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What Are the Best Ways of Promoting Financial Integration in Sub-Saharan Africa?

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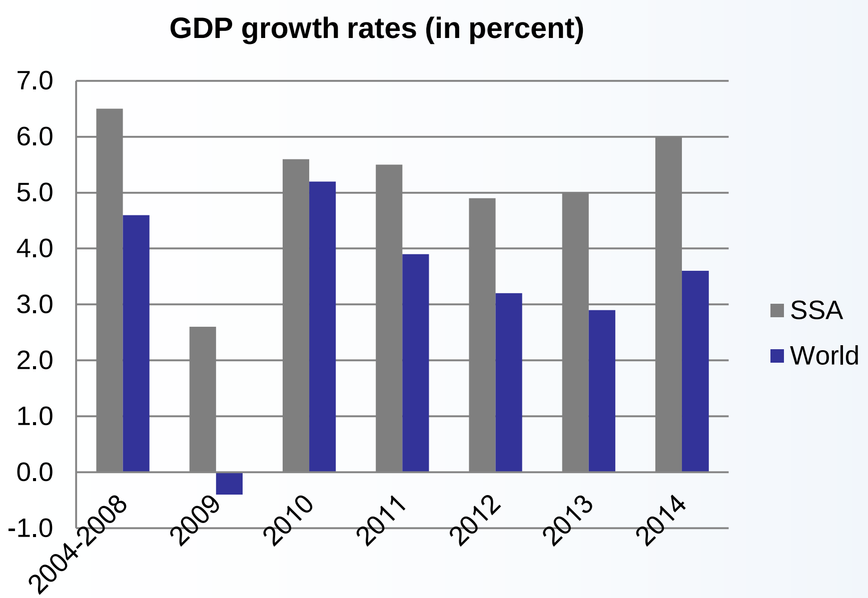
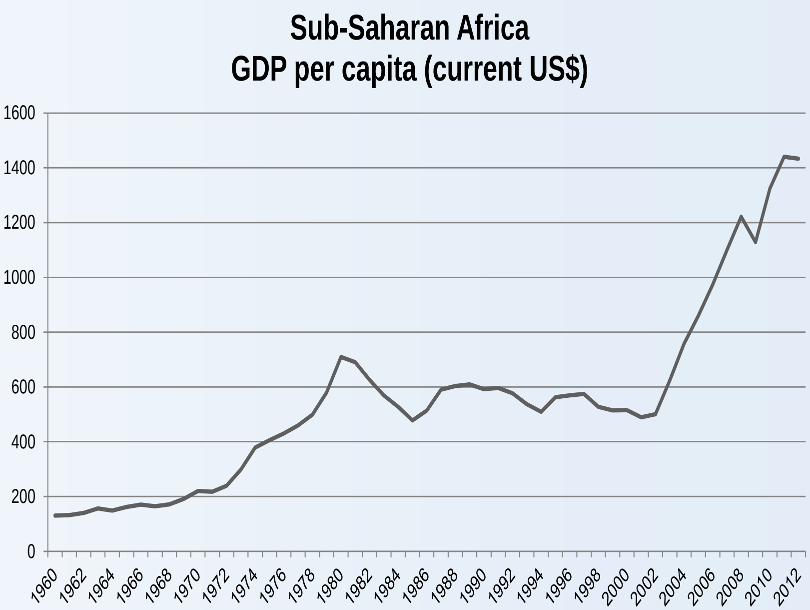
1. Why focus on financial integration now?

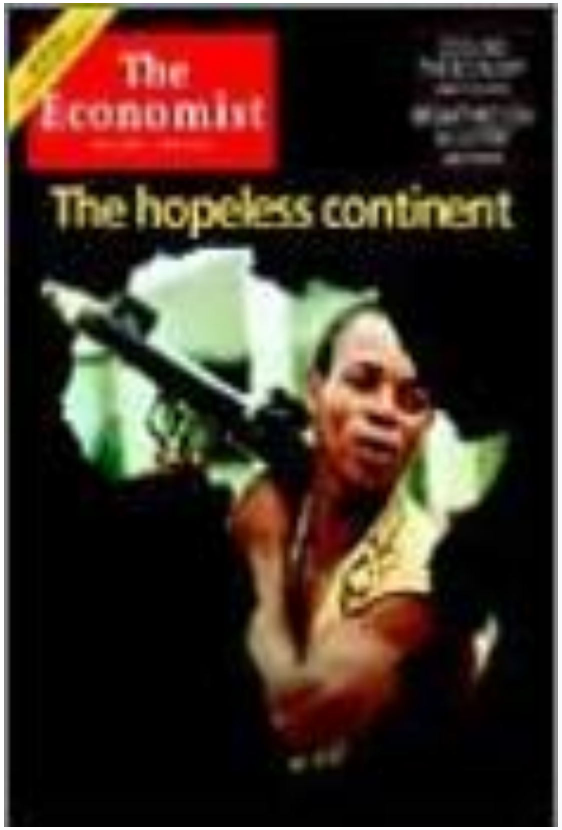
The “Africa Rising” Narrative

- Over the past 10 years, SSA grew 5% per year and, at this rate, it can DOUBLE its size before 2030.
- GDP is projected to rise by at least 6% in 2014 (7 of the world’s fastest 10 economies in 2011-2015 will be from SSA).
- Financial integration can be a key driver of sustainable and inclusive growth.



