



# Financial System Strategy 2020



FSS 2020 International Conference

Financial Sector Reform and the Economy



# **FINANCE AND GROWTH: CAN THE ENGINE WORK FOR NIGERIA?**

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## The two strands of the presentation

- **Financial sector helps growth and lowers poverty**
- **Nigeria (as other African financial systems) has much to gain from energetic financial policy development combining**  
***modernism with activism***

**Illustrated with data charts**



## Finance, growth & poverty: Surprising research findings

Financial development is an important **cause** of growth

General financial development (as measured by *depth*) widens opportunities and reduces poverty

i.e. Finance-rich growth is pro-poor

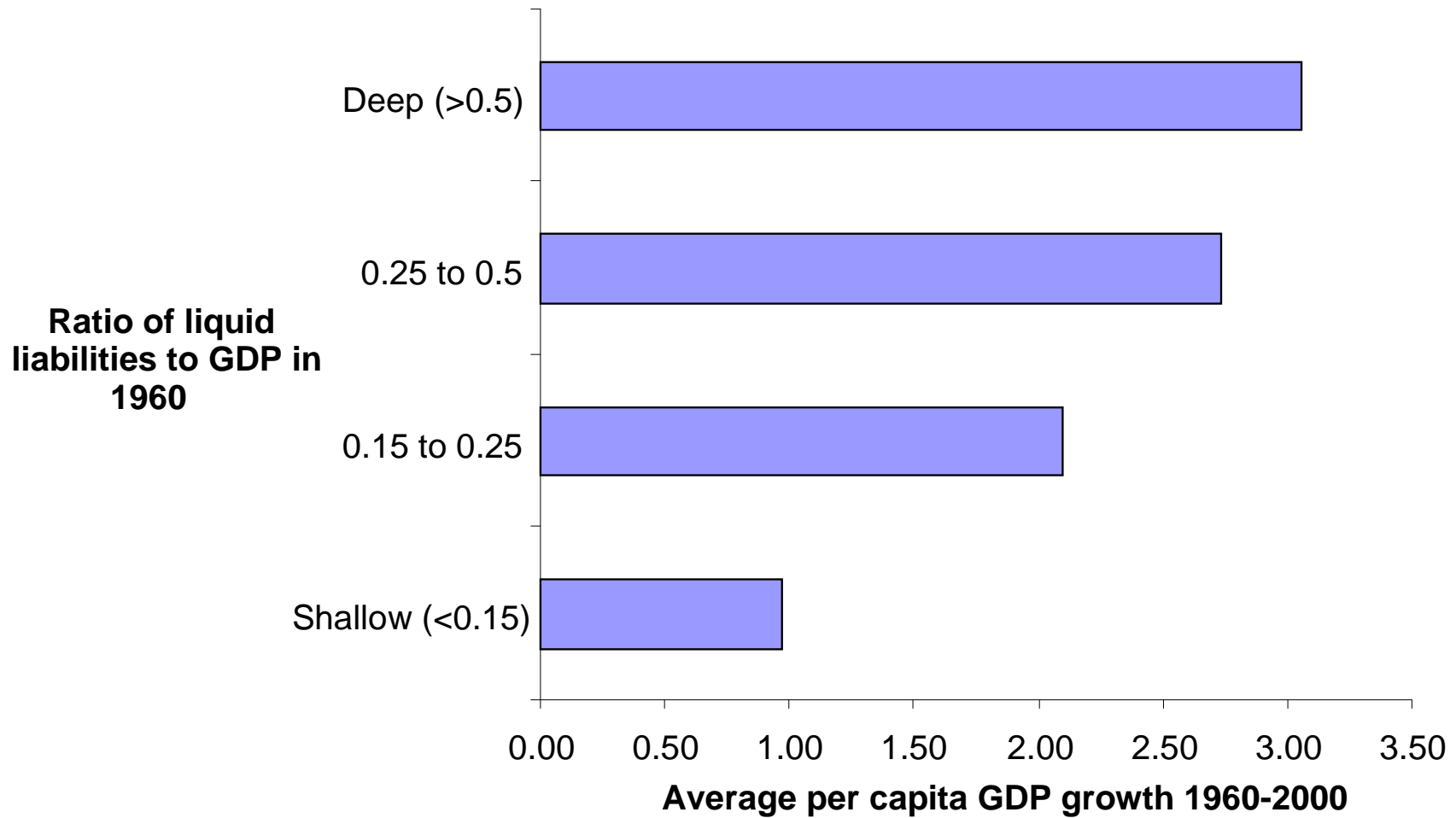
Even conditional on mean income

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

[Banking crises do *not* always hit the poor disproportionately (but did in Nigeria)]



