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

Amadou Sy
Senior Fellow, Africa Growth Initiative
Paris, May 2014
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
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.
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 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.
4. The financial integration trinity
The integration trinity

- Baele et al. (2004): On the road to a single, integrated regional market REC's 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).
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).

**Largest intra-regional investors in Africa**
(Share of FDI projects from Africa as source region)

- Nigeria: 11.6%, 10.7%, 11.4%
- Kenya: 15.9%, 10.9%, 11.2%
- South Africa: 34.8%, 44.6%, 38.3%

Source: fDi Intelligence.
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:

- **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).

![Diagram showing commercial payments and currency distribution](chart.png)

Source: SWIFT (number of cross-border MT103 sent from Africa to end-beneficiary country/region in April 2013)
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.

![Graph showing 2004-2013 Average Reserves (Months of imports)](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**

<table>
<thead>
<tr>
<th>5 Most Costly Corridors in USD</th>
<th>Average Cost</th>
<th>5 Least Costly Corridors in USD</th>
<th>Average Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa &gt; Zambia</td>
<td>21.06</td>
<td>Saudi Arabia &gt; Pakistan</td>
<td>1.73</td>
</tr>
<tr>
<td>South Africa &gt; Botswana</td>
<td>20.18</td>
<td>Singapore &gt; Thailand</td>
<td>2.05</td>
</tr>
<tr>
<td>South Africa &gt; Mozambique</td>
<td>19.81</td>
<td>UAE &gt; India</td>
<td>2.68</td>
</tr>
<tr>
<td>South Africa &gt; Angola</td>
<td>19.55</td>
<td>UAE &gt; Sri Lanka</td>
<td>2.87</td>
</tr>
<tr>
<td>South Africa &gt; Malawi</td>
<td>19.51</td>
<td>Singapore &gt; Bangladesh</td>
<td>3.03</td>
</tr>
</tbody>
</table>

Source: World Bank
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