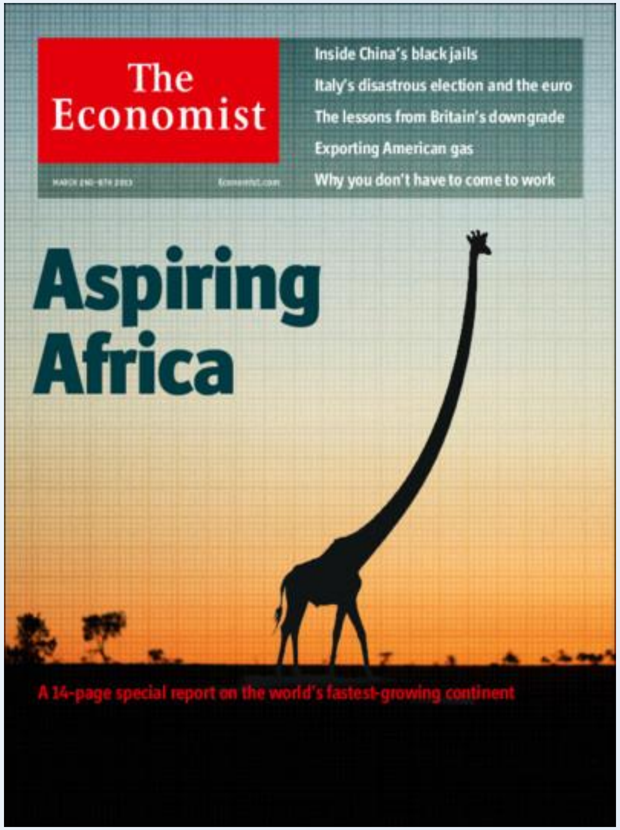


The "Africa Rising" Narrative



May 2000

December 2011



March 2013

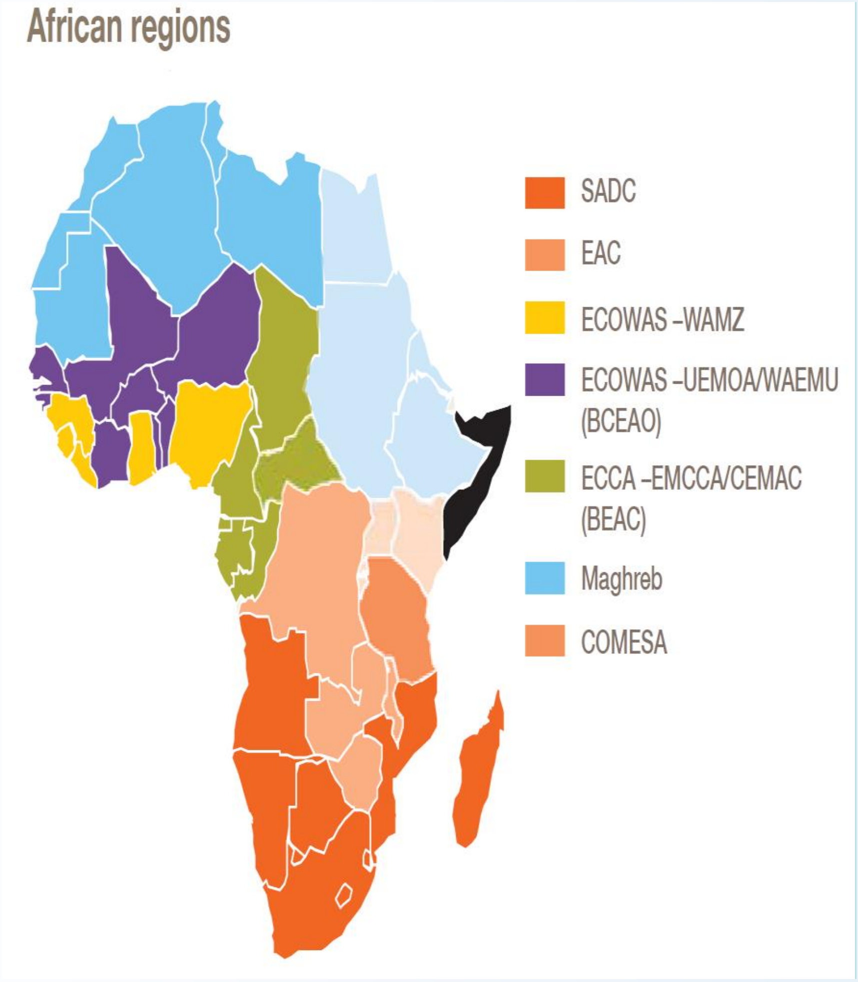
2. Political appetite for financial integration

The Road to an Africa Economic Community

- The 1991 Abuja Treaty established a roadmap towards an African Economic Community to be completed by 2028.
- The roadmap included 6 stages starting with the creation of regional blocs (the Regional Economic Communities, RECs).
- Four stages remain and progress across RECs has been uneven.

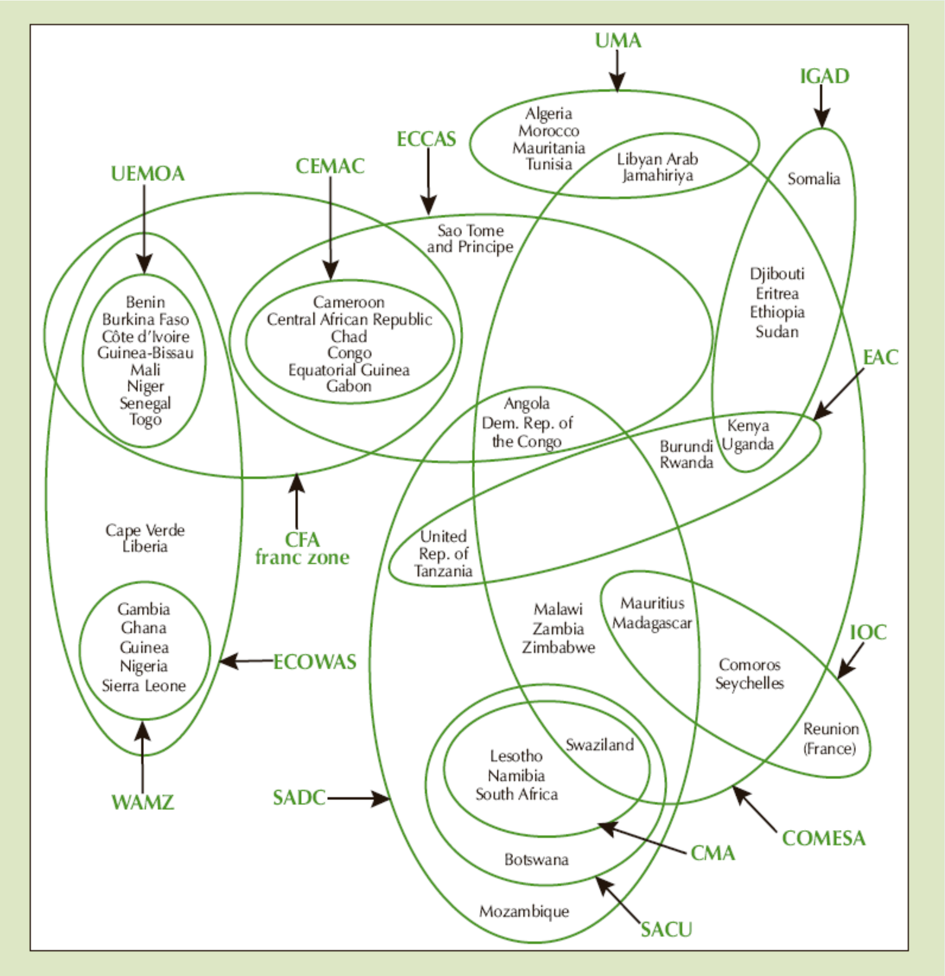
Africa's Integration

- Regional Economic Communities (RECs) are the AEC's building blocks.



Africa's Integration

- But multiple memberships and varied priorities do not help.



