafa Bank), subsidiaries of Tunisian banks and financial institutions in Algeria (Tunisia Leasing, a subsidiary of Tunisia Leasing Group and Amen Leasing, a subsidiary of Amen Bank), the Banque Tuniso-libyenne (BTL) in Tunisia, a subsidiary of the BTL in Tunisia (North Africa International Bank – NAIB), and an Algerian investment bank in Tunisia (International Market Bank – IMB). The Moroccan and Tunisian authorities have signed a Memorandum of Understanding (MOU) for the cross-border supervision of the Moroccan bank branch in Tunisia.

Microfinance Institutions The microfinance sector is growing in Africa,⁵³ including in the Maghreb region. In the case of Morocco, it is estimated that microfinance currently reaches some 1.5 million people with assets close to EUR 500 million. In Tunisia the microfinance sector is expanding rapidly, while in Algeria it is associated with government-run social programs. In Mauritania the microfinance sector has mushroomed as a result of 1998 legislation and this sector relies heavily on foreign aid for its operations. Little information is available on either the structure of these MFIs or their financial operations, including the interest rates charged to customers. It is likely, as was noted in the chapter on COMESA, that lending rates are quite high. Given the growth of MFIs, there is a pressing need to develop an appropriate regulatory and supervisory framework for these institutions.

4.4.2 Non-banking Financial Sector: Pension Funds and Insurance Companies

Insurance and Pension Funds Specialized banks, insurance companies and pension funds are quite well developed in Morocco and to a lesser extent in Tunisia. In Morocco, insurance represents 11 percent of total assets, which is in line with other emerging markets, such as

⁵² As noted in the section on COMESA, these ratios fall well below those considered as helping GDP growth and cushioning output variability.

⁵³ As is happening within COMESA and SADC regions, MFIs in the Maghreb zone could grow and seek regional presence by either opening branches or purchasing MFIs in neighboring countries. There is a growing recognition that some regulatory and supervisory framework should be put in place to make MFIs more transparent and to ensure their soundness.

Mexico (8 percent) and Poland (10 percent). In Morocco, insurance companies and pension funds match most of their liabilities with government bonds. Insurance companies, pension funds, and banks are also the main holders of government securities, which are in a dematerialized form (book-entry system), and there are very little secondary market activities. To further develop the secondary market activities, the Moroccan authorities are considering reducing the number of primary dealers from 12 to 8, with the objective of encouraging the eliminated four primary dealers to purchase securities in the secondary market.

In Morocco and Tunisia, there is a limit of 20 percent on the amount of government securities held by non-residents. It is not clear what the rationale for this limit is, since it is in the interest of the two governments to expand the securities market to increase demand and lower the cost to the governments. This limit is an example of legal obstacles to capital market integration in UMA. Cognizant of this obstacle, Tunisian authorities are considering lifting this limitation on foreign holdings.

Overall, the insurance sector is not well developed in the UMA, except for Morocco. Most of the insurance sector in UMA covers automobile insurance. In Morocco, the insurance sector represents about 16 percent of total assets (in 2007) and comprises insurances and re-insurances. The three largest companies dominate the industry, and non-life business generates more than 70 percent of total business. Insurance companies and pension funds are considered key sectors for the development of capital markets. Insofar as insurance companies and pension funds invest in medium- and long-term securities to match assets with liabilities, their presence is important for the development of long-term securities, both government and private.

Similarly, with the exception of Morocco, pension funds are at an embryonic stage in the Maghreb countries. In Morocco, the sector is developing under the placements of the insurances, non-financial enterprises, and pension schemes. In Tunisia, the non-bank financial sector is largely represented by a number of mutual funds, venture capital companies, and some pension funds.

4.4.3 Securities Markets

These operate in Algeria, Morocco, and Tunisia (Table 4.3).. In comparison to many other countries, Maghreb stock markets are small. For example, Egypt, which has the largest stock exchange in the northern Africa region, has a stock exchange that has double the capitalization of all three UMA exchanges put together. The Moroccan stock exchange is by far the largest of the three in terms of capital, number of listed firms, and value traded

Nevertheless, it is important to highlight the rapid growth of the Moroccan stock exchange in the three years 2005-2007. During this period, the number of listed companies increased from 53 to 73 (rising to 76 in 2008) while its capitalization more than doubled from Dhs 252 billion to Dhs 586 billion during the same timeframe. The traded values have also almost tripled to Dhs 360 billion in 2007.⁵⁴ Similarly, the Tunisian Stock Exchange registered a strong performance in 2007.⁵⁵ The measure introduced in Tunisia in 2005 to reduce the number of information and

⁵⁴ The Moroccan Stock Exchange is currently providing technical assistance.

⁵⁵ The team was also informed that the financial transparency requirements (accounting standards) are considered costly in Tunisia and represent one of the main bottlenecks for the stock market development.

certification requirements between listed and unlisted companies has helped in developing the market. In addition, the recent introduction of a new trading platform and the new department dealing with PME has added further business to the Exchange. In 2007 the market capitalization increased by 18 percent from MD 5.5 billion to MD 6.5 billion and the trading volume rose by 23 percent to MD 915 million.

The rapid growth of the Moroccan and Tunisian stock markets sends a powerful signal that there is a strong demand for active capital markets in the region. According to the Moroccan authorities, after taking account of the potential exchange rate risk, there has been a convergence between the interest rates in securities in Morocco and Tunisia. Opening up the two markets would certainly boost further capital integration. In this context, Morocco and Tunisia could electronically link the two exchanges to broaden further the development of the capital market in UMA. There are, however, obstacles to this development because current capital controls inhibit residents from investing abroad, including in the Maghreb region. Another obstacle, which is not technically related to capital controls, is the reluctance of UMA companies to be listed in non-domestic exchanges.

Table 4.3: UMA: Stock Markets, 2007

Country	Number of listed firms	Market capital (US\$ mn)	Value traded (US\$ mn)
Algeria	2	97	0.207
Morocco	73	75,495	22,009
Tunisia	51	5,339	727
Egypt	435	138,828	64,772

Sources: Moroccan and Tunisia Stock Exchanges.

4.5 Status of the Supporting Financial Sector Infrastructure

4.5.1 Supervision and Regulation of the Banking Sector

According to information collected in an IMF study⁵⁶ and based on FSSA reports, the overall soundness of the UMA banking sector has improved considerably in recent years. All countries have undertaken a comprehensive bank restructuring and adopted international standards by moving toward compliance with Basel I Core Principles. Analysis of the supporting infrastructure of the financial sector – in terms of the supervision of the banking sector, insurance sector, securities markets, payments systems, legal frameworks, and information systems – is provided below.

As shown in Table 4.4, as of 2005,⁵⁷ all UMA banks were, on average, above the minimum Basel I capital adequacy threshold of 8 percent. Some of the UMA banks (in Mauritania, Algeria, and Libya), had a large portfolio of NPLs resulting from various restructuring exercises. Even though provisions for part of these loans had been made, the NPLs acted as a constraint on the profitability and performance of the banks, as shown by the relative low ROA for all the five

⁵⁶ A. Tahari, P. Brenner, E. De Vrijer, M. Moretti, A. Senhadji, G. Sensenbrenner, & J. Sole (2007), *Financial Sector Reforms and Prospects for Financial Integration in Maghreb countries*, IMF Working Paper /07/125:

⁵⁷ Latest published information available at time of report's compilation.

countries. In Tunisia, where the ratio of NPLs to gross loans is relatively high (21 percent), the risk control mechanism is reportedly not functioning well.

Table 4.4: UMA Financial Soundness Indicators for Commercial Banks, 2005
(End of period, %)

UMA Member Country	Capital Adequacy	NPLs to Gross Loans	Provisioning to NPLs	Profitability (ROA)	Growth of Credit in Real terms over 2000-05
Algeria	12.9	32.4	55.6	0.4	100.7
Libya*	...	25.0	...	...	26.1
Mauritania 1/	22.2	46.0	...	...	33.7
Morocco	11.5	15.7	67.1	0.5	32.2
Tunisia	10.7	20.9	46.4	0.6	30.0

Sources: IMF/ WP: National authorities; and Bank-Fund staff estimates.

* As of 2004, except for real growth of credit.

In terms of compliance with the Basel I principles (Table 4.5), there is a convergence and greater compliance in Morocco and Tunisia, and to a lesser extent in Algeria and Mauritania. In the case of Libya, no FSAP has taken place, and hence comparable figures of bank soundness are not publicly available. The Algeria assessment is relatively old, while that for Morocco is in the process of being updated. The central banks in Algeria and Mauritania are relatively less independent, while the overall supervisory framework is more developed in Morocco and Tunisia. The overall impression is that the countries have generally attempted to implement the recommendations contained in FSSAs and have improved the soundness of their banking systems.

Table 4.5: UMA: Compliance with Basel Core Principles

Core Principles	Algeria: 12/2003	Mauritania: 4/2007	Morocco: 2008 (Prelim.)	Tunisia: 5/2006
Objectives, autonomy, powers, and resources of authorities	Limited independence. Governor and Monetary Credit Board do not have fixed term. Grounds for dismissal not disclosed.	Formal institutional framework not well developed. Some independence but Governor dismissal is not clear. Influence of economic conglomerate. No legal protection for supervisory authority.	Good autonomy; No fixed term appointment for Governor	Good autonomy
Licensing and ownership structure	Minimum capital often not fully paid. Information on	Criteria not in line with BCP and no obligation to assess origin capital. Testing of managers' fitness and adequacy is	Licensing criteria in line with BCP.	Criteria are well defined

Core Principles	Algeria: 12/2003	Mauritania: 4/2007	Morocco: 2008 (Prelim.)	Tunisia: 5/2006
	stockholding imperfect. Not all data/info is provided.	unsatisfactory. Banks cannot open subsidiaries.		
Prudential regulations and requirements	No routine verification. Lending policies inadequately based on risk assessment and recovery. No internal controls for banks. No anti-money laundering (AML).	No income statement and balance sheet consolidation. Risk management weak. No AML.	Reformed regulations dealing with the classification and loan provisioning was done AML is being implemented	Capital adequacy ratio to be calculated on a consolidated basis. Loan classification rules in line with best practices; loan loss provisioning weak (this has been corrected)
Methods of ongoing banking supervision	Not enough resources. Information on direct/indirect ownership of banks is irregular.	No consolidated supervision. No regular meetings between bank managers and directors.	To intensify contacts with bank managers, directors and external auditors.	Framework for off- and on-site supervision is adequate
Accounting standards	Chart of accounts has serious flaws.	Banks do not follow international accounting norms.	New chart of accounts established.	Largely complies with International Accounting Standard.
Corrective measures	Authorities do not take immediate corrective actions.	Enforcement to be strengthened.	To strengthen supervisory authority and reduce MOF influence.	Implementation to be strengthened.
Control of cross-border banking	To be strengthened by entering into information-sharing with Algeria's principal banking sector partners.	BCM not allowed to sign agreements with foreign controlling authorities to exchange information.	Exchange info subject to approved convention.	No Tunisian banking group has branches abroad. However no agreement is signed.

Banking supervision is in place in all UMA countries that have made tangible progress in strengthening the powers and capacity of the supervisory authorities. In Algeria, bank supervision is conducted by the Banking Commission, while in the other countries the central bank is empowered with the surveillance of the system. In 2006 Morocco established a commission for coordinating financial sector supervisory agencies. At the regional level, a supervisory committee has prepared a report on steps to be taken to comply with Basel II. The Moroccan authorities are planning to adhere to Basel II in 2011. In Tunisia also, the authorities have expressed their intention to adhere to Basel II but no concrete measures have been taken so far. It is worth recalling here that Morocco and Tunisia have a cross-border agreement for the Moroccan bank that is operating in Tunisia. Also, the authorities seem to meet on occasions to discuss common matters and convergence criteria.

Although supervision of the banking sector is satisfactory overall, performance and enforcement are somewhat uneven. For example, the IMF study⁵⁸ notes that in some countries, the frequency of supervision is insufficient to ensure adequate oversight. The study also reports that offsite monitoring is often based on inconsistent data from a variety of sources. The sanctioning powers of supervisors need strengthening in Algeria, Libya, and Mauritania. Also, there are no formal agreements on information sharing with foreign supervisory agencies, except that in Morocco the banking law stipulates that the authorities in the country of origin need to be consulted when foreign banks submit licensing applications.

4.5.2 *Supervision and Regulation of the Non-Banking Financial Sector*

According to the FSSA assessments, supervision for the insurance sector appears less adequate, due to a lack of financial and human resources, including qualified supervisors. In the case of Morocco, following a major restructuring of the industry in 1995, new legislation was introduced establishing reserve requirements similar to that of banks. On the other hand, the supervision of the capital markets in Morocco and Tunisia is quite appropriate. Each country has been asked to prepare a report on the status of compliance with IOSCO principles.

4.5.3 *Supervision and Regulation of the Securities Markets*

To encourage development, and possible integration, of Maghreb capital markets, it is essential that the legal, regulatory, and institutional framework governing them is strengthened and conforms to international standards. This will help to attract increased domestic and foreign investor participation. Full compliance with IOSCO principles and cross-border cooperation will be essential to ensure the integrity and reputation of the exchanges and to limit investment and reputation risks. Future integration of the UMA exchanges could be facilitated if they were to intensify meetings between the exchange operators and their supervisors. The authorities should also consider lifting restrictions on foreign participation in the holding of government bonds, and quantitative limits on investment allocations by pension funds and insurance companies. An interesting development, which may pave the way to more bold steps, is the opening of a subsidiary of *Tunisie Valeurs* in the Moroccan stock exchange.

As emphasized in the earlier part of this report, developing capital markets in the region should be among the top priorities in any plan for regional integration. In that regard, a specific study on the desirability and feasibility of integration of the Moroccan and Tunisian stock exchanges should be undertaken.

4.5.4 *Reform and Regulation of Payments and Settlements Systems*

Currently Algeria, Morocco, and Tunisia have implemented RTGS (Real Time Gross Settlement) systems; and Libya is in the process of introducing one in the near future. Algeria has introduced an automated clearing house for large volume payments, and similar systems are being setup, or are already in place, in other countries. Reforms have also been implemented to remove other deficiencies in the payments system, such as poor integration between central

⁵⁸ A. Tahari et al. (2007), *Financial Sector Reforms and Prospects for Financial Integration in Maghreb Countries*, IMF Working Paper /07/125:

banks and commercial banks, and long settlement lags.⁵⁹ These systems are in line with international standards and reduce settlement risks. However, most of the payments are still cash-based, and checks and credit cards are only developing at a slow pace in the region. There are still delays and large floats in the domestic payment systems, particularly in Algeria, Libya, and Mauritania. The payment system is one of the areas that will require considerable resources to further develop in the UMA countries.

At the regional level, a UMA payment system was launched at the outset of the UMA Treaty. This system would have allowed UMA countries to settle payments via the domestic central banks in convertible currency. However, not all countries have ratified this system, which has never been used. It was explained that the system was too cumbersome and complicated. Work is underway to simplify this system and making it more attractive to the UMA membership.

4.5.5 *Legal Supervisory Framework for the Financial Sector*

Legal frameworks lie at the center of the financial sector. As the World Bank report (2007) notes “they provide the basis for regulation and supervision of the system and its components, determine many aspects of financial sector infrastructure, and govern all aspects of transactions within the system.”⁶⁰ Considerable progress has been made in Maghreb states since the 1990s to modernize the laws and regulations governing financial intermediation. Nonetheless, some of them do not conform entirely to best practices and international standards, and in others further reforms may be needed,⁶¹ especially as they concern the speed of court proceedings relating to bankruptcy and foreclosures, costs of enforcing decisions, and the training of the judiciary in commercial matters. In Algeria, Libya, and Mauritania there is no modern bankruptcy law; while in Morocco and Tunisia, ad hoc commercial courts have been introduced to deal with financial sector issues.

4.5.6 *Information Systems for Financial Sector Regulation*

Two components of information system are relevant for the financial sector: *accounting standards* that govern financial reporting, and *credit information*, which is the basis for automation of credit analysis in modern banking.

Accounting Standards At an international level, accounting standards now correspond to International Financial Reporting Standards (IFRS) and International Audit Standards (IAS). Both in Morocco and Tunisia, IFRS has been introduced, though in Tunisia the requirement applies only to conglomerates. Tunisian authorities remarked that no country really applies IFRS standards only, or for all enterprises. They have argued that enterprises have to file separate and different accounting standards forms for the fiscal authorities. Consequently, they maintain that if they were required to conform and prepare separate IFRS-compatible statements, it would place an unnecessary administrative burden on smaller enterprises. In that regard they were looking forward to the publication of “*IFRS for Small and Medium-Sized Entities*,” which could resolve this dilemma. In other countries, international standards are in the process of being implemented. Generally, training in the field of auditing and accounting is still limited in the

⁵⁹ IMF/WP, *op. cit.*

⁶⁰ World Bank (2007), *op. cit.*, p. 21.

⁶¹ IMF/WP, *op. cit.*

Maghreb region, and international assistance in the form of workshops could enhance accountability and transparency of enterprises there.

Credit Information The availability of credit information is of considerable benefit to borrowers and lenders alike.⁶² As concerns credit information, all five countries have a public credit registry but, according to the above-quoted IMF study, the accessibility and the quality of information could be improved throughout the region, along with appropriate safeguards for consumer and data protection. Furthermore, there are no private credit bureaux. Morocco is planning to introduce a private credit bureau in 2009 by putting its credit information database under private management.

4.6 Assessment of UMA's Progress toward Financial Sector Integration

The above survey of the structure and developments in the financial sector of the five member countries indicates that, despite the existence of UMA for almost 20 years, there has been little concrete integration. However, in the financial sector, thanks to domestic financial sector reforms, substantial harmonization appears to have taken place as countries have introduced internationally accepted standards of supervision, accounting, and other regulatory provisions. Additionally, the achievement and maintenance of macroeconomic stability has narrowed the “economic distance” between countries, especially between Morocco and Tunisia, even though they lag behind in terms of convergence of critical economic indicators. Thus, in terms of the stages of RFI mentioned in the introductory chapter, the five countries have satisfied preconditions for forming a regional financial integrated zone. They also seem to have implemented measures requisite to Stage I, except that for some countries further work is still needed to improve the payment system.

Thus the region as a whole is poised to move toward completing the harmonization Stage II of the roadmap. However, beyond that stage, individual conditions in different countries are too divergent to place them in one category for advancing on the roadmap to full integration. Morocco and Tunisia could be considered as having implemented most of the domestic measures to move to Stage III (the cooperative stage). They might assist other countries to complete the journey on the second stage and join them in an expanded financial integrated area corresponding to Stage III (Table 4.6). But even in this interim period, both countries have a few common measures that they would need to implement immediately.

One such measure is to accelerate establishment of an effective FTA, and removal of intraregional exchange controls. While the former is a complex process and needs careful consideration of requisite actions, including any “compensatory” measures to offset the social costs of liberalization, there is no economic justification for delaying action on intraregional exchange liberalization, including capital account liberalization. These controls are a serious obstacle on the path of RFI and the earlier they are removed, the better will be the prospects for advancing RFI in the region. Combined with measures to further strengthen and link stock exchanges of Morocco and Tunisia, these initial steps alone could attract capital inflows that may themselves provide further push towards integration.

⁶² World Bank (2007), *op. cit.*, p. 48.