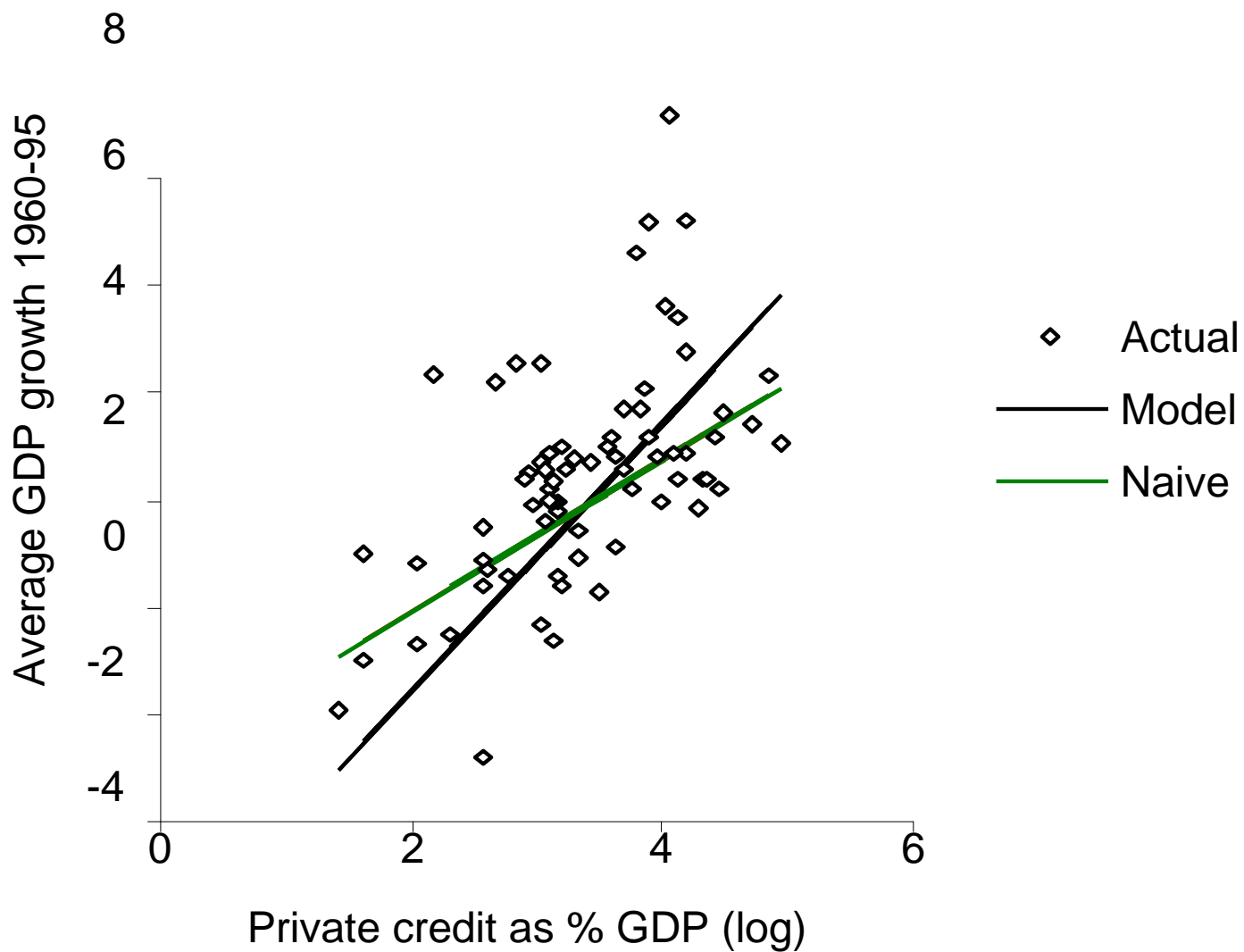
## Countries with deeper financial systems in 1960 grew more rapidly