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3. Thresholds in financial integration

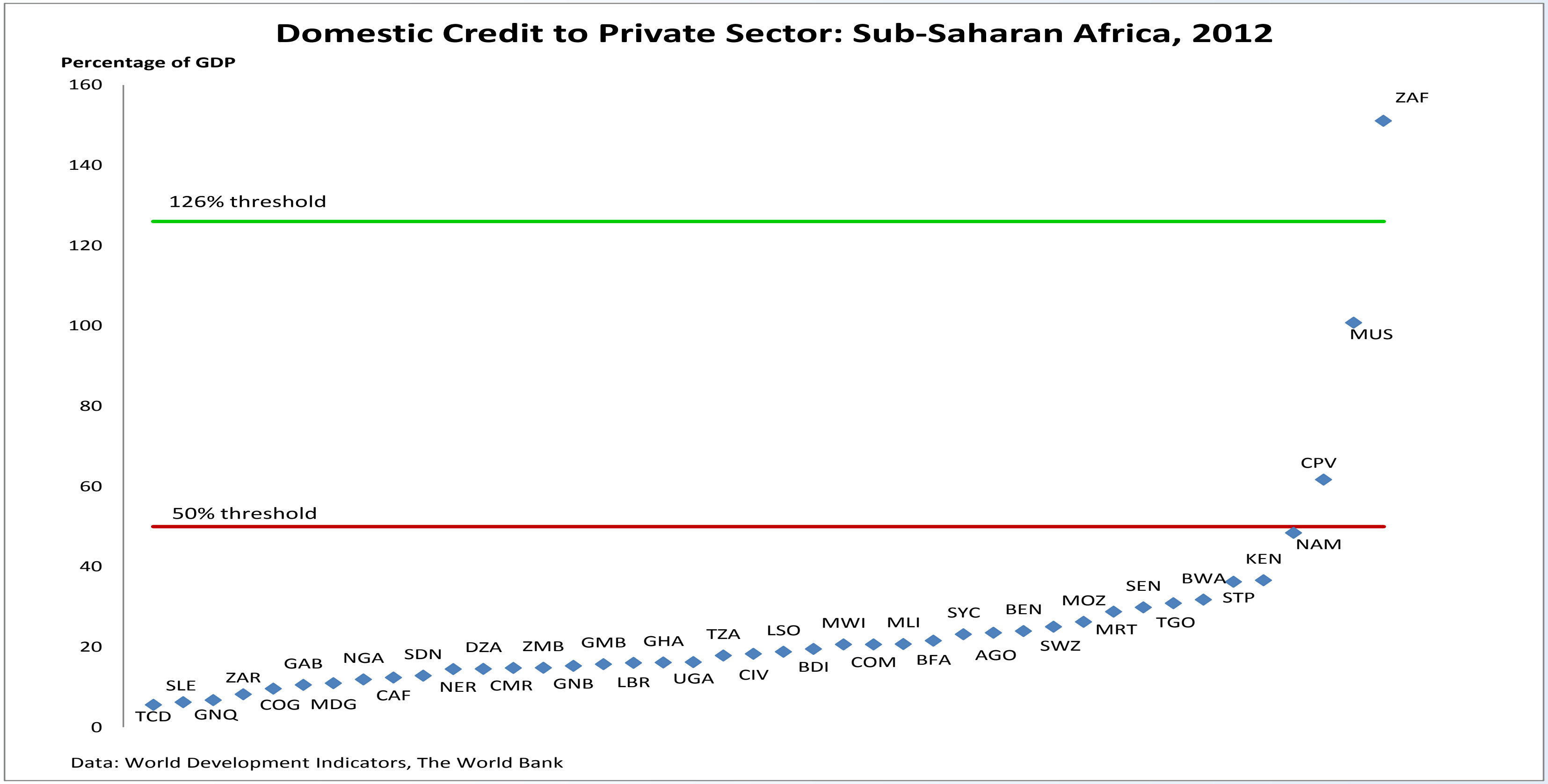
How to benefit from financial integration?

- Financial integration leads to better macro outcomes when certain thresholds are met.
- Financial depth, the quality of supervision of the financial sector, and institutional capacity matter the most (Kose, Prasad, and Taylor, JIMF 2011).

Thresholds in the Process of Financial Integration. Source: Kose et al. (2009).

Thresholds for financial development

- Credit to GDP remains low and for most countries below the thresholds, suggesting that policies to develop the financial sector are needed.

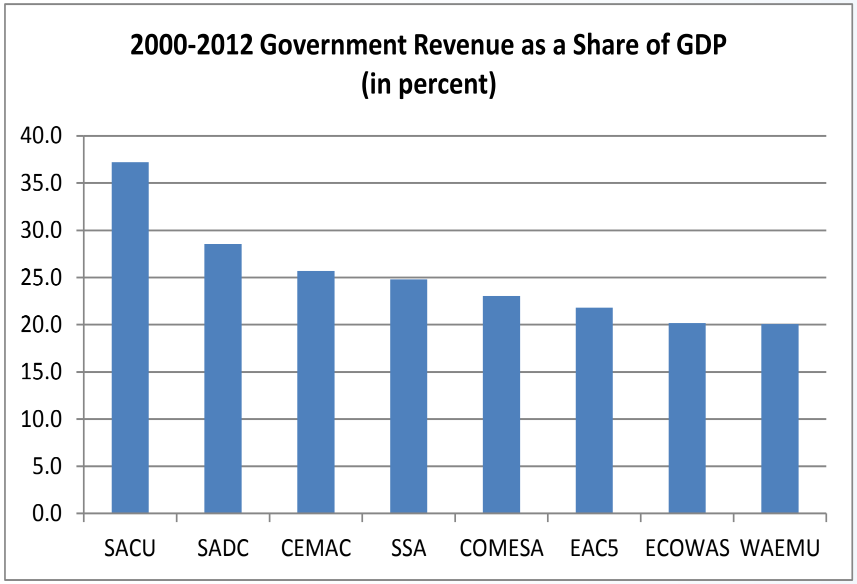


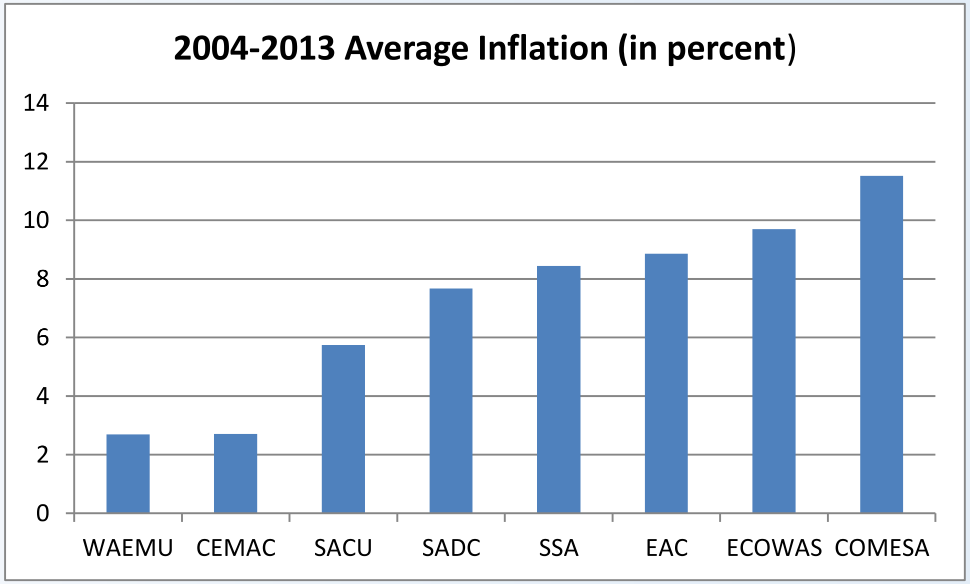
Thresholds for financial development

- There is also ample room to improve governance indicators (e.g., Ibrahim Index of African Governance, IIAG)

Thresholds for financial development

- Macro policies have improved but performance remains uneven across regions.
- Inflation is below double digit in most RECs.
- However, government revenue to GDP remains low.