Table 4.6: UMA: Stages of Country Preparedness for Regional Financial Integration

UMA Member	Stage I	Stage II	Stage III
Algeria		X	
Libya		X	
Mauritania		X	
Morocco			X
Tunisia			X

While governments can provide the facilitating environment for integration, actual integration is likely to occur in the private sector, since most of the financial sector is now privately held. Maghreb authorities have recognized this and have ascribed an important role to the private sector. At the Tunisia meeting held in November 2007, based on a study conducted in 2007, the employers' trade union *Union maghrébine des employeurs* (UME) raised a number of interesting points related to obstacles to UMA integration and made a list of recommendations on how to remove these and accelerate progress toward UMA integration. Among the obstacles, they listed the lack of transportation infrastructure, lack of appropriate regional trade financing, exchange controls, and non-convertibility of local currencies. Their main recommendations included: the lifting of all exchange controls; harmonization of investment codes and of legal and supervisory regimes; and the establishment of credit information and other information systems that are easily accessible by market operators. They also emphasized the importance of exchanging information between private financial and non-financial national organizations (see Box 4.1 below).

Box 4.1: UMA Integration: Private Sector Recommendations

Based on a study conducted in 2007, the private sector *L'Union maghrébine des employeurs* (UME) raised some interesting points related to obstacles to UMA integration and made a list of recommendations to accelerate progress in this direction.

The UME lists below some of the main initiatives to be undertaken in the immediate future to advance in this area. Some of the most relevant are:

- Harmonization of the "Codes d'Investissements" in the five countries;
- Creation of a "guichet unique" and similar procedures for the investors;
- Lifting of all controls and introducing free movement of capital and labor;
- Development of an infrastructure to facilitate the free exchange of movements of capital and labor;
- Harmonization of the legal and regulatory regimes in the area of investments, exchanges, and financing. The creation of a "Fonds d'Investissements Communs pour la region du Maghreb" was proposed;
- Development and training of the staff and officials responsible for the PME investments;
- Cooperation with UMA institutions in exchanging information and know-how of common interests;
- Providing credit information to the investors in order to minimize investment risks;
- Intensifying the meetings among the various associations and hosting seminars on investment related issues;
- Developing a system of information that is easily accessible by the market operators;
- Creating a special school to train economic operators;
- Encouraging training and apprenticeships in specialized professional associations for economic operators.

Following the Morocco meeting on financial sector integration in 2006, the experts from the five countries met under the chairmanship of Morocco, the lead country in this area, and developed an *Action Plan for Reforms of the Maghreb Financial Sector* (see Appendix 4.1), to be implemented by the five countries. The Plan has five main components: (i) Financing of external trade and investment in the Maghreb; (ii) Harmonization of the payments systems and technical platforms; (iii) Harmonization of banking and financial supervision regulations; (iv) Strengthening cooperation and coordination between institutions and operators of the banking and financial sectors; and (v) Information on regulations and the financial sector.

The overall Plan and the recommended actions are comprehensive enough and take into account practically all the steps needed to advance financial integration. It is perhaps important to note that the Plan does not envisage, at this stage, a single currency or a single central bank (Stage V), nor does it envisage full integration (Stage IV). In keeping its aims modest, the Plan is perhaps more realistic than the original objectives of the UMA Treaty. It is also clear in terms of leadership in each area. Thus the Action Plan, developed by the lead country (Morocco) and approved by the five countries, is probably more achievable, as long as the lead countries provide appropriate leadership,⁶³ and effective evaluation and monitoring mechanisms are put in place.

Despite the positive aspects of the Action Plan, as presently devised by the authorities, it lacks prioritization among its components. Its principal failing is that it fails to prescribe clear benchmarks for achievement, or firm timelines for the objectives to be realized. In that sense, the Plan lacks a sense of urgency, especially in the context of the rapid globalization that is proceeding in other countries and regions. The Maghreb must not become marginalized in this process, particularly since an integrated UMA financial region could represent an attractive destination for European and other FDI, in addition to a possible relocation destination for MNCs looking to move their production processes. Furthermore, as the Action Plan has mainly to be implemented at the country level, it is important that the authorities simultaneously develop national action plans consistent with the regional plan in terms of the objectives and timelines.

While the setting of benchmarks and a timetable for their realization may be subject to further deliberations at the regional level, Plan priorities could be set by the lead country. To assist in this exercise, the RFI generic roadmap, with its five stages for RFI, could be a useful guide. With all the caveats previously mentioned in relation to the roadmap, UMA as a whole is currently only at the second (harmonization) stage of RFI. Nevertheless, different countries are at different stages of preparedness for RFI, when account is taken of their respective financial sector development and status. In this context, those countries (**Algeria, Libya, and Mauritania**), that have completed most of the requirements of Stage I and some of those for Stage II, need to focus on implementing, inter alia, subcomponents of the Action Plan. These include:

- Creation of financing instruments for economic operators, to facilitate and reduce delays in payments;

⁶³ It is perhaps worth noting that while an Action Plan has been prepared for the financial sector, no such plans as yet are ready for the other two areas identified (trade and commerce, and private sector development) for integration purposes.

- Harmonizing legal and regulatory framework according to best practices and international standards;
- Making compatible the payment systems for large-value transactions by introducing the recommended IBAN;
- Completing FSAP reviews to identify regulations and procedures as per international standards;
- Improving supervision by utilizing technical assistance offered by central banks of other member countries; and
- Promoting and joining banking and other financial sector professional associations on a regional basis.

Morocco and Tunisia, on the other hand, could move to implement in the immediate period the recommendations of the most recent FSAP review updates:

- Enhance cooperation between the supervisory and regulatory agencies;
- Enhance coordination and convergence between the operators in the financial sector, stock exchanges, etc.;
- Encourage the formation of regional professional associations in the financial sector and enhance the exchange of information among them;⁶⁴
- Encourage their domestic institutions to open branches and offer financial services in other countries of the region.

Measures relating to the operations of the Banque Maghreb (with perhaps a revised mandate to provide a more active participation of the private sector), the operationalization of the recently established Committee of Supervisors, and gradually advancing the FTA agenda could be taken up at the regional level. In this context, the UMA Secretariat, under close guidance from the designated lead countries, could take a more active role. These measures should be implemented in conjunction with the recommendations made in the earlier paragraph relating to exchange regime, and others.⁶⁵

In this context, it is interesting to note the recent intervention of the Governor of the Central Bank of Morocco (Box 4.2) where he sets some priorities to achieve financial integration in the Maghreb. These recommendations are consistent with those contained and supported in this report. It is perhaps worth emphasizing that the above categorization of measures according to the generic roadmap elucidated in the introductory section should be taken as tentative and to facilitate further discussions at the lead country level and elsewhere on this issue of priorities.

In the private sector area, it is important to note the initiative taken by the Morocco central bank to create a system of “*médiation bancaire*” among the banking sector operators to address issues that may arise in the daily operations and of contacts with the central bank and the professional financial associations.

⁶⁴ These associations could also include the other three members of the region.

⁶⁵ These recommendations should be taken, as in the case of similar recommendations for COMESA, as providing a basis for further discussions within the UMA region prior to finalizing priorities within the official Action Plan.

Box 4.2: Extract from Speech delivered by Mr. Abdellatif Jouahri, Governor of the Bank Al-Maghrib, on the occasion of the Emerging Market Forum in Rabat on April 9, 2008

The main challenges for the Maghreb financial sector are:

- The modernization of the financial sector;
- The consolidation of the structures of the financial systems: i) by banking groups capable of taking the lead to facilitate the local financial operators to interact nationally and internationally; ii) by completing the rehabilitation of the public banks; and iii) by developing and implementing appropriate corporate governance practices and credit risk management;
- The deepening of the financial sector: opening of bank branches to reach a large volume of population; and
- The increase in banking competition to lower costs and to reach PME needs;
- The strengthening of the financial sector supervision: the supervisory agencies will need to have enough human and financial resources, as well appropriate skills, to monitor and ensure the soundness of the financial sector;
- The adoption of international standards in accounting and auditing; and an increase in transparency and improvement in the legal and judicial framework;
- The need for human qualified skills to perform the functions in the financial sector.

4.7 Role of the Development Partners Going Forward

In general, the Maghreb region as a whole possesses sufficient human and financial capacity to advance its integration agenda on its own. However, development partners could play a catalytic role in encouraging countries to move more rapidly in that direction. Development partners could assist the authorities in prioritizing measures under the Action Plan and in setting the timeframe within which those measures could be implemented. In that regard, the Bank could assist countries to prepare their own national plans for financial sector development and integration that are consistent with the overall objectives and timeframe of the regional Action Plan. Given that the AfDB is mandated to assist African countries in forging regional and eventually Africa-wide integration, it could, through its involvement, ensure that RECs' plans are also consistent with that broader objective. Most of this intervention will need to occur at the level of national ministries, especially finance and trade. An immediate area of assistance in some of the member countries would be the development of national payment and credit information systems.

The report has highlighted the importance of accelerating moves towards FTA, and removing intraregional exchange controls. The EU, the WTO, the AfDB, and others could assist the authorities in appreciating and resolving the complex issues involved in launching FTA. The proposed removal of exchange controls would also involve reviewing the investment codes of different countries, which is an area where the IMF and the World Bank could assist.

A missing link in the current RFI plan is the role to be played by the UMA Secretariat. A general impression is that the Secretariat lacks appropriate human and material capacity and needs to be strengthened to take a more proactive role in the integration process. Its role vis à vis the lead countries needs to be clarified. The Bank could assist in reviewing the functions and capacities of the Secretariat. Based on its knowledge of how other regional secretariats function, the AfDB

could make appropriate recommendations and provide the follow-up support to strengthen the UMA Secretariat to discharge its role effectively. In particular, the AfDB could provide technical support for the evaluation functions of the Secretariat, and take a lead role in raising and channeling international financial and technical support for RFI. The AfDB could help create a donor coordination process for Maghreb states (similar to that proposed by the World Bank for EAC) to ensure that technical assistance priorities for the financial sector conform to the alignment of the country and regional strategies for the sector.

This report has highlighted the importance of establishing at an early stage a larger, appropriately regulated, cross-border securities market in the region. Development partners could advise as to the best method for linking national securities markets, among the various alternatives available. Technical experts could assist in linking electronically the two stock exchanges and create a platform for Algeria to join and for Libya and Mauritania to have electronically access to the three stock exchanges. The AfDB could finance the required technical, and eventually the soft- and hardware for this project.

Appendix 4.1: Action Plan of Reforms of the Maghreb Financial Sector

(Approved, Rabat July 4-5, 2007)

Recommendation	Responsible Body	Status of implementation
I. Financing of external trade and investments in the Maghreb		
1. Opening of the <i>Banque Maghrébine d'Investissement et du Commerce Extérieure</i> (BMICE)		An internal UBM commission is working on the finalization. An agreement of convertibility already exists between Tunisia and Libya (but not yet implemented)
2. Encouraging Maghreb banks to develop relations and opening letters of credit	Union des Banques Maghrébines (UBM)	Consideration has been given but no dossier has been prepared
3. Create financing instruments for the economic operators to accelerate delayed payments	UBM	
4. Considering by end-2007 a process to liberalize commercial credits	Moroccan delegation	
5. Considering by end-2007 measures to allow transactions of stocks and shares for institutional investors supervised, the insurance companies, pension funds and OPCVM	Tunisian delegation	
II. Harmonization of the payments system and technical platforms		
1. Harmonization of the legal and regulatory framework according to best practices and international standards	Maghreb Committee on Payments Systems (MCPS)	
2. Making compatible the payment systems for large-value transfers	MCPS	On July 23, 2007 at a meeting in Tripoli this aspect was studied. SWIFT is in place but it was agreed to switch to the International Bank Account Number (IBAN)
3. Encouraging Maghreb banks to harmonize the "monétique système - smart cards" in line with international standards	UBM	At the July meeting it was agreed that in order to proceed, it is first necessary to modify the legal framework in each country and to develop a common payments system. Other meetings have been taking place in this area to create a "Confédération des sociétés de monétique"
4. Ensuring that the technical platforms in each country are in line with international standards in the area of : -negotiation of financial instruments - payment -settlement/transfers	Moroccan delegation	A regional meeting will be held with the participation of all interested parties of the five countries. The Moroccan authorities are planning to hold the seminar in the first semester of 2008
III. Harmonization of banking and financial supervision regulations		
Identification via FSAP of the regulations and procedures to ensure convergence and adoption of international standards for: -banking sector (Basel I) -capital markets(IOSCO) -Accounting standards (IAS-IFRS) and audit (ISA)	IMF Bank Al-Maghrib (BAM) CDVM (regulator)	IMF is summarizing the necessary steps to take during FSAP exercises in the countries. A supervisory committee has prepared a study that was presented on February 21, 2008 in Tripoli on the steps to undertake to comply with Basel II.

Recommendation	Responsible Body	Status of implementation
		Each country has been asked to prepare a report on the status on the compliance with IOSCO principles.
2. Beginning of work by the Committee of Supervisors	Committee of UMA Supervisors	
3. Cooperation among the supervisors of the Maghreb central banks, banking commissions, and capital market to coordinate and harmonize work via technical assistance and exchange of information		An agreement is in effect between the central banks of Libya, Mauritania, and Tunisia. On April 11, 2007, an agreement was reached between the capital market supervisors of Morocco and Tunisia and the two central banks as well. Discussions are underway between the capital market supervisors of Algeria and Morocco. The Mauritanian central bank has already signed two agreements of cooperation with the Morocco central bank and the Tunisian central bank.
IV. Strengthening the cooperation and coordination between institutions and operators of the banking and financial sectors		
1. Enhance the coordination and convergence between the operators of financial sector: banks, stock exchanges, etc.		The organization of a seminar is expected to take place soon.
2. Encourage/motivate the professional associations of the banking and financial sector to get together to enhance the exchange of information among the operators in the financial sector		Regional seminars should be considered. One seminar should take place soon. UBM organizes regular meetings and has opened a window of considerable and relevant information.
3. Stimulate and encourage the opening of branches of Maghreb financial institutions in the Maghreb countries		The committee has recommended reinforcing the process of harmonization of the banks and stock exchanges towards international standards. An agreement in 2006 was given by the Tunisian authorities to a company to enter in partnership with a Moroccan bank. An accord was given by the Moroccan authorities to a company listed on the Tunisian stock exchange.
4. Examine the possibility for Maghreb enterprises to be listed on the Maghreb stock exchanges in a multiple list.	Tunisian delegation	A study is underway by the Tunisian authorities

Recommendation	Responsible Body	Status of implementation
5. Stimulate the exchange of experience in the area of microfinance.	Moroccan delegation	A meeting is being organized by the Moroccan delegation.
V. Opening up of a window on the regulations and information available for the financial sector		
1. Creation of an open window of information on the Maghreb banking and financial sector. The information must be exhaustive and correct.	Moroccan delegation	The Moroccan delegation is preparing the terms of reference, which will be circulated to all parties. The TORs will provide: - technical specifications and details - action plan for implementation - the cost of the project and its financing - the timing of the updating of the information - the modalities of where the "site" will be placed.
VI. Other Measures		
1. Strengthening the AML /CFT framework	Algerian delegation	The Algeria will conduct a study Mauritania has a Finance Intelligence Unit in place and will share its experience with other Maghreb countries
2. Arrange annual meetings to discuss Maghreb macroeconomic issues (monetary and fiscal policies)		Yet to be scheduled
3. Organize a committee to follow up on the status and progress of the financial integration in Maghreb: - assessment of the process of integration - identification of obstacles - making recommendations to the relevant authorities to ensure the completion of the process.	Annual meetings - First meeting in Morocco-first semester 2008	On the occasion of the first meeting: - assessed the status of integration and identified the obstacles - set benchmarks to better monitor the process - agreed on the list of information to be provided and their frequency for the updating
4. Establishment of a cooperation between the central banks to exchange information on the customers of UMA banks for better commercial relations.		
5. Agreement on training of staff and officials via specialized unilateral and multilateral financial institutions.	Algerian delegation	A working group led by the Algerian authorities has to be created. UBM has created a working group to study the creation of a professional academy for training staff in banking operations.

Appendix 4.2: UMA Exchange Rates and Prices, 2005

	Algeria	Libya	Mauritania	Morocco	Tunisia
Official Exchange Rate (local currency units to \$)					
2005	73.28	1.31	265.53	8.87	1.30
2006	72.65	1.31	268.60 ^a	8.80	1.33
Purchasing Power Parity (PPP) (local currency units to \$)					
1990	5.0	...	26.7	3.3	0.4
2005	32.3	...	72.5	3.3	0.4
Ratio of PPP Conversion Factor to Official Exchange Rate					
2005	0.4	...	0.3	0.4	0.3
Real Effective Exchange Rate (index 2000=100)					
2005	83.3	...	...	91.8	85.3
GDP Implicit Deflator (ave. annual % growth)					
1990-2000	18.5	...	8.7	2.9	4.4
2000-2005	7.3	18.7	8.7	0.9	2.3
Consumer Price Index (ave. annual % growth)					
1990-2000	17.3	5.6	6.1	3.8	4.4
2000-2005	2.6	-5.9	6.9	1.5	2.7
Wholesale Price Index (ave. annual % growth)					
1990-2000	...	...	...	2.9	3.6
2000-2005	3.8	...	...	-0.6	3.0

Source: World Bank- 2007 World Development Indicators

Appendix 4.3: UMA: Financial Access, Stability, and Efficiency, 2005

Indicator	Algeria	Libya	Mauritania	Morocco	Tunisia
Legal Rights Index 0 (weaker) to 10 (stronger) April 2006	3	...	5	3	3
Credit Information Index 0 (less) to 10 (more) April 2006	2	...	1	1	3
% of Adults: Public Credit Registry Coverage April 2006	0.2	...	0.2	2.3	11.6
% of Adults: Private Credit Bureaux Coverage April 2006	0.0	...	0.0	0.0	0.0
Bank Capital Asset Ratio (%) 2005	...	...	...	7.7	7.7
Bank Non-Performing Loans to Total Gross Loans (%) 2005	...	...	...	15.7	20.9
Domestic Credit Provided by Banking Sector (% of GDP) 2005	11.1	-50.7	-6.1	88.0	71.5
Interest Rate Spread (lending rate minus deposit rate percentage points) 2005	6.3	4.0	15.1	7.9	...
Risk Premium on Lending (Prime lending minus treasury bill rate percentage points) 2005	6.7	0.6	11.2	...	...

Source: World Bank – 2007 World Development Indicators

Appendix 4.4: UMA's Integration with the Global Economy, 2005

	Algeria	Libya	Mauritania	Morocco	Tunisia
Merchandise Trade (% of GDP)					
1990	36.6	64.2	84.1	43.3	73.5
2005	64.9	95.8	71.1	60.0	82.5
Trade in Services (% of GDP)					
1990	2.9	5.2	16.0	13.4	20.6
2005	...	7.4	...	23.1	21.6
Growth in Real Trade Less Growth in Real GDP (percentage points)					
1990-2005	0.1	...	-1.0	2.1	-0.4
Gross Private Capital Flows (% of GDP)					
1990	2.6	7.3	48.8	5.5	9.5
2005	...	7.9	...	8.4	3.2
Foreign Direct Investment (% of GDP)					
Net Inflows: 1990	0.0	...	0.7	0.6	0.6
Net Inflows: 2005	1.1	...	6.2	3.0	2.5
Net Outflows: 1990	0.0	0.4	0.0	0.0	0.0
Net Outflows: 2005	...	-0.7	...	0.0	0.0

Source: World Bank – 2007 World Development Indicators

5. CENTRAL AFRICAN ECONOMIC AND MONETARY COMMUNITY



CEMAC

Number of Countries: 6

Member Countries: Cameroon,
Central Africa Republic,
Chad
Republic of Congo
Equatorial Guinea
Gabon

5.1 Introduction

The Economic and Monetary Community of Central Africa (CEMAC)⁶⁶ presently includes six countries (Cameroon, Central African Republic or CAR, Chad, Congo, Equatorial Guinea, and Gabon) in Central Africa. The process of economic integration among Central African countries was initiated in the pre-independence days when CAR, Congo, Gabon, and Chad constituted an integrated geo-economic entity under the name of French Equatorial Africa (AER) and shared a common currency. After their independence in 1960, this process was spurred in 1964 by the signing of the Treaty establishing the Customs and Economic Union of Central Africa (UDEAC). This cooperation was further strengthened by the creation of a common central bank and a common currency in 1972. However, although monetary cooperation functioned well, it did not promote the expected economic and financial integration of member states. This in turn revived the debate for the establishment of a new institutional framework to strengthen economic, monetary, and financial integration.