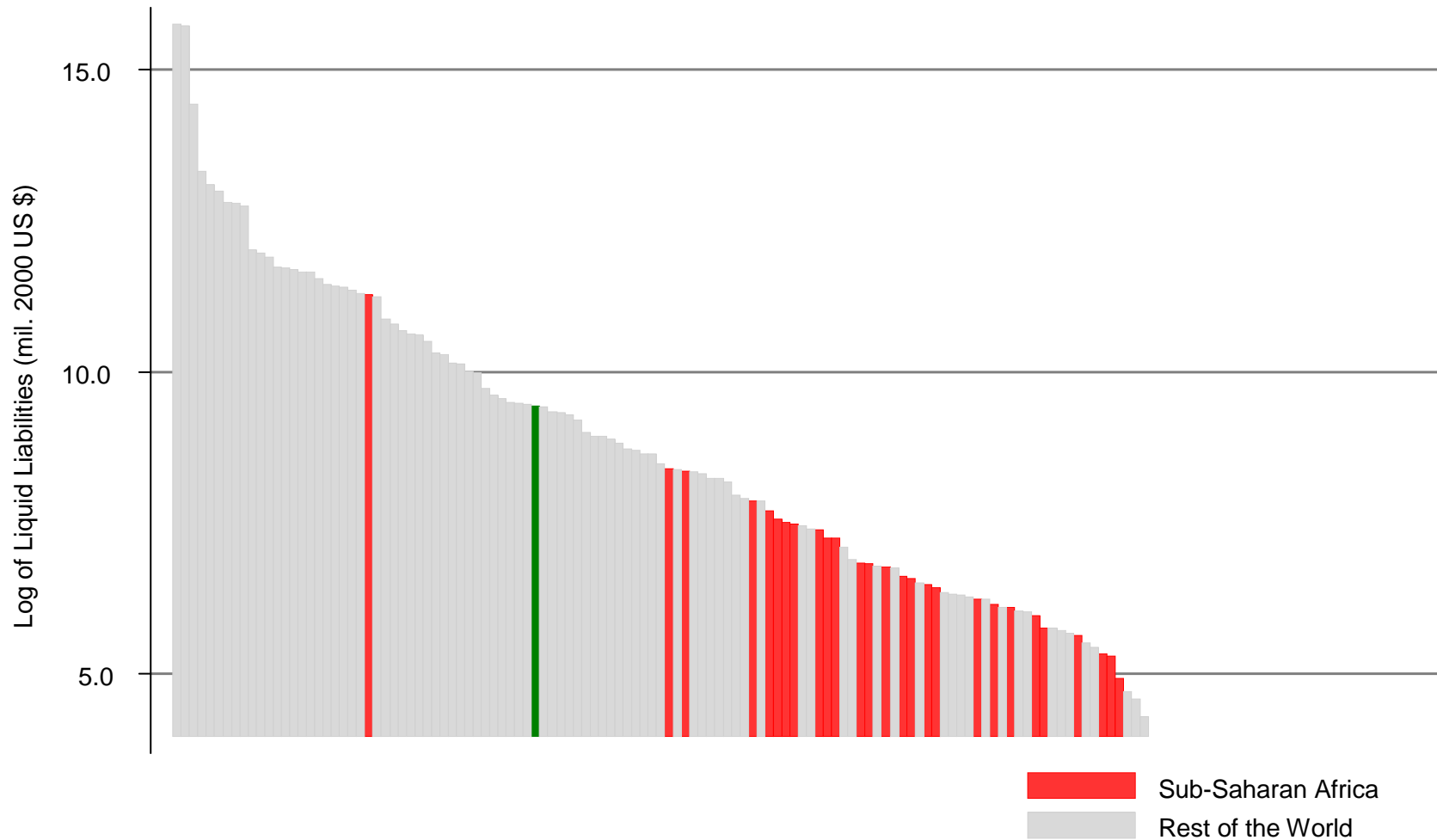
# Growth and financial development

## Naïve and model-based relations



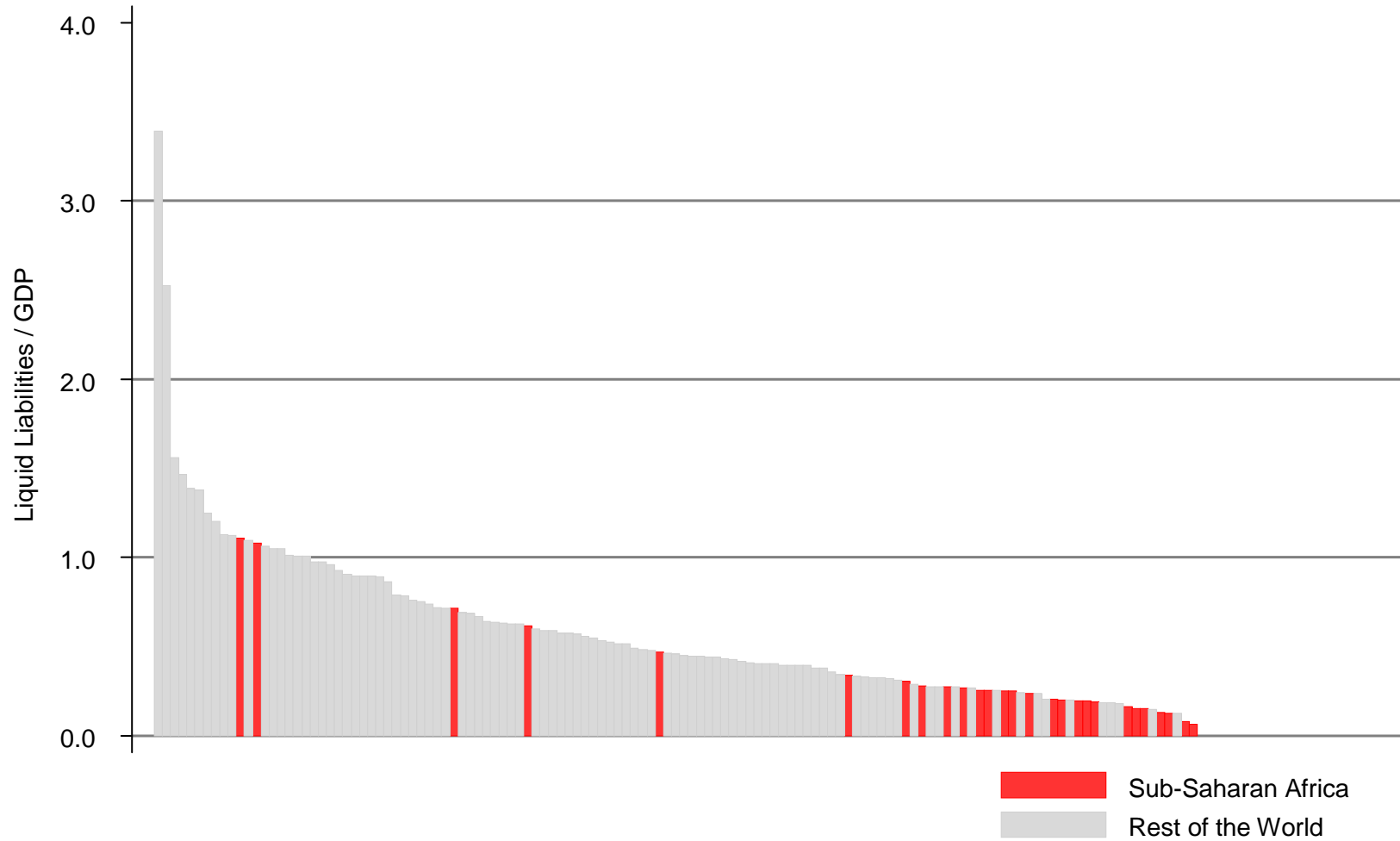


## Nigerian banking system is second largest in