Financial System Strategy 2020

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Financial Sector Reform and the Economy
FINANCE AND GROWTH:

CAN THE ENGINE WORK FOR NIGERIA?

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The two strands of the presentation

- Financial sector helps growth and lowers poverty

- Nigeria (as other African financial systems) has much to gain from energetic financial policy development combining *modernism with activism*

Illustrated with data charts
Finance, growth & poverty: Surprising research findings

Financial development is an important cause of growth

General financial development (as measured by depth) widens opportunities and reduces poverty
   i.e. Finance-rich growth is pro-poor
   Even conditional on mean income

But data gaps make it difficult to establish how much direct access to finance by the poor reduces poverty

[Banking crises do not always hit the poor disproportionately (but did in Nigeria)]
Countries with deeper financial systems in 1960 grew more rapidly.
Growth and financial development
Naïve and model-based relations

Average GDP growth 1960-95

Private credit as % GDP (log)
Nigerian banking system is second largest in Africa but is still small -- absolutely
...and (even more so): relatively:
Liquid Liabilities (M3+) as % GDP

Sample size: 127 countries
Time period: Latest available year: 2004-05
...and (even more so): relatively:
Liquid Liabilities (M3+) as % GDP

Sample size: 127 countries
Time period: Latest available year: 2004-05
Still...Nigeria does a little better than average given income and inflation levels

Sample size: 151 countries
Time period: 2000-2005
Source: Financial Structure Database, 2006; World Development Indicators, 2005 (The World Bank)
One reason for low depth: Offshore Deposits

Regional Distributions

1. High Income
2. East Asia & Pacific
3. Europe & Central Asia
4. Latin America & Caribbean
5. Middle East & North Africa
6. South Asia
7. Sub-Saharan Africa

Sample size: 90 countries
Time period: 2005
Source: Financial Structure Database, 2006; BIS, 2006
But there is a deepening in progress across Africa
African Stock Markets Picking Up
Stock Markets: A difficult area for all developing countries

- Access
- Stability
- Efficiency
- Size

Developing countries
Sub-Saharan Africa
SSA excluding South Africa
Many other dimensions to finance

- Payments (new technologies)
- Insurance (including microinsurance)
- Pension
- Deposit services
- Legal and regulatory infrastructure
- Provision of financial information
- Etc etc.
Banking is expensive: Net Interest Margins

Regional Distributions

1. High Income
2. East Asia & Pacific
3. Europe & Central Asia
4. Latin America & Caribbean
5. Middle East & North Africa
6. South Asia
7. Sub-Saharan Africa

Sample size: 142 countries
Time period: 2004
Source: Financial Structure Database, 2006 (The World Bank)
And African banks are reluctant to lend
More and more foreign-owned banking systems: Africa and ROW

Bank ownership (Africa)
- Mainly local: 21%
- Equally shared: 19%
- Foreign: 46%
- Foreign+Govt: 7%
- Mainly govt: 7%

Bank ownership (Rest of Developing World)
- Mainly local: 25%
- Equally shared: 25%
- Foreign: 29%
- Foreign+Govt: 9%
- Mainly govt: 12%
Firms demand better financing: Africa and Rest of World

% of firms reporting as barrier

- Cost of financing
- Access to financing
- Tax rates
- Electricity
- Macroeconomic instability
- Corruption
- Tax administration
- Economic and regulatory policy uncertainty
- Anti-competitive practices
- Customs and trade regulations
- Crime, theft and disorder
- Access to land
- Skills and education of workers
- Telecom
- Transportation
- Legal system
- Labor regulations
- Business licensing and permits

Africa
Rest of World
Map 1: Composite Measure of Access to Financial Services

For definition see Table 1. The map includes eight countries not listed in Table 1 by assuming that AUS, ISL and NZL are in the highest category; COD (formerly ZAR), GNB, TCD, MRT and SOM in the lowest category.
Financial access vs. financial depth

![Graph showing financial access vs. financial depth](image)
Approaches (1): Modernism (vs. Activism)

Transplant “best practice” from advanced economies, e.g.:

Better legal protection for creditors including
  – procedures for collecting on collateral (including leasing)
  – judicial efficiency and probity

Clarify land ownership (good for collateral)

Improve information
  – credit bureaus
  – accounting (and auditing)

Better protections for investors in stock exchange

Strengthen prudential supervision of banks; AML/CFT

Liberalize entry
Excesses of Modernism

Land issues: not just a question of better land registration

Unrealistic stock exchange rules prevent SMEs from listing. AIM-type model might work better.

Basel 2 bank regulation would be counterproductive.

Excessive AML/CFT procedures a barrier to access of the poor.

Approaches (2): Activism (vs. Modernism)

African environment (sparse population, low incomes, poor infrastructure) makes access problematic

Mainstream banks etc have not delivered long term, risk finance; or any services for the majority (market failure)

So new (or re-engineered) entrants with dedicated mission needed

- To be patient, take risks, experiment with new technology including enhanced use of soft information/relationship lending
- To take up the “fight for an inclusive financial system” (example: South Africa financial sector charter, 2003)
Activists are not restrained by immediate market pressures; they have chosen to plough money and effort into endeavours that the market has turned down.

Willie Sutton effect

To be even reasonably confident that these efforts and resources will not be wasted or subverted, the sponsoring agency must have good governance.
Governance issues

Composite Governance Indicator

Sample size: 209 countries
Time period: 2004
Governance issues

KKZ Data Africa & ROW, quartiles

Africa: Change in ratings median 1998-2005

- Control of Corruption
- Rule of Law
- Regulatory Quality
- Government Effectiveness
- Political Stability
- Voice and Accountability
Governance issues

Nigeria: Change in ratings
1998-2005

Control of Corruption
Rule of Law
Regulatory Quality
Government Effectiveness
Political Stability
Voice and Accountability
Concluding remarks

- Financial sector development can be a powerful agent for growth and transformation
- Nigeria has plenty of headroom here
- “Open access” should be the watchword
  
  helped by technology and by nimble regulation

- Achieving this requires a champion who will fight for access when necessary against the vested interests of incumbents