Following that debate, in 1994 member states replaced UDEAC and created the Economic and Monetary Community of Central Africa (CEMAC), and set as its ultimate objective the creation of a Common Market. The CEMAC has a comprehensive structural and institutional framework, and a series of policies and measures have been put in place to promote regional economic and financial integration among its member states. Within CEMAC there is a very clear distinction

⁶⁶ CEMAC derives from the French *Communauté Economique et Monétaire de l'Afrique Centrale*.

between the missions of the Central African Economic Union (UEAC), responsible for all issues related to economic integration, and the Central African Monetary Union (UMAC) responsible for monetary and financial integration. The CEMAC countries have supported the monetary union through the establishment of common community institutions for supervising the financial system, multilateral surveillance of macroeconomic and financial policies, and a harmonized legal system. These arrangements were aimed at strengthening the monetary and financial integration process in CEMAC.

However, a common currency and a full and comprehensive institutional framework have not enabled the CEMAC countries to achieve a high level of financial integration, as underscored by IMF. The situation reflects (i) an absence of consensus at national levels regarding the benefits of regional integration and (ii) difficulties in going beyond national and short-term interests.⁶⁷ An effective implementation of a series of institutional reforms agreed to by monetary and financial supervisory authorities in 2007 and 2008 should help to strengthen financial integration (and beyond that regional economic integration). However, as emphasized by the IMF,⁶⁸ certain initiatives taken in the past have either not yet been implemented (regional financial market)⁶⁹ or are being implemented only gradually (launching of a regional government securities market,⁷⁰ single bank licensing system, etc).

This chapter's structure adopts a similar focus to that of the previous two chapters. After this introduction, there follows an overview of the macroeconomic context in the CEMAC zone. The next section examines the structure of the financial sector in the region (underscoring, in particular, the ongoing programs and reforms, as well as the actions envisaged by the regional institutions to strengthen regional economic and financial integration). There then follows an examination of the status of the institutional framework that supports the financial system, comprising regulation, supervision and control of the financial system, payment and settlement systems, legal and institutional framework, counterparty information system, and the securities markets. The next section analyzes the progress of financial integration achieved to date and highlights some of the barriers and obstacles encountered. The support that the multilateral institutions and development partners, including the AfDB, could provide to advance this process is then outlined. The last section presents the conclusions of the chapter and the key recommendations for strengthening the financial integration process in CEMAC.

5.2 Macroeconomic Context

In 2006, the overall GDP of the six member states of CEMAC, with a total population of 36.1 million inhabitants, stood at US\$ 51.7 billion (see Table 5.1). The various member states have different levels of economic development. Cameroon stands out as the biggest economy in the region, with a GDP of US\$ 18.0 billion, or 34.8 percent of the total. On the other hand, the GDP per capita is higher in Equatorial Guinea (US\$ 13,106), which is the leading oil exporter of the region and third in SSA after Nigeria and Angola. Next come, in descending order, Gabon (GDP per capita of US\$ 6,240), Congo (US\$ 2,140), and Cameroon (US\$ 1,021). Chad and the Central

⁶⁷ Bernard L. Laurens (2008), "The Case of CEMAC," *Workshop on Regional Financial Integration in Africa*, December 1, 2008, Tunis.

⁶⁸ IMF (2006), *CEMAC Financial Sector Assessment Program*, Washington DC.

⁶⁹ There is ongoing discussion on the gradual integration of the two existing financial markets in the CEMAC zone.

⁷⁰ The market is expected to be launched on July 1, 2009.

African Republic, whose economies are relatively less developed, have a GDP per capita of US\$777 and US\$ 373 respectively, and are ranked among the least developed countries according to the United Nations.

Table 5.1: CEMAC: General Characteristics of Member Countries, 2006

	Area	Population			GDP		HDI ²	Business climate ³
	Km2	Million inhabitants	Population below the poverty line ¹	(US\$ billion)	As % of CEMAC total	Per capita (US\$)		
Cameroon	475,442	16.3	17,1	18.0	34.8	1,020.8	144	154
CAR	622,984	4	66,6	1.6	3.0	372.8	172	177
Congo	342,000	4	n.a. ^{4/}	7.4	14.4	2,140.4	140	175
Gabon	267,667	1.4	n.a. ^{4/}	9.8	18.9	6,240.4	124	144
Equatorial Guinea	28,051	0.65	n.a. ^{4/}	8.5	16.5	13,105.9	120	165
Chad	1,284,000	9.7	n.a. ^{4/}	6.4	12.4	776.9	171	173
CEMAC	3,020,144	36.1		51.7	100.0	1,450.0	145	165
Africa	29,797,500	897.5		1,131.9		1,261.0		

¹ Less than 1 dollar/day.

² Human Development Index (HDI) (Ranking among 177 countries).

³ Ranking among 178 countries.

⁴ Not available.

Sources: BEAC (Economic, Financial and Monetary Situation-Meeting of the Franc Zone, April 2008, Paris), Banque de France (Annual Report of the Franc Zone in 2006), UNDP, Human Development Report 2006 - data 2004), World Bank – Doing Business 2008.

Although the region has enormous energy and mining, fishery, forest and agricultural resources, economic activity in CEMAC remains heavily dependent on oil production and price trends. Five of the six member states are oil producers, and the oil sector represents more than 40 percent of GDP of the region, generating over 80 percent of export receipts and approximately 70 percent of tax revenues (see Table 5.3).

In spite of the soaring oil prices and increasing oil production, the CEMAC zone continues to face major growth and development challenges.⁷¹ Many bottlenecks, notably the poor development of infrastructure, the recurrent weakness of intra-zone trade, the extremely unfavorable business environment,⁷² and rigidities regarding the movement of people, goods and capital, continue to hamper the diversification of the economies, medium-term growth and development prospects, and the process of economic and financial integration of the region. Five CEMAC countries are ranked among the bottom third according to the UN Human Development Index established by UNDP (see Table 5.1), and the majority of the countries are unlikely to achieve the Millennium Development Goals by 2015.

⁷¹ The growth rate of the region remains below its potential (the real GDP increase for 2007 is estimated at 4.2 percent, as against 3.1 percent in 2006, while the forecasts for 2008 give a growth rate of 6.2 percent).

⁷² The mean rank of the economies of the region in the classification established by the World Bank (*Doing Business 2008*) is 165th out of a total of 178 countries (Table 5.1).

Table 5.2: CEMAC: Selected Macroeconomic Indicators, 2006

	Real GDP Growth (%)	Inflation (%)	Investment Rate (% of GDP)	Budgetary Balance (% of GDP)	Current External Balance (% of GDP)
Cameroon	3.2	5.2	25.4	28.8	-1.3
CAR	4.2	6.6	8.8	6.8	-3.1
Chad	-0.5	8.1	27.1	0.5	-8.3
Congo	6.7	5.5	40.2	17.6	1.6
Gabon	1.3	3.9	23.0	9.0	17.0
Equatorial Guinea	5.3	5.0	27.0	25.8	9.0
CEMAC	3.1	5.4	27.1	18.8	3.3
SSA	5.5	11.8	20.4	4.1	-1.4

Sources: BEAC (Economic, Financial and Monetary Situation – Franc Zone Meeting, April 2008, Paris), Banque de France (Annual report of the Franc Zone in 2006), IMF (International Financial Statistics - 2007) and World Bank (World Development Indicators – 2007).

Furthermore, the pegging of the CFAF to the Euro with a fixed exchange rate, the heavy dependence on oil, coupled with the aforementioned negative factors, have generated over-liquidity and volatility of macroeconomic performance, with adverse effects on the financial system and its regional integration efforts.

Table 5.3: CEMAC: Importance of Oil in the Economies of the Region, 2006

CEMAC member country	Production (in millions of tonnes)	In % of African Production	Share of Oil GDP in GDP	Oil Exports % of Export	Oil Revenues in % of Budgetary Revenue
Cameroon	4.4	0.9	10.5	49.7	34.4
Chad	7.9	1.7	47.7	86.8	70.8
Congo	13.3	2.8	65.1	92.5	87.5
Gabon	11.9	2.5	54.2	82.8	64.0
Equatorial Guinea	17.1	3.6	84.2	90.7	93.4
Total CEMAC	54.6	11.5	43.8	82.8	70.5

Sources: BEAC, BP (BP Statistical Review of World Energy 2007).

5.3 History of CEMAC and the Path to Regional Integration

The countries of Central Africa have long been aware of the importance of economic cooperation and regional integration as factors likely to contribute to the acceleration of their growth and development. Indeed, in the pre-independence era, the Central African Republic, Chad, Congo, and Gabon constituted an integrated geo-economic entity, under the name of French Equatorial Africa (AEF). On 29 June 1959, these countries created the Equatorial Customs Union (UDE). Having become autonomous and then independent in 1960, they decided to consolidate the ties established under colonial rule, and to strengthen their customs union.

In 1962, Cameroon joined the UDE, and on December 8, 1964, the Heads of State of these five countries signed in Brazzaville the Treaty establishing the Central African Customs and Economic Union (UDEAC), thus confirming a regrouping and integration process that had

started in the colonial period. Equatorial Guinea adhered to UDEAC on January 1, 1985, thus becoming the sixth member. The Treaty clearly expressed the determination of the Heads of State of the countries concerned to pool their efforts and build an optimal economic area, likely to boost interdependent economic development and create development poles, while facilitating the integration of their national economies.

This cooperation was reinforced by the signing, on November 22 and 23, 1972, of two monetary cooperation conventions, one between the member states and the other with France. This made it possible to establish a common central bank (the Bank of Central African States or BEAC) and a common currency (*Franc de la Coopération Financière en Afrique* or CFA Franc). The monetary cooperation functioned well, but did not foster the economic integration of member states, particularly due to non-observance by the members of the principle of free movement of people, goods, and capital. The absence of reinforced economic cooperation during the 30 years of existence of UDEAC has severely penalized the member states in the context of the advent of globalization, marked notably by the formation of regional economic blocs. This has revived the debate on the establishment of a new institutional framework to strengthen economic, monetary, and financial integration.

Following that debate, in 1994 member states decided to replace UDEAC by the creation of the Economic and Monetary Community of Central Africa (CEMAC),⁷³ which had the following objectives:

1. Improve the competitiveness of economic and financial activities.
2. Ensure convergence toward sustainable performance by coordinating economic policies and harmonizing national budget policies with the common monetary policy.
3. Set up a Common Market based on the free movement of people, goods, services, and capital.
4. Coordinate sector policies.

To achieve these goals, it adopted a new approach to integration based on: (i) the convergence and coherence of economic policies; (ii) the stability of the currency; (iii) increased private sector participation, and (iv) harmonious development, shared between the member states.

5.4 Institutional Framework

CEMAC is one of the most structured regional groupings among RECs in Africa. It is based on two pillars, an Economic Union (UEAC)⁷⁴ and a Monetary Union (UMAC)⁷⁵. It comprises the following institutions and bodies: the Conference of Heads of State which determines the policy

⁷³ The Treaty establishing CEMAC was signed on March 16, 1994 in Ndjamena, Chad. The conventions appended to the Treaty were signed on July 5, 1996 in Libreville, Gabon, and the Heads of State and Government of member states officially launched the activities of the Economic and Monetary Community of Central Africa on June 25, 1999, with the appointment of officials of the various bodies created and the adoption of an action plan known as the "Malabo Declaration."

⁷⁴ Economic Union of Central Africa.

⁷⁵ Central Africa Monetary Union.

of the Community and directs the action of UEAC and UMAC; the Council of Ministers which runs UEAC; and the Ministers of Finance Committee, which runs the Monetary Union. The Presidency of the Commission is the executive organ.

The Bank of Central African States (BEAC) is the institution that issues money; it defines and implements the monetary policy of the Union. The Development Bank of Central African States (BDEAC) is the main instrument for financing regional integration.⁷⁶ The Central African Banking Commission (COBAC) ensures the harmonization and control of banking between member states of the monetary union. The Community Court of Justice (institution of CEMAC) is charged with ensuring: (i) compliance with the provisions of the treaties and conventions by member states and institutions and organs of the Community; (ii) the audit of CEMAC accounts; (iii) harmonization of jurisprudences in matters concerning the Treaties; and (iv) settlement of disputes under its jurisdiction and Community Parliament.

This institutional framework was further strengthened when the April 2007 summit of CEMAC Heads of State in N'Djamena, Chad, approved a series of institutional reforms which, if implemented effectively, should help to boost the regional integration program. BEAC, in close collaboration with the other institutions of CEMAC, is working out a long-term vision for the region based on a Regional Economic Program (REP) for the period through to 2015. It is aimed at promoting the construction of a Community space in order to improve the standard of living of the populations. BEAC has also envisaged, in consultation with member states, the launching of the project to issue government securities (Treasury bonds and securities) on July 1, 2009 for the development of the securities market in the region. Furthermore, BDEAC has put in place a strategic plan for the 2008-2012 period and a series of measures to enable the institution to fulfill a number of roles: to become the principal source of financing development in CEMAC, a major actor at the level of the regional financial market, a sponsor of the financing of regional integration, and a key institution for private financing in the region. As regards COBAC, a reform process is underway to increase its independence, the effectiveness of its actions, and an integration of the financial system at the regional level.

The multilateral supervision of macroeconomic policies is undertaken by the Presidency of the CEMAC Commission. The Directive of August 3, 2001 defined four convergence criteria and macroeconomic indicators: (i) the primary budget balance / GDP ratio must be zero and above; (ii) the national debt/GDP ratio should not exceed 70 percent; (iii) new arrears, internal and external, must not be accumulated; and (iv) the average annual inflation rate should not exceed 3 percent.

A review of the convergence situation as at December 31, 2006 shows deterioration in terms of compliance with the multilateral supervision criteria by member states (see Table 5.15). At that date none of them completely complied with all the criteria, whereas in 2005, Cameroon and Gabon fulfilled the four criteria. Owing mainly to the worsening of inflationary tensions in

⁷⁶ Like many development banks, BDEAC experienced a serious financial crisis during the 1980s in connection with the economic and financial crisis that hit the member states, but also due to governance problems of the bank. The restructuring plan adopted in the early 2000s concerned: (i) institutional reform; (ii) reduction of the shares of member states in the capital; (iii) controlled resumption of financing; and (iv) highest level of transparency thanks to the auditing of accounts by international firms.

CEMAC, the countries are witnessing a decline in their performance as regards convergence, except for Equatorial Guinea and Chad, which as at year-end 2005, fulfilled three and two criteria respectively.

However, although the conceptual framework and community regulation of CEMAC are fairly well developed and complete, the regional integration process thus far has not yielded the expected outcomes. Useful synergies have not always been mobilized with sufficient determination to organize real complementarity of the tools and means of production. The application of community regulations by member states is inadequate. The overall macroeconomic situation, as well as the limited progress in the economic and financial integration process, is reflected on the structure of CEMAC's financial system and the level of development of the supporting financial infrastructure, as analyzed below.

5.5 Structure of the Financial System

Financial Depth The financial system in CEMAC is still underdeveloped, insufficiently diversified and largely dominated by the banking sector (see Table 5.4). It comprises the dominant banking sector (which holds over 85 percent of the financial assets and liabilities), non-banking financial institutions (NBFIs), MFIs, and insurance companies. The activities of NBFIs and MFIs are very marginal in CEMAC, and are developed almost exclusively on national bases. Most of the financial indicators show that the CEMAC zone has a low level of financial development (Table 5.5); the average ratios of M2/GDP and private sector credit to GDP are estimated at 15.2 percent and 7.3 percent respectively compared with 33.6 and 17.4 percent for Sub-Saharan Africa (SSA). No single member country of CEMAC is even close to these SSA average ratios.

Table 5.4: CEMAC: Structure of the Financial Systems at Dec. 31, 2006

	Number		Assets of the financial system		
	Institutions	Branches	US\$ billion	Percentage	
				Assets	GDP
Banks	35	223	8.3	87.5	16.0
Private	32	210	8.0	85.1	15.5
Domestic	8	60	2.1	22.4	4.1
Foreign ^{1/}	24	150	5.9	62.7	11.4
Government	3	13	0.2	2.4	0.4
Insurance companies ^{2/}	36	...	0.3	3.3	0.6
Financial institutions ^{2/}	18	...	0.4	4.4	0.8
MFI	679	...	0.5	4.8	0.9
Total financial system	768	...	9.4	100.0	18.2

Sources : COBAC. 1/ Banks controlled by an entity outside CEMAC. 2/ Data at end-2005.

Table 5.5: CEMAC: Selected Indicators of the Financial System, at Dec. 31, 2006

	Number of banks	M2/ GDP	Bank assets/GDP	Credits to the private sector/GDP	Net credits to the Govt/GDP	Population having bank accounts (%)
				(%)		
Cameroon	11	17.5	20.6	10.6	-1.5	...
CAR	3	15.1	8.8	6.9	9.7	...
Congo	4	17.1	11.2	2.5	-11.7	...
Gabon	6	19.1	22.5	10.8	-1.8	...
Equatorial Guinea	4	7.1	9.6	2.9	-30.4	...
Chad	7	11.2	8.5	4.1	0.7	...
CEMAC	35	15.2	15.9	7.3	-7.2	3.0
Averages for ^{2/} :						
Sub-Saharan Africa	30	33.6	67.4	17.4	3.8	26.8
Middle-income countries	30	50.4	96.0	28.7	3.5	41.2
Low-income countries	30	24.9	38.3	11.8	4.0	7.6
Oil exporting countries	53	14.9	33.6	6.3	-4.8	7.1
Oil importing countries	23	38.3	77.5	20.1	5.8	33.9
Member countries (CFA Zone)	9	19.9	16.1	10.8	-1.8	3.9
Non-member countries (CFA Zone)	34	41.8	72.5	21.2	6.9	29.2

^{1/} Banks controlled by an entity outside CEMAC. ^{2/} Data at end- 2005.

Sources : BEAC, COBAC, Banque de France, IMF and World Bank

5.5.1 The Banking Sector

The banking system of CEMAC, which has 35 credit institutions in operation,⁷⁷ is very unevenly distributed geographically and its weight varies greatly across member states (Tables 5.6 and 5.7). Of a total of 35 banks, nearly one-third are in Cameroon, and three other countries of the subregion host 50 percent of the total number of banks in the region.⁷⁸ On the other hand, the Cameroonian and Gabonese banking systems, which for a long time represented more than 80 percent of the banking market of CEMAC as regards credit distribution and collection of deposits, are witnessing a gradual reduction of their share (approximately 70% for deposits and 75% for credits) to the benefit of Equatorial Guinea, Congo, and Chad.

The banking system is also dominated by foreign banks, which mobilize approximately 63 percent of bank assets (Table 5.4). Two of them are present in five countries and manage approximately one-third of the resources of the CEMAC banking sector. On the whole, four financial conglomerates and groups handle the bulk of the regional financial transactions, thus contributing to the integration of the financial sector. Bank shareholding in CEMAC is dominated by financial holdings and credit institutions, which hold 68 percent of the capital. An analysis of the shareholding of the banks in CEMAC by country or region of origin of the

⁷⁷ Statistics at December 31, 2006 (COBAC, Annual Report 2006, Yaoundé). As at December 31, 2008, the banking system of the Central African Economic and Monetary Community (CEMAC) comprised 38 active banks distributed as follows: Cameroon (12 banks), the Central African Republic (3 banks), Congo (5 banks), Gabon (7 banks), Equatorial Guinea (4 banks) and Chad (7 banks).