Africa but is still small -- absolutely





# ...and (even more so): relatively: Liquid Liabilities (M3+) as % GDP

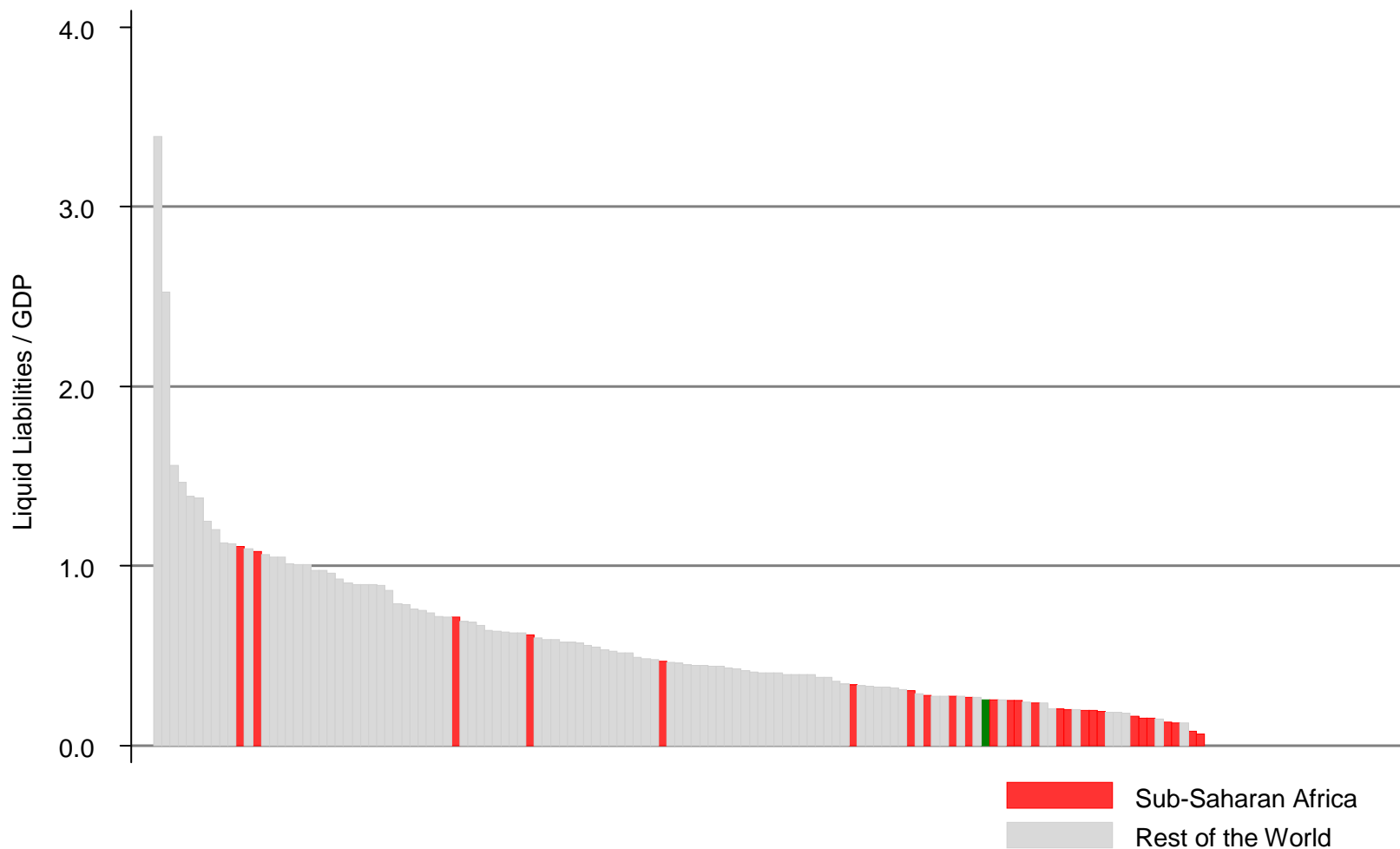


Sample size: 127 countries  
