SPECIAL EDITION FOR THE THIRD INTERNATIONAL CONFERENCE ON FINANCING FOR DEVELOPMENT

UNCTAD: Fostering Africa's Services Trade for Sustainable Development

UNITED NATIONS

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NOTES

Further information can be found in the 2015 *Economic Development in Africa Report: Unlocking the Potential of Africa’s Services Trade for Growth and Development*

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ABBREVIATIONS

CFTA	continental free trade area
EAC	East African Community
ECOWAS	Economic Community of West African States
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GDP	gross domestic product
ICT	information and communications technology
IMF	International Monetary Fund
M&A	mergers and acquisitions
MFN	most favoured nation
OECD	Organization for Economic Cooperation and Development
SADC	Southern African Development Community
SMEs	small and medium-sized enterprises

1. MAIN FINDINGS AND RECOMMENDATIONS

A. STYLIZED FACTS ABOUT AFRICA'S SERVICES TRADE

1. Africa's services sector grew at more than twice the world average rate during 2009–2012.

Africa's rapid growth rate in services is comparable to that of the developing world and has a great potential to drive overall growth in the future. During 2009–2012 the services sector in Africa grew at a rate of 4.6 per cent, compared to 5.4 per cent in the developing world. The fastest growing services subsectors were transport, storage and communications, which are important for Africa's economic development. Broader economic growth and increased export revenue in the past decade, largely due to the commodity boom drove these encouraging trends. Regional trade in services has also increased tremendously especially along the three main lines of finance, telecommunications and retail.

2. Of the 45 countries where the share of services in output rose, 30 experienced a contraction in manufacturing from the period 2001–2004 to the period 2009–2012

Many African countries have undergone a process of shifting from agriculture to mainly non-tradable services, without going through a process of manufacturing development marked by significant productivity improvements, formal job creation, exports of sophisticated goods and the application of technology to the wider economy. From the period 2001–2004 to the period 2009–2012, of the 45 countries where the share of services in output rose, 30 experienced a contraction in manufacturing. This suggests that the complementarities between the two sectors are yet to be fully developed in some countries.

3. Africa's services sector propelled GDP growth in 30 out of 54 countries during 2009–2012

Weighted real GDP growth rates were calculated for each African country, and the contribution of the services sector to real growth was assessed. This exercise confirmed the importance of services acting as a cushion for the national economy at times of global economic shocks. For the period from 2009 to 2012, the services sector was the most significant driver of economic growth in 30 out of 54 African countries, accounting for more than 50 per cent of real economic growth. It accounted for more than 70 per cent of total real economic growth in 12 countries, of which 7 had services accounting for more than 50 per cent of their GDP.

4. The share of services in real GDP was highest among manufactures exporters and lowest for fuel exporters

The share of services in Africa's real output rose from 45.8 per cent to 49.0 per cent from the period 2001–2004 to the period 2009–2012. Within the categories of exports specializations, the shares of services in real output was highest among manufactures exporters (which consist of Lesotho and Tunisia) at 61.7 per cent, followed by services exporters at 57.0 per cent, and was lowest for fuel exporters at 33.9 per cent.

5. The services sector accounted for 32.4 per cent of total employment in Africa during 2009–2012

The services sector accounted for 32.4 per cent of total employment in Africa as compared to 56.5 per cent in agriculture and 11.0 per cent in industry during 2009–2012 (International Labour Organization, 2014). Since 2001, the services share of employment has risen steadily while those of manufacturing and agriculture have stagnated. However, countries that are services-oriented do not necessarily source a large share of their formal employment from the services sector. In some countries where the services sector contributed more than 40 per cent to GDP over the period 2009–2012 (e.g. Ethiopia, Mozambique, Rwanda and Zambia), the services sector accounted for less than 20 per cent of total employment. This may be due to the nature of the services sector in these economies and the consequent labour intensity. For the services sector to increase its contribution to employment, the informal sector, which accounts for between 60 to 80 per cent of total employment in Africa, needs to be addressed.

6. Africa is a marginal player in global services exports and imports – only 11 African countries have consistently been net services exporters since 2005

Global exports of services in 2012 were $4.4 trillion, and for developing countries they were $1.3 trillion (at current prices). Total imports of services amounted to an estimated $173 billion in 2012 for Africa while exports of services totalled an estimated $98 billion (UNCTADStat, February 2015). In 2012 Africa accounted for only 2.2 per cent of the world's total exports of services compared to 3.6 per cent for developing America, and 24.3 per cent for developing Asia. The continent accounted for 4.0 per cent of total world's services imports compared to 5.2 per cent for developing America and 27.9 per cent for developing Asia. Only 11 African countries have consistently been net services exporters since 2005, 9 of which are dependent on exports of travel (mainly tourism) services. Africa continues to capture a small share of global trade in services because of a lack of strategic support to the sector, hence the need for the continent to build and expand on services trade activities that may generate greater value added.

7. Foreign bank penetration in terms of both ownership and bank assets is comparatively much higher in Africa than in other regions

Since the 1990s the ownership structure of African banks has been radically transformed. Foreign bank ownership in Africa has almost doubled since 1995, rising from 120 to 227 banks by 2009. In Africa foreign bank assets as a share of total bank assets in 2009 was 58 per cent; the OECD equivalent was 38 per cent. Since the global financial crisis, there has been a trend in Africa towards both greater cross-border activity and consolidation in the banking sector.

8. Effective regulatory coordination requires the creation of cross-border supervisory and crisis management groups for systemically important banks in Africa

Given the rising prevalence of cross-border banking, for Africa's largest cross-border banks countries will need to consider establishing bank-specific supervisory colleges and strengthen national and regional cross-border supervisory practices. This will require improved central bank coordination, resolution frameworks and stronger burden-sharing arrangements. For those countries and banks where systemic cross-border risks are identified, this may also require greater pan-African coordination and monitoring through the Financial Stability Board Regional Consultative Group for Sub-Saharan Africa and the Community of African Banking Supervisors.

9. Most commitments on financial services in the African schedules translate into limitations or restrictions on ownership and control of investment and employment decisions on foreign banking activity

While most African countries initiated financial sector liberalization in the context of structural adjustment programmes during the 1980s and 1990s, the liberalization of financial services is now conducted in the context of the GATS. Indeed, financial services represent the third most committed services sector in African GATS schedules, after tourism and business services. A total of 20 African member States have made important commitments that are specific to financial services. Most limitations in Africa pertain to authorization and licensing requirements, as well as limitations on the form, amount or control of the investment of foreign banks mostly in mode 3 and mode 4. These two modes are conduits for investment and employment decisions on foreign banking activity in a given market and can influence the decision of a foreign bank seeking local presence abroad. Hence, they are critical elements that also reflect the level of restrictiveness foreign banking faces in Africa and have influenced the international banking scene taking shape in the continent today.

10. African countries need to explore the potential for positioning themselves as services suppliers in global and regional value chains in goods and services

Services are also enablers of many production and sales processes. There are important input–output linkages between manufacturing and services. For example, in South Africa, of all domestically produced intermediate inputs into manufacturing, 31.4 per cent are purchased from the services sector while 18.6 per cent of all domestically sourced intermediate inputs into services come from manufacturing. There is significant scope for African countries to position themselves as reliable and competitive services suppliers in manufacturing value chains. Global value chains can offer significant new opportunities for structural transformation in Africa. About 60 per cent of global trade consists of trade in intermediate goods and services that are incorporated at various stages in the production process of goods and services for final consumption (UNCTAD, 2013a).

B. POLICY RECOMMENDATIONS

The policy analysis and discussion underlying the services sector in Africa can be recast in six main messages.

- First, the services sector has the potential to become a significant driver of sustained economic growth and structural transformation in Africa. This would, however, require policies to be aligned to build complementarities between the services sector and other sectors of the economy especially manufacturing. Several services are likely to exert positive spillover effects on other sectors of the economy (e.g. ICT, finance and infrastructure, but also distribution and logistics). Africa must make greater efforts to link these services and industries, that is, to prioritize those services that are relevant for a value chain that is strategically important to a certain country. (For example, Botswana has generated higher benefits from its diamonds industry since it promoted downstream linkages with cutting and polishing activities; similarly the Nigerian oil industry has created some strong upstream linkages with exploration, project and construction services). A precondition for this requires a proactive policy response from African Governments, with measures tailored to support businesses in the services sector and forging public–private partnerships.

- Second, services provision remains suboptimal and is delivered at a high cost. Various regulatory and policy shortcomings prevail, which explain these inefficiencies and impede Africa from fully capitalizing on its services sector potential. For Africa to better harness the potential of its services economy, regulation of and policies for infrastructure services need to better target existing market failures including issues of accessibility, quality, affordability and competition. Indeed, because infrastructure services have a strong bearing on the cost structure of many of Africa's exports, including commodities and manufactures, improving the quality and quantity of such services will enhance the continent's competitiveness. This is all the more important if the continent is to achieve structural transformation.
- Third, for Africa to build on established intra-African trade — which has a more sophisticated composition than its commodity exports to the rest of the world and a higher intensity of services component — the link between human capital and high value added services (i.e. having good software developers, well-trained financial expertise etc.) needs to be better supported. This requires stronger State intervention in developing technical training systems and subsidizing higher education. Without this State support, it will be difficult for most African countries to exploit "knowledge-intensive trade" opportunities and to insert themselves as service suppliers into both higher value global and regional value chains for goods and services.
- The fourth message relates to the regulatory challenges and opportunities of liberalizing services trade. Although African countries have made efforts to address services trade at the national, regional and global levels, a policy disconnect prevails between these three levels, hampering Africa's opportunities to tap into the benefits of greater services trade. Policymakers and negotiators at these three levels need to cooperate and engage to bridge this divide, so that Africa may better harness the gains of greater services trade and market integration.

- The fifth message places emphasis on the potential role of services enhancing existing regional integration efforts and processes. In order to boost the prospective benefits of greater intra-African trade, the CFTA negotiations need to incorporate services trade. The impact of a continent-wide free trade area will only be meaningful for Africa if services are opened up in parallel with trade in goods.
- Finally, recent studies suggest that the informal sector ranges from 50 to 80 per cent of GDP in Africa. It inhibits enterprise development and the continent's services trade potential. Specific measures are required to support the formalization of informal service providers with a view to enhancing their productivity. This can be achieved, for example, through the modernization of transport and logistics value chains by addressing the efficacy and fairness of the tax system, lowering corruption and regulatory burdens, providing small business support services, improving access to credit for small firms and enforcing compliance with regulatory frameworks to improve the efficiency and accountability of public institutions.

In addition to these key messages, UNCTAD suggests specific policy recommendations on how to better harness Africa's services trade potential and the related developmental, employment and growth benefits. The main policy recommendations are discussed below.