⁷⁸ Congo, Gabon, and Chad.

principal shareholder shows that 40 percent of all the banks have as principal shareholder an economic agent hailing from the Community (Figure 5.1).

Figure 5.1: Distribution of Banks by Origin of the Main Shareholder
(as at Dec. 31, 2006)

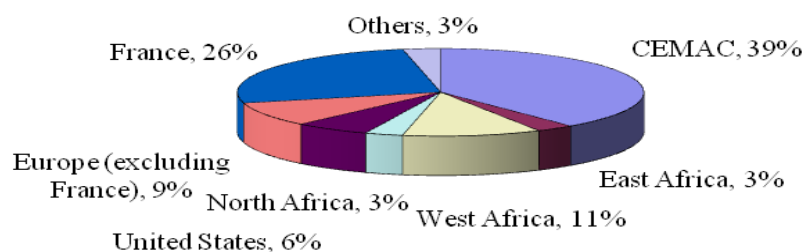


Table 5.6: Concentration of the Banking System, 2006

Country	Herfindahl-Hirschman Index (HHI)	
	2002	2006
Cameroon	1621	1411
Central African Republic	3673	3397
Chad	2154	2002
Congo	3098	2704
Gabon	2716	2715
Equatorial Guinea	4346	4297

Note: HHI<1000 = low concentration; 1000<HHI<1800 = average concentration;

HHI>1800 = high concentration.

Formula: HHI = Sum of relative market shares (percentage).

Source: COBAC.

Table 5.7: List of Approved Banks in Operation, Dec. 31, 2006

Country	Institutions
Cameroon (11 banks)	Afriland First Bank (First Bank) Amity Bank Cameroon Plc (Amity) Banque Internationale du Cameroun pour l'Epargne et le Crédit (Bicec) Citibank N.A. Cameroon (Citibank) Commercial Bank of Cameroon (CBC) Crédit Lyonnais Cameroun (CLC) Ecobank Cameroun (Ecobank) National Financial Credit Bank (NFC Bank) Société Générale de Banques au Cameroun (SGBBC) Standard Chartered Bank Cameroon (SCBC) Union Bank of Cameroon Plc (UBC Plc)
Central African Republic (3 banks)	Banque Internationale pour le Centrafrique (BICA) Banque Populaire Maroco-Centrafricaine (BPMC) Commercial Bank Centrafrique (CBCA)
Congo (4 banks)	BGFIBANK Congo Banque Commerciale Internationale (BCI) Crédit Lyonnais Congo (CLCO) La Congolaise de Banque (LCB)
Gabon (6 banks)	BGFIBANK Banque Gabonaise de Développement (BGD) Banque Internationale pour le Commerce et l'Industrie du Gabon (BICIG) Citibank N. A. Gabon (Citibank) Financial Bank Gabon (FBG) Union Gabonaise de Banque (UGB)
Equatorial Guinea (4 banks)	BGFIBANK Guinea Ecuatorial Banco Nacional de Guinea Ecuatorial (BANGE) CCEIBANK Guinea Ecuatorial (CCEI GE) Société Générale de Banques en Guinea Ecuatorial (SGBGE)
Chad (7 banks)	Banque Agricole et Commerciale (BAC) Banque Commerciale du Chari (BCC) Banque Sahélo-saharienne pour l'Investissement et le Commerce – Tchad SA (BSIC - Tchad SA) Commercial Bank Tchad (CBT) Ecobank Tchad S.A. (Ecobank) Financial Bank Tchad (FBT) Société Générale Tchadienne de Banque (SGTB)

Source: COBAC, Annual Report 2006, Yaounde.

The level of concentration is also high in the majority of the banking systems of CEMAC on account of the narrow domestic markets, except for that of Cameroon where the banking market is fairly concentrated. The results regarding the level of bank concentration were obtained using the Herfindahl-Hirschman Index (HHI) ⁷⁹ (Table 5.6). Similarly, while there is no direct causality between the level of concentration and the level of integration, the high concentration of the banking market in CEMAC does not appear to foster greater integration of the banking system.

Table 5.8: CEMAC: Conglomerates and Financial Groups, as at Dec. 31, 2006

Banks ^{1/}		Country	Assets	%	Branches	%
			(US\$ mns)	Assets/ country		Branches/ country
Société Générale	Société Générale de Banques au Cameroun	Cameroon	387.847	20.1	18	15.3
	Société Générale de Banques en Guinée Eq.	Equatorial Guinea	180.817	42.3	5	38.5
	Société Générale Tchadienne de Banque	Chad	88.279	30.9	4	25.0
	Subtotal (as % of CEMAC)		656.943	15.2	27	12.1
IUB Holding	Crédit Lyonnais Cameroun S.A.	Cameroon	264.614	13.7	15	12.7
	Crédit du Congo S.A.	Congo	105.891	24.2	2	6.1
	Union Gabonaise de Banque	Gabon	232.233	20.1	3	8.3
	Subtotal (as % of CEMAC)		602.738	14.0	20	9.0
Citibank	Citibank N.A. Cameroun	Cameroon	66.092	3.4	2	1.7
	Citibank N.A. Gabon	Gabon	80.671	7.0	2	5.6
	Subtotal (as % of CEMAC)		146.763	3.4	4	1.8
Commercial Bank of Car	CBC Bank	Cameroon	179.381	9.3	9	7.6
	Commercial Bank Centrafrique	CAR	28.421	39.4	3	42.9
	Commercial Bank Chad	Chad	48.143	16.8	2	12.5
	Subtotal (as % of CEMAC)		255.945	5.9	14	6.3
BGFI Bank	BGFI Bank Congo	Congo	155.556	35.6	2	6.1
	BGFI Bank Gabon	Gabon	442.672	38.2	7	19.4
	BGFIBANK Guinée Equatoriale	Equatorial Guinea	31.364	7.3	2	15.4
	Subtotal (as % of CEMAC)		629.592	14.6	11	4.9
Afriland	Afriland First Bank	Cameroon	283.093	14.7	13	11.0
	CCEIBANK Guinée Equatoriale	Equatorial Guinea	211.329	49.5	4	30.8
	Subtotal (as % of CEMAC)		494.422	11.5	17	7.6
Ecobank	Ecobank Cameroun	Cameroon	103.482	5.4	10	8.5
	Ecobank Chad	Chad	36.575	12.8	4	25.0
	Subtotal (as % of CEMAC)		140.057	3.2	14	6.3
Financial BC Togo	Financial Bank Gabon	Gabon	25.679	2.2	1	2.8
	Financial Bank Chad	Chad	31.149	10.9	1	6.3
	Subtotal (as % of CEMAC)		56.828	1.3	2	0.9
Total Networks			2,983.29		216	96.9
Rest of CEMAC			1,327.71		7	3.1
Total CEMAC			4,311.00		223	100

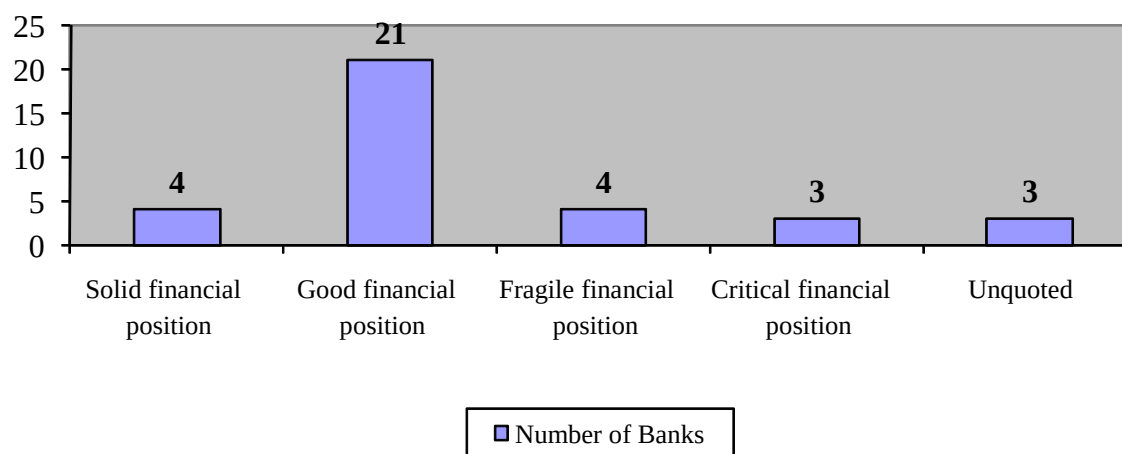
^{1/} Bank in which the financial group holds the majority of the capital

Source: COBAC.

⁷⁹ Source: COBAC, *Annual Report 2006*, Yaoundé.

*The subregional banking system remains generally vulnerable, but presents very different situations according to countries.*⁸⁰ The solidity of the regional banking system can be assessed using the classification by COBAC based on a rating system (SYSCO) which it has developed and which distinguishes four levels. Among the 35 institutions in the zone, 32 have been evaluated by COBAC and given an overall rating: 4 have a solid financial position, 21 a good financial position, 4 a fragile financial position, and 3 a critical financial position (see Figure 5.2).

Figure 5.2: CEMAC: Distribution of Banks by Quotation in 2006*



Source: COBAC.

* Ranking according to COBAC quotation system (SYSCO). Quotation 1: Solid financial situation; Quotation 2: Good financial situation; Quotation 3: Fragile financial situation; Quotation 4: Critical financial situation.

⁸⁰ Source: COBAC, *Annual Report*, 2006.

Table 5.9: CEMAC: Geographical Distribution of Banking Networks, as at Dec. 31, 2006

Conglomerates and financial groups	Country/ region of origin	Host Country of Branches and Subsidiaries					
		Cameroon	CAR	Congo	Gabon	Equatorial Guinea	Chad
Société Générale	France	X			X	X	
IUB Holding	France	X		X	X		
Citibank	USA	X			X		
Commercial Bank of Cameroon (CBC)	Cameroon	X	X				X
BGFI Bank	Gabon			X	X	X	
Afriland	Cameroon	X				X	
Ecobank	West Africa	X					X
Financial BC Togo	West Africa				X		X

Source: COBAC.

Microfinance Institutions Microfinance institutions (MFIs) play a significant and increasing role for low-income segments of the population, even though their overall weight in the regional financial system remains low (Table 5.3). The microfinance sector is particularly well developed in Cameroon and Congo (see Table 5.10). For all the six states of CEMAC, the deposits collected amounted to US\$ 453 million (as against approximately US\$ 6,505 million for banks) and outstanding credits amounted to US\$ 246 million (as against approximately US\$ 3,918 million for banks) at December 31, 2006. According to COBAC, outstanding deposits and credits of MFIs quadrupled between 2000 and 2006. However, the overall financial situation of the sector remains fragile. Consequently, COBAC has pursued its action as regards tightening regulation of the sector, using in particular the MFI certification procedure. As at year-end 2006, COBAC had given its consent for the approval of 629 MFIs, recommended the closure or delisting of 274 MFIs, and rejected 94 applications.

Table 5.10: CEMAC: Activity of MFIs as at Dec. 31, 2006

Country	Number	Capital	Deposits	Credits	Number Members/ Clients	Number of Branches	Average amount of deposits	Average amount of credits
		(US\$ million)					(US\$)	
Cameroon	453	38.1	310.9	199.4	849,030	1,052	366.1	234.8
CAR	14	0.2	6.7	3.0	32,267	25	209.0	92.4
Congo	54	2.7	124.6	37.0	194,331	148	641.1	190.4
Gabon	3	0.2	1.0	1.0	3,742	9	273.6	258.3
Equatorial Guinea	...	...	...	...	...	...	...	...
Chad	155	1.7	9.5	5.4	132,328	216	71.9	40.8
Total CEMAC	679	42.9	452.7	245.7	1,211,698	1,450		

Source: COBAC and IMF (foreign exchange rate).

BDEAC The Development Bank of Central African States (BDEAC) was established in December 1975 as the development finance institution of CEMAC countries. It is recognized as an international financial institution. Its authorized capital is CFAF 81.5 billion (about US\$ 195 million). The reform of its statutes adopted in November 2002 opened 29 percent of its authorized capital to institutional investors. The BDEAC has two groups of shareholders: A and B. Group A comprises the founding states (Cameroon, CAR, Chad, Congo, Equatorial Guinea, and Gabon). Group B comprises regional organizations and nonregional countries (BEAC, AfDB, France, Kuwait, and Germany).

BDEAC is mandated to: (i) contribute to the economic development of the CEMAC countries through the mobilization of domestic and external resources for the financing of investments in the subregion; (ii) allocate credits for the implementation of development projects in the CEMAC zone; (iii) provide technical and financial assistance for the conduct of feasibility studies on investment projects; and (iv) promote the economic integration of the member countries. Sectors and activities that contribute to social development and economic growth are eligible for BDEAC loans.⁸¹ These sectors are: the productive sectors (industries and mines, agriculture, livestock breeding and forests); rural development; basic infrastructure (roads, ports, airports and railways); public infrastructure and services (energy and water, equipment for services, telecommunications, hotel equipment and tourism facilities); and financial sector. The eligible borrowers for BDEAC loans are: (i) the member states; (ii) private enterprises (including the SMEs/SMIs as well as multinational companies); (iii) regional and subregional organizations; (iv) local communities; and (v) financial institutions.

Like the other development banks, BDEAC experienced a serious crisis in the 1980s resulting from the economic and financial downturn affecting the member countries; but this was exacerbated by governance problems at the bank itself. The restructuring plan adopted in

⁸¹ The principal sectors are: (i) regional integration programs; (ii) the establishment and modernization of production enterprises; (iii) expansion and diversification of production infrastructure and equipment; and (iv) rehabilitation of enterprises.

November 2001 (BDEAC 2002-2007 Strategic Plan) aimed to strengthen corporate governance, reduce the state's influence in decisionmaking, and strengthen the risk control mechanisms. The Plan focused on: (i) institutional reforms; (ii) reduction in the share of member countries in the capital; (iii) the resumption of financial controls; and (iv) increased transparency due to auditing of accounts by international firms. BDEAC also launched a strategic plan for the development of infrastructure (transportation, energy and telecommunications) and regional integration by expanding the area of activity to nonmembers of CEMAC.

This policy led to the adoption of three major institutional initiatives: (i) modification of Article 2 of its Statutes limiting the area of activity to CEMAC members alone. This zone was extended to CEMAC border countries, namely the CEEAC⁸² countries (November 2002), (ii) the introduction of a formal definition of the notion of integration project in its general policy paper; (iii) strengthening of partnerships with RMCs and other international regional organizations operating in Central Africa on the basis of formal memoranda, other protocols and conventions of cooperation and partnership, either ongoing or pending, and informal consensus on cooperation with other international financial institutions operating in the CEMAC and CEEAC zones.

In June 2007, the BDEAC approved loans and other financings for a total amount of CFAF 54.1 billion, allocated to 24 projects, 20 of which represent 70 percent of these approvals. The breakdown by economic sector of this amount shows that: (i) energy and transportation infrastructure received 49 percent; (ii) telecommunications infrastructure received 17 percent, (iii) agriculture and industry, 18 percent, and (iv) the financial sector (including refinancing MFIs operating in rural areas) and services, 16 percent.

Two principal regional infrastructure development programs for the promotion of regional integration have been backed by the BDEAC since 2003: (i) the Central African Consensual Transport Master Plan; and (ii) the Central African Power Pool Development Program. BDEAC is currently exploring avenues for increased participation in the regional development program and for the promotion of regional integration. Through its Medium-Term Strategic Plan for 2008-2012, BDEAC aims to firmly establish itself and to fully play its role as: (i) CEMAC's principal DFI; (ii) an active player in the subregional financial market; (iii) sponsor of regional integration financing; and (iv) key institution for private investment financing in CEMAC.

5.5.2 *The Non-banking Financial Sector*

NBFIs⁸³ The NBFIs sector in CEMAC is embryonic and generally these institutions are subsidiaries of banks. Only three countries out of six in the region have NBFIs (Cameroon, Gabon, and Congo; see Table 5.11). Furthermore, the number of approved financial institutions operating in CEMAC dropped slightly to 15 in 2006 compared to 16 in 2005 and 17 in 2004. The lack of exhaustive and reliable data on volumes of credits and financing granted makes it impossible to assess the trend of the volumes of their activities.

⁸² Communauté économique des états de l'Afrique Centrale.

⁸³ For the purposes of this CEMAC chapter, insurance companies are treated separately to other NBFIs (see next section).

**Table 5.11: CEMAC: List of Agreed Non-banking Financial Institutions
Operating as at Dec. 31, 2006**

Country	Institutions
Cameroon (10 financial institutions)	Africa Leasing Company (ALC SA) Crédit Foncier du Cameroun (CFC) Fonds d'Aide et de Garantie des Crédits aux Petites et Moyennes Entreprises (FOGAPE) ^{1/} PRO-PME Financement SA (PRO-PME) Société Camerounaise de Crédit Automobile (SOCCA) Société Camerounaise d'Equipement (SCE) Société de Recouvrement des Créances du Cameroun (SRC) Société Financière Africaine (SFA SA) Société Générale d'Equipement et de Crédit (SOGEC) Société Nationale d'Investissement (SNI)
Congo 1 financial institution	Société Congolaise de Financement (SOCOFIN)
Gabon 4 financial institutions	BGFI-Bail BICI-Bail FINATRA Société Gabonaise de Crédit Automobile (SOGACA)
Source: COBAC. ^{1/} In reality, FOGAPE has for several years been under provisional management. The institution has ceased all lending activities and is only collecting loans that can still be recovered.	

Insurance Sector The weight of the insurance sector in CEMAC is marginal. The volume of financial assets managed in insurance companies is 3.3 percent, representing 0.6 percent of the regional GDP (Table 5.4). Furthermore, as in the case of banks, the insurance sector in CEMAC is dominated by big foreign groups. Of the total number of 36 insurance companies at the end of 2006,⁸⁴ eight (representing about 25 percent) are subsidiaries of foreign groups (French and West African), which together control approximately 50 percent of the market. CEMAC countries are signatories to the Treaty of the *Conférence Interafricaine des Marchés d'Assurance* (CIMA) (Inter-African Insurance Markets Conference)⁸⁵ and are bound by common laws and regulations.

⁸⁴ Despite the narrow market, the number of approved companies rose from 29 in 2002 to 36 in 2006, notably on account of the low minimum capital requirement for setting up an insurance company in the region and the poor supervision and control of insurance company activities in CEMAC.

⁸⁵ The CIMA Treaty was signed on July 10, 1992 in Yaoundé, Cameroon, by the governments of the following member states: Benin, Burkina, Cameroon, Central African Republic, Comoros, Côte d'Ivoire, Gabon, Equatorial Guinea, Mali, Niger, Senegal, Chad and Togo. Of the 14 signatory states, only Comoros has not yet ratified the Treaty. The CIMA Treaty became effective on February 15, 1995. It provides for membership for any other African State which so desires. The number of CIMA member states rose from 13 to 14 with the accession of Guinea Bissau on April 15, 2002.

Many insurance companies are in a vulnerable situation, taking into account their undercapitalization, the low diversity of investment products,⁸⁶ the constraining rules as regards reinsurance,⁸⁷ the narrow market and the principle of territoriality whereby insurance companies must insure risks only on the territory where they are established.