Time period: Latest available year: 2004-05  
Source: Financial Structure Database, rev. 2006 (The World Bank)





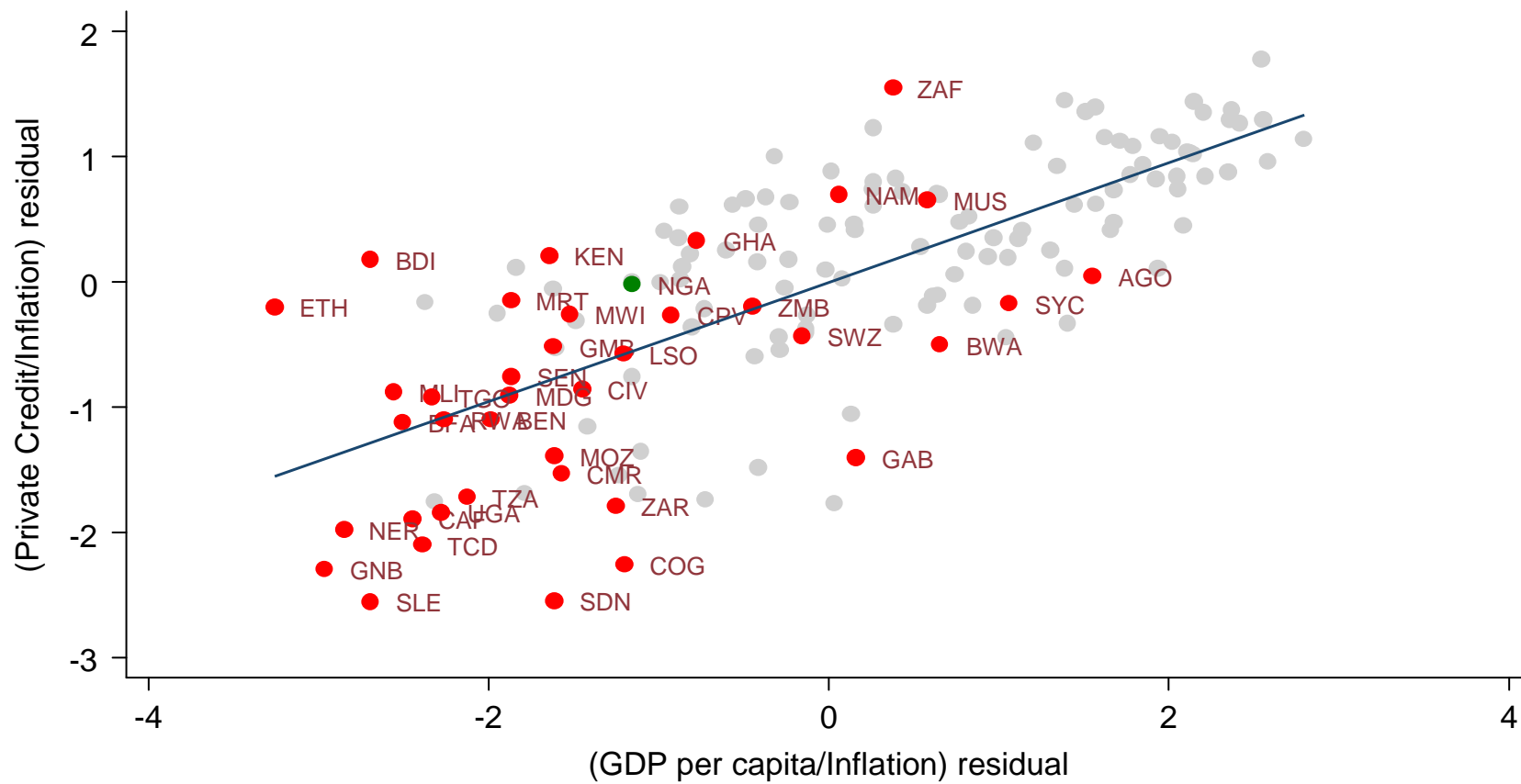
# ...and (even more so): relatively: Liquid Liabilities (M3+) as % GDP