From the non-exhaustive mapping exercise of existing services trade policies in the African continent at the national, regional and global levels, it became apparent that a disconnect between these three levels exist, which needs to be bridged if Africa is to harness the benefits of greater trade in services. The following policy recommendations are aimed at bridging this hiatus in a practical manner:

Make use of multi-stakeholder consultations for policy processes at all levels

African countries have made strides to regulate services trade at the national, regional and global levels. Nonetheless, a policy disconnect prevails between these three levels, hampering Africa's opportunities to tap into the benefits of greater services trade. Policymakers and negotiators at these three levels need to link and engage to bridge this divide, so that Africa may better harness the gains of greater services trade and market integration.

Efforts to align the different levels of policy will require political will, considerable resources and a sensitization and advocacy agenda. African member States and regional economic communities have a number of tools available (such as multi-stakeholder consultation processes, interministerial and parliamentary coordination groups and working parties, focus groups, and surveys) to inform and support these policy processes. This exercise needs to start early on, at a policy design stage which embraces multi-stakeholder approaches and consultation.

Increase efforts to operationalize and implement existing African Union decisions and institutions on trade

National and regional efforts to transpose African Union decisions must be doubled up, as evidence on the ground suggests that part of the disconnect between policies and realities lies in the absence of operationalization and mainstreaming of services trade into existing policy instruments, including monitoring and evaluation. The national mapping of services policies exercise suggests that there is a poor formulation of a services development strategy at both the national and regional economic community levels, which could trump any efforts at the continental level to develop a pan-African strategy for services. In parallel, existing institutions, such as the High-Level African Trade Committee, need to be vested with sufficient resources and autonomy to implement a services trade agenda that is coherent and coordinated at the three policy levels.

Include services trade in any CFTA negotiations strategy

In order to boost the prospective benefits of greater intra-African trade, the CFTA negotiations need to incorporate services trade. The impact of a continent-wide free trade area will only be meaningful for Africa if services are opened up in conjunction with liberalizing trade in goods, especially as many services are critical trade enablers and have the potential to create important backward and forward linkages in the services economy that give rise to employment and growth opportunities.

From the applied case study on the financial sector covered in this report, there are also several policy recommendations that address the financial sector, as this services subsector has evolved rapidly in recent years. As Africa becomes increasingly integrated into global financial markets through foreign banking, there are several potential pitfalls that African policymakers and regulators need to both avoid and consider when exploring opportunities to harness greater capital flows towards improving productive capacity and economic diversification for a transformational agenda in the continent. African policymakers must improve the prudential regulation of the sector.

Address structural impediments to finance

An imperative for realizing the benefits of a prosperous and efficient financial services sector is that Africa tackles critical structural impediments that burden financial sector development, growth and inclusion. These impediments include poor infrastructure, monopolies and inadequate regulation of the sector. Many African member States still need to introduce policies which foster greater domestic competition and address financial market concentration. Greater financial sector diversification and competition through better regulation could also reduce the impact of external shocks. Measures to help banks deal with regulatory hurdles that constrain access to finance might include making more State benefits available electronically and providing official identification cards to make it easier for banks to verify the identity of potential customers, thereby easing access to financial services for the unbanked.

In tackling the chronic undersupply of financial services in rural areas, regulation can also be instrumental to tackle financial market information asymmetries and moral hazard while supporting government efforts to improve financial inclusion, integrity and stability. Major possible reform areas include improving property rights regimes; using the extensive rural branch networks of State and development banks to extend access quickly and relatively cheaply to rural financial services; developing regulatory systems that engender confidence in the role of non-bank financial institutions in rural savings mobilization and as channels for rural payments and transfer of remittances; diversifying the supply of financial products and services in the banking sector; and regionalizing financial markets through legal harmonization and cross-listing at the regional level.

Align regional and multilateral regulatory frameworks for financial services

Africa could also benefit from improved regulation by ensuring there is greater consistency in the regional and multilateral frameworks that already exist for financial services. For example, prudential regulation appears to be overlooked in many African GATS schedules of commitments; this is an area where African countries wishing to regulate the entry of foreign banks should be able to exercise discretion on the basis of their prudential regulation. In addition, countries which are yet to liberalize their financial services sector, have to make sure they use the flexibilities the system has to offer, by inscribing prudential carve-outs as MFN exemptions. The definition of these carve-outs will require greater coordination between trade policymakers and central banks as well as other financial sector authorities and stakeholders.

Furthermore, greater efforts to align the sector with existing regional regulation, such as the protocols covering aspects of financial sector integration and/or investment, such as the Arab Maghreb Union, EAC, ECOWAS and SADC, will be required. As the continent makes greater progress in regional integration, here too, the formulation of carve-outs will be required to cater to financial integration and the emergence of a regional banking sector.

The above-mentioned disconnect is counterproductive especially with respect to regulatory issues and frustrates deeper regional trade. For instance, financial services regulatory frameworks in some countries (e.g. in a regional economic community) are contrary to regional financial services and investment protocols which are supposed to be binding on member States of that regional economic community. A national strategy or plan that incorporates financial services must be aligned to regional plans, as per the country's regional economic community membership, and also to global issues. In addition, these strategies must clearly define services as per the four modes of GATS and also identify embedded and embodied services as a way to properly diagnose and understand the services sectors they deal with or plan for.

2. UNLOCKING FINANCIAL SERVICES POTENTIAL IN AFRICA THROUGH CROSS-BORDER BANKING

A. INTRODUCTION

A well-functioning financial system is critical to Africa's long-term growth. The financial sector can promote economic growth, stimulate investment and contribute to poverty reduction (Demirguc-Kunt, 2006; Fry, 1995). This section discusses the importance of financial inclusion in the context of financial sector development, the regulatory dimensions of financial services trade in the context of growing banking internationalization in Africa, and the importance of striking a balance between domestic development priorities and policy space in relation to liberalization commitments, rising competition and foreign entry. The section concludes with policy recommendations on how countries can approach the regulatory dilemma they often face, between greater financial inclusion on the one hand and liberalization on the other.

B. FINANCIAL SECTOR DEVELOPMENT IN AFRICA: DEPTH AND ACCESS ISSUES

Financial depth

A useful starting point for an analysis of the role of financial services in economic development in Africa is to consider its contribution to GDP. Despite the empirical challenges of estimating the contribution of financial services to the economy, a number of observations may be drawn from the data. Table 1 shows that financial depth as measured by M2 as a share of GDP[1] is much lower in Africa than most other developing regions. In comparative terms, the formal financial sector in Africa performed more poorly during the period 2009–2012, as monetary resources mobilized by the sector was 42.1 per cent on average, compared with 76.5 per cent in other developing countries and the world average of 72.3 per cent.

Table 1 shows that there is a wide range of variation in private credit to GDP across Africa according to export orientation (classification). In terms of export-orientated manufactures (41.2 per cent) and services (38.1 per cent), exporters reported much higher private credit to GDP ratios than fuel (12.2 per cent) and ores/metals (16.7 per cent) exporters. Across the continent, private credit-to-GDP ratios range from 4.5 per cent in the Democratic Republic of the Congo and Chad to 90.7 per cent in Mauritius.

While there has been improvement in all three indicators from 2000 to 2013 and the average M2 ratio to GDP has increased from 35 per cent to 42 per cent (table 1),

Table 1. Financial depth indicators

Exports specialization	Liquid liabilities (M3) as percentage of GDP		Money and quasi money (M2) as percentage of GDP		Bank deposits to GDP (percentage)		Domestic credit to private sector by banks (percentag of GDP)	
	2001–2004	*2009–2012*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2011*	*2001–2004*	*2009–2012*
Fuel	*44.6*	*46.4*	*22.5*	*33.4*	*13.5*	*22.8*	*8.2*	*12.2*
Algeria	44.6	46.4	57.9	63.1	38.8	44.6	10.6	14.9
Angola	..	..	18.5	37.6	11.1	29.3	4.5	20.9
Chad	..	..	11.3	11.6	4.0	6.1	4.0	4.6
Congo	..	..	12.5	25.8	6.7	14.7	3.6	7.2
Equatorial Guinea	..	..	8.1	17.2	4.7	10.2	3.5	8.8
Gabon	..	..	16.3	20.3	12.8	16.1	12.2	9.6
Libya	..	..	41.3	74.6	21.6	39.1	16.3	12.6
Nigeria	..	..	21.7	26.5	15.1	32.2	14.1	19.5
South Sudan	..	..	..	..			..	..
Sudan	..	..	14.9	24.1	6.9	13.4	5.3	11.8
Food and agriculture	*21.5*	*32.4*	*20.3*	*32.1*	*9.9*	*18.7*	*6.7*	*14.5*
Côte d'Ivoire	24.9	34.5	24.9	34.5	13.3	21.6	14.5	16.6
Guinea-Bissau	20.2	30.3	20.2	30.3	5.3	12.7	1.2	8.8
Malawi	19.4	..	15.9	31.3	11.1	21.9	4.5	17.9
Somalia	..	..	..	..	..	..	..	..
Ores and metal	*28.2*	*25.5*	*22.0*	*28.4*	*14.7*	*22.3*	*9.7*	*16.7*
Botswana	..	..	44.9	46.5	24.5	44.0	19.4	28.4
Democratic Rep. of the Congo	..	..	3.5	10.2	2.4	..	0.7	4.5
Guinea	..	..	15.3	33.3	..	17.3	3.7	6.2
Mauritania	..	..	..	33.6	15.7	19.5	..	28.0
Mali	28.2	29.1	28.2	29.1	..	21.7	18.6	19.3
Zambia	..	16.2	18.3	18.8	16.1	9.2	6.1	10.3
Manufactured goods	*54.0*	*67.5*	*41.5*	*52.1*	*35.9*	*42.1*	*32.8*	*41.2*
Tunisia	54.0	67.5	51.6	65.3	45.9	50.7	55.2	67.3
Lesotho	..	..	31.3	38.8	25.9	33.5	10.3	15.1
Services	*48.0*	*26.2*	*42.4*	*60.5*	*32.5*	*46.4*	*20.0*	*38.1*
Cabo Verde	..	..	71.1	79.5	58.9	72.5	33.0	61.8
Comoros	14.1	26.2	26.1	36.6	13.4	23.0	7.4	18.6
Djibouti	..	..	65.4	84.8	51.8	71.7	23.6	29.7
Ethiopia	43.8	..	42.9	..	32.3	..	17.4	..
Gambia	..	..	28.7	50.8	39.1	35.1	9.6	15.3
Liberia	..	..	13.1	35.4	7.2	32.0	4.3	14.6
Mauritius	86.1	..	90.2	99.8	15.2	16.4	65.6	90.7

Table 1 (contd.)