To address the fragile situation of the insurance companies, the low penetration rate and the weak development of the insurance sector in CEMAC, the CIMA General Secretariat has taken the following principal initiatives: (i) raising the minimum capital of insurance companies from CFAF 500 million to CFAF 1 billion from February 1, 2010; (ii) the promotion of intra-group operations within CEMAC with the authorization to open branches for life assurance in the CAR, Chad and Equatorial Guinea⁸⁸ and the establishment of subsidiaries in the other countries of the region; (iii) the promotion of high-risk fronting insurance in oil, shipping and aviation; and (iv) building the supervision and control capacities of CRCA (with the recruitment of four auditors in 2008).

The other policy initiatives taken by CIMA are as follows: (i) adoption of regulations for the supervision and monitoring of groups (estimated entry into force in 2010); (ii) adoption of regulations to crack down on money laundering; (iii) fostering collaboration with the other regional and international regulators; and (iv) implementation of the process to establish a single market (with the effective implementation of the single approval).

Table 5.12: CEMAC: Insurance Market – International Comparison, 2005

Country	Country GDP per capita (US\$) ¹	Insurance Density (US\$) ²	Insurance Penetration ³
Cameroon	1,020.8	0.02	0.01
CAR	372.8	0.00	0.00
Congo	2,140.4	0.01	0.00
Gabon	6,240.4	0.11	0.01
Equatorial Guinea	13,105.9	0.01	0.00
Chad	776.9	0.00	0.00
CEMAC	1,450.0	0.01	0.01
Kenya ⁴	320.0	10.11	2.98
Ghana ⁴	320.0	2.22	0.64
OECD ⁴	23.4	2,339.9	9.00
World ⁴	8,155.6	469.6	8.07

Source: World Bank Data

¹ Data for year 2006;

² Insurance density shows amount spent as insurance premiums per capita;

³ Insurance penetration shows the percentage of total premiums compared to GDP

; ⁴ Data for year 2004.

⁸⁶ As there are a limited number of transferable securities in the region, insurance companies invest approximately 80 percent of their assets in the form of term deposits in the banks.

⁸⁷ CIMA requires that a company post as liability, the total amount which it must pay, even where the policy is to a large extent reinsured, which could be impossible in the event of major disasters.

⁸⁸ The insurance companies established in these three countries do not provide life assurance services.

Table 5.13: CEMAC Insurance Premiums by Country, 2001-05 (US\$ mn)

(US\$ million)	2001			2005		
	Sundry risks	Life	Total	Sundry risks	Life	Total
Cameroon	79.0	15.2	94.2	148.5	30.5	179.0
CAR	2.5	0.1	2.6	3.2	0.1	3.3
Congo	2.4	...	2.4	32.6	...	32.6
Gabon	50.6	7.9	58.6	83.3	11.6	94.9
Equatorial Guinea	1.3	0.0	1.3	2.9	...	2.9
Chad	5.8	0.1	5.9	10.0	0.4	10.4
CEMAC	141.7	23.4	165.1	280.6	42.6	323.2

Sources : CIMA, Annual report 2005 and IMF (foreign exchange rate).

5.5.3 Securities Markets

The establishment of a two stock exchanges in CEMAC has led to serious incompatibilities at the regulatory, judicial, and financial levels. The launching of the Central African Stock Exchange (BVMAC) in Libreville in 2003, was supported by the creation of a regional regulator, the Central African Financial Market Monitoring Commission (COSUMAF). In Cameroon, a national stock exchange, the Douala Stock Exchange (DSX) was inaugurated in 2003. A regulatory body, the Financial Market Commission, was also set up. The coexistence of two regional stock exchanges has resulted in: (i) legal insecurity related to the overlapping of the regulations of the management and supervision organs of the two financial markets; (ii) duplication of operating and capital expenditure of the two financial markets. In addition, the activity of the two stock exchanges is limited and it is not evident that there is a potential market to ensure the viability of both, as underscored by both BEAC and the IMF.⁸⁹

5.6 Status of the Supporting Financial Infrastructure

The viability and level of development of the financial systems and markets depend on the strength of their support infrastructure, and therefore distortions and defects in the infrastructure may result in inefficient operation of the financial systems. The five key elements of the financial sector infrastructure examined in this section are: (i) the regulation, supervision and control of the financial sector, (ii) the regulation of the non-banking financial sector, including insurance, (iii) regulation of the counterparty information system, (iv) the payment and settlement system; and (v) the legal supervisory framework.

⁸⁹ Conference on the “Development of the Financial Sector in CEMAC” jointly organized by BEAC and the IMF in Yaoundé (Cameroon) from June 3-4, 2008.

5.6.1 *Supervision and Regulation of the Financial Sector*

This process is carried out by the Central African Banking Commission (COBAC), which was established in October 1990.⁹⁰ Its key mission is to control the conditions of operation of credit institutions, oversee the quality of their financial situation, and ensure compliance with the code of ethics of the financial sector. The COBAC prudential system is based largely on the principles enacted by the Basel Committee on banking control, but also on the specificities of the national economies of the zone. The prudential framework was updated in 2001. The legal framework and the implementation of banking control satisfy to a large extent the 18 fundamental principles of Basel, as emphasized by the IMF.⁹¹ Microfinance prudential regulations were instituted only in 2002.⁹² They are deemed to be compliant with international practices, having established a three-tier framework with rights and responsibilities adapted to each category.⁹³

5.6.2 *Supervision and Regulation of the Non-Banking/Insurance Sector*

The regulation, supervision and control of the insurance sector are the responsibility of the Regional Insurance Control Commission (CRCA), which is the regulatory arm of CIMA. CRCA enjoys all the usual powers of insurance supervision bodies, such as the approval of insurance companies and their management, permanent control of solvency, and the authority to issue injunctions and inflict sanctions, including the withdrawal of approval.

5.6.3 *Regulation of the Information Systems*

Accounting Standards The legal framework of accounting and auditing is strongly influenced by regional and international agreements. The private sector financial reporting system in CEMAC is governed by the OHADA accounting system (SYSCOHADA), adopted in 2002. In 2000, OHADA adopted the Uniform Act relating to the organization and harmonization of corporate accounting in the member states party to the Treaty on the Harmonization of Business Law in Africa. This instrument (which became effective on January 1, 2001 for personal accounts and on January 1, 2002 for group accounts) defines the accounting law applicable to all enterprises governed by commercial law, and includes an annex entitled "OHADA Accounting System." This system is based on the French Accounting Plan with some amendments reflecting certain principles stated in the IFRS. With regard to the banking system specifically, rules on the organization of accounting of credit institutions were adopted by the Banking Commission in 2003. The main purpose of these rules is to incorporate the accounting law enacted by OHADA in banking regulations.

Credit Information Systems The counterparty information system within CEMAC relies on information prepared by the central bank of each country.⁹⁴ At the level of CEMAC, the banks, NBFIs, and large microfinance institutions, as well as state-owned debt recovery⁹⁵ structures, are

⁹⁰ The October 1990 convention setting up COBAC was supplemented by the January 1992 Convention on the Harmonization of the Banking Regulations in Central African States.

⁹¹ IMF (2006), *CEMAC: Financial System Stability Assessment*, IMF Country Report No. 06/321, August.

⁹² Regulation No. 01/02/CEMAC/UMAC/COBAC relating to the conditions of exercise and control of microfinance activity in CEMAC, signed on April 13, 2002, governs FI regulations at the regional level.

⁹³ IMF (2006), *CEMAC: Financial System Stability Assessment*, IMF Country Report No. 06/321, August.

⁹⁴ BEAC plans to put in place a regional risks center.

⁹⁵ These are credits of liquidated state-owned banks that were transferred to the state in Cameroon and Congo.

required to communicate to the central bank information relating to the level of commitments of their customers. This system enables the banks and other financial institutions to have reliable information on the creditworthiness and credit record of potential borrowers. The information published in the Risks Center in electronic format is put at the disposal of all declaring institutions and is updated monthly. It covers almost all customers because the minimal declaration threshold is fixed at CFAF 10,000.⁹⁶

5.6.4 *Payment and Settlement Systems*

To comply with international norms and standards governing payment systems, BEAC in 1999 launched the project for reform of the payment and settlement systems in CEMAC countries. The project is aimed at fostering the dissemination and use of modern payment instruments. The underlying strategy is to increase, between 2007 and 2012, the average bank use rate, from about 3 percent to 10 percent, and to introduce legal incentives to use scriptural means of payment. The project is based on the introduction and development of a broad-based interbanking system through the harmonization of payment and settlement instruments and the standardization of formats for information and data exchange among the various participants.

The overall architecture of the project is focused on the following elements: (i) a real-time gross settlement system at the regional level (SYGMA) equivalent to the EU's TARGET system; (ii) a teleclearing system for mass payments at the country level (SYSTAC);⁹⁷ (iii) an interbank electronic banking system (SMI), which will be managed by the banking community within two structures set up on an *ad hoc* basis (the Central African Electronic Banking Authority (OMAC) and the Central African Electronic Banking Company (SMAC)); and (iv) a risk management and payment default system with the creation of a regional information system, the "Payment Default Center."

The payment system put in place only recently is still not completed, but significant progress has been made. The SYGMA and SYSTAC components are operational throughout CEMAC (since November 2007), while the CIP⁹⁸ component has been shelved since December 2006. An internal Select Committee was established by the Governor of the BEAC in January 2009 to consider relaunching this component.

5.6.5 *Legal Supervisory Framework*

This framework has been developed at two levels in CEMAC states: regional and national. All the CEMAC countries are members of OHADA, and many legal issues relating to the credit environment are governed by a uniform regional legislation. However, although basic problems are, on the whole, governed by the OHADA legislation, the judicial, legal and institutional issues (such as the level of the implementation of uniform legislation) are treated at the national level. However, knowledge and understanding of the OHADA acts seem extremely limited, and dissemination and training have been insufficient. These problems are exacerbated by the

⁹⁶ Equivalent to approximately US\$ 24.

⁹⁷ Central African Teleclearing system (This system should come into force throughout the region by December 2008 or January 2009).

⁹⁸ Payment Default Center.

judicial system dysfunction, which severely undermines the rights of creditors and hinders the harmonious development of the financial sector throughout the region.

BEAC has also revamped the legal environment in line with three principles: (i) conformity with international standards defined by the Core Principles of the Bank for International Settlements (BIS), (ii) the implementation of law reforms, and (iii) the introduction of innovations indispensable for the operation of automated payment systems. The new regulations governing payment systems, means and defaults came into effect on July 1, 2004.

5.7 Assessment of CEMAC's Progress toward Financial Sector Integration

An analysis of the level of integration of the financial system concerns only the banking system, insofar as the non-banking financial institutions (the NBFIs, microfinance institutions, and insurance companies) are not authorized to carry out cross-border operations except for a very limited number of operations (such as the reception of funds from abroad by certain MFIs on behalf of their customers). Only banks are entitled to carry out cross-border operations directly, receive deposits of non-residents, and grant credits to non-residents. A number of indicators are used to assess the level of integration of the banking system. These indicators are divided into two categories:⁹⁹ (i) indicators based on prices; and (ii) indicators based on quantities.

Price-based Indicators The single price law or convergence of financial service prices are key factors in assessing the level of integration of the banking system. The trend of banking margins within CEMAC reinforces the observation that the banking systems of the region are poorly integrated. The interest margin stands on average at 9.2 percent for the entire CEMAC (as against 8.7 percent in 2005). This margin stands at 13.4 percent in Equatorial Guinea, which is the highest, and at just 7.9 percent in Cameroon, owing to greater competition among the banking institutions in that country. This divergence is also explained by the fact that the banks operate to a very large extent on a national basis, which is even the case for banking conglomerates, where the bulk of intraregional transfers are carried out. It also reflects the lack of competition in the banking sector. Moreover, the circulation of bank liquidity is limited in the absence of an active money and interbank market.

Quantity-based Indicators Quantity-based indicators are generally used to reinforce the price-based analysis. The most used indicator to assess the level of integration of the banking system is the level of cross-border flows. According to COBAC statistics, these flows remain marginal, suggesting very limited integration of the banking systems. On the basis of data from COBAC and discussions held with banking officials, banking activity within CEMAC is concentrated mainly on their customers, who have limited cross-border economic activities, thus reflecting the very low level of cross-border flows.

The volume of deposits held by non-resident economic agents hailing from other CEMAC countries in resident banks also indicates the degree of regionalization of banking operations, and hence of regional financial integration. An examination of the available data shows that the proportion of deposits of non-residents in the resident banks of the region is very marginal, at less than 2 percent of total deposits for the whole of CEMAC. With regard to credits granted to

⁹⁹ Saab and Vacher (2007), *Banking Sector Integration and Competition in CEMAC*, IMF Working Paper, 07/3.

non-residents by resident banks, their proportion compared to the total volume of credits is even lower (less than 1.5 percent).¹⁰⁰

In spite of significant progress made in CEMAC to organize a regional banking market with the establishment of a cross-border payment and clearing infrastructure, an analysis of banking integration based on prices and quantities shows that it is very limited in the region. The limited development of migratory and commercial flows, as well as the lack of information on the solvency of banking counterparties considerably limits the provision of financial services beyond the borders.

5.8 Obstacles to Regional Financial Integration

The expansion of cross-border financial activities in CEMAC is severely hampered by certain institutional and functional obstacles, most of which are not attributable to the actions of financial system supervision institutions. The principal underlying factors that constrain RFI are:

- The current macroeconomic situation characterized by cash surpluses generated, in particular, by the oil incomes and the positive impact of bank restructuring has led to a serious over-liquidity of the banking systems in the region, which also limits cross-border financial flows.
- The weaknesses of regional financial infrastructure and the operational environment of banks, in particular: the absence of credit offices, the weak development of payment systems (even though progress has been made in this area), the lack of transparency and information on the solvency of banking counterparties, and the shortcomings of the legal and judicial framework.
- The operation of the single approval system falls short of objectives.
- The existence of two stock exchanges, which develop and operate in parallel and independently within an undeveloped economic area, hampers their development.
- The weak development of trade within the region (Table 5.14) also limits the expansion of cross-border financial services.

¹⁰⁰ Source: COBAC.

Table 5.14: Geographic Structure of CEMAC Trade (2001-05)
(% of trade value)

	2001	2002	2003	2004	2005
Total Africa	7.4	8.2	8.6	7.4	8.0
<i>Of which: intra CEMAC</i>	2.4	3.0	3.5	2.3	2.3
EU	44.6	36.8	39.2	35.6	31.8
<i>Of which: France</i>	21.8	16.1	17.5	16.8	12.5
North America	30.5	35.8	31.7	34.5	42.2
<i>Of which: United States</i>	30.2	35.6	31.6	34.2	42.0
South America	0.5	0.4	0.7	0.5	0.7
Asia	11.8	14.0	13.6	16.8	12.3
<i>Of which: China</i>	2.5	3.2	5.3	7.7	5.2
Middle and Near East Orient	0.3	0.3	0.2	0.2	0.2

Source: BEAC.

Table 5.15: CEMAC: Indicative Position of Member States as regards Convergence Criteria as at Dec. 31, 2006

Monitoring Criteria	Cameroon	Chad	CAR	Congo	Gabon	Equatorial Guinea
Annual average inflation rate $\leq$ 3 %	-	-	-	-	-	-
Primary budget balance (positive or nil)	+	+	-	+	+	+
Variation arrears $\leq$ 0	+	-	-	-	+	+
Overall public debt/nominal GDP $\leq$ 70 %	+	+	-	-	+	+
Number of criteria fulfilled	3	2	0	1	3	3

(+) = fulfilled ; (-) = not fulfilled

Source : CEMAC.

5.9 Role of Development Partners Going Forward

In view of the gaps and weaknesses identified in the financial integration process within CEMAC, support from the AfDB and other multilateral institutions and development partners is vital for strengthening RFI. The potential areas of intervention may be divided into three main categories, which are further analyzed below: (i) the coordination of national and regional strategies; (ii) financing of regional operations; (iii) technical assistance and capacity building. The proposals presented in this document are not intended to be exhaustive. Ongoing consultations and discussions with the other multilateral institutions and development partners, as well as with regional and local institutions, will seek to broaden the range of initiatives and reforms by including the views and expertise of all stakeholders and their respective roles

5.9.1 *Coordination of National and Regional Strategies*

The improvement of the business environment and strengthening of economic integration in CEMAC require coordination of actions at the regional and country levels to achieve convergence and synergy between the various development partners. Reforms are necessary at country and regional levels, with the support of donors¹⁰¹ and regional institutions,¹⁰² to support the basic infrastructure in order to foster the regionalization process. Support to CEMAC from the AfDB, and other multilateral institutions and development partners, could help to restore coherence between the Regional Economic Program (REP),¹⁰³ national programs and the regional strategy within the framework of the RIASP 2009-2013 which will be put in place, in particular with regard to the diversification of economic bases and private sector development. It has been shown that greater economic diversification and private sector development at a regional level could help to drive regional financial integration

There are also reforms which could be implemented partly at the national level, and partly on a regional basis as regards the development and integration of financial markets (e.g. support for merging the Cameroon stock exchange with the regional stock exchange by assisting the two stock markets, as well as the two supervisory bodies, to harmonize the legal, judicial and operational frameworks).

Lastly, it is necessary to undertake coordinated actions at the regional and country levels for the harmonization of the fiscal provisions relating to financial transactions (taxation of income from securities, etc). Similarly, coordinated actions are necessary to improve the judicial environment in the region.¹⁰⁴ It will be necessary to include these actions in the regional and national programs supported by the Bank Group, the other multilateral institutions, and development partners.

5.9.2 *Financing of Regional Operations*

Three focal areas are recommended for financing by the AfDB, the other multilateral institutions and development partners so as to support the regional financial integration process: (i) financing of infrastructure; (ii) financing of the extension of mobile communication networks as part of the development of the regional payment systems; and (iii) financing of the Payment Default Center component of the regional payments system.

Infrastructure Financing Like almost all the RECs in Sub-Saharan Africa, CEMAC has substantial infrastructure financing needs (especially for transportation, telecommunications, and energy). Instead of conventional infrastructure project financing, the AfDB and other multilateral

¹⁰¹ Multilateral institutions (AfDB, World Bank, IMF, etc.) and multilateral and bilateral development partners (EU, UNDP, AFD, etc).

¹⁰² CEMAC, BEAC and BDEAC, in particular.

¹⁰³ The general objective is to develop an economic program (2008-2015), unifying the development actions in the region to strengthen the building of the Community space in order to improve the standard of living of the populations.

¹⁰⁴ During the discussions, representatives from the banking sector underscored the weaknesses of the national judicial systems (which are characterized notably by the non-observance of the legal instruments and the difficulties faced by financial institutions in providing guarantees and obtaining fair judgments) which hamper the development of the financial system and its regional integration.

institutions¹⁰⁵ (including BDEAC)¹⁰⁶ and multilateral and bilateral development partners,¹⁰⁷ could help CEMAC countries finance their infrastructure needs through the issuance of bonds (taking into account the over-liquidity in the region). These operations should contribute to the development of the regional bond market. One advantage of issuing securities on a regional basis would be to offer bonds in sufficient quantity to warrant the expenditures involved, and provide sufficient liquidities to attract investors.

Mobile Communications Network Financing Within the framework of development of the regional payments system, the AfDB, the other multilateral institutions and development partners could finance at low cost or provide subsidies for the extension of mobile networks in the region in order to extend coverage to more rural areas. This extension could foster the development of the use of mobile telephony for national, regional and international payments, following the example of progress made in other countries of Africa (Kenya, South Africa, etc.) and the rest of the world (East Asia, Europe, etc). This system has the advantage of reaching segments of the population and micro and SMEs/SMIs which generally have no access to the financial system, and would thus help to develop access to financial services for these economic agents.

Payment Default Center Financing A supplementary financial support or subsidy from the AfDB, other multilateral institutions and development partners could be put in place to effectively revive this CIP component of reform, in order that the entire SYSTAC deployment throughout the region is not put at risk. The Payment Default Center is a vital instrument in the risk management profile of commercial banks, to help safeguard their profitability and financial soundness. Financial support from development partners would help to establish a comprehensive and viable system in accordance with the express wishes of the banks and other financial institutions, as communicated during the mission.