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# Still...Nigeria does a little better than average given income and inflation levels

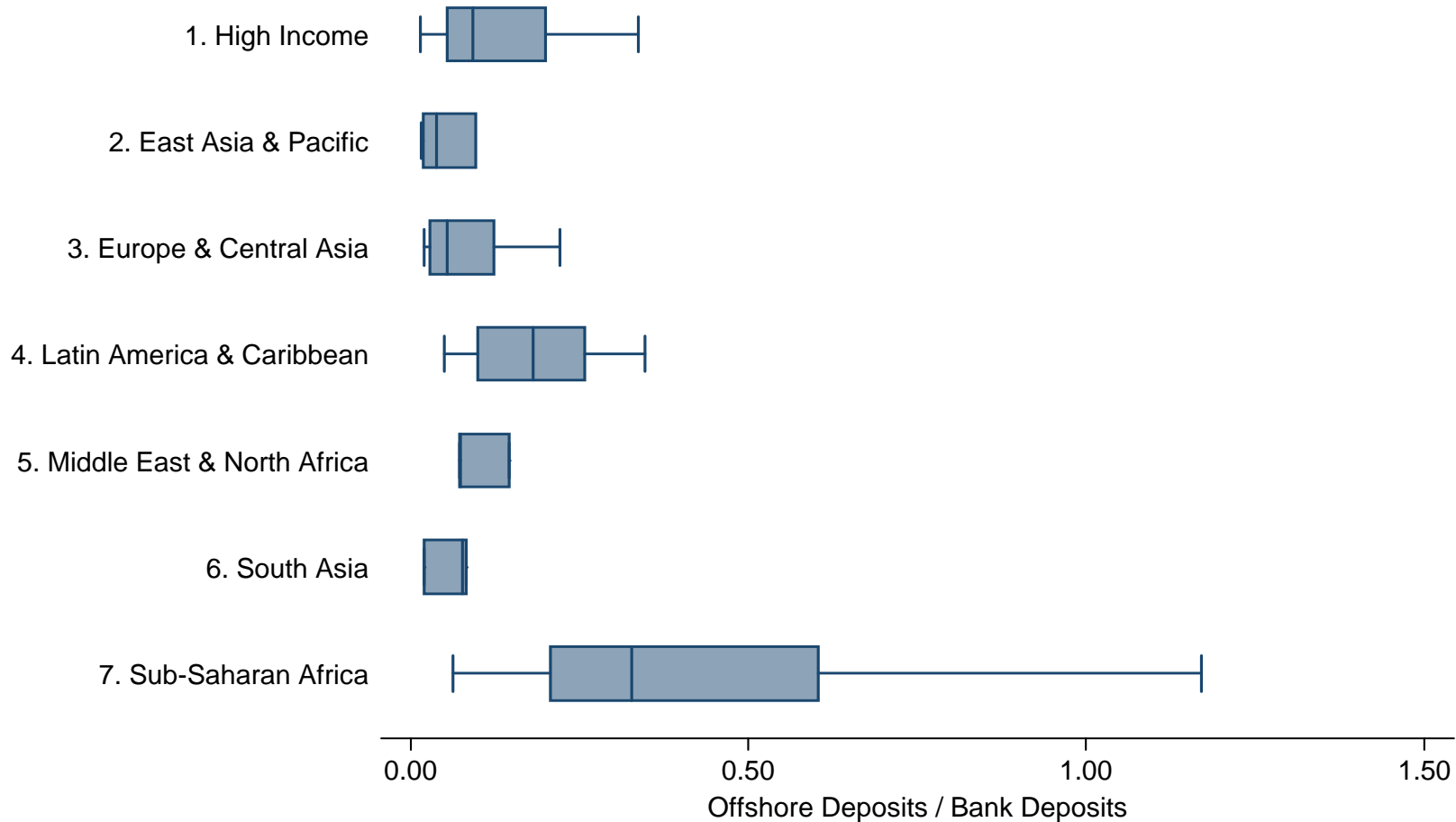


- Sub-Saharan Africa
- All Other Regions

Sample size: 151 countries  
Time period: 2000-2005  
Source: Financial Structure Database, 2006; World Development Indicators, 2005 (The World Bank)

# One reason for low depth: Offshore Deposits

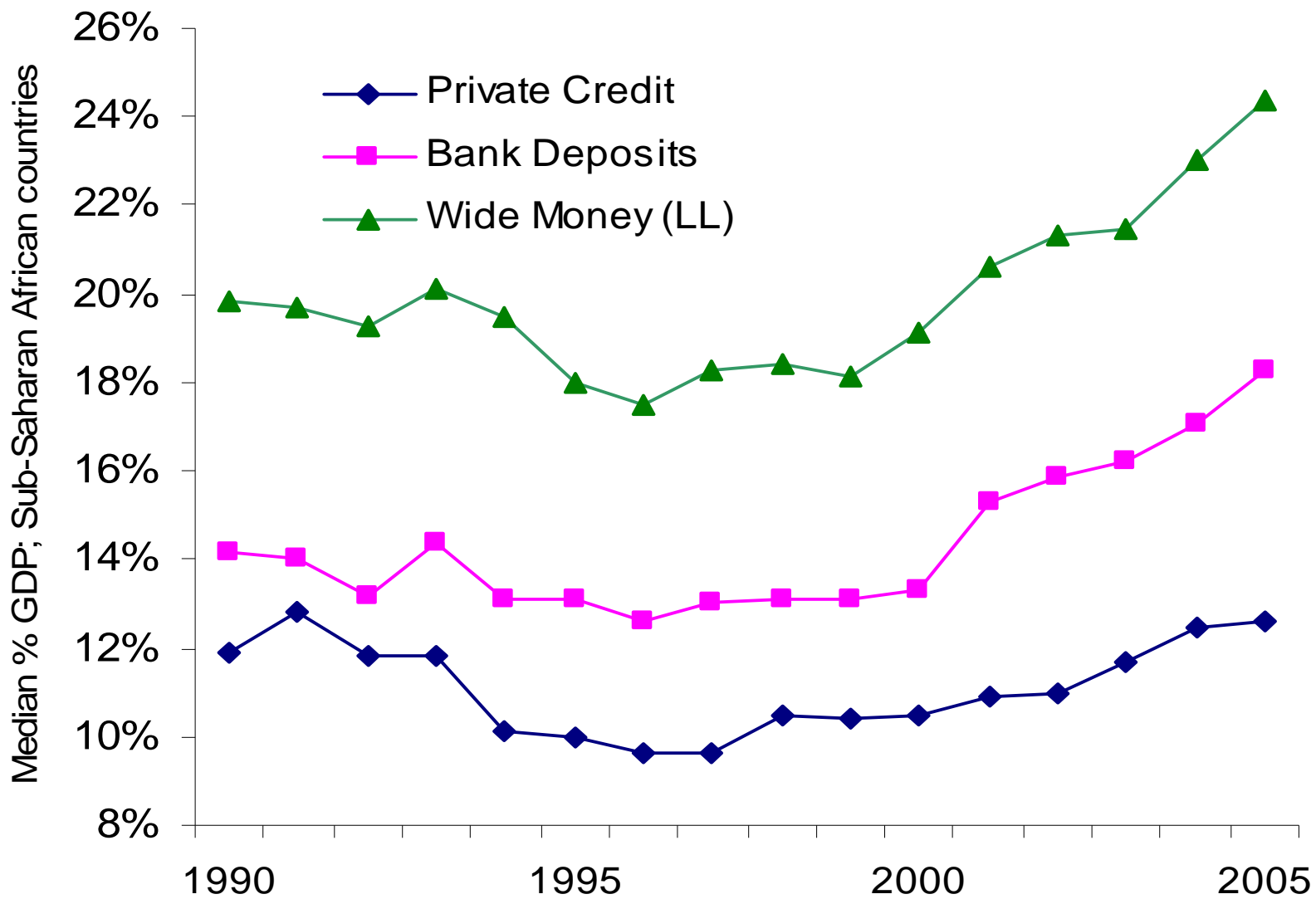
Regional Distributions



Sample size: 90 countries  
 Time period: 2005  
 Source: Financial Structure Database, 2006; BIS, 2006