Exports specialization	Liquid liabilities (M3) as percentage of GDP		Money and quasi money (M2) as percentage of GDP		Bank deposits to GDP (percentage)		Domestic credit to private sector by banks (percentag of GDP)	
	2001–2004	*2009–2012*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2011*	*2001–2004*	*2009–2012*
Rwanda	..	..	17.4	..	75.5	90.8	10.2	..
Sao Tome and Principe	..	..	26.5	36.6	13.0	..	8.8	35.9
Seychelles	90.2	53.5	102.7	57.0	18.9	29.6	21.9	22.2
Madagascar	..	..	23.7	24.1	89.2	54.2	8.8	11.3
Mixed exporters	*31.6*	*33.6*	*39.3*	*44.1*	*24.6*	*32.3*	*21.8*	*25.9*
Benin	26.4	38.9	26.4	38.9	16.1	26.9	12.7	23.6
Burkina Faso	21.5	28.3	21.5	28.3	13.4	21.1	13.5	18.7
Burundi	16.2	20.5	21.0	24.9	18.6	18.6	18.3	16.9
Cameroon	..	..	15.7	20.8	12.3	17.4	9.2	13.1
Central African Republic	..	..	15.3	17.8	3.8	8.1	6.3	9.6
Egypt	..	..	91.2	78.4	72.6	65.5	54.4	32.4
Eritrea	..	..	143.8	119.8	..	..	26.8	14.8
Ghana	..	..	32.3	29.7	18.0	21.0	12.3	14.8
Kenya	39.5	..	37.9	39.6	31.9	40.0	25.7	28.0
Morocco	..	..	77.5	111.1	61.4	84.7	43.1	69.6
Mozambique	..	..	27.2	39.0	21.3	32.4	11.6	23.5
Namibia	..	..	36.6	61.8	37.1	58.1	43.6	48.9
Niger	11.3	20.7	11.3	20.7	6.6	11.1	5.3	13.1
Senegal	29.4	39.2	29.4	39.2	20.7	28.8	19.1	27.2
Sierra Leone	..	..	13.9	21.3	..	18.0	2.4	7.6
South Africa	41.4	42.9	61.7	77.8	50.6	60.7	65.8	72.7
Swaziland	..	..	20.2	29.1	18.1	27.0	13.6	23.6
Togo	26.0	44.7	26.0	44.7	18.1	31.7	15.2	25.3
Uganda	..	..	18.0	25.2	12.8	16.5	7.6	15.8
United Republic of Tanzania	19.7	..	22.2	33.2	15.6	25.2	6.7	16.5
Zimbabwe	84.6	..	75.4	..	17.9	..	45.3	..
World	*48.6*	*46.5*	*59.0*	*72.3*	*44.0*	*55.8*	*39.6*	*55.2*
Africa total	37.1	37.0	35.1	42.1	24.2	31.8	17.2	23.6
East Asia and Pacific	47.3	52.8	73.3	88.7	60.3	68.6	49.9	64.1
Latin America and Caribbean	35.8	39.7	55.2	61.2	45.0	50.7	38.5	45.4
South Asia	43.8	52.9	48.6	56.1	38.8	46.2	24.7	36.9
Other developing countries	55.3	48.3	71.6	76.5	44.0	66.5	35.8	45.6

Source: UNCTAD secretariat calculations, based on data from the *World Development Indicators* (World Bank, 2014) and the *Global Finance Development* database, February 2015.

Africa's financial sector remains shallow in comparison with other developing regions. Even during the global financial crisis of 2008–2009, credit to the private sector in relation to GDP increased on average, although by less than deposits. From 2001 to 2004 and 2009 to 2012, the credit-to-GDP ratio also increased — from 17.2 to 23.6 per cent — but this did not necessarily translate into significant financial deepening.

The financial sector is highly heterogeneous, given the economic size of a country or depth of banking markets (table 1). South Africa, Mauritius, Morocco and Nigeria generally report the highest continental levels of financial development. Even some countries with comparatively small populations such as the Seychelles have relatively large offshore financial services sectors. This heterogeneity may be one of the main obstacles to the development of an integrated framework for continental cross-border supervision.

Financial access

The United Nations defines the goals of financial inclusion as follows:

a) Access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance;

b) Sound and safe institutions governed by clear regulation and industry performance standards;

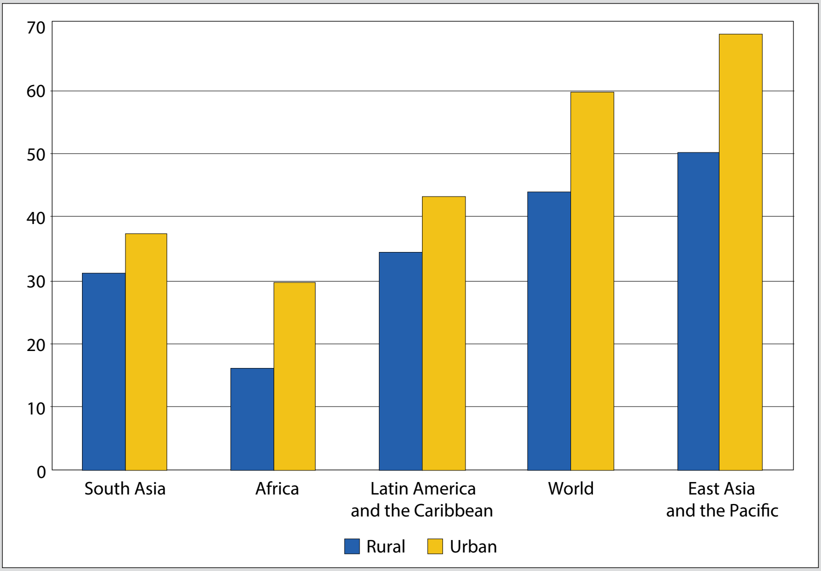
c) Financial and institutional sustainability, to ensure continuity and certainty of investment;

d) Competition, to ensure choice and affordability for clients (United Nations Capital Development Fund, 2006).

In 2011, roughly 21.5 per cent of Africa's population had access to formal financial services, compared with 54.9 per cent in East Asia and the Pacific, 31.3 per cent in South Asia and 42.7 per cent in other developing countries (see figure 1). The unbanked are largely women (only 20 per cent had access to formal financial services), the rural population and the urban poor (Demirguc-Kunt and Klapper, 2012).

Within Africa, there is a large variation in formal account ownership, ranging from 80 per cent in Mauritius to 1.5 per cent in the Niger (see table 2). Less than 5 per cent of adults have an account at a formal financial institution in the Niger, the Central African Republic, the Democratic Republic of the Congo and Guinea.

Figure 1. Adults holding an account at a formal financial institution, by rural-urban designation, 2011 (Percentage)



Source: UNCTAD secretariat calculations, based on data from Demirguc-Kunt and Klapper, 2012.

Some countries such as Egypt, which have relatively well-developed financial sectors, have well below the continental average levels of access to formal financial services, particularly in rural areas. If export orientation is used as the base criterion, the services (28.5 per cent) exporters' category is above the continental average for formal financial account penetration (see table 2).

A variety of obstacles to financial inclusion have been reported, such as the lack of demand for financial services due to limited disposable income as a main reason for not having a bank account. Also, financial exclusion caused by physical, economic, and administrative barriers such as cost, travel distance, bureaucracy and a lack of trust in the banking system play a role. Greater financial inclusion will require development strategies that make financial services available to the aforementioned groups and SMEs. Since the 1980s, financial sector development strategies have mainly focused on achieving stability and efficiency, and increasing the availability of finance to Government and large firms.

Table 2. Financial access indicators

Exports specialization	Depositors with commercial banks (per 1,000 adults)		Borrowers from commercial banks (per 1,000 adults)		Commercial bank branches (per 100,000 adults)		Account-holders at a formal financial institution aged 15+ (percentage)		Automated teller machines (per 100,000 adults)		Mobile phones used to pay bills by users aged 15+ (percentage)	
	2001–2004	*2009–2012*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2011*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2011*
Fuel	*226.6*	*292.0*	*31.1*	*38.0*	*3.3*	*5.3*	*..*	*20.9*	*0.9*	*6.3*	*..*	*5.4*
Algeria	330.8	352.7	25.2	37.3	4.6	5.0	..	33.3	1.2	5.7	..	9.7
Angola	..	87.1	..	..	2.2	9.2	..	39.2	1.0	14.3	..	13.6
Chad	5.7	18.5	0.4	2.6	0.4	0.6	..	9.0	0.0	0.4	..	2.8
Congo	14.7	67.4	..	24.1	0.7	2.4	..	9.0	0.5	2.2	..	1.6
Equatorial Guinea	100.2	196.6	2.8	12.4	3.2	4.7	..	..	0.0	5.6	..	..
Gabon	..	174.5	2.0	28.5	2.4	5.6	..	18.9	0.6	10.0	..	4.9
Libya	681.4	755.3	125.4	152.0	9.2	11.5	..	..	3.6	3.7	..	..
Nigeria	..	517.2	..	29.3	4.7	6.3	..	29.7	..	11.4	..	1.4
South Sudan	..	..	..	..	..	..			..	..		
Sudan	..	..	..	..	2.5	2.7	..	6.9	0.0	3.2	..	4.0
Food and agriculture	*41.3*	*133.6*	*..*	*16.5*	*0.8*	*2.8*	*..*	*23.8*	*0.7*	*3.1*	*..*	*13.5*
Côte d'Ivoire	73.5	168.7	..	..	1.3	4.0	..	..	..	4.3	..	..
Guinea-Bissau	9.0	61.0	..	..	0.1	2.1	..	..	..	1.7	..	..
Malawi	..	176.3	..	16.5	1.0	2.4	..	16.5	0.7	3.4	..	0.8
Somalia	..	..	..	..	..	..	..	31.0	..	..	..	26.2
Ores and metal	*101.0*	*164.8*	*47.2*	*72.1*	*3.1*	*3.9*	*..*	*14.1*	*7.7*	*10.0*	*..*	*2.3*
Botswana	337.1	500.1	139.9	195.3	6.5	8.6	..	30.3	14.6	27.3	..	2.2
Democratic Rep. of the Congo	0.5	17.1	0.0	1.7	0.5	0.6	..	3.7	..	0.4	..	0.1
Guinea	..	..	..	..	..	1.2	..	3.7	..	..	..	1.1
Mauritania	..	54.9	..	43.0	..	4.4	..	8.2	..	..	..	0.3
Mali	53.4	112.7	..	..	2.4	3.7	..	17.5	..	3.1	..	7.5
Zambia	13.1	27.5	1.5	18.7	3.1	4.2	..	21.4	0.9	7.3	..	2.4
Manufactured goods	*233.2*	*574.5*	*41.1*	*122.1*	*7.3*	*9.9*	*..*	*25.3*	*5.7*	*14.3*	*..*	*2.3*
Tunisia	..	732.6	75.3	165.3	12.0	16.6	..	32.2	8.5	20.8	..	0.0
Lesotho	233.2	297.3	6.8	42.9	2.6	3.2	..	18.5	2.9	7.8	..	4.6
Services	*323.0*	*396.5*	*30.2*	*32.6*	*4.4*	*10.6*	*..*	*28.5*	*5.4*	*13.1*	*..*	*1.9*
Cabo Verde	890.2	1437.2	82.6	122.0	..	29.8	..	..	..	42.0	..	..
Comoros	71.5	75.1	7.7	7.0	0.6	1.4	..	21.7	0.6	4.9	..	0.3
Djibouti	..	78.3	..	17.9	2.0	4.7	..	12.3	0.8	3.2	..	2.8
Ethiopia	..	110.4	..	1.8	0.8	1.9	..	..	0.0	0.3	..	..
Gambia	..	..	..	..	4.3	8.8	..	..	..	..	..	..
Liberia	..	..	..	..	..	3.5	..	18.8	..	1.4	..	5.2
Mauritius	..	..	..	..	18.0	21.0	..	80.1	30.7	41.1	..	0.0

Table 2 (contd.)