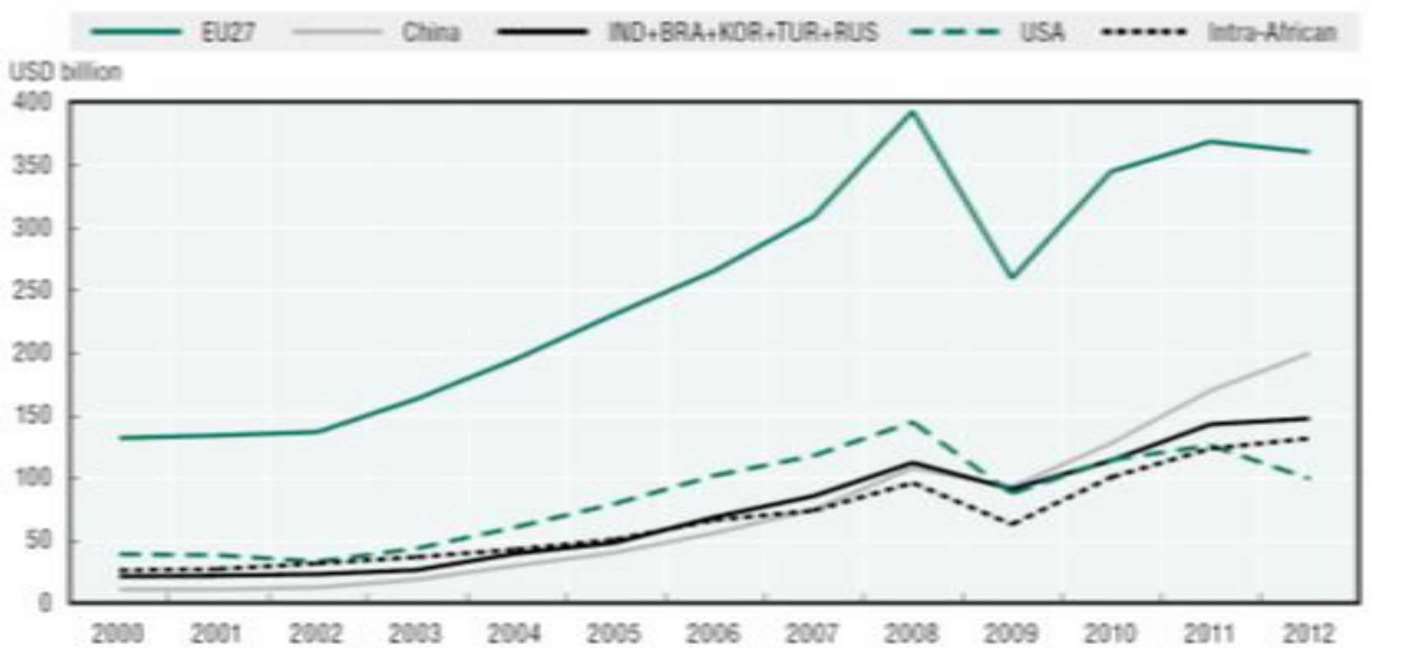




Thresholds for financial development

- Intra-regional trade has increased but remains low and non-tariff barriers are high.
- Nigeria and South Africa are important trade partners within SSA.

Africa's trade flows with selected partners



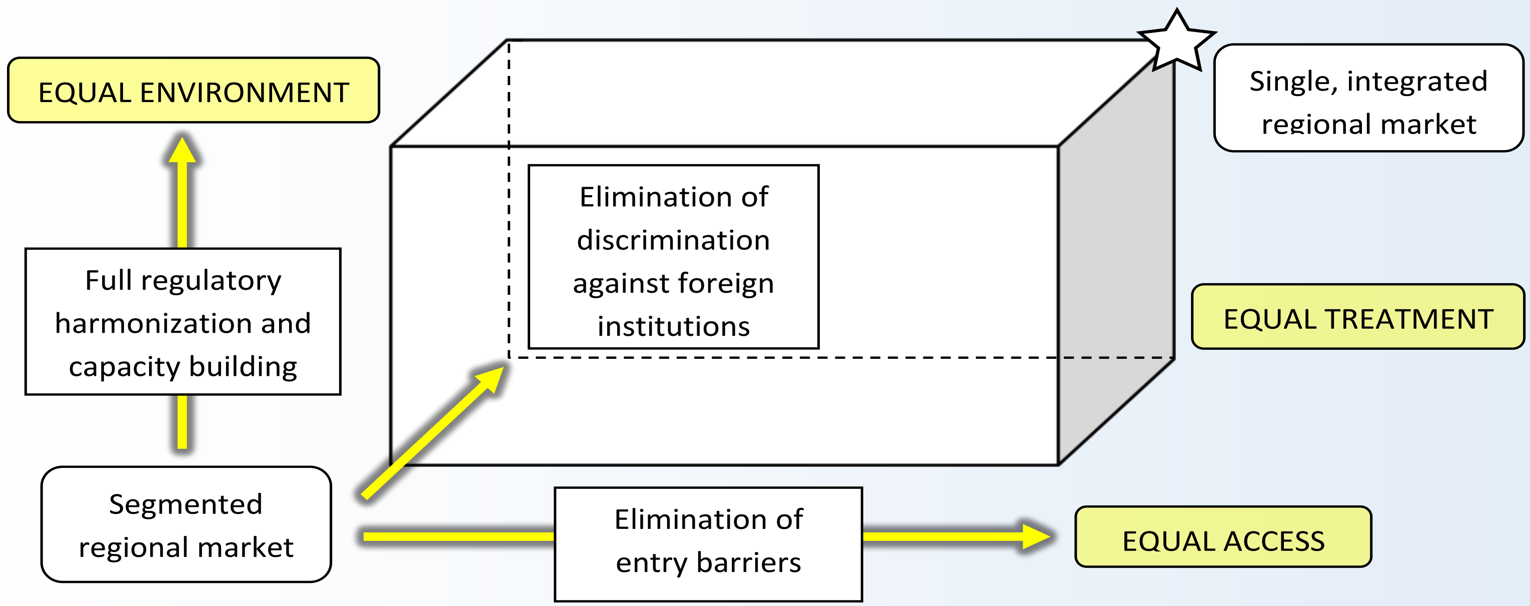
Source: UN Comtrade (2012).