5.9.3 *Technical Assistance and Capacity Building*

The support of the Bank Group, other multilateral institutions and development partners as regards technical assistance and capacity building to promote RFI should be provided both at the regional and country levels. It could cover the following aspects: (i) enhancement of the capacities of BDEAC with regard to PPP; (ii) definition of an appropriate regulatory framework at the level of CEMAC concerning PPP; (iii) strengthening the capacities of COBAC in the fields of banking supervision and control; (iv) building the capacities of MFIs; (v) building the capacities of structures of the Ministries of Finance in the member states, charged with supporting COBAC in the supervision and control of MFIs; and (vi) building the capacities of BEAC and the member states in the implementation and monitoring of harmonized exchange control regulations and the preparation of reliable and exhaustive statistics on commercial and financial transactions.

¹⁰⁵ Such as the IFC.

¹⁰⁶ BDEAC has expressed the desire to move towards the public issue of bonds (taking into account the over-liquidity in the region) in order to develop the regional bond market. The participation of BDEAC in such operations should afford the institution the opportunity to enhance its capacities in this area, working alongside the AfDB and other development partners.

¹⁰⁷ Such as the AFD.

During the mission in CEMAC, the regional development finance institution (BDEAC) was very enthusiastic about the development of a public-private partnership for the financing of infrastructures and integrative projects, and the definition of an appropriate legal framework at the regional level for PPP. Multilateral institutions, such as the AfDB and the World Bank, could assist BDEAC in capacity building in this area.

Technical assistance for capacity building of COBAC in banking supervision and control, particularly in the supervision and control of banks in their interventions on the bond market,¹⁰⁸ also seems necessary. The development of mobile banking requires the preparation of specific regulations in view of the need to regulate the inherent risks which accompany this new technology (i.e. consumer protection). Furthermore, the regulatory process is complicated by the dual nature of the technology, which requires coordination between the regulatory bodies of the Ministries of Communication, the common central bank, and the banking supervision body. Technical assistance in this regard is also indispensable.

The development of the microfinance sector and its participation in the regional financial integration process requires (i) MFI capacity building in order to improve their management through training workshops, in particular; (ii) preparation, for the MFIs, of procedures manuals in accounting, management and credit (this task could be carried out by a consultant or consulting firm); (iii) establishment of a clearing house specifically for MFIs; and (iv) establishment of a risk and outstanding payments center to secure savings and limit the volume of NPLs in MFIs, and (v) building the capacities of structures of Ministries of Finance in the member countries. These ministries would be responsible for supporting COBAC in the supervision and control of MFIs (given the limited human resources of the supervisory body), particularly through training workshops.

Lastly, the banking sector was very prudent during discussions, as regards the development of regional activities and financial transactions, because of existing obstacles to the implementation of common exchange control regulations. Support from the multilateral Institutions (AfDB, World Bank, IMF, etc.) and development partners seems necessary, for example, in capacity building for BEAC and the member states in the monitoring and implementation of harmonized exchange control regulations in order not to obstruct the development and integration of the financial systems and markets in CEMAC.

A project for capacity building in the analysis of private and foreign capital flows, to be implemented and coordinated by Development Finance International (DFI) is currently underway in CEMAC. The pilot phase concerning Cameroon has already been finalized, and an extension of this project to the other countries of the region is envisaged. Technical and financial support from multilateral institutions (AfDB, World Bank, IMF, etc.) and development partners could extend the scope of the statistics covered to intraregional and external trade in order to have reliable and exhaustive data on financial and commercial flows.

¹⁰⁸ For instance, in the form of financing of training courses in countries with experience in this domain (Tunisia, Morocco, WAEMU, etc.), or of the organization of training workshops at the COBAC headquarters.

5.10 Conclusions and Recommendations

To promote regional economic and financial integration among the Member States of CEMAC, a structural and comprehensive framework and a range of policies have been put in place. However, progress towards financial integration has been slow, thus reflecting difficulties in the implementation of regional programs and initiatives, as well as major challenges for integration in the region.

Indeed, the Stage of RFI of the CEMAC members (Stage V: Unification), which is characterized by the existence of an exhaustive and coherent institutional framework, a single currency,¹⁰⁹ a common central bank,¹¹⁰ and common community institutions for supervising the financial system¹¹¹ (banks, MFIs, and insurance companies), has not resulted in significant financial integration within CEMAC. *The financial system remains highly fragmented and continues to develop primarily on national bases*, even within banking and financial groups, where the bulk of intraregional transactions are carried out. Significant progress has, however, been made in the regulation and control of the banking system, financial institutions, and microfinance institutions, and this has laid the foundation for the development of an integrated and competitive regional financial system. The gradual establishment of cross-border settlement and clearing facilities, in spite of their weaknesses, is also contributing to the financial integration process. Similarly, the efforts to introduce a single regional money market fall within the scope of this process.

The Conference of CEMAC Heads of State, held in April 2007 in N'djamena, Chad, approved a series of institutional reforms whose effective implementation should help to boost the regional integration program. Similarly, BEAC, in close cooperation with the other institutions of the region, is preparing a long-term vision for CEMAC based on a Regional Economic Program (REP). However, beyond these reforms aimed at modernizing and improving the governance of the regional institutions and strengthening regional economic and financial integration, the crucial and urgent issues – such as the development of regional infrastructures, the diversification of the economies, free movement of goods and factors in the region, and the improvement of the business environment – are still pending.

Similarly, the Conference on the Development of the Financial Sector in CEMAC jointly organized by BEAC and IMF, which was held in Yaoundé (Cameroon) in June 2008, led to the preparation of a matrix of recommendations and concrete action proposals aimed at strengthening the regional financial system and its integration. These recommendations concern the following areas: (i) the liquidity management framework and strengthening of monetary policy instruments; (ii) the development of regional stock markets; (iii) the promotion of financial intermediation in CEMAC in particular an improved legal and judicial environment, and a reduction in the cost of credit and improved financial infrastructure; (iv) the strengthening of regional banking supervision; and (v) supervision of financial and insurance markets.

¹⁰⁹ CFA franc pegged to the Euro with a fixed rate.

¹¹⁰ The Bank of Central African States (BEAC).

¹¹¹ With the exception of the two financial markets (Central African Stock Market or BVMAC and Douala Stock Exchange or DSX).

On the basis of observations and analyses of ongoing reforms and actions within CEMAC to promote economic and financial integration, the following key recommendations are proposed in this report for the consideration of the authorities and development partners:

- *Strengthen financial infrastructure* (with the establishment of credit offices, the development of payment systems, enhancement of financial transparency, etc.). The key targeted objectives are to facilitate access to financial services for the vulnerable segments of the population and to develop credit operations in the region by improving the quality of counterparty information.
- *Strengthen supervision of the financial sector:* Strengthen the currently limited supervision and control capacities of COBAC and CRCA. Raise the current prudential systems to international standards. Strengthen supervision and control of the microfinance institutions (in collaboration with Finance Ministries). Furthermore, enhance the capacities of COSUMAF and CMF for the development of the regional financial market and its unification.
- *Establish a unified regional money market and development of the bond market:* Accelerate the integration of the two markets with a view to putting in place in the medium-term a single financial market, which would foster the movement of capital within the region and the development of a regional bond market.
- *Strengthen BDEAC's capacities and resources:* Enhance the capacities and resources of the institution to a level that responds to its ambitions, and enable BDEAC to play a more active role in financing development and infrastructures, the expansion of the regional financial and the bond market.
- *Strengthen the legal and judicial environment:* Improve the legal and judicial environment at the level of CEMAC through far-reaching reform of the judicial systems in the region. Restore the credibility of the courts and judicial officers in the region in order to reassure the financial institutions and regain their confidence in the judicial system.

Appendix 5.1: Summary Action Plan for Strengthening Regional Financial Integration

Recommendations	Timeframes	Multilateral Institutions & Development Partners Identified	Regional and Local Bodies and Institutions Identified
- Implement a "variable-geometry" strategy for the integration of the financial systems because of the different levels of development of the national financial systems - Improve access to banking and financial services of households and SMEs/SMIs - Improve the legal and judicial environment - Develop the non-oil private sector, the diversification of the economy and intraregional trade - Enhance supervision of the banking sector and non-banking financial institutions - Establish / strengthen supervision and evaluation mechanisms at the regional level - Speed up implementation of the recommendations of FSAP/PESF - Develop and integrate the financial markets - Develop the regional interbank market - Create a regional bond market - Accelerate establishment of the regional financial infrastructure (establishment of credit offices, etc.)	Short and medium term Short and medium term Short and medium term Short and medium term Short and medium term Short and medium term Short and medium term Short and medium term Short and medium term Short and medium term	- IMF - World Bank - AfDB - BIS - European Union - Bilateral agencies	- CEMAC Secretariat - BDEAC - BEAC - Ministries of the Economy and Finance - Ministry of Trade - Professional associations of the banking sector and other private sector non-banking financial institutions - Financial markets

Appendix 5.2: RFI in CEMAC: Observations, Recommendations, Programs and Reforms

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹¹² partners	
			Programs and Reforms	Institutions
I. Macroeconomic and financial environment, convergence of economies and economic integration in CEMAC				
Weakness of the macroeconomic performance (in spite of the oil price hikes) and the convergence of economies of the region	Effectively implement structural reforms intended to increase the diversification of the economies of the region and limit their heavy dependence on the oil sector.	Definition of a matrix of 12 key recommendations for strong, sustainable, diversified and shared growth in CEMAC.	Prepare a coherent infrastructure development plan which could be supported by the multilateral institutions (including BDEAC).	AfDB, World Bank, BDEAC, EU
Limited economic integration (weakness of the infrastructures, commercial flows and cross-border investments) which limits regional financial flows.	Effectively remove the obstacles to the reinforcement of economic integration in the region.	Development of a long-term vision of CEMAC on the basis of a Regional Economic Program (REP). Definition of measures to accelerate freedom of movement of goods (effective in principle since 1 July 2007) and people (which should become effective in December 2009). Acceleration of construction and establishment of quality, effective, diversified and coherent infrastructures.	Assist CEMAC in the implementation of its Regional Economic Program (REP) within the framework of a regional strategy that would be supported by the multilateral institutions and which could be incorporated into a more general strategy at the level of the Economic Community of Central African States (ECCAS). Ensure in particular consistency between the PER (infrastructure component) and the PDCT-AC	AfDB, World Bank and IMF
Low quality of balance of payments statistics (notably statistics on intra-zone commercial and financial flows)	Improve the balance of payments statistics (and in particular of intra-zone commercial and financial flows)	Establishment of a memorandum of understanding on data exchange with the banks to improve balance of payments statistics.	Ensure the coordination of this initiative with COBAC.	AfDB, World Bank and IMF
Absence of a regional balance of payments	Prepare national balance of payments together with a subregional balance of payments.	Ongoing project on capacity building in analysis of private and foreign capital flows implemented and coordinated by	Extend this memorandum of understanding to all institutions carrying out transactions with the outside world in order to have reliable and exhaustive statistics on trade and financial transactions.	

¹¹² Subject to approval.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹¹² partners	
			Programs and Reforms	Institutions
Non-observance of international norms and standards on publication and dissemination of foreign trade data	Need for greater involvement of the national institutions (NIS¹¹³, Customs Departments, etc). Move gradually, as regards the processing and dissemination of data on external trade, toward compliance with international norms and standards put in place by the IMF (General Data Dissemination System (GDDS) and the Special Data Dissemination Standards (SDDS).	DFI ¹¹⁴ (finalization of the pilot phase in the case of Cameroon and extension to the other countries of the region envisaged)	Carry out sensitization campaigns to the attention of the principal declarants on the importance of reliable statistics on intra-zone commercial and financial transactions and those with the rest of the world, notably through the organization of regional workshops. Enhance the capacities of institutions of CEMAC involved in this survey (BEAC, COBAC, national Authorities, etc.) Assist BEAC with the approach to be used for the production of a regional balance of payments (assistance could be in the form of a consultation to be put in place with the support of other multilateral institutions).	AfDB, World Bank, IMF, Afristat AfDB, IMF.
Weakness of regional transactions at the level of the money market. Cross-border financial transactions essentially between the subsidiary companies of the same banking group	Improve the conditions of absorption of the banking overliquidity. Effectively implement, as soon as possible, the project of issuance of government securities (bonds and securities) by the member states and abolish the system of statutory advances from BEAC to the National Treasuries to offer new opportunities for investment of the surplus liquidity of banks.	Evolution of the orientation of the monetary policy of the BEAC with the lifting of the limitation of placements of banks. Use of monetary programming for the definition of a volume of absorption of liquidities.	Move gradually toward a quarterly frequency of coherent monetary programming to coincide with the periodicity of meetings of the Monetary Policy Committee (CPM).	IMF World Bank AfDB

¹¹³ National Institutes of Statistics.

¹¹⁴ Development Finance International.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹¹² partners	
			Programs and Reforms	Institutions
Weaknesses in the effective implementation of the provisions of the harmonized exchange control regulations (notably as regards cross-border financial transactions) Limited involvement of BEAC in the application and monitoring of the harmonized exchange control regulations	Increase BEAC's involvement in the implementation of the harmonized exchange control regulations by putting in place the necessary mechanism and human resources.	Increase of the duties of the services in charge of preparing the balance of payments within BEAC which are also charged with the implementation and monitoring of the harmonized exchange control regulations.	Remove lingering obstacles to the regulation of external financial relations and exchange control which can hinder the development and integration of financial the systems and markets in CEMAC. Enhance the capacities of BEAC in the implementation and monitoring of the harmonized exchange control regulations	IMF, World Bank
Uncompleted establishment of the regional means of payment system. (The SYGMA ¹¹⁵ and SYSTAC ¹¹⁶ components are operational throughout CEMAC, while the CIP ¹¹⁷ has been shelved since December 2006).	Accelerate the completion of the reform of means of payment. Put in place, as soon as possible, the CIP component of the project or else the entire system could be discredited.	BEAC has put in place a detailed timeline to complete the deployment of SYSTAC throughout the region. Taking into account the financial constraints, BEAC has decided to reduce the component relating to the CIP.	Ensure that within the framework of redesigning the CIP component of reform, the entire project is not at risk. Seek where necessary complementary sources of financing to effectively revive the CIP component of the reform in order to have a comprehensive and viable system (as desired expressly by the banks and financial institutions).	AfDB, World Bank
II. Supervision of the banking sectors, financial and microfinance institutions by COBAC				
Weaknesses at the level of banking supervision and control	Strengthening of the banking supervision and control capacities of COBAC.	COBAC is currently engaged in a process of reforms which aim mainly at increasing its independence and the effectiveness of its actions. The principal reforms ¹¹⁸ under way are: • Raising of the level of the required minimum capital and	Put in place a more appropriate supervision and control system at the regional level on a consolidated basis of the banking groups established in the region.	

¹¹⁵ Automated Large-Volume Payments System.

¹¹⁶ Central Africa Teleclearing System (This system should come into force throughout the region by December 2008 or January 2009).

¹¹⁷ Payment Default Center.

¹¹⁸ These reforms fall within the framework of the implementation of Basel II and of corporate governance in credit institutions.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹¹² partners	
			Programs and Reforms	Institutions
		standardization of this level throughout CEMAC ¹¹⁹ • Raising of the key prudential ratios • putting in place corporate governance standards within the banks¹²⁰ • establishment of a system of insurance of deposits at the regional and national levels • putting in place credit bureaux at the regional and national levels.		
Difficulty of implementation of the single approval system following the reserve of the national authorities of the region.	Carry out in-depth reflection on allaying the reserve of the national authorities on the single approval system. Sensitize the national authorities on the advantages of the single approval for the development of the banking system and its regional integration	COBAC is carrying out reflection for a possible revision of the single approval system for its effective implementation.	It would be advisable to gradually move toward a regional approval (instead of the current national approval) by regarding the CEMAC zone as a single territory, and by obtaining from the Ministerial Committee of the region a delegation of powers to COBAC to grant and withdraw the approval to banking institutions.	

¹¹⁹ Currently, the required minimum capital varies across member states. This reform should foster greater competition among the various banks of the region and the improvement of the capital structure of the various banking institutions.

¹²⁰ This reform is intended to strengthen the independence of banking institutions vis-à-vis the authorities and to limit meddling and interference of the national authorities in the management of banking institutions.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹²² partners	
			Programs and Reforms	Institutions
Mismatch between the current prudential regulation and the development of the bond market in the region Weak involvement of COBAC within the framework of the project of issue of government securities.	Update the prudential¹²¹ aspects relating to: - Method of accounting for transactions concerning government securities; - Prudential processing of securities (requirements as regards own capital stocks, thresholds, etc). - Put in place an appropriate legal framework to support the issue of government securities.¹²² - Increase COBAC involvement within the framework of the project.	Ongoing reflection within COBAC for the drafting of a specific regulation on bonded loans in accordance with the needs expressed by the banks.	Enhance the banking supervision and control capacities of COBAC as concerns their bond market transactions (notably by financing training courses in countries with experience in this domain: Tunisia, Morocco, WAEMU, etc).	AfDB, World Bank and IMF
Weakness of banking statistics on cross-border flows (except for interbank market operations) in COBAC publications and studies on regional banking integration.	Publish and disseminate systematically statistics on regional banking operations (deposits, credits, etc.) and transactions carried out by non-residents for better monitoring of regional banking integration and the integration of the banking system of the region in the rest of the world by exploring the information contained in CERBER statements communicated by the banks to COBAC. Conduct periodic banking studies (annual or biannual) on regional banking integration.			IMF, BIS

¹²¹ The current regulation does not make a distinction between private and public securities and only refers to the following categories of security: investment and transaction securities. COBAC Regulation R-2003/03 relating to accounting and the prudential treatment of security transactions carried out by credit institutions distinguishes five categories of securities: trading securities, securities held for sale, investment securities, equity interests, and securities held in portfolio. The regulation gives a precise definition of each type of security, as well as its accounting method.

¹²² A suitable regulatory framework should foster the issue of government securities and the development of the bond market in CEMAC.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹¹² partners	
			Programs and Reforms	Institutions
	Establish quantitative and qualitative indicators for the monitoring and analysis of regional banking integration.			
Weaknesses in the supervision and control of microfinance institutions (MFIs)	Strengthen the supervision and control of MFIs (in collaboration with Finance Ministries).	Finalization of the monitoring infrastructure, notably through : • adoption and putting in place of regional regulations specific to MFIs • putting in place of prudential standards specific to MFIs • finalization of the approval procedure • putting in place of an accounting plan of accounts specific to MFIs • preparation of reporting statements for MFIs • development of documentary control software • effective start of supervision of MFIs	Put in place an effective organization and an efficient division of duties between COBAC and Finance Ministries. Build the capacities of the structures of Finance Ministries in the member states, charged with supporting COBAC in the supervision and control of MFIs (taking into account the limited human resources of the supervisory body) notably through training workshops. Enhance the capacities of MFIs in order to improve their management, notably through training workshops. Prepare, for the MFIs, procedures manuals in accounting, management and credit (this task could be undertaken by a consultant or consulting firm). Prepare a clearing house specifically for MFIs. Establish a risks and outstanding payments centre in order to secure savings and limit the volume of non-performing credits in MFIs. Move gradually towards the authorization to open branches in other countries of the region and carrying out of cross-border	AfDB, World Bank

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹¹² partners	
			Programs and Reforms	Institutions
			operations for MFIs (which are deemed to satisfy ¹²³ the requirements in terms of observance of regulations and size).	
III. Financial markets				
Existence of two financial markets which develop and function in parallel and independently in an underdeveloped economic area. Existence of two bodies for the supervision and control of the independent financial markets, which does not foster coming together and/or integration process of the two stock markets. Near -absence of transactions on the two financial markets. Institutional resistance to the unification and integration of the two financial markets.	Carry out the short-term unification of the two stock markets and their medium-term merger to create a single stock exchange at the regional level. Accelerate the creation of the technical platforms at the level of the BVMAC in order to organize the first quotations.	Process under way for the putting in place of a single regulator with the appointment of the Commissioners by Cameroon within the COSUMAF college of since December 2007	Accelerate the technical integration of the two markets¹²⁴ through a simultaneous quotation on the two markets for the short-term creation of a single financial market which would foster freedom of movement of capital within the region. Assist the two stock markets, as well as the two supervisory bodies (COSUMAF and CMF), in conducting an audit or consultation to find appropriate and adequate technical solutions to harmonize the legal, judicial and operational frameworks on the two markets. Adopt a single general instrument governing stock exchange operations in the region under the authority of the decisionmaking authorities of CEMAC.	World Bank, American Treasury, Moroccan Stock exchange
IV. Insurance Sector				
Weakness in the supervision and control of activities of insurance companies in CEMAC	Reorganize the insurance sector and establish the good governance principles recommended by the International Association of Insurance Companies.		Enhance the currently limited supervision and control capacities of CIMA (through its control body; Regional Insurance Control Commission - CRCA),	

¹²³ This reform would imply to revamping the current regulations on MFI which does not authorize MFI to carry out cross-border transactions.