Exports specialization	Depositors with commercial banks (per 1,000 adults)		Borrowers from commercial banks (per 1,000 adults)		Commercial bank branches (per 100,000 adults)		Account-holders at a formal financial institution aged 15+ (percentage)		Automated teller machines (per 100,000 adults)		Mobile phones used to pay bills by users aged 15+ (percentage)	
	2001–2004	*2009–2012*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2011*	*2001–2004*	*2009–2012*	*2001–2004*	*2009–2011*
Rwanda	7.4	214.0	0.4	6.9	0.4	5.7	..	32.8	0.0	2.4	..	1.8
Sao Tome and Principe	..	463.7	..	..	..	22.1	..		0.0	9.4	..	1.1
Seychelles	275.0	780.0	76.1	133.6	42.0	46.8	..	..	34.0	46.4	..	..
Madagascar	12.4	40.0	5.9	18.6	1.2	1.6	..	5.5	0.3	1.5	..	..
Mixed exporters	*143.4*	*234.2*	*16.8*	*49.9*	*3.0*	*5.3*	*..*	*21.2*	*4.9*	*12.5*	*..*	*2.3*
Benin	49.1	122.8	..	..	1.0	3.3	..	10.5	..	3.8	..	0.2
Burkina Faso	..	..	..	..	..	..	..	13.4	..	..	..	0.3
Burundi	12.0	27.4	2.1	5.6	1.5	2.2	..	7.2	0.0	0.6	..	0.8
Cameroon	1.1	54.0	3.6	16.9	0.5	1.5	..	14.8	0.3	2.0	..	0.6
Central African Republic	..	30.3	0.6	0.6	0.3	0.8	..	3.3	0.0	0.7	..	0.2
Egypt	..	363.6	..	76.5	3.8	4.6	..	9.7	2.7	9.1	..	0.4
Eritrea	..	..	..	..	..	..	..	..	..	..	..	..
Ghana	..	339.4	27.5	34.8	3.1	5.4	..	29.4	..	4.3	..	0.9
Kenya	103.4	523.9	20.1	77.8	2.7	4.9	..	42.3	1.6	8.9	..	13.4
Morocco	..	..	..	..	9.9	21.5	..	39.1	8.3	20.8	..	2.8
Mozambique	..	..	3.8	23.8	1.8	3.4	..	39.9	1.8	5.9	..	1.3
Namibia	98.5	471.8	32.7	109.8	7.7	7.4	..	..	..	39.7	..	..
Niger	..	..	..	..	..	..	..	1.5	..	..	..	0.4
Senegal	..	..	..	..	..	..	..	5.8	..	..	..	0.2
Sierra Leone	..	154.6	3.4	11.8	1.2	2.8	..	15.3	..	0.4	..	0.7
South Africa	..	..	..	..	4.8	10.1	..	53.6	29.9	57.2	..	4.4
Swaziland	370.0	521.3	79.1	156.7	6.3	6.7	..	28.6	7.5	24.4	..	4.7
Togo	82.8	202.8	..	..	1.5	4.2	..	10.2	..	..	..	0.4
Uganda	87.1	179.5	..	17.5	1.1	2.4	..	20.5	1.1	3.6	..	3.3
United Republic of Tanzania	..	..	9.6	31.4	1.2	1.9	..	17.3	0.3	6.6	..	5.5
Zimbabwe	486.3	105.0	2.4	14.5	2.7	5.7	..	39.7	..	5.5	..	2.6
World	*359.2*	*589.2*	*111.5*	*180.2*	*17.6*	*19.0*	*..*	*45.2*	*32.8*	*42.9*	*..*	*3.2*
Africa total	169.2	283.2	28.3	52.3	4.2	6.8	..	21.5	4.8	11.1	..	3.3
East Asia and Pacific	581.8	695.4	200.4	235.8	14.5	14.6	..	54.9	29.8	40.8	..	2.4
Latin America and Caribbean	524.8	736.2	138.4	233.8	15.8	21.9	..	34.1	27.5	41.8	..	1.4
South Asia	426.6	462.0	78.0	57.6	7.9	10.2	..	31.3	1.9	8.4	..	1.4
Other developing countries	563.8	642.9	214.1	162.6	14.8	14.9	..	42.7	21.7	33.6	..	5.4

Source: UNCTAD secretariat calculations based, on data from the *World Development Indicators* (World Bank, 2014) and *Global Finance Development* database, February 2015.

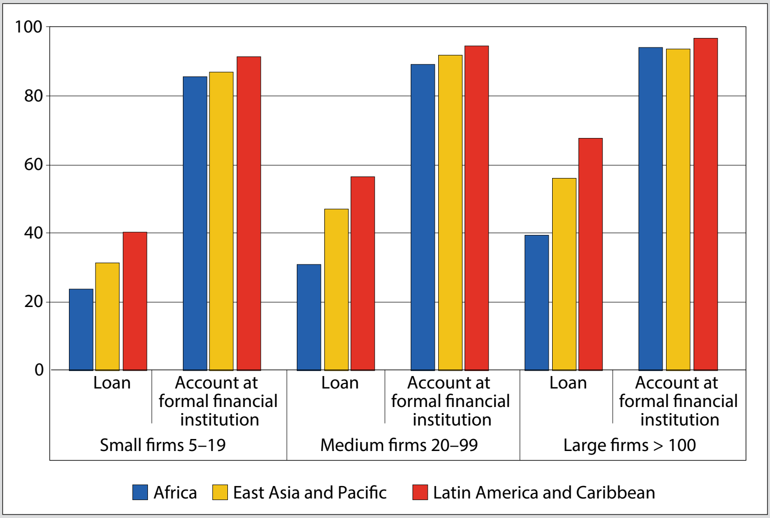
Improving access to finance for SMEs and poor households that are currently excluded may require State intervention, through regulation or direct provision by State-owned development finance institutions, as market-led processes may not be sufficient in some countries.

Kenya's Equity Bank and M-PESA are good examples of banks successfully improving access to finance in rural and urban areas to the unbanked. Indeed, these banks and the financial and technological innovations that they have deployed to increase access and outreach are extending the financial mainstream to the unbanked. Indeed, there is some evidence that many of the traditional services banks provide (credit, payments, money storage) are being unbundled and sold separately. For example new forms of remittance service provider firms are emerging that allow people to transfer funds using pipelines that bypass banks and other traditional intermediaries and reduce fees in the process. Nonetheless, most of the poor have scant access to financial services such as savings and insurance products. Microlenders still have an important role to play in providing basic financial services, but many Governments can also do more by encouraging innovation and helping banks to deal with regulatory hurdles that constrain access to finance, especially for SMEs. Measures might include making more State benefits such as pensions available electronically and providing official identification cards to make it easier for banks to verify the identity of potential customers, thereby easing the access of the poor to financial services.

Figure 2 shows that about 22 per cent of small firms acquired a formal loan in 2011, despite 86 per cent of these firms having a formal bank account, either a savings or checking account. In proportionate terms, the medium and large firms do slightly better. Across all three size groups defined by the number of employees, enterprises in African countries are less likely to have a loan than other developing countries, with large firms in Africa even less likely to have a loan than medium-sized firms outside Africa. Almost two thirds of small firms in Africa lack access to formal sources of finance. The lack of finance available from African banks to SMEs is due in part to a reluctance to lend to them and a tendency to adopt risk-adverse lending strategies. The capacity of SMEs to invest is to some extent determined by these tight credit constraints.

In many enterprise surveys, access to credit and the relatively high costs of finance in Africa are often cited as key constraints to the growth of SMEs (Aghion et al., 2007). Also, at the sectoral level the agricultural sector suffers most from acute financing and investment constraints because of overstretched legal systems

Figure 2. Use of formal account and loan services across firm-size groups, 2011 (Percentage)



Source: UNCTAD secretariat calculations, based on data from G20 Financial Inclusion Indicators Database.

Note: Denotes the percentage of small (5–19 employees), medium (20–99 employees) or large (> 100 employees) enterprises with a checking or savings account.

and weak property rights systems for land and capital equipment, making the collateralization of loans difficult (UNCTAD, 2009).

In terms of financial access and outreach, African countries have fewer depositors with commercial banks (on average 283 per 1,000) than most other developing countries (642.9 per 1,000) with double the number of depositors.

Africa also has among the lowest number of commercial bank branches (seven per 100,000 adults) in the world. Table 2 shows that there is a large variation in the number of commercial bank branches, ranging from the Seychelles with 46 per 100,000 adults, to the Central African Republic, Chad and the Democratic Republic of the Congo, with one branch per 100,000 adults. The number of depositors and borrowers with commercial banks has risen since 2004. With the onset of the global financial crisis of 2008–2009, lending conditions tightened, and the number of borrowers declined slightly.

African countries average 11.1 automated teller machines (ATMs) per 100,000 adults, compared with 33.6 in other developing countries. South Africa, the Seychelles and Mauritius have four to five times the average number of ATMs in Africa per 100,000 adults (see table 2).

Mobile money and remittance transfer payments systems are evolving, and new channels and technologies are emerging. From 1995 to 2005, mobile phone subscribers increased from zero to 88 million and by 2010 had reached 360 million subscribers (Visa sub-Saharan Africa, 2013). This may compensate for a lower number of commercial bank branches. In most of Africa there remains little interoperability between ATM and point of sale networks, which limits customer numbers and therefore the financial viability of these networks. Most bank branch and ATM networks are located in major population centres, which limits rural access. With improving infrastructure and the growth of mobile bank branches, branchless banking, and rural clientele access to financial services should improve, given the sharp increase of mobile phone use for financial services. Interactive connectivity in Africa is rapidly growing, creating greater potential for access to finance, for example, mobile money services, and low-cost mobile microinsurance and savings products. However, regulatory issues have arisen as a result of concerns at the international level about money laundering (IMF, 2015). Smartcard and wireless technologies are enabling the development of services being offered in previously unbanked areas and consumers. Mobile money is, however, not a panacea for financial inclusion, as it still accounts for a smaller value of transactions than traditional instruments (Jack and Suri, 2011).