4. The financial integration trinity

The integration trinity

- Baele et al. (2004): On the road to a single, integrated regional market RECs will differ on:

  1. Entry barriers;
  2. Regulatory harmonization and capacity building;
  3. Discrimination against foreign institutions.

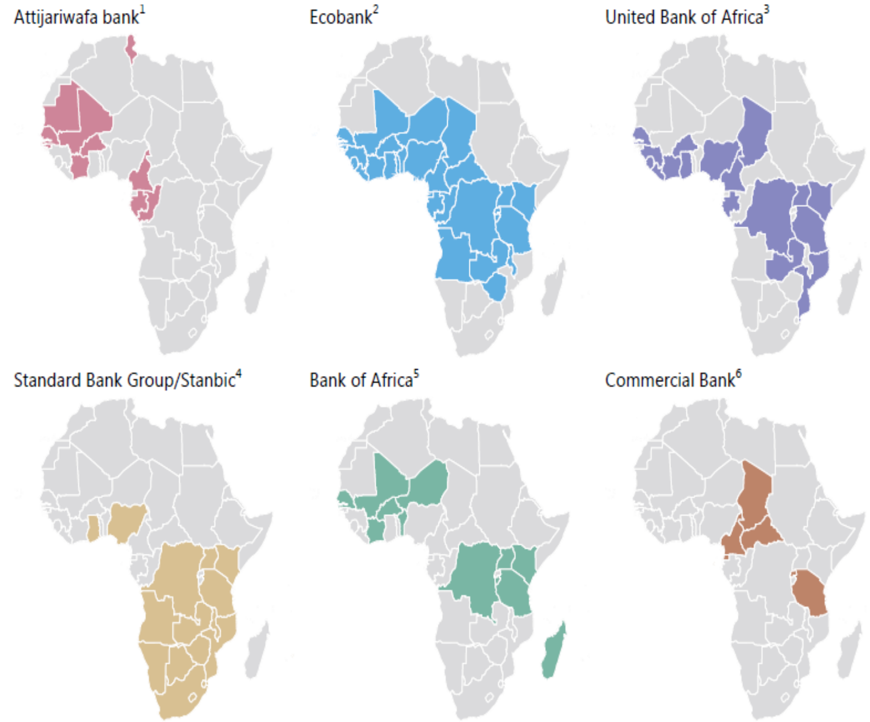


Source: The Road to ASEAN Financial Integration (Asian Development Bank, 2013)

The integration trinity

- The growth of pan-African banking indicates progress in reducing barriers to financial integration.
- Financial integration can increase if pan-African banks are able to unlock economies of scale and scope from their expansion (e.g. in liquidity management).

Geographical distribution of pan-African banking — Graph 5

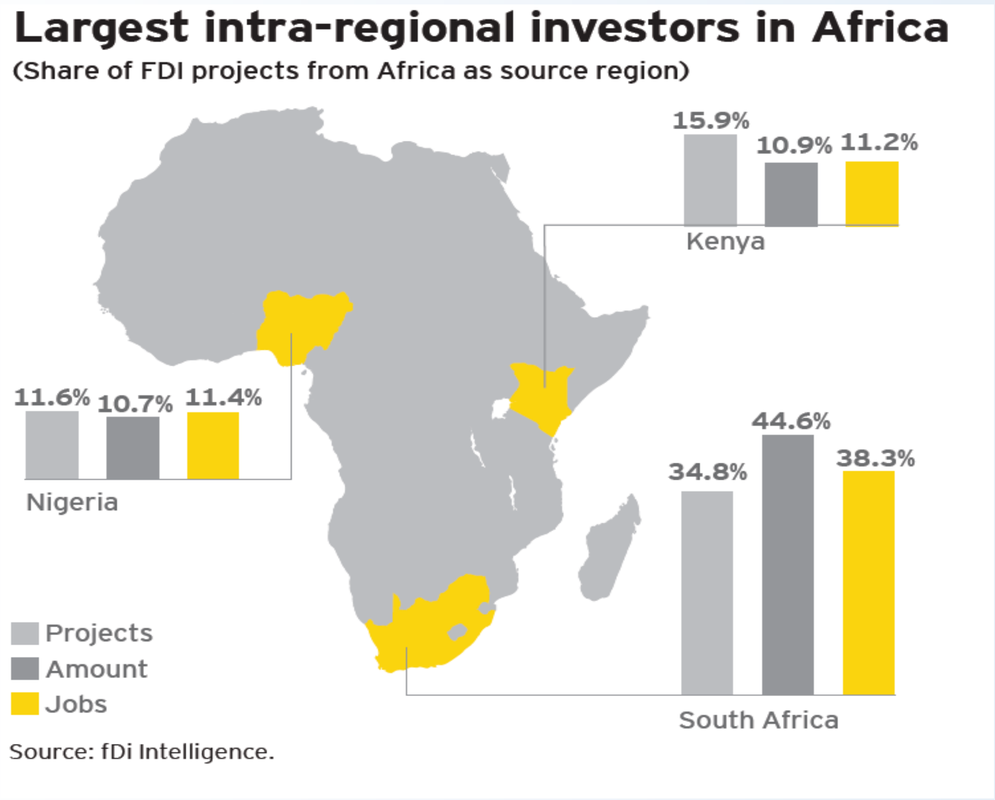


[1] Burkina-Faso, Cameroon, Congo, Côte d'Ivoire, Gabon, Guinea-Bissau, Mali, Mauritania, Senegal and Tunisia. [2] Angola, Benin, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of Congo, Equatorial Guinea, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Liberia, Malawi, Mali, Niger, Nigeria, Republic of Congo, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Tanzania, Togo, Uganda, Zambia, Zimbabwe. [3] Burkina Faso, Cameroon, Chad, Côte d'Ivoire, Democratic Republic of Congo, Gabon, Ghana, Guinea, Kenya, Liberia, Mozambique, Nigeria, Senegal, Sierra Leone, Tanzania, Uganda and Zambia. [4] Angola, Botswana, Democratic Republic of Congo, Ghana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Nigeria, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. [5] Benin, Burkina Faso, Burundi, Côte d'Ivoire, Democratic Republic of Congo, Mali, Niger, Kenya, Madagascar, Senegal, Tanzania and Uganda. [6] Cameroon, Central African Republic, Chad, Equatorial Guinea, Rwanda, São Tomé and Príncipe and Tanzania.

Sources: IMF, *Regional Economic Outlook*, April 2011; Attijariwafa bank website.