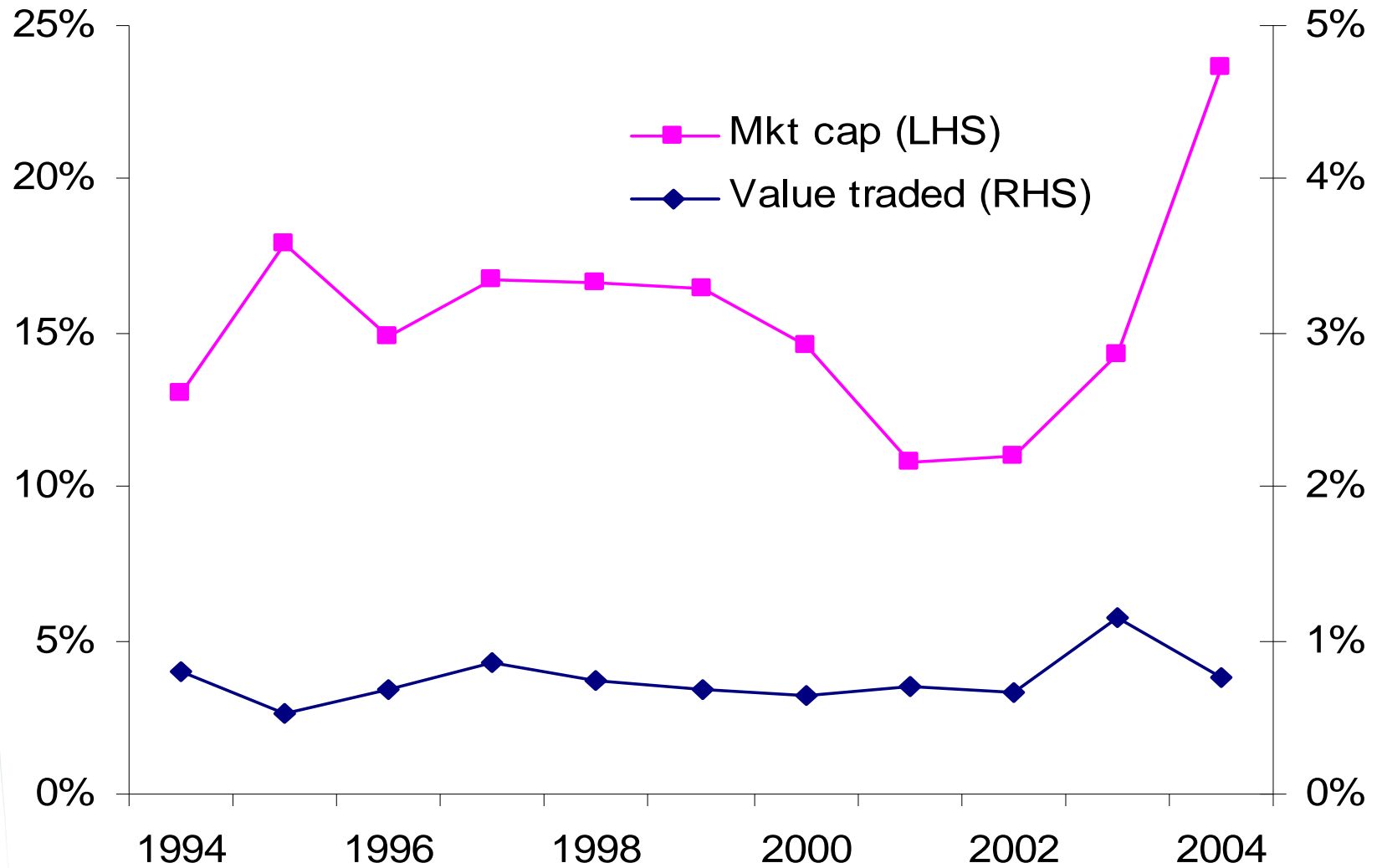


## But there is a deepening in progress across Africa