¹²⁴ According to officials of the two stock markets (BVMAC and DSX), this solution is technically feasible.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹¹² partners	
			Programs and Reforms	Institutions
			Establish a fraud control centre before the opening of frontiers Increase the capitalization of insurance companies Extend the control of CRCA to private insurers and pension funds Enhance the capacities of the national directorates of insurances in the countries of the region.	
Weak development of the insurance sector	Increase the resources of insurance companies, notably through : - introduction of long- term savings products supported by tax facilities to foster the mobilization of savings, - extension of the fields of mandatory insurance coverage in the region¹²⁵, - introduction of complementary pension scheme to be managed by private insurers and private pension funds.	Make it possible for insurance companies to diversify the investment of their resources outside of CEMAC zone in order to optimize their profitability but subject to prior authorization and control of the appropriate authorities.		CIMA, World Bank
Absence of regional integration of the insurance sector	Implement the single approval under consideration within the framework of CIMA.			CIMA

¹²⁵ Currently limited to motor insurance.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹²⁶ partners	
			Programs and Reforms	Institutions
V. Development of the regional bond market				
Reserve of CEMAC countries to implement the project to issue government securities for financing their budgets instead of the current system of statutory advances from BEAC to national treasuries. Weaknesses in undertaking the project to issue government securities (absence of close coordination between the structures involved in this project: the Department of Credit, the capital market and banking control of BEAC, COBAC and Debt Pole). Institutional, strategic and operational weaknesses at the level of states as regards the project. risk (or perception of risk) still high on sovereign issuers. Lack of reliable financial information (worsened by the strong reluctance of banks and enterprises to publish their financial statements).	Ensure, before the date of launching of the project, the effective putting in place in all member states of CEMAC, the necessary organization for the issue and management of government securities, the procedures and decisionmaking circuits. Ensure the effective existence of capacities to manage the new system at regional and of country level. Ensure proper coordination in control of the project between the structures involved in this project: the Department of Credit, the capital market and banking control of BEAC, COBAC and Debt Pole). Harmonize at the regional level the taxation on transactions concerning government securities. Put in place an incentive framework for the development of collective savings (pension funds, corporate savings plans, complementary insurance) Define a consultation framework between various regulators (central bank, banking commission, CIMA,	<i>Ongoing projects and initiatives for the development of a bond market in CEMAC:</i> - Definition, by BEAC in consultation with the members, of a detailed timeline which envisages the launching of the project to issue government securities (Treasury bonds and securities) on January 1, 2009 and capacity building for the various parties involved in this project. - Envisaged launching of issues of bonds at the level of the regional financial market by BDEAC. - Intention of the French Development Agency (AFD) and the International Finance Corporation (IFC)¹²⁷ to raise capital on the money market of Central Africa in the form of bonds. - Envisaged quotation of the Gabonese bond on the	<i>Put in place the reforms necessary for the creation and development of a secondary bond market.</i> Reforms to be undertaken by BEAC regarding its monetary policy by putting in place the open marker on bonds in order to revitalize the inter-bank section of the regional money market and foster better recycling of banking cash surpluses. Assist CEMAC, where necessary, by financing an audit or consultation mission to verify all the requirements for successful launching of this project on 1 January 2009. Develop technical assistance and training on debt markets. Improve the quality and credibility of macroeconomic policies and transparency in public finance management.	IMF, World Bank American Treasury Debt Relief International BCEAO/BEAC -Regional Pole For debt management training (Debt Pole)

¹²⁶ Subject to approval.

¹²⁷ Subsidiary of the World Bank Group. The IFC has just issued on the West African regional financial market securities of an amount of CFAF 22 billion with 5 years' maturity.

Observations (Weaknesses and obstacles to regional financial integration)	Recommendations	Ongoing programs and reforms envisaged by the authorities	Additional programs and reforms likely to be supported by donors and development ¹²⁶ partners	
			Programs and Reforms	Institutions
Non-existence or lack of depth of secondary markets (interbank or organized). Taxation of incomes and operations on securities insufficiently harmonized and attractive.	Financial Markets Monitoring bodies) Approach ODA institutions to guarantee certain issues and to issue securities in order to participate in the financing in local currency of the economies of the region.	BVMAC 28 August 2008. ¹²⁸		
VI. Financing of integrative projects and of the regional financial integration process by BDEAC¹²⁹				
Weakness of capacities and resources which limit the ambitions of the Institution as regards the financing of integrative projects, development of the regional financial and bond market and the regional financial integration process	Need to enhance the capacities and resources of CEMAC to raise them to a level matching the ambitions of the institution and enable BDEAC to play a more active role in the financing of development and the expansion of the regional financial and bond market.	Putting in place a strategic plan for the period 2008-2012 ¹³⁰ and a set of measures aimed at increasing the role of the institution. Benefit of lines of credit from multilateral institutions (AfDB, etc.) Development of co-financing operations with the regional banking system Launching of private issue of bonds.	Develop a public-private partnership for the financing of the infrastructures and integrative projects. Enhance the capacities of the institution in this domain. Put in place an appropriate legal framework at the level of CEMAC for private-public partnership. Move towards public issues of bonds (taking into account the overliquidity in the region) and develop the bond market in the region.	AfDB World Bank AfDB, World Bank, Moroccan stock exchange.

¹²⁸ This quotation should take place after the testing phase following the installation of the NSC V900 electronic trading system by Euronext and Casablanca Stock Exchange, Morocco.

¹²⁹ Development Bank of Central African States.

¹³⁰ This plan seeks to achieve the following objectives: become the principal development financing institution in CEMAC, a key player in the regional money market, a sponsor of the financing of regional integration, and a major private financing Institution in the region.

VII. Legal and judicial environment				
	Need to improve the legal environment at the level of CEMAC through far-reaching reform of the judicial systems in the region. Need to restore the credibility of the courts and judicial officers in the region to reassure the financial institutions and regain their confidence in the financial system.		Need to undertake actions aimed at improving the judicial environment in the region within the framework of a regional program.	AfDB, World Bank, UNDP

Appendix 5.3: Matrix of Key Recommendations for Ensuring Private Sector Development in CEMAC¹³¹

ISSUES COVERED	No	AREAS OF ACTION	MEASURES TO BE TAKEN	RESPONSIBLE BODIES	INDICATIVE SCHEDULE	OBSERVATIONS
MANAGEMENT OF BANK LIQUIDITY AND STRENGTHENING OF MONETARY POLICY INSTRUMENTS	1	Ensure effective <i>ex ante</i> coordination of budgetary and monetary policies.	1. Develop a non-oil budget deficit indicator in a percentage of non-oil GDP as the principal indicator of budgetary policy.	CEMAC Commission BEAC and member States		
	2	Implement reversible monetary programming.	1. Build capacities in the areas of macroeconomic forecasting, price fluctuations, and monetary aggregates. 2. Define annual and quarterly objectives of liquidity withdrawals. 3. Deepen discussions with member States on national budgetary policies during the preparation of the monetary programming.	BEAC		
	3	Adapt monetary policy instruments to facilitate the development of the interbank monetary market.	1. Build short-term liquidity forecasting capacities with a view to the timely determination of predetermined amounts for weekly liquidity withdrawal operations.	BEAC		
	4	Strengthen the range of savings instruments proposed to the member states	1. Create instruments that will give the members a risk/risk ratio reflecting the investment ratio; 2. Updating of exchange regulations with a view to optimizing exchange reserve management (future generation funds).	BEAC		

¹³¹ BEAC (2008), *Conference on the Development of the Financial Sector in CEMAC: Conclusions of the Conference* Yaoundé, 3-4 June.

ISSUES COVERED	No	AREAS OF ACTION	MEASURES TO BE TAKEN	RESPONSIBLE BODIES	INDICATIVE SCHEDULE	OBSERVATIONS
DEVELOPMENT OF REGIONAL STOCK MARKETS	5	Work towards ensuring close cooperation between the two financial markets. Carry out sensitization activities to popularize the stock-market culture.	1. Harmonize the legal and regulatory frameworks of the two stock exchanges as a prelude to closer cooperation between the two financial markets. 2. Decide on practical modalities for bringing BVMAC and DSX closer with a view to the effective integration of the market. 3. Develop collective savings through the promotion of Undertakings for Collective Investments in Transferable Securities (UCITS). 4. Ensure and increase market depth.	Member states BVMAC, DSX COSUMAF, CMF/Cameroon OMAC		
	6	Implement the project for the issuance of public securities with free subscription with a view to abandoning the monetary financing of public deficits.	1. Improve states' cash management. 2. Develop national public debt management strategies. 3. Develop programs for the issuance of public securities. 4. Minimize the period of transition during which statutory advances coexist with the issuance of public securities.	BEAC Member states		
PROMOTION OF FINANCIAL INTERMEDIATION IN CEMAC A. Legal and Judicial Environment B. Cost of Credit and Financial Infrastructure	7	Facilitate access to financial services .	1. Abolish the maximum lending rate to improve credit risk tariffing. 2. Conduct reflection on the institutionalization of a usury rate. 3. Determine the optimal level of the minimum savings rate to facilitate the mobilization of savings. 4. Ensure compliance with the Governor's decision to abolish account maintenance charges.	BEAC COBAC		

ISSUES COVERED	No	AREAS OF ACTION	MEASURES TO BE TAKEN	RESPONSIBLE BODIES	INDICATIVE SCHEDULE	OBSERVATIONS
	8	Improve information on credits and credit risks.	1. Improve the quality of information by speeding up the establishment of the credit agencies and the Central Balance Sheet Office. 2. Improve financial information on enterprises through the implementation of the new OHADA accounting standards. 3. Strengthen the commercial and land registries. 4. Strengthen cooperation between the commercial banks and the BDEAC in project evaluation and medium and long-term credit refinancing.	1. COBAC/BEAC 2. Member states 3. Banks/BDEAC		
	9	Reorganize the legal and judicial environment.	1. Strengthen the national legal systems and make them compliant with the OHADA texts. 2. Redraft the OHADA texts to ensure fluidity in debt recovery procedures. 3. Better inform the public on rules and laws in force in CEMAC. 4. Improve the reliability of guarantees and the rights of creditors in the event of personal bankruptcies. 5. Strengthen the working conditions of court experts and trustees in bankruptcy; 6. Adopt an appropriate regulatory and supervision framework; 7. Build the capacity of the judicial system to deal with financial issues.	Member states CEMAC OHADA		
STRENGTHENING OF BANKING SUPERVISION AND MICROFINANCE	10	Build the community nature of supervision.	1. Confer all the powers on COBAC concerning the granting or rescinding of approval, the definition and application of prudential standards as well as the management of banking crises. 2. Confer on COBAC the power to determine and raise the minimum capital of banks. 3. Strengthen the consensus on the direction of reforms among the different actors.	Inter-Ministerial Committee COBAC Member states		
	11	Strengthen the prior conditions for efficient banking control.	1. Adopt forthwith the rules on corporate governance of banks.	BEAC Inter-Ministerial Committee		

ISSUES COVERED	No	AREAS OF ACTION	MEASURES TO BE TAKEN	RESPONSIBLE BODIES	INDICATIVE SCHEDULE	OBSERVATIONS
	12	Implement efficient microfinance supervision mechanisms taking into account the staff strength of COBAC.	1. Strengthen the role of the umbrella organs in the supervision of the funds affiliated to them. 2. Strengthen off-site surveillance which must be placed at the core of the supervision mechanisms in view of the ever increasing number of establishments. 3. Strengthen the roles and autonomy of the certified external auditors. 4. Involve the microfinance units of the Ministries of Finance in the control of small-scale independent establishments.	COBAC National Authorities		
SUPERVISION OF FINANCIAL AND INSURANCE MARKETS	13	Creation of conditions for joint and complementary supervision of the regional financial sector (COBAC, COSUMAF, CIMA, CMF/Cameroon, OMAC).	1. Establishment of a forum for monetary and financial stability in CEMAC. 2. Conduct of a study on the existing potential of the regional financial market. 3. Building capacities and means of supervision of the financial markets.	BEAC COBAC COSUMAF OMAC CMF/Cameroon CIMA		
	14	Creation of a single integrated insurance market.	1 Develop diversified investment products in the long-term in the region so that institutional investors can contribute to the development of the financial markets. 2 Separate the promotion and control functions of CIMA.	Private Sector CIMA		

6 CONCLUSIONS AND RECOMMENDATIONS

This chapter summarizes similarities and differences in the experience of the three regions in promoting RFI, as drawn from the analysis of the previous chapters. It then highlights their requirements, which serve to define the agenda for further enhancement of that integration, and the areas for assistance by Africa's development partners, including the AfDB. This is followed by defining a broad strategy to guide the Bank's contribution¹³² within that identified list of assistance.

6.1 Common Characteristics and Differences between the Three Regions

All countries in the regions studied in this report recognize the added contribution that regional financial integration could make to the modernizing of their domestic financial sectors, and how this could increase their potential for economic growth and poverty reduction. Accordingly, following on their policies to restore macroeconomic stability and improving the soundness of the banking system, these countries have formulated, and are implementing, programs of RFI in their respective regions.

The approaches taken toward financial integration and its implementation have differed among the regions, and indeed among their individual member countries. Thus, in the case of CEMAC, countries have introduced a common currency and a common central bank at the outset of their integration journey, while COMESA started with modest steps, introducing PTA as the first arrangement among its member states.

In CEMAC the underpinning policies and institutions are being gradually introduced; however to date the member countries, including the common central bank, have not been effective, or sufficiently proactive, in implementing the required policies. As a result, "So far, the common currency and a comprehensive and well-structured regional institutional setup have not led to financial integration in the region."¹³³ Thus, although CEMAC exhibits the outward manifestations of Stage V of the generic roadmap, in effect some countries are yet to realize even the preconditions (especially bank soundness) for RFI arrangements, and the region as a whole is still struggling with implementing common core measures (e.g. payments system, and compliance with BCPs) required for the earlier stages of RFI.

In COMESA, on the other hand, initially the organization focused on real sector integration, and, having successfully introduced an effective FTA and a plan to launch a customs union at the end of 2008, only more recently has it turned its attention to financial integration. It is encouraging members to introduce measures, such as BCPs and other international financial standards, and consolidated supervision of the financial sector that would align their financial sectors as preliminary actions toward RFI. Progress

¹³² The specific recommendations for the AfDB's intervention in each region given in the respective chapters above are made in conformity with the strategy outlined in this chapter.

¹³³ IMF (2006), *Central African Economic and Monetary Community: Financial Sector Stability Assessment*.

has been made in about half the number of member countries in terms of harmonizing their financial sectors, and others are following suit.

The UMA, for its part, has until recently adopted a rather passive approach toward implementing the 1989 Treaty establishing the Union. This Treaty envisaged a more comprehensive integration, involving both trade and financial sectors. Nevertheless, individual countries have implemented various reforms in their financial sectors, including bank restructuring, international supervisory, regulatory, and accounting standards, etc. that have brought about significant development and harmonization among their financial sectors. This augurs well for the Union's renewed efforts, which began in 2006, aimed at enhancing trade and financial integration, as well as private sector development.

Within these three regions, some countries are well advanced to embrace advanced stages of financial integration (such as linking capital markets) among themselves, while other members lag behind. This diversity in the preparedness of member countries is one reason why this report advocates the adoption of a "variable geometry" approach to RFI in some cases.

The overall assessment of this report is that progress in RFI has been slow and needs to be accelerated through a more proactive policy stance. The reasons for this slow progress are many and vary across regions and across countries. Some common obstacles to RFI include: a lack of physical infrastructure (roads, ICT); divergent initial macroeconomic situations; low degree of bank soundness in some member countries; lack of political commitment to RFI; lack of adequate (human and financial) capacities; over-ambitious and ill-defined objectives and timeframes; weak regional institutions charged with managing the integration process; lack of coordination between national and regional strategies; conflicting regional obligations due to multi-organization membership of some countries, etc.

While some progress has been made in overcoming these obstacles, others persist, acting as constraints to the regionalization process. Here we can cite the need to prioritize the action plans and prescribe realistic timetables for their achievement; to prepare consistent national action plans; and to overcome institutional weaknesses and capacity shortages. There may also be a lack of perception among policymakers that RFI is a long process that needs careful calibration of policy and institutional actions, and requires dedicated leadership and coordinated national implementation. The AfDB and other development partners could help RECs in overcoming these and other obstacles through appropriate technical and financial assistance.

6.2 Implications of the Global Financial Crisis for Regional Financial Integration

As the present study was finalized before the full dimensions of the global financial crisis could be appreciated by national authorities and the international community, a final complementary chapter (entitled "Epilogue") has been added to cover the most recent developments. This briefly analyzes the effects of the crisis on Africa, and its

implications for RFI in the three regions, as well as for the generic roadmap proposed in this report. Although initially the crisis had a limited impact on financial sectors and regional financial integration process on the continent, the second round of impacts (on national fiscal balances, cost and availability of capital market funds, and slowdown of remittances) indirectly impacted on macroeconomic convergence efforts in the various regions. This study, therefore, advocates accelerating financial sector reform and its integration in order to help withstand future shocks and to strengthen macroeconomic convergence. In this regard, it also suggests strengthening regional cooperation in financial regulation and supervision.

6.3 Supporting the Process of RFI

6.3.1 Areas of Intervention by Development Partners

The above review has revealed various areas where donor assistance could advance financial integration in the three regions studied here. These areas, which relate to RFI strategy in general, financial infrastructure, and financial institutions and policies, are categorized in Table 6.1 below within four broad categories: (i) Policy Action Frameworks, (ii) Capacity Building /Governance, (iii) Advocacy, and (iv) Finance. As mentioned in individual regional reviews above, these areas will need further discussion among the Bank, the RECs, member countries, and development partners.