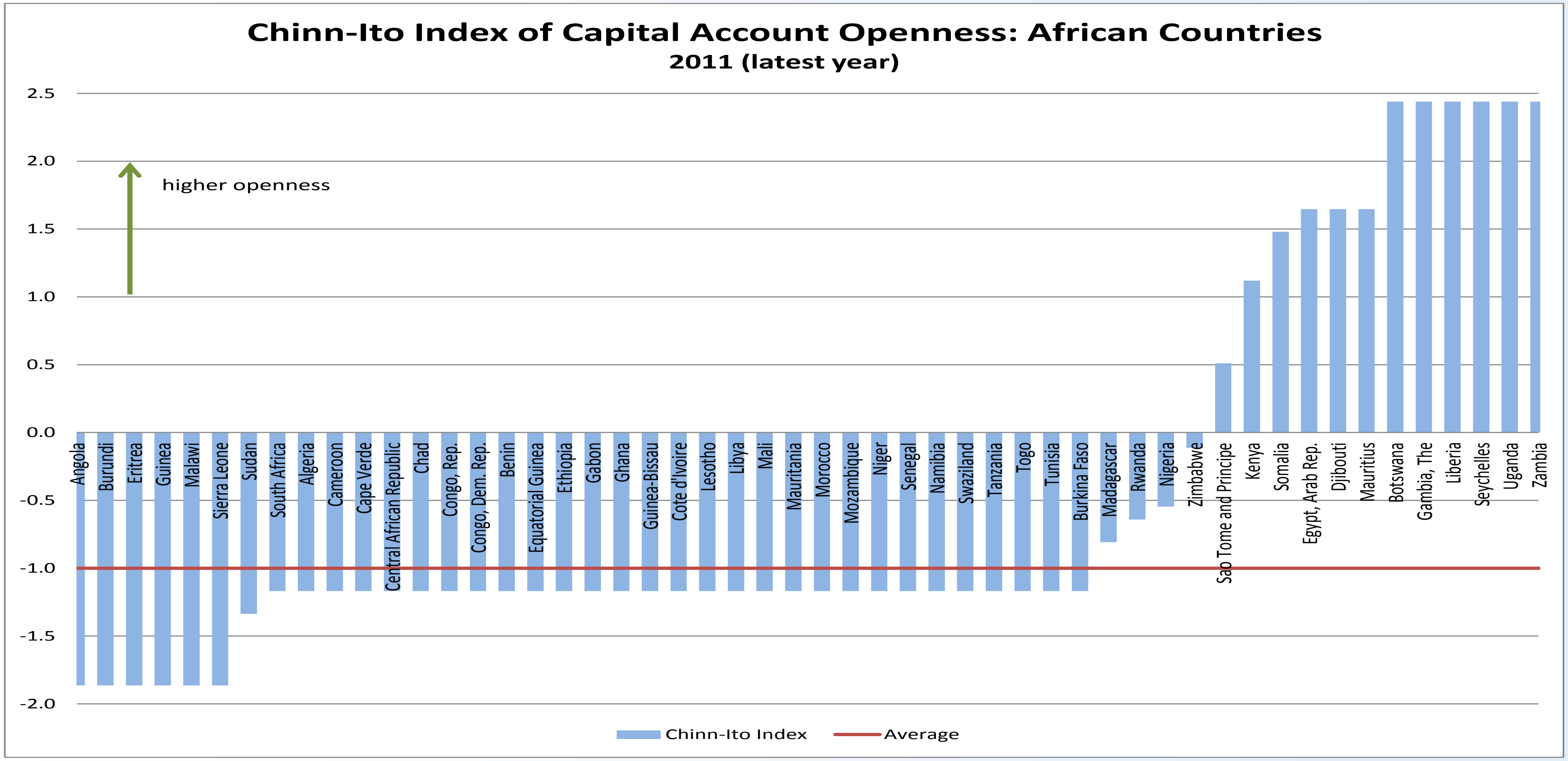
The integration trinity

- Intra-Africa investment into new FDI projects is growing rapidly.
- At a 32.5% per year growth rate since 2007, intra-African investments are growing 4 times faster than FDI from developed markets (EY 2014).



The integration trinity

- There is ample scope to reduce barriers to FI as most SSA countries still restrict the free movement of capital (as measured by the Chinn-Ito index of capital account openness).



The integration trinity

- Efforts to reduce capital controls include the EAC Common Market Protocol.

Article 24, EAC Common Market Protocol: Requires elimination of restrictions on the free movement of capital including restrictions based on nationality, place of residence, current payments, and where capital is invested:

20 operations

1-14 → Securities Operations : quoted and unquoted securities, some collective investment schemes, money market instruments, and derivatives.

15-16 → Credit Operations : external borrowing and lending by residents.

17-19 → Direct Investment Operations : direct international acquisitions, greenfield investments, establishment of branches of enterprises, re-investment of profits in enterprises, outward direct investment, and repatriation of profits from asset sales.

20 → Personal Capital Transactions

Key Regional Institutions: *Capital Markets, Pensions, and Insurance Committee under the EAC Council of Ministers; East African Securities Regulators Association; East African Securities Exchanges Association; and EAC Monetary Affairs Committee.*

Source: EAC Common Market Protocol, EAC Secretariat.