C. INTERNATIONALIZATION OF BANKING: CROSS-BORDER BANKING

This section explores the development in the internationalization of banking and in particular cross-border banking in the context of financial services liberalization. The development of cross-border banking in Africa is in some ways the actual realization or not of the commitments discussed later with regard to GATS modes 3 and 4. This section briefly considers cross-border banking and its regulation in Africa.

Over the past two decades, the banking systems of Africa have undergone significant structural changes, such as the creation of regional banking commissions in francophone Africa and improved supervision of counterparty risk at most commercial banks (Beck et al., 2009; Kasekende, 2010). Similarly, since the bank privatization and financial liberalization trends of the 1980s, the ownership structure of Africa's banks has undergone significant transformation, with foreign banks dominating in some countries and only a few banking systems with largely State-owned banks. For example, in 2009, foreign bank assets as a share of total bank assets in Africa was 58 per cent; the OECD (34 members) equivalent was 38 per cent.

Similarly, figure 3 shows that by 2009, foreign banks accounted for 52 per cent of all commercial banks in Africa. The trend towards greater foreign bank ownership in the African banking sector has almost doubled since 1995, rising from about 120 banks to 227 by 2009. Hence, foreign bank penetration in terms of both ownership and bank assets is comparatively much higher in Africa than in other regions.

There is inevitably some arbitrariness about any threshold of ownership, but identifying banks as foreign only if ownership is greater than 50 per cent may be problematic. For example, Ecobank could be identified as South African on that basis. Hence, ownership and corporate strategy are complex, and foreignness does not imply a pre-determined pattern of behaviour that is either good or bad for development. It is also important to note that ownership is not the only route to improving banking competitiveness in foreign markets. What is important is the increasing trend in cross-border banking in Africa and its effects on and implications for financial intermediation and financial services regulation.

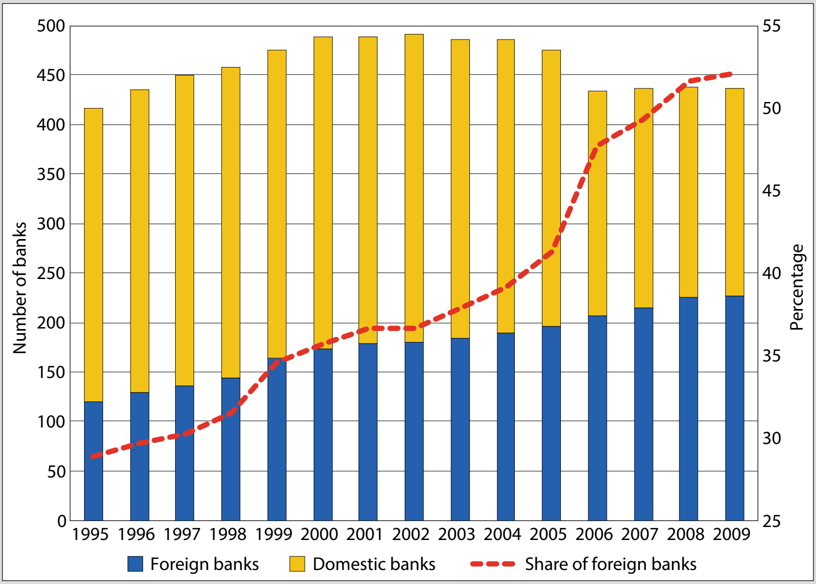
Foreign bank ownership in Africa can be grouped into two categories:

(a) International banks from outside Africa, usually from Europe but also increasingly South–South banks from emerging economies such as India and China;

(b) African cross-border banks incorporated in African continental jurisdictions where the main players are Kenya, Morocco, Nigeria and South Africa.

The share of African foreign-owned cross-border commercial banks between 1995 and 2009 rose by 12 percentage points from 15 to 27 per cent. During the same period, the share of foreign-owned (non-African) banks in Africa increased by 4 percentage points from 24 to 28 per cent. The rate of growth of African cross-border banks outstripped foreign (non-African) bank ownership in Africa especially in Uganda, Burundi and Senegal. Algeria, Egypt, Mozambique and Zambia have witnessed the highest rates of growth in foreign (non-African) bank ownership. Underlying these trends are large variations. For example, many African

Figure 3. Number and share of domestic and foreign banks, 1995–2009



Source: UNCTAD secretariat calculations, based on data from Claessens and Horen, 2014.
Note: Covers full ownership data from 1995 to 2009 of all commercial banks, saving banks, bank holding companies and cooperative banks (as identified in Bankscope) that are currently or have been active in 36 African countries. Bank ownership is defined as foreign if more than 50 per cent of shares are held by foreigners. Unless otherwise specified, ownership reflects direct ownership. Only banks that are or have been reporting to Bankscope are included.

countries have banking systems dominated by domestic banks, such as Ethiopia (100 per cent), Nigeria and South Africa (80 per cent). On the other hand, in some countries such as Burkina Faso and Madagascar, there are only foreign-owned banks. Mozambique has less than 10 per cent domestically owned banks and the ECOWAS region has many banks operating from neighbouring countries.

What are the driving forces underpinning the trends presented in figure 3. These trends show that between 2006 and 2009 there is a period of consolidation, with the number of domestic banks in Africa declining, compared with the period 2000–2005, and the rate of foreign banks slowing after 2007. This decline can be attributed to a combination of bank-specific and home- and host-country factors.

Since 2000, there has been a rise in the integration of financial services by way of consolidation within and across financial services subsectors and M&A. In Africa, greater financial sector opening-up and internationalization has led to a drive to enhance competitiveness, efficiency and economies of scale, and to grow market share through M&A. In the light of the 2008–2009 crisis, several banks in European countries have been forced into liquidation, or were on the verge of bankruptcy, leading to heightened M&A activity. Since the financial crisis, there has been a trend towards both greater cross-border activity and consolidation in the sector.

Table 3 provides a simplified classification of the major cross-border and international banks in Africa, as both a bank's headquarters and shareholding may change over time. From a banking regulatory perspective, the criteria used to determine a bank's home supervisor is generally the ownership structure (Beck et al., 2013). Most of the major international banks active in cross-border banking in Africa reflect strong economic and political ties with former colonial powers such as France (Société Générale) and the United Kingdom of Great Britain and Northern Ireland (Standard Chartered) and have expanded operations beyond their colonial connections. The United States Citigroup Bank has in recent decades established a presence in Africa by expanding its branch network and opening subsidiaries across the continent.

The rise in pan-African or perhaps more accurately South–South banking enables African banks to exploit local and regional knowledge in designing appropriate services and products for their widening clientele. For example, Ecobank Africa's biggest lender by geographic reach provides financial services in 32 African countries (see table 3). It was started as an international bank and provides innovative retail, corporate and investment banking services and is one of the continent's fastest growing banks. Ecobank's growth has also been driven through consolidation and M&A of other banks. Similarly, South Africa's Standard Bank, Africa's top lender by assets, currently operates in 18 African countries (see table 3). In 2008, the Industrial Commercial Bank of China bought a 20 per cent stake in Standard Bank, leaving the former well placed to take advantage of Asia's growing presence in Africa.

Although there is a rising presence of major foreign banks and their subsidiaries in Africa, these institutions have tended to focus on high-margin businesses, such as consulting services on M&A and asset-backed finance; and corporate and trade financing. The unbanked, for example, women, SMEs, and the rural and urban poor, have been largely excluded from recent developments in more sophisticated

Table 3. Major cross-border and international banks, 2013

Name	Number of African countries	Location of headquarters	Majority ownership
Cross-border banks			
Ecobank	32	Togo	South Africa
United Bank for Africa (UBA)	19	Nigeria	Nigeria
Standard Bank Group (Stanbic)	18	South Africa	South Africa
Banque Marocaine du Commerce Extérieur (BMCE)	18	Morocco	Morocco
Société Générale	17	France	France
Citigroup	15	United States	United States
Standard Chartered	15	United Kingdom	United Kingdom
Banque Sahélo Saharienne pour l'Investissement et le Commerce (BSIC)	14	Libya	Libya
BNP Paribas	13	France	France
Attijariwafa Bank	12	Morocco	Morocco
International banks			
Name	*Number of African countries*	*Location of headquarters*	*Majority ownership*
Société Générale	17	France	France
Citigroup	15	United States	United States
Standard Chartered	14	United Kingdom	United Kingdom
BNP Paribas	13	France	France
Bank of Baroda	9	India	India
Access Holding	5	Germany	Unknown
Albaraka Bank (Group)	5	Bahrain	Bahrain
HBL Pakistan (Habib Bank Ltd.)	5	Pakistan	United Rep. of Tanzania
International Commercial Bank (ICB)	5	Switzerland	Malaysia
Rabobank	5	Netherlands	Netherlands

Source: Beck et al., (2014); Claessens et al., 2014; bank websites and annual reports.
Notes: Number of countries includes home country (if African) and representation through subsidiaries or branches in African countries; representative offices are not included.

financial service products and provision. Most foreign-owned commercial banks have used variations of the same basic business model, focusing on serving wealthy consumers, Government ministries and large firms (Claessens and Van Horen, 2014). Retail banking remains a largely untapped market and provides scope for greater expansion and competition on service quality and products. As long as Europe remains in recession, it is likely that international banks will continue to expand their operations in Africa in the short to medium term.

Another means of assessing the magnitude and growth of cross-border banking activity is to consider bank loans and deposits with non-residents. The rapid growth of outstanding cross-border loans and deposits from 2000 until the onset of the 2008–2009 financial crisis was interrupted by a retrenchment in the following years, but the positive trend in international banking has since resumed. As of June 2011, seven countries (France, Germany, Greece, Ireland, Italy, Portugal and Spain) accounted for $61 billion of the $200 billion cross-border lending from Europe to Africa (World Bank, 2012). South Africa received around 20 per cent of these flows, Liberia 16 per cent, Mauritius 12 per cent and Angola, Morocco and Nigeria, 7 per cent each.

Constraints on cross-border banking and impact on development

The most significant constraint on cross-border banking is probably the limited availability of inputs, especially low levels of capabilities in host country financial markets for essential tasks such as credit evaluation and risk management. But ICT skills are also in short supply. Well-known deficiencies in physical infrastructure provision of electricity supply and communications hamper financial services by creating bottlenecks and service interruptions, requiring banks to insure themselves against this by providing their own supply at high cost. Mobile telephony has substantially expanded access to financial services for consumers, and reduced operational and transactional costs. Indeed, the success of Equity Bank, Commercial Bank of Africa in East Africa and UBA of Nigeria has depended on the capitalization of mobile phone access to reduce the operational costs of banking.