Table 6.1: RFI – Areas for Development Partners’ Intervention

	Policy Action Frameworks	Capacity Building/Governance	Advocacy	Finance
RFI Framework	Sharpen Regional Action Plans Coordinated national Action Plans Coordination of FTA & RFI Fragile & LIC countries	Strengthen regional secretariats’ capacity Strengthen national coordinating body Ministries of commerce & trade, Finance, & central banks Institution building,	TA/FA coordination channeling Technical assistance & monitoring Assessment of costs & needs Technical missions	Adjustment & development costs
Financial Infrastructure	FSAPs	Supervisory bodies, central banks, national governments. Regional payments system National payments systems Supervision & regulation Legal systems, property rights, judiciary	Policy dialogue Workshops/training institutions	Equipment costs Personnel recruitment

	Policy Action Frameworks	Capacity Building/Governance	Advocacy	Finance
Financial Institutions		Strengthen central banks MFIs (Review) Strengthen stock exchanges Link/merge stock exchanges Regional & national credit bureaus/information systems Regional infrastructure dev. bodies Pension funds & Insurance	Monitoring & Evaluation mechanism	Equity & loans
Financial Policies		Monetary policies Intra-regional bond and credit markets Liberalization of exchange controls, Region-wide policies for FDI	Ad hoc workshops & training facilities	

EPILOGUE

The Global Financial Crisis and Its Implications for Regional Financial Integration in Africa

The present report on regional financial integration in the UMA, COMESA, and CEMAC regions was being finalized before the scale of the present global financial crisis had been fully appreciated by national authorities and the international community. Given the depth and breadth of the crisis, this final chapter seeks to summarize its principal effects on the African continent, and its implications for RFI in the three regions under review. It also examines the impact of the crisis on the generic roadmap, as propounded in this report. Attention is also given to the broad approach that African nations might adopt in order to safeguard the hard-won gains in economic fundamentals achieved over the past two decades.

1. Background

The present financial crisis is the second major downturn to have occurred in the past 20 or so years; the first being the East Asian crisis of the mid-1990s. However, the earlier crisis originated in and was confined mainly to the East Asian region, although some other emerging economies also suffered an adverse impact due to the rating agencies' downgrading of their creditworthiness. The present crisis is more truly global. Although it originated in the USA, largely as a result of the subprime mortgage crisis, its impact soon spread to Europe and beyond, leading to a tightening of credit and lack of liquidity in international financial markets, the collapse of many blue-chip financial institutions, declining demand for exports and primary commodities, and a reduction in trade and capital flows.

This crisis has sharply revealed the inadequacy of the regulatory frameworks of the major economies to keep up with the financial innovations in the global economy. In the event, no domestic (or regional) regulatory body has proven effective in preventing the crisis or confining it to a country or a region. The crisis has affected not only the financial sector but almost all the real sectors of the economies of the USA, Europe, and beyond. Through intertwined investments, the crisis has impacted globally across a whole raft of financial products and services.

International financial experts have pointed to various factors that have contributed to this outcome: insufficient liquidity of the banking sector, low interest rates, emergence of risky financial products (including the derivatives market), inappropriate accounting standards that allowed for untimely profit-taking and inadequate reserves, constant capital ratios, failure in the assessment and management of risks resulting in an underestimation of capital requirements, lack of transparency and accountability, etc. This long list of multiple contributory factors suggests a pressing need for a fundamental review of national and international regulatory/institutional financial frameworks, as is indeed under consideration now.

As a result of the financial crisis, the world economy is facing a deep and protracted downturn. The January 2009 update of the IMF's *World Economic Outlook*¹³⁴ projected global growth to slow from around 3.5 percent in 2008 to about 0.5 percent in 2009 before recovering somewhat in 2010. Although the advanced economies, particularly their banking sectors, were the first to be hit by the crisis, Africa too is experiencing a slowdown in economic activity and regional trade, as analyzed further in the next section.

2. Economic Impact and Prospects for RFI in Africa

The crisis came at a time when Africa was turning the corner, steadily building the foundations for higher growth and poverty reduction.¹³⁵ Initially, Africa appeared to be relatively shielded from the major impacts of the financial crisis, reflecting its limited integration into the global financial system. However, Africa was also hit during 2008 by the food and fuel price shocks which preceded the global financial crisis. These earlier crises weakened the external position of net importers of food and fuel, caused inflation to accelerate, and dampened growth prospects. The recent global slowdown in economic activity has exacerbated the situation in Sub-Saharan Africa generally, negatively impacting export earnings, fiscal revenues, and household incomes. Commodity exporters in particular are facing major terms of trade deterioration, while credit is proving hard to access as commercial banks are retreating in the face of increased perceived risk.

In response to the global financial crisis, a meeting of Finance Ministers and Central Bank Governors was convened by the African Development Bank President, Donald Kaberuka, in Tunis in November 2008, and further Ministerial Roundtable discussions were held in May 2009, in Cape Town. These talks concluded that the financial crisis was damaging economic growth across the continent, undermining fiscal balance of payments and price stability, with long-term consequences for poverty reduction and realization of the Millennium Development Goals (MDGs). The main drivers of growth affected by the crisis were exports, portfolio and foreign direct investment, infrastructure development, mining, tourism, and inward remittances. There have been widespread currency depreciations in the continent and by the end of 2008, most African currencies were at values well below their end-2007 levels in US\$ terms.¹³⁶ According to the latest African Development Bank projections, GDP growth in Africa will be drastically reduced to only 2.8 percent in 2009, compared to an average of over 5 percent annually in the recent past. This is due mainly to the negative effect of the crisis on aid inflows, African exports, and FDI.

Initially, the limited integration of African economies into the global financial market had the positive effect of minimizing their exposure to the full impact of the crisis. This

¹³⁴ International Monetary Fund, 2009, *World Economic Outlook Update, Global Economic Slump Challenges Policies*, January 2009, Washington DC.

¹³⁵ African Development Bank, 2009, "Impact of the Crisis on African Economies – Sustaining Growth and Poverty Reduction," Policy Briefs on the Financial Crisis, No. 8/2009.

¹³⁶ Ibid.

may tempt some analysts to advocate a slowing, if not total abandonment, of regional financial integration. However, this would be a gross mistake. Such an insular approach would deprive African countries of economies of scale, and other advantages elucidated in Chapter 1 of this report. Instead, African governments should accelerate their efforts to foster RFI, since this is critically important for the continent's ability to withstand exogenous shocks and integrate into the global economy, notably through market expansion, gains from economies of scale, and improved competitiveness. The present crisis points to the need for accelerating financial integration initiatives to move more quickly on the roadmap to fuller integration of their financial systems.

What should be the main objectives of this accelerated action? They should be twofold: (i) to prevent the emergence of a domestically generated systemic financial crisis, and (ii) to increase resilience against externally generated financial shocks. As regards the first objective, African countries need to ensure strong representation in the ongoing international discussions focusing on the crisis. These talks seek to address the shortcomings of the existing international financial standards and regulatory frameworks, as well as the revision of Basel principles. The way forward points toward a new regulatory agenda aimed at enhancing risk management and risk assessment, minimizing procyclical amplifiers that are disruptive to financial stability, and improving the incentive structure to discourage early corporate profit-taking while encouraging a building-up of adequate reserves. Revisions would also encourage coordinated supervision among countries that are closely aligned financially, and provide for more active macro-prudential monitoring, as well as enhanced supervision at the level of individual financial institutions. Supervision and monitoring mechanisms will likely be strengthened and extended to all financial sectors, with common standards for all.

African countries need to implement these revised standards as a stepping-stone toward fuller integration into the global financial system; this would also help to safeguard the integrity and sustainability of their domestic financial systems. Even though African countries may not be able to fulfill all the requirements designated for the corresponding stage of integration (as set out in the generic roadmap outlined in this report), they might still consider implementing specific policies/institutions at an earlier stage. This pertains in particular to transparency and good governance, region-wide regulatory frameworks, and supervision to keep pace with the expansion of cross-border banking and other financial services areas. The report highlights the difficulties that African countries may have in implementing Basel 2, and these difficulties will multiply as Basel 2 is revised. Africa will need substantial technical assistance to implement those recommendations and may have to opt for a gradual implementation of those standards.

As concerns increasing resilience to externally generated shocks, experience suggests that Africa cannot rely solely on export growth for its economic development. There is a need to rapidly scale up regional Free Trade Agreements (FTAs) and Customs Unions (CUs) to broaden "domestic" markets for local manufacturers and providers of services. The generic roadmap underscores the mutual dependence of real sector integration and financial sector integration, and the present experience reinforces that link. African countries are heavily dependent on private capital inflows to supplement domestic

investments and there is a need to further develop capital markets and to establish wider regional markets. Hence the recommendation in the report that capital market development should be initiated at the earlier stages of regional integration rather than at the later stages.

Macroeconomic stability will also shield countries from a multiplier effect of externally generated financial shocks. As such, it continues to be not only a precondition for RFI but also an instrument to improve domestic resilience to those shocks. African countries are being urged to employ fiscal stimulus measures, while safeguarding foreign exchange reserves, maintaining fiscal balance of payments, and ensuring debt sustainability. As the effects of the crisis have spread to Africa, some countries have set up special units to monitor the impact of the crisis and to formulate targeted responses. Others have introduced a range of policy measures such as fiscal stimulus packages, targeted assistance to sectors and population groups, new banking sector regulations, expansionary monetary policies, and bond financing of public expenditures. The African Monetary Unions (including CEMAC) and the regional financial integration programs such as for COMESA, advocate convergence criteria to reduce macroeconomic imbalances and build macroeconomic stability. The establishment of regional surveillance mechanisms with regular performance reviews, as proposed in the generic roadmap, would also be helpful in this process.

The international development community, including the MDBs and IFIs, have introduced various facilities to assist Africa and other developing and emerging economies.¹³⁷ For its part, the African Development Bank Group established its own targeted mechanisms for an effective response, notably the Emergency Liquidity Facility (ELF), the Trade Financing Initiative (TFI), plus accelerated transfers to ADF countries. The first tranche of the TFI comprised US\$ 500 million in the form of lines of credit to African financial institutions to support their trade finance operations. The second phase of the Bank's response was a US\$ 500 million participation in the Global Trade Liquidity Program, to help reverse the decline in trade resulting from the economic crisis. All these initiatives aim to keep trade flows open both regionally and globally, and will help to stabilize African economies.

2.1. *Economic Impact and Prospects for RFI in the UMA Region*

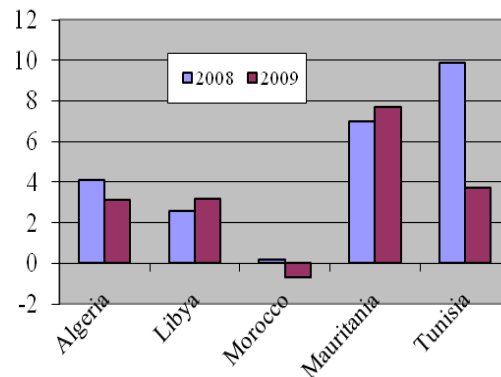
The impact of the 2008 global financial crisis on the Maghreb region has been relatively subdued. The region is expected to continue growing in 2009, even though export revenues, remittance inflows, and tourism receipts are projected to weaken somewhat due to the recession in Western Europe, which constitutes a major client market.

¹³⁷ For example, the IMF's Exogenous Shocks Facility (ESF), which was set up originally in 2005 within the Poverty Reduction and Growth Facility (PRGF) Trust, was modified in September 2008 to provide policy support and financial assistance more quickly to low-income countries dealing with exogenous shocks. Malawi, Comoros, Senegal and Ethiopia have accessed the facility.

Macroeconomic Effects of the Financial Crisis on the UMA Region

The global recession is dampening demand for North African exports. This could lead to job losses, especially in Morocco and Tunisia where export industries and agriculture are highly labor-intensive. As European consumers restrict discretionary spending, the tourism industry in Tunisia and Morocco is set to slow. As an offsetting factor, North Africa's proximity to Europe puts it in a better position than many other tourist destinations in Africa and Asia, once European economies resume growth.

UMA: Real GDP Growth, 2008-2009 (%)



While the global financial system suffered huge losses as a result of collapse of the US subprime mortgage market and exposure to “toxic debts,” North Africa's banking system appeared relatively insulated from the crisis. Banks in Tunisia, Algeria, and Morocco had minimal exposure to foreign assets. Indeed, Tunisia's stock market was one of the few in the world to remain positive, registering 17 percent annual growth in November 2008. Morocco's stock market fell by 5 percent, while most other global markets fell 40 percent or more in the same period.

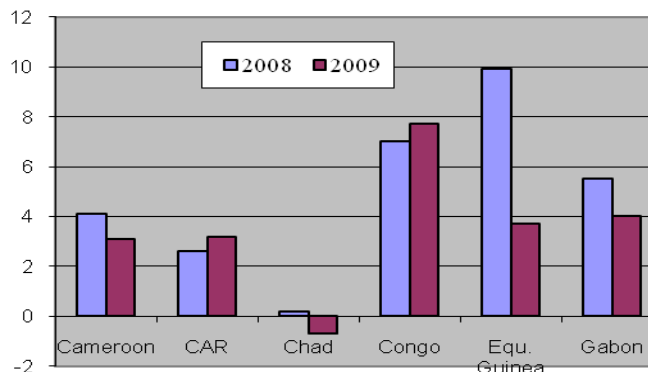
Despite these positive signs, the Maghreb region lacks a collective response mechanism to limit the negative impact of the crisis on its economies. Firstly, there is a shortage of established institutions to promote regional cooperation and financial integration. Secondly, regional action is needed in a number of areas to ensure macroeconomic and financial stability, including harmonization of fiscal policies and financial regulations, coordination of monetary and exchange rate policies, and other measures. Maghreb economic and financial authorities need to enhance their institutional capabilities by strengthening and streamlining existing mechanisms (the UMA Secretariat is an obvious example), and by creating new ones as the need arises. Consideration should also be given to establishing a “Maghreb Financial Dialogue or Forum” to bring together finance ministries, central banks, and other supervisory and regulation institutions to formulate a collective and effective response.

2.2. Economic Impact and Prospects for RFI in the CEMAC Region

Macroeconomic Impact in the CEMAC Region

The CEMAC institutions are envisioning a series of measures to scale up economic growth in Central Africa's six nations, where growth has slowed due to the global recession. The GDP of the CEMAC region is forecast to drop sharply from 4.4 percent in 2008 to 2.8 percent in 2009. This is largely due to the fall in the price of petroleum products and other primary commodities such as timber and mineral resources, upon which the CEMAC countries heavily rely.

CEMAC: Real GDP Growth, 2008-2009 (%)



In CEMAC, the existence of an exhaustive and coherent institutional framework and common community institutions for supervising the monetary and financial system, in addition to the multilateral surveillance of macroeconomic and financial policies, has facilitated an effective collective response to the financial crisis. Indeed, the Conference of CEMAC Heads of States, held in January 2009 in Libreville, advocated that CEMAC institutions should meet and come up with recommendations on how to mitigate the impact of financial crisis on the region. The CEMAC institutions have formulated a number of strategies to diversify the export base of CEMAC member countries, and to reinforce economic integration within the region.

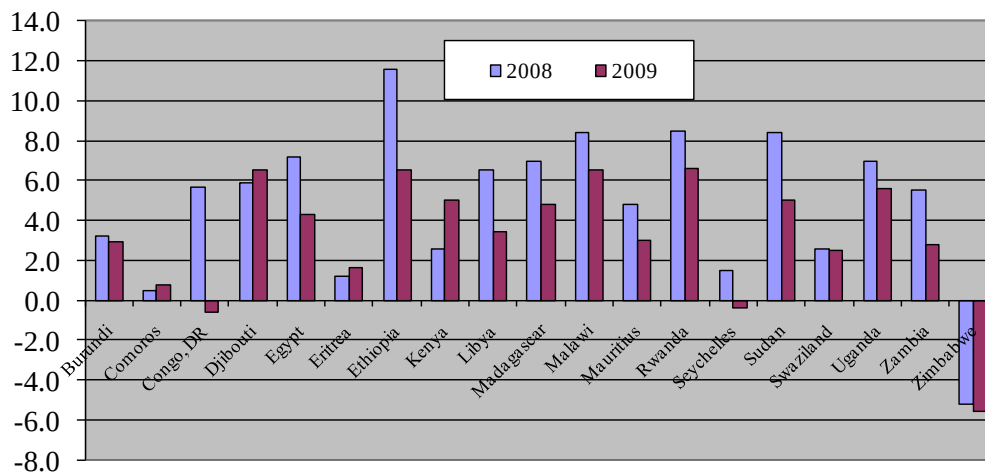
Concerning the financial sector in the CEMAC region, one particular risk faced by borrower commercial banks is the non-renewal of some lines of credit extended by the parent banks and other global financial institutions. However, the current level of international reserves, liquidity levels of CEMAC banks, the opportunities available through the interbank market, and refinancing from the BEAC (the region's central bank) should help to mitigate this risk. Besides, the prudential and soundness indicators of CEMAC borrowing banks remain good, with adequate capital adequacy ratios, limited liquidity and interest risks, low levels of non-performing loans, and relatively limited exposure to foreign exchange risk. However, to maintain the monetary and financial stability, secure the financial resources, and preserve RFI, the BEAC has agreed to lower its interest rate to reduce the cost of credit, and is also ready to provide more liquidity to the banks and non-bank financial institutions (NBFIs). Other proposed measures to scale up macroeconomic stability in the region include: (i) strengthening coordination and cooperation among the various regulatory and supervisory regional institutions, including the creation of a Financial Stability Forum and the establishment of a Central African Deposit Guarantee Fund; (ii) scaling up supervision of the financial sector; and (iii) expediting the establishment of a regional bond market.

2.3. Economic Impact and Prospects for RFI in the COMESA Region

COMESA countries have been hit severely by the crisis, with the growth rate forecast to dip to 3.2 percent in 2009 compared to 4.9 percent in 2008; after an average growth rate of 5.5 percent per annum maintained between 2000 and 2007. The worst affected economies are the financially developed and open economies (e.g. Egypt and Mauritius), the oil exporters (e.g. Libya and Sudan), the mineral-exporting economies (e.g. Congo DR, Zambia, and Zimbabwe), and some fragile economies (e.g. Burundi, Comoros, Seychelles, Madagascar, Ethiopia, and Rwanda). The financial crisis has also seen a tightening of credit in international capital markets and an increase in the risk premiums that some COMESA countries are being forced to pay. This had led to some countries (e.g. Kenya and Uganda) canceling plans to raise funds in these markets. The drying-up of this source of external finance is a serious setback for development in the region as it is constraining vital infrastructure development and other critical investments. The private sector is also facing challenges in raising funds in international capital markets.

The regional financial integration process in COMESA is also being negatively impacted as a result of the financial crisis. In particular, progress on macroeconomic convergence has slowed. The COMESA Action Plan details a number of measures and a timetable for their implementation, especially regarding exchange rate and macroeconomic stability. Unfortunately, the foreign exchange markets of COMESA countries have been under enormous pressure since the onset of the crisis, with significant depreciations expected in several countries. Furthermore, the expected depreciation of currencies in the region will increase domestic prices of consumer goods and thereby increase macroeconomic instability.

COMESA Countries: Real GDP Growth 2008-2009 (%)



3. Role of the Development Partners

The African Development Bank Group President, Donald Kaberuka, during the 13th Summit of the COMESA held in Zimbabwe in June 2009, called for an enhancement of integration and liberalization programs in response to the global financial crisis. The present report has identified various areas where the international community, including the African Development Bank, could be of assistance in advancing regional financial integration across Africa. The emphasis is firmly on capacity building for regional institutions, financial infrastructure development, effective regional monitoring mechanisms, and increased resource allocation to crisis-response initiatives.

As noted above, the AfDB has established targeted initiatives (notably ELF and TFI), and has also accelerated transfers to ADF countries. As President Kaberuka stated to the Assembly of African Union Heads of State and Government in February 2009, the Bank has a strong risk-bearing capacity to scale up its activities. An early decision on the AfDB's Sixth General Capital Increase will further increase this capacity. The Bank will also continue to play a catalytic role by mobilizing financial and technical resources to meet Africa's needs, and intensify its role in mobilizing private sector resources for regional infrastructure, including financial infrastructure.

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