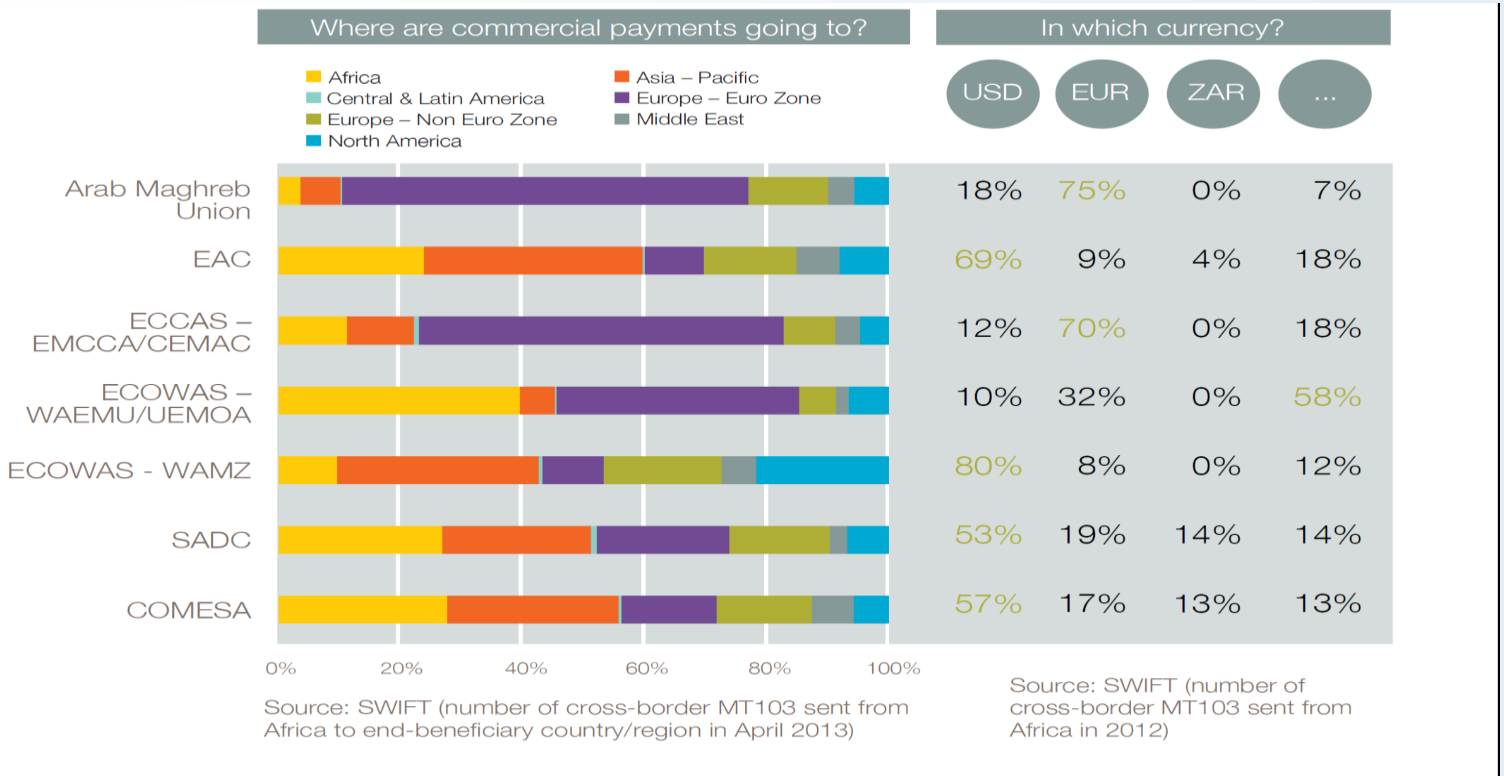
5. Trade, Finance & Plumbing

Trade, Finance, & Plumbing

- SWIFT figures point to intra-African trade accounting for 23% of total trade.
- 50% of intra-African import/export settlement involves a bank outside Africa.
- US$ clearing banks more important as trade/investment within SSA and with China and EMs rise (Africa-China trade corridor).
- Know-Your-Customer (KYC), anti-money laundering and combating financial terrorism AML/CFT regulation increases transaction costs.

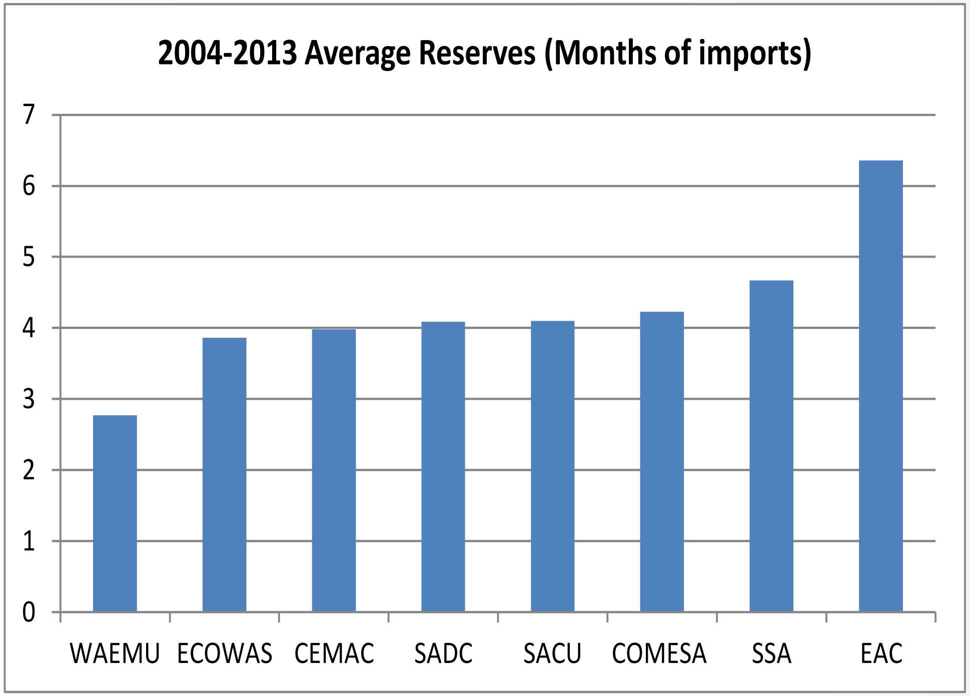
Trade, Finance, & Plumbing

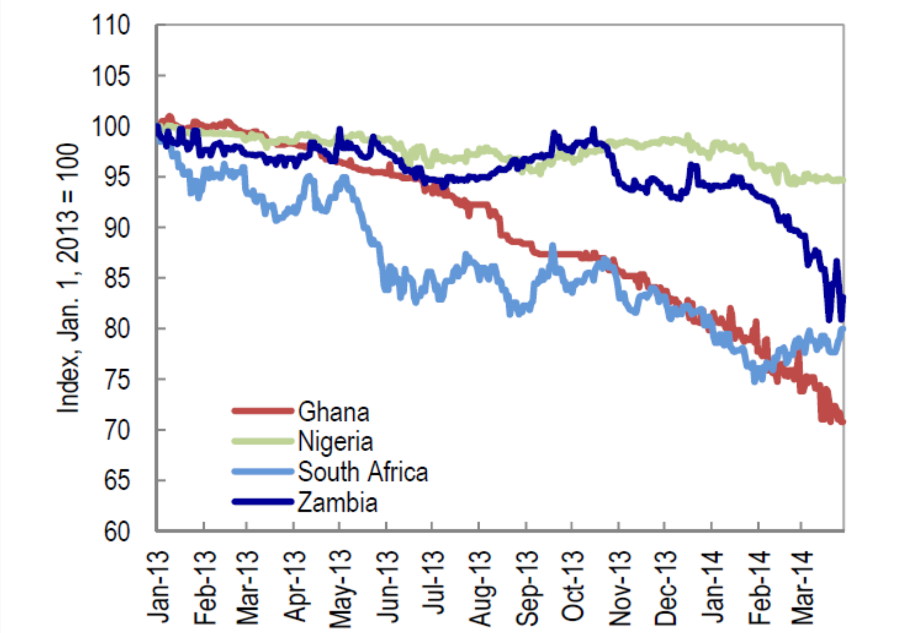
- SWIFT figures show that intra-regional trade is higher in the WAEMU, reflecting the use of a common currency, a single central bank, a regional real time gross settlement (RTGS) system, and a regional automated clearing house (ACH).



Trade, Finance, & Plumbing

- There is a need to reduce the transaction costs from trading in at least 30 different currencies.
- High market volatility and administrative measures by central banks with at times low FX reserves remain an issue.





Source: Bloomberg, L.P.