Skill and capability shortages limit the number of banks with the potential to operate across-borders, even in neighbouring economies within the continent. This is intensified by the small size of most African banks, that is, low capitalization and limited balance sheets, which restricts expansion. With the exception of BMCE and Attijariwafa banks, most of the regional banks have more direct entry presence than alliances in regional countries. Cross-border alliances among banks are few and may have far smaller benefits for development than foreign entry, owing to fewer technology transfer effects, and reduces the competition-enhancing impact of new bank entry into a national market (Bleeke and Ernst, 1991).

Further, regulatory limitations and shortcomings are common in Africa. These include poor accounting and auditing standards and practices, and weak legal systems, resulting in poor rule of law and contract enforcement. Both of these are likely to restrict foreign banks' appetite for business loans in foreign markets with which they are less familiar. In addition, there are risks of financial instability and contagion because of weak financial regulation and supervision in many African economies. Problems include the lack of harmonization of banking supervision standards and requirements across jurisdictions, and regulatory skills shortages leading to a lack of capability to supervise across borders or across financial services subsectors, or to maintain oversight of outsourced activities. For many foreign banks, this may be a disincentive to entry, as weak or inconsistent regulation could undermine their potential competitive advantages in the host market as a result of inconsistent treatment of foreign and national firms.

D. FINANCIAL SERVICES AND CROSS-BORDER BANKING REGULATION

National and pan-African financial services regulation

This note is less about financial service liberalization per se in the sense of financial deregulation and capital account liberalization; it focuses more on the implications of further opening up the financial services sector to trade with foreign suppliers. Since the financial crisis of 2008–2009, it has become clear that many developing countries have greater concerns about the process of financial liberalization and the extent to which it will foster greater financial inclusion or yield tangible economic benefits for their countries (Bellmann, 2014). Opening up to financial services trade in the absence of appropriate domestic regulations may not necessarily increase trade or generate greater efficiency in the provision of financial services. The financial crisis struck at the heart of the international financial system and affected most multinational banking groups (Acharya and Schnabl, 2010). Many of these banks took excessive risks before the financial crisis and exploited countries' commitments to liberalizing trade in financial services to engage in regulatory arbitrage. Since the crisis, there has been a gradual reappraisal of the evidence on the stability implications of financial sector liberalization and multinational banking (UNCTAD, 2011). Clearly, financial markets need regulation, limits and surveillance in order to make market failures less frequent and less costly.

Domestic financial sector supervision and regulation must be enhanced

Domestic financial services and cross-border supervision and regulation are critical and are improving in Africa. The legal and regulatory environment plays a pivotal role in the efficient functioning of the financial sector. African policymakers also recognize the importance of improving the domestic regulatory environment for the financial sector and related market infrastructures. Regulatory differences in the responsibilities of home-country supervisors (ensure solvency of the banking group) and of host-country supervisors (ensure that there is sufficient liquidity to meet all obligations and protect depositors) can lead to both overlaps and gaps in the regulatory framework applicable to a cross-border bank. This can generate serious regulatory coordination problems, requiring the creation of cross-border supervisory and crisis management groups for systemically important banks.

Given the growing internationalization of banking and the recent experience of the global financial crisis, the emerging regulatory environment needs to better incorporate mechanisms for crisis prevention and resolution. In Africa, there remains scope for better domestic regulation of the financial sector in the provision of clear supervisory guidance to help improve domestic banks' risk management and stress-testing frameworks. These initiatives should also include regional shocks into stress-test scenarios. Central bank authorities and policymakers may also need to increase efforts aimed at monitoring and handling bank balance sheet mismatches, for example those arising from foreign currency funding, while avoiding an imbalance between the potential costs and benefits of any associated regulatory measures such as constraints on certain types of funding. In some countries, there will also be a need for regulatory authorities to address constraints on the ability of banks to better hedge their balance sheet risks by helping to improve local markets for bonds and related hedging instruments.

The regulatory environment for preventing potential financial system crises, bank failures and resolution regimes for financial institutions will require greater efforts at regional coordination to better address potential spillover effects. Regional coordination and arrangements will need to be put into place to both strengthen existing safety nets and enhance existing regulatory frameworks such as supervisory colleges and regional forums. For example, the Financial

Stability Board Regional Consultative Group for Sub-Saharan Africa, comprising African financial sector policymakers and supervisors, meets to discuss ways to increasingly synchronize monetary conditions and regulatory frameworks. This process includes engaging with its non-African counterparts and reaching out to countries that are not represented in the regional consultative groups. UNCTAD analysis of data of meetings of the Regional Consultative Group from 2012 to 2014 shows that issues such as the resilience and stability of financial institutions and the effective supervision of systemically important financial institutions are of prime concern and most frequently referred to. Also, at the bi-monthly meetings of central bank governors at the Bank for International Settlements, there is a regular Africa session where regional representatives gather to discuss themes of special relevance to their economies.

Despite some progress, most African banking systems continue to be small and costly in terms of overheads, lacking the scale required to significantly reduce the cost of their services. Promoting cross-border banking and implementing regulatory coordination measures to address emerging challenges has the potential to promote growth through deeper regional integration. Regional and subregional integration is a key condition for achieving economies of scale. The regional integration of finance and regulatory frameworks is gradually developing in Africa. For example, in 2013, the SADC Integrated Regional Electronic Settlement System, commonly known by its acronym SIRESS, was successfully implemented in the four countries of the Common Monetary Area: South Africa, Namibia, Lesotho and Swaziland. Similarly, in 2010, EAC initiated the process of harmonizing payment systems by setting up the East African Payment System (Economic Commission for Africa, African Union and African Development Bank, 2010).

Regional integration and the existence of several currency unions in Africa, the Common Monetary Area and the CFA zones in francophone Africa, also have potentially important implications for financial services and for financial services trade. Despite the importance of this, there is relatively little empirical research on the issue. Wakeman-Linn and Wagh (2008) found that financial integration contributes significantly to the strengthening and development of Africa’s financial market if two conditions are present: (a) that there is political commitment to the integration process and effective independent regulatory bodies; and (b) there is a broad commitment to deepening economic integration and to the provision of adequate financial resources to building the necessary institutions and infrastructure.

Frey and Volz (2011) examined the effects of political agreements concerning regional financial integration in Africa on financial market development and access to and cost of finance. They found that regional financial integration positively affects financial development (measured as the size of the financial sector, including the liabilities of the central banks) when combined with a sufficient level of institutional quality. Both Wakeman-Linn and Wagh (2008) and Frey and Volz (2011) identify one caveat concerning the implications of regional financial integration for financial development, namely that unless institutional quality is improved, combined with adequate political commitment, access to financial services will continue to be inadequate for the unbanked and SMEs. As African Governments increase efforts to deepen integration with the CFTA, they will also need to develop in tandem a more robust regulatory framework for the financial sector.

Given the rising prevalence of cross-border banking, countries will need to consider establishing bank-specific supervisory colleges for Africa's largest cross-border banks. They will also need to strengthen national and regional cross-border supervisory practices. This will require improved central bank coordination, resolution frameworks and stronger burden-sharing arrangements. In order to resist future financial crises, this is particularly important as Africa's internationalization of banks and deeper integration into global financial markets continues. This may require greater pan-African coordination and monitoring of those countries and banks where systemic cross-border risks are identified. For example, the Community of African Banking Supervisors could perhaps play a greater role managing and coordinating this process.

Cross-border banking regulation and supervision

The international regulatory and supervisory context matters for enhanced financial stability in Africa. Since 2012, emerging debates concerning GATS and the Trade in Services Agreement have tended to divert attention from the need to incorporate and regulate financial inclusion. These factors are not featured in the mandate of the Bank for International Settlements and other financial supervisory bodies. It is also worth noting that international initiatives to promote financial inclusion are not legally binding. Global Standard-Setting Bodies and Financial Inclusion for the Poor: Toward Proportionate Standards and Guidance (Global Partnership for Financial Inclusion, 2011) and Principles for Investors in Inclusive Finance are examples of non-binding initiatives. With several foreign banks operating in Africa, the impact on financial inclusion practices could be serious if these banks fail, reminiscent of what occurred during the recent global financial crisis, and if they lead to greater financial exclusion.

The globalization of finance, shaped by trade and investment agreements, national policies and corporate strategies has encouraged greater and perhaps more intense competition in the financial sector leading to financial sector business models that tend to serve the wealthier clients and larger firms. As foreign banks dominate the sector in many African countries, this is changing the portfolio of credit and services offered and business strategies pursued such as "cherry picking" the most profitable services, which usually excludes rural clientele. There could however be greater scope for local and State banks to offer services to rural areas, women and SMEs.

Nonetheless, more African States will need to enhance their capacity to regulate cross-border banking. For example, Ecobank's corporate governance problems that emerged in 2014 and severely shook confidence in the Bank has provided a critical test for central bank regulators tasked with developing effective cross-border supervision (Financial Times, 2014a). Insufficient cross-border supervision and lower regulatory standards in some frontier markets are constraints on the ratings of pan-African banking groups. Consolidated supervision of cross-border banking groups in Africa would encourage a more cohesive approach to risk management and regulation, and reduce corporate governance risks. The investigation in 2014 of Ecobank by Nigeria's Securities and Exchange Commission has shown how the crisis at the holding company, which falls outside the regulatory purview of the Commission, could by association undermine confidence in a broader banking-sector recovery. There was great concern about the risks that a run on the Nigerian subsidiary might have and pose elsewhere, as it represents 40 per cent of a business spread across 32 African countries (Financial Times, 2014b).

Therefore, African banks should aim to implement the Basel Core Principles for Effective Banking Supervision as they pertain to cross-border activities (Bank for International Settlements, 2012). The standards, developed by the Basel Committee, constitute non-legally binding minimum standards mainly aimed at internationally active banks. It contains 29 principles focusing on powers, responsibilities and functions of supervisors of banks as well as on prudential regulation[2] and bank supervision. For example, principle 12 highlights the importance of supervising banking groups on a consolidated basis. The principle requires supervisors to monitor and apply prudential standards to all aspects of the business conducted by a banking group worldwide. This obligation includes reviewing whether the oversight of a bank's foreign operations by management of the parent bank is sufficient.

In the context of these principles, recent experience in supervising and regulating cross-border banking in Africa has been varied and largely non-compliant. The World Bank and IMF assess countries' compliance with the principles in the context of financial sector assessment programmes, which include financial sector stability assessments. Beck et al. (2014) surveyed the compliance of 18 assessed African supervisory authorities between 2006 and 2013 with the key Basel principles and categorized them as compliant, largely compliant, materially non-compliant or non-compliant. The results show them to be largely compliant with the Basel core principles. However, Beck et al (2014) note that these standards have been raised since the global financial crisis. The findings also show that most African supervisory authorities failed to comply with principle 12; further, 11 African countries were non-compliant. However, strict adherence to some of these accords (for example on capital adequacy) in an already financially constrained environment could be counterproductive and stifle the growth of financial institutions and access to credit.

Cross-border banking supervision and regulation is particularly challenging for a number of reasons. First, Africa's high level of financial heterogeneity makes regional regulators adopt a lowest-common-denominator approach to supervision. Second, the lack of incentives for host and home supervisors to share information and the absence of binding regional regulations hinder effective cross-border supervision. Third, in some countries, political constraints may inhibit cross-border cooperation and deeper regional integration. Although cross-border cooperation on financial services cannot be enforced at the regional level, positive steps are being taken to address this through information-sharing forums.

E. GLOBAL REGULATORY COMMITMENTS ON FINANCIAL SERVICES TRADE

African member States have made important financial services commitments at the global level in the context of the General Agreement on Trade in Services.

African countries have been engaged in financial services liberalization in the context of GATS under the aegis of WTO since its establishment in 1995. As previously noted, financial services represent the third most committed services sector in African GATS schedules, after tourism and business services. A total of

20 African member States have made important commitments in return for market access in the 160-plus members of WTO, representing virtually half of the Africa Group. Table 4 summarizes the main features of the schedules of commitments as they pertain to financial services in its two main subcategories: banking and other financial services, and insurance services.

Commitments on financial services portray a high level of variability across African countries in terms of coverage and depth.

Twenty African countries have made commitments that are specific to the banking and other financial services subcategory, while a smaller subgroup of 15 countries made commitments relating to insurance services. A total of 14 countries have inscribed horizontal commitments that affect all sectors, including financial services, whereas only 8 countries have carved out MFN exemptions, which apply to either all sectors or are specific to financial services. From the aforementioned group of 20 countries, Angola, Benin, Gabon, Mozambique and Zimbabwe are the only ones that have exclusively undertaken sectoral commitments in financial services and have made no commitments in the horizontal and MFN exemption sections of their schedules. Swaziland has carved out an MFN exemption in financial services without a sectoral or horizontal commitment in place. The remaining countries have covered financial services more comprehensively, scheduling horizontal commitments and/or MFN exemptions in addition to their sectoral commitments. In particular, Cabo Verde, Egypt, Mauritius, Sierra Leone and South Africa are among the most prolific, with commitments in the three sections of their schedules. In almost all countries, the majority of the horizontal commitments affecting all sectors include financial services and mainly modes 3 and 4. These pertain primarily to requirements or limitations on land and firm ownership, entry and temporary stay of business persons, as well as foreign personnel requirements, and certification and accreditation requirements. The schedules of Lesotho, Ghana and Morocco also include modes 1 and 2, but in large part bear no limitations, as "none" is inscribed, meaning that foreign banks can offer financial services such as electronic banking and the holding of bank accounts for foreign private persons.

There are two types of MFN exemptions that affect financial services: first, those which are afforded cross-sectorally for all the services sectors inscribed in a schedule, and second, those which are exclusive to financial services. The first type of exemption is found in the schedules of Cabo Verde, Egypt and Sierra Leone. These mainly deal with waivers on existing limitations or mode 4 requirements for services providers, depending on their nationality and on the extension of full national treatment to nationals of countries that are members of regional economic communities. These exemptions respond to the desire to maintain historical ties, observe regional integration obligations or ensure reciprocity with main trading partners. The second type of exemption is found in the schedules of Côte d'Ivoire, Mauritius, Senegal, South Africa and Swaziland and relates to waivers conferring preferential treatment specifically to financial services providers in mode 3 and 4, either on the basis of regional integration obligations or reciprocity. Turning to the scope of the sectoral commitments for financial services in African schedules and what it means for foreign commercial banking activity in Africa, table 5 summarizes the measures inscribed in the schedules that affect commercial presence and movement of persons, that is to say, modes 3 and 4. These two modes are conduits for investment and employment decisions of foreign banking activity in a given market and can influence the decision of a foreign bank seeking local presence abroad. There are a total of 117 sectoral commitments on financial services, of which 88 pertain to market access and 29 to national treatment limitations. In all, 47 commitments have been inscribed for mode 3 and 70 for mode 4.

Most commitments on financial services in the African schedules translate into limitations or restrictions on ownership and controls of investment and employment decisions of foreign banking activity.

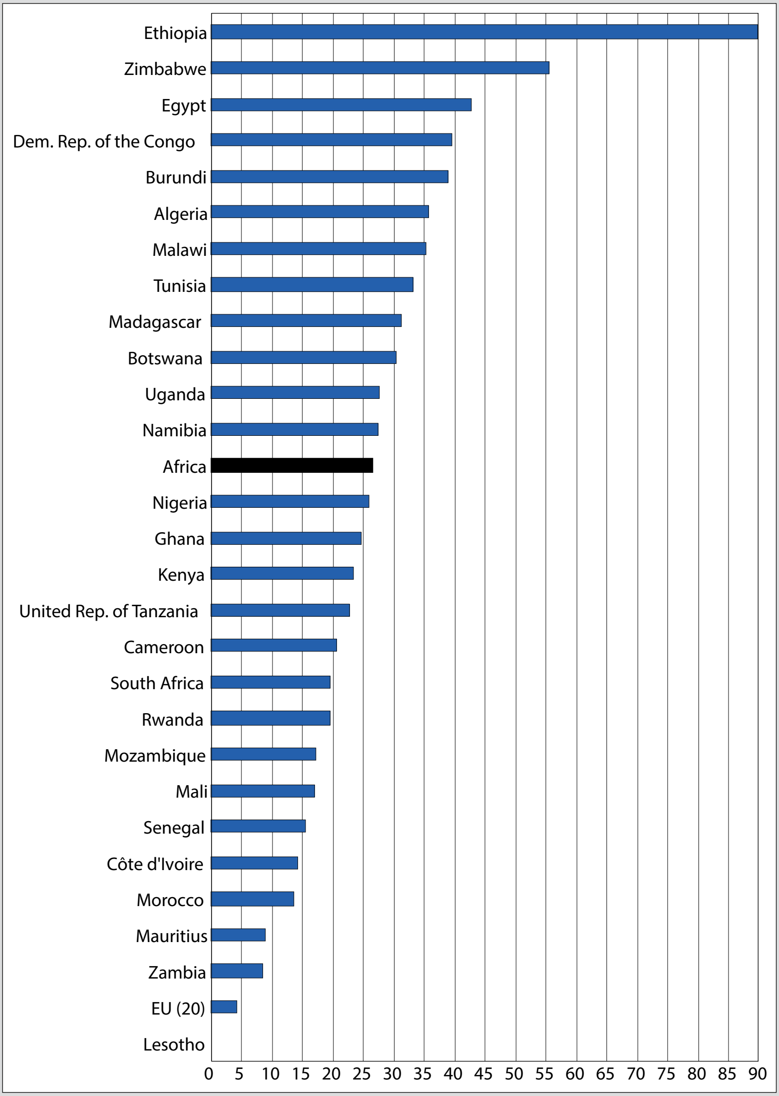
In the case of financial services, most limitations in mode 3 applicable to foreign commercial banks include authorization and licensing requirements, as well as limitations on the form, amount or control of the investment an institution would incur to establish operations through an office. These are critical limitations to banking activity, as they set pre-establishment conditions and limit the capacity of the investing bank to make decisions over the management and control of its investment and operations. For example, Côte d'Ivoire requires that banks be set up as closed-end joint stock companies. According to Benin, Senegal and Tunisia, banks need to be established as a public limited company. Cabo Verde requires that commercial presence take the form of a limited liability company, whereas Sierra Leone requires that subsidiaries be incorporated, and Egypt and Zimbabwe put caps on foreign equity participation in financial institutions. Less frequent are limitations or restrictions of commercial banks participating in equity investment either in the banking or non-banking sector that are also present in mode 3, as well as limitations on the transfer of money or borrowing or lending money to and from the local banking sector. Examples of these are found in the schedules of Kenya, Lesotho, Zimbabwe, South Africa and Morocco, and refer to caps or prohibitions on investment and authorization for transfers and foreign currency operations.

Prudential regulation, which is critical to ensure financial soundness, figures less prominently and only in a few African schedules of commitments.

An important element of market access for foreign banks pertains to prudential regulation in the host country's market, because it sets limitations on financial exposure decisions banks may take, as it is crucial to ensuring financial soundness in a financial system. However, prudential regulation is rarely cited as a limitation in most African schedules. Of the 20 countries with sectoral commitments, only 6 have included express limitations in the form of prudential regulation under mode 3. Ghana, for example, makes reference to the observance of prudential regulations, while Egypt, Sierra Leone, South Africa and Tunisia mention capital requirements, and Mauritius makes reference to criteria for credit exposure of lending activities. In turn, limitations in mode 4 mainly have a bearing on the employment decisions pertaining to the physical presence of managers, senior executive and experts and specialists of banks. All countries have inscribed such limitations in their schedules, with the exception of Angola and Senegal. Some countries such as Egypt also require labour market tests, while the Gambia, Sierra Leone and Zimbabwe require that expatriates for management and expert jobs only be approved if no qualified person is found in the domestic market. Finally, Ghana and Lesotho require training in higher skills for their nationals so that domestic expertise may be developed. With regard to the level of restrictiveness, most countries have numerous and elaborate limitations, especially on market access, that allow them to discriminate against foreign services providers on an MFN basis. This favours domestic commercial banks and makes it difficult for foreign banks to compete and enter the local market. In countries where some level of access is offered to foreign banks, national treatment restrictions may still afford domestic banks an advantage.

Nonetheless, a few countries have lower levels of restrictions, such as Mozambique, which requires foreign banks to abide by the domestic rules and regulations that govern investment and operations in the local banking sector. Angola, Kenya, Malawi, Morocco and Nigeria also appear to have similar restrictions, equating requirements to what is provided for in national laws which regulate the sector or simply portraying the term "none" for no restrictions in mode 3. In view of the coverage and scope of African schedules of commitments for the financial services sector, an important question arises. Does the level of restrictiveness of measures contained in these schedules de facto apply? Some studies have attempted to compare the level of restrictiveness contained in the schedules with reality, with inconclusive results (Barth et al., 2013; Páez, 2008b; Tamirisa et al., 2003). The reality for Africa remains mixed at best.

Figure 4. Financial services trade restrictions index scores, 2012



Source: UNCTAD secretariat calculations, based on Borchert et al., 2012.
Note: EU (20) refers to the European Union at 20 members.

