



United Nations
Economic Commission for Africa

21st Intergovernmental Committee of Experts Transformative Growth in Eastern Africa: *Catalysts and Constraints*

Venue: Moroni, Union of Comoros

Dates: 7-9th November 2017.

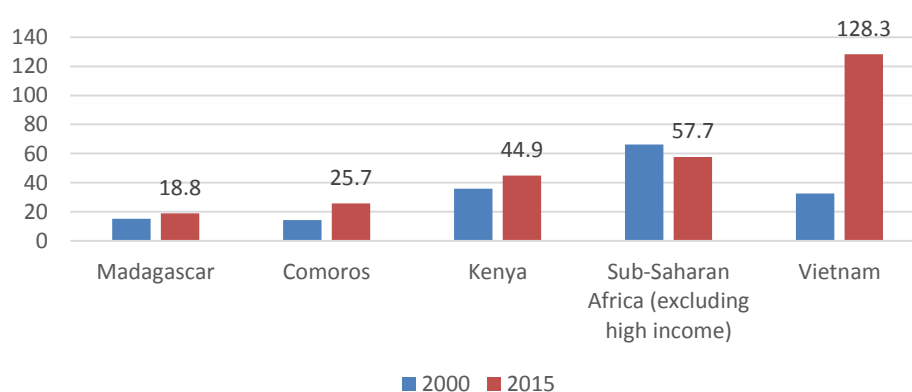
**Banking on Success? Leveraging the Banking Sector
Better for Accelerated Structural Transformation**

I. Background

One of the major limiting factors for growth and transformation in Eastern Africa has been the lack of finance. Mainstream debates tend to focus on the issue of 'financial inclusion' at the expense of considering why the banking sector in Eastern Africa has not been more effective. The banking sector across the region has not been playing its role in terms of providing sufficient credit to the private sector and strategic industries. This session will discuss how the banking sector can be more closely aligned to national development objectives and structural transformation. It will count on various experts to inform the discussions, and will look in particular at a number of case studies from the region (e.g. Kenya and Ethiopia), as well as drawing on international experience.

The measures of credit show that the supply of credit to the region has remained relatively low and stagnant, the credit-to-GDP ratio being lower than the average for the continent over the last decade. Rapidly growing countries like Vietnam had similar credit-to-GDP ratios to regional averages at the beginning of their growth spurt, but have subsequently experienced a much more rapid expansion of credit (Figure below).

Figure 1: Credit supply to the region (private credit as a share of GDP)



Source: World Bank 2017

Yet, profits for commercial banks operating in the region have been high. According to one evaluation, commercial banks in sub-Saharan Africa are the most profitable in the world (Flamini et al. 2009). Why does the region have low levels of credit supply and very high bank profits? One possible explanation is the market structure of the banking sector. In most countries, the market is characterised by a small number of banks that dominate the market, allowing them to function as an oligopoly with the power to set both the quantity of credit supplied and the price of the credit. Oligopolistic firms work together to increase their market power, while in a truly competitive market new companies would join the sector resulting in a decline in profits and operating costs.

In a low-profit environment, banks would be forced to increase their efficiency by driving down their operating costs. Despite new entrants into the financial sector, it does not seem to have had the desired impact. The telecom companies through the mobile money platform have been the latest entrants to the sector, providing new financial products. However, the long-term effect of the mobile money technology on the cost of credit is yet to be determined.

What has been the role of government in the credit market? Historically, governments in the region were significant players in the financial sector, but following economic liberalisation in the 1990s, the majority of state-owned banks were privatised. Following complaints from the private sector, governments in the region have recognised the need to provide cheaper credit to investors. Consequently, different policies have been experimented in an effort to provide more affordable credit. For example, in 2016, the Kenyan government set a cap on interest rates in an attempt to lower the price of credit. Other countries have set up or revived the state-owned development banks to provide cheaper credit to the private sector. It is therefore essential to investigate the optimal policy mix that would ensure more low-cost credit to the region.

Given the importance of cheaper financing for industrialisation in the region, it is important to analyse how we can strengthen the financial sector. Against this background, the United Nations Economic Commission for Africa (ECA) is organising a panel discussion on the topic **“Banking on Success? Leveraging the Banking Sector Better for Accelerated Structural Transformation.”**

II. Objectives of the Session

The objective of the session is to discuss policies that can lower the cost of credit in the region. Participants will be invited to provide inputs to the discussion and to review the following questions;

- a) Why is the banking sector so profitable in the region?
- b) Do we have a banking cartel in the region? What does the evidence suggest?
- c) What has been the effect of government borrowing on the supply of credit to the private sector?
- d) How has inflation affected credit supply in the region?

III. Provisional programme

14:00 – 16:00

Presentation: Leveraging the Banking Sector Better for Accelerated Structural Transformation - Dr. **Radha Upadhyaya**, Institute for Development Studies, University of Nairobi-Kenya

Panel Discussion: Banking Sector for Accelerated Structural Transformation

Moderator: *Mr. Laban-Cliff Onserio, Business Reporter at Nation Media Group-NTV*

- **Dr. Imani Younoussa**, Central Bank Governor of the Union of Comoros
- **Hon. Haruna Kasolo Kyeyune**, Minister of State for Finance, Planning and Economic Development(Microfinance) - Ministry of Finance, Planning and Economic Development, Kampala, Uganda
- **Mr. Andrew Mold**, Acting Director, ECA in Eastern Africa
- **Prof. Thomas Kigabo**, Chief Economist, National Bank of Rwanda
- **Dr. Yohannes Ayalew**, Chief Economist and Vice Governor of Monetary Stability National Bank of Ethiopia

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