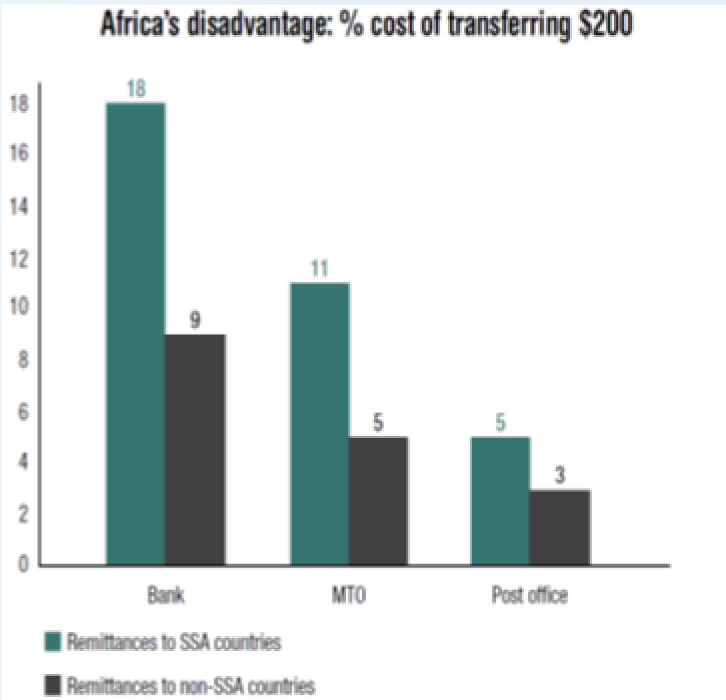
Trade, Finance, & Plumbing

- Remittances to Africa are the most expensive in the world and intra-regional remittances are even more costly.

U.S. dollar cost of transferring $200

5 Most Costly Corridors in USD	Average Cost	5 Least Costly Corridors in USD	Average Cost
South Africa > Zambia	21.06	Saudi Arabia > Pakistan	1.73
South Africa > Botswana	20.18	Singapore > Thailand	2.05
South Africa > Mozambique	19.81	UAE > India	2.68
South Africa > Angola	19.55	UAE > Sri Lanka	2.87
South Africa > Malawi	19.51	Singapore > Bangladesh	3.03

Source: World Bank



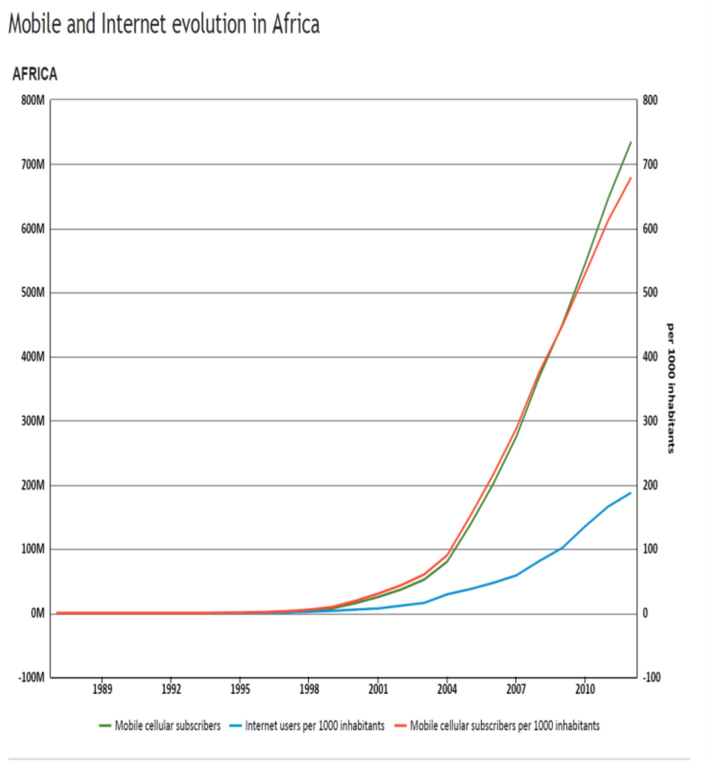
Source: Remittance Prices Worldwide database of the World Bank, 2013.

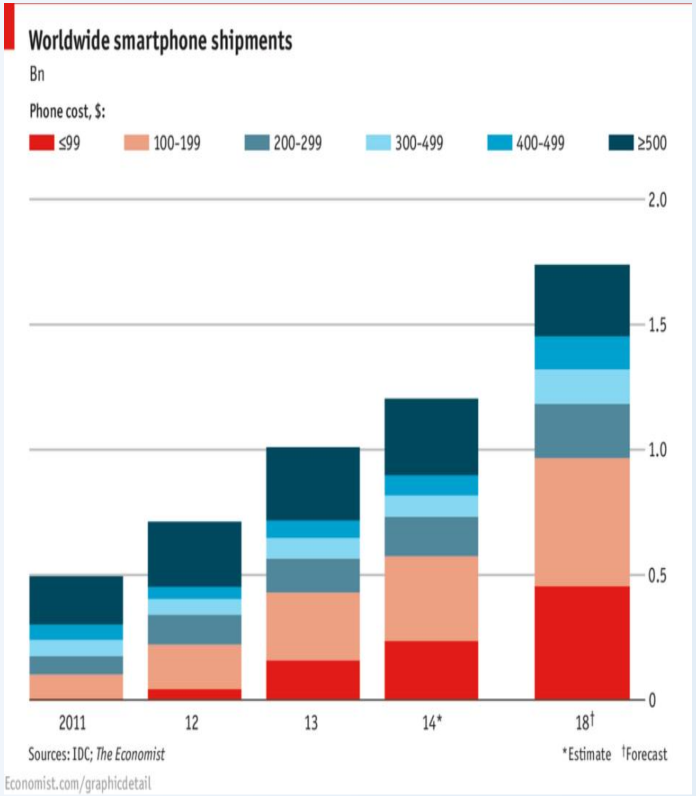
Trade, Finance, & Plumbing

- Mobile payments could help reduce transaction costs.
- In West Africa, Orange Money is present in 11 countries in sub-Saharan Africa and mobile-to-mobile payments in CFA francs are possible between Côte d’Ivoire, Mali and Senegal.
- In East Africa, Tigo offers cross-border mobile money transfers with automatic currency conversion between Tanzania and Rwanda.

Trade, Finance, & Plumbing

- There is a potential for mobile payments to increase as the number of mobile cellular subscribers and internet users increase.
- It will be important to strike the right balance between regulatory objectives and the pace of innovation.





6. Conclusions

Four tools to strengthen financial integration

1. Political commitment devices
   - » Strengthen common institutions/surveillance
   - » Regional infrastructure and other projects
2. Threshold conditions
   - » Financial development/inclusion and governance
3. The Integration Trinity
   - » Same Access, Rules, and Treatment

Four tools to strengthen financial integration

4. Plumbing (financial infrastructure)

   » Risk management tools and payments and settlement systems

   » Multilateral solutions for swap arrangements

   » African multi-currency clearing center? (Hong Kong 1996 example)

   » Mobile payments regulation, innovation, and development

AMPI
The African Mobile Phone Financial Services Policy Initiative