Table 4. Overview of financial services commitments under the General Agreement on Trade in Services schedules of African member States

	Angola	Benin	Botswana	Burkina Faso	Burundi	Cameroon	Cabo Verde	Central African Rep.	Chad	Congo	Côte d'Ivoire	Dem. Rep. of the Congo	Djibouti	Egypt	Gabon	Gambia	Ghana	Guinea	Guinea Bissau	Kenya	Lesotho	Madagascar	Malawi	Mali	Mauritania	Mauritius	Morocco	Mozambique	Namibia	Niger	Nigeria	Rwanda	Senegal	Sierra Leone	South Africa	Swaziland	Togo	Tunisia	Uganda	United Rep. of Tanzania	Zambia	Zimbabwe
Horizontal commitments affecting financial services							•							•		•	•			•	•		•			•	•				•			•	•			•				•
Sectoral commitments on financial services	•	•					•				•			•	•	•	•			•	•		•			•	•	•			•		•	•	•			•				•
Banking and other financial services excluding insurance	•	•					•				•			•	•	•	•			•	•		•			•	•	•			•		•	•	•			•				•
Insurance services							•				•			•	•	•	•			•	•					•	•				•		•	•	•			•				
MFN exemptions affecting financial services							•				•			•												•							•	•	•	•						
All sectors covered							•							•																				•								
Exclusive to financial services											•															•							•		•	•						

Source: Developed by UNCTAD, based on country schedules of commitments. http://i-tip.wto.org/services/Search.aspx (accessed 5 April 2015).

Table 5. Measures affecting investment and employment in banking and financial services of African General Agreement on Trade in Services schedules[a]

Country	Admission, authorization, licensing or notification requirements	Limitations on form, amount or control of foreign direct investment	Limitations to participating in mergers and acquisitions/ privatization	Limitations on lease or purchase of real estate	Limitations on subsidies, tax write-offs, transfers or preferential treatment	Establishment approval, registration or residency requirements	Qualifications, skills or employment requirements	Limitations on employee category or function	Limitations on duration of stay[b]	Economic needs, social benefit or labour market tests
Angola					MA 3					MA 3
Benin	MA 3	MA 3	MA 3			MA 4	MA 4	MA 4		
Cabo Verde		MA 3					MA 4	MA 4	MA 4	
Cote d'Ivoire	MA 3	MA 3				MA 4				
Egypt	MA 3, NT 3	MA 3					MA 4			MA 3, NT 3
Gabon	MA 3						MA* 4	MA* 4		
Gambia	MA 3	MA 4				MA 3, MA*4	MA* 4			MA* 4
Ghana	MA 3				NT 3	MA 4	MA 4	MA 4		MA 4
Kenya	MA 3	MA 3	MA 3			MA 4		MA 4		
Lesotho	MA 3	MA 3	MA 3				MA 4	MA 4	MA 4	MA 4
Malawi						MA* 4	MA* 4	MA* 4		
Mauritius	MA 3	MA 3	MA 3				MA* 4	MA* 4		
Morocco					MA 4	MA 4	MA 4	MA 4	MA 4	
Mozambique						MA 4				
Nigeria		MA 3				MA* 4	MA* 4	MA* 4		
Senegal	MA 3	MA 3								
Sierra Leone	NT 3	MA 3			MA 3		MA* 4	MA* 4		MA 4
South Africa	MA 3	MA 3	MA 3		MA 3, NT 3		MA* 4	MA* 4	MA* 4	
Tunisia	MA 3, NT 3	MA 3	MA 3			MA 4, NT 3		MA 4, NT 3		
Zimbabwe		MA 3	MA 3	MA 3			MA* 4	MA* 4		MA* 4

Source: Developed by UNCTAD, based on country schedules of commitments. http://i-tip.wto.org/services/Search.aspx (accessed 5 April 2015).

Notes: a Does not cover insurance or insurance-related sectors.

b Refers to expressly stated limitations on the number of years, months or days.

Modes of supply: 3 = commercial presence, 4 = presence of natural persons.

Abbreviations: MA, market access column; NT, national treatment column; MA*, limitations inscribed in MA also apply to NT modes of supply.

The restrictiveness of trade in financial services varies widely among African countries and is highest in Ethiopia, Zimbabwe and Egypt, which boast well above-average financial services trade restrictions index scores of 26 (figure 4). Zambia, Mauritius and Morocco have among the most open services trade regimes in the world. However, in many African countries, the absence of sectoral regulation can often lead to a low score. Thus financial services trade openness is probably qualitatively different in Africa, compared with other regions. Nonetheless, financial services trade in Africa appears on average to be less restrictive than in other developing regions (Borchert et al., 2012).

F. BALANCING DOMESTIC AND GLOBAL FINANCIAL SERVICES REGULATION

Lack of a regulatory regime limits access and sustainability

Given that the African financial market is underperforming compared to other world regions, foreign banks could have an important role to play in facilitating external finance and in raising the quality of capital through better risk leverage. The presence of foreign bank subsidiaries in African financial markets has increased the availability and quality of financial services, but these improvements remain out of bounds for lower-income households, SMEs and the unbanked sectors of the economy. These banks have not necessarily broadened access to credit or the financial system more generally (Beck et al., 2011). Risk management continues to be weaker in Africa, compared with other parts of the world (Mlachila et al., 2013), especially as the sector remains largely focused on financing the public sector and State-owned firms often to the detriment of productive sector financing (Berg and Fuchs, 2013). As the financial sector evolves and becomes increasingly integrated in global financial markets through foreign banking, there are several potential pitfalls that African policymakers and regulators need to avoid and consider when exploring opportunities to harness greater capital flows towards improving productive capacity and economic diversification.

Africa must address structural impediments to finance

Key structural impediments to financial sector development, inclusion and growth include poor infrastructure, monopolies and inadequate regulation of the sector. Many African States still need to introduce policies that foster greater domestic competition and tackle financial market concentration. Greater financial sector diversification and competition through better regulation could also act as a deterrent to external shocks. Although there have been improvements in communications (hence the growth of M-PESA and Equity bank), deficits in energy and transport infrastructure still hold back progress in tackling the chronic undersupply of financial services in rural areas. Regulation can also help address financial market information asymmetries, moral hazard and undersupply to the unbanked, while supporting Government efforts to improve financial inclusion, integrity and stability (see principles for innovative financial inclusion of the Group of 20). Finally, State and development banks also have extensive rural branch networks that can be used to quickly and relatively cheaply extend access to rural financial services.

Africa needs to improve prudential regulation of financial services

An important regulatory aspect for financial services pertains to prudential regulation, which is what regulates the behaviour of banks through capital requirements, lending criteria and other risk exposure criteria so that these do not elicit financial instability. Prudential regulation is critical for the well-being and proper functioning of any financial system, especially to ward off and navigate through financial crises. More generally, prudential regulation can also improve the quality of credit allocation decisions towards those sectors in the economy that are more productive and can therefore report higher returns on investment. The impact of financial crises is a function of information asymmetries and the quality of prudential regulation and authorities. Financial markets tend to be opaque and imperfect, leading to undesirable behaviour by market actors who are in pursuit of better information, such as herding, adverse selection and moral hazard. This tends to skew responses away from sound risk assessment, generating systemic risk and severe liquidity constraints in times of crisis (Eichengreen et al., 1998). Regulation needs therefore to cater for the disclosure of financial information by financial institutions and the establishment of monitoring mechanisms which reliably "read" the market and alert financial authorities about potential systemic risks. Regulations that enhance the disclosure of financial institutions, such as the Basel II and III regulations and the International Accounting Standards, can help discipline financial markets (Baumann and Nier, 2003); foreign banks can improve reporting practices in markets where they establish themselves if they are able to transfer desirable bank governance and risk assessment practices from their country of origin (Buch et al., 2011). African financial markets have managed to steer clear of recent financial crises because they are poorly integrated into global financial markets. However, as these integration ties deepen through the activity of foreign banks, as well as through the monetization of economic activity, potential contagion effects can quickly spread in the absence of effective prudential regulation. The inadequacy of prudential regulation in Africa also explains insufficient financing of the private sector and can lead to a captive audience of credit institutions for the benefit of the less efficient sectors of the economy and to the detriment of those industries that could report higher productivity gains. In Africa, this is a well-known weakness. For SMEs in particular, access to finance even in countries with strong banking sectors, is relatively constrained. Among the factors explaining this constraint is the extent of Government borrowing (Berg and Fuchs, 2013). Therefore, best practice as mediated through prudential regulation, should allow banks to monitor firms more closely, allocating credit to performing firms, rather than to incumbents. Countries following such practices have been reported to enjoy greater financial depth, which can generate growth through greater allocative efficiency in productive investment (Barth et al., 2013).

Africa must align regional and multilateral regulatory frameworks

In the context of the multilateral trading system, prudential regulation appears to be overlooked in many African GATS schedules of commitments. African countries wishing to regulate the entry of foreign banks should be able to exercise discretion on the basis of their prudential regulation, and since MFN is a major principle for liberalization under GATS, the ability to exercise this discretion may be compromised. Hence, African countries that have yet to liberalize their financial services sector must make sure they use the flexibilities the system has to offer by inscribing prudential carve-outs as MFN exemptions. The definition of these carve-outs will require greater coordination between trade policymakers and central banks, as well as other financial sector authorities and stakeholders.

In addition, African countries will need to extensively examine how to align the sector with existing regional regulation, as some regions already have some protocols in place covering aspects of financial sector integration and/or investment, such as the Arab Maghreb Union, EAC, ECOWAS and SADC, especially as they envisage the free movement of capital in their respective subregions. There is a disconnect between the various existing regional regulations of capital markets; in spite of it, African banks have expanded regional operations. Here too, the formulation of carve-outs will be required to cater for financial integration and the emergence of a regional banking sector, which is developing slowly.

Furthermore, other elements that can be incorporated into the schedules of commitments and which some countries have already used are economic and social needs tests that require foreign banks to facilitate access to the poor and the private sector. This could also be accompanied by requirements on training, better risk assessment and management to ensure that the expected economy-wide effects take root. Lastly, an important element of caution pertains to the potential regulatory encroachment that current negotiations on regional trade agreements covering financial services could bring. African countries are not participating in mega-regional initiatives such as the Trade in Services Agreement and the Transatlantic Trade and Investment Partnership. Both agreements, if endorsed, could imply a financial regulatory encroachment beyond GATS commitments and pre-empt future services liberalization rounds, as they could set a GATS-plus standard in financial services liberalization, well beyond the capacity of many African countries. Therefore, it is critically important that African countries follow these processes closely so that policy processes on financial services are informed of the developments of these agreements with a view to retaining the policy space that has been carved out for financial sector development.

NOTES

1 M2 is money and quasi money comprising the sum of currency outside banks, demand deposits other than those of the central Government, and the time, savings, and foreign currency deposits of resident sectors other than the central Government (World Bank, 2014).

2 Prudential regulation, concerns regulatory monitoring of a bank's asset quality and effectiveness of monitoring; capital adequacy; and other portfolio restrictions to avoid financial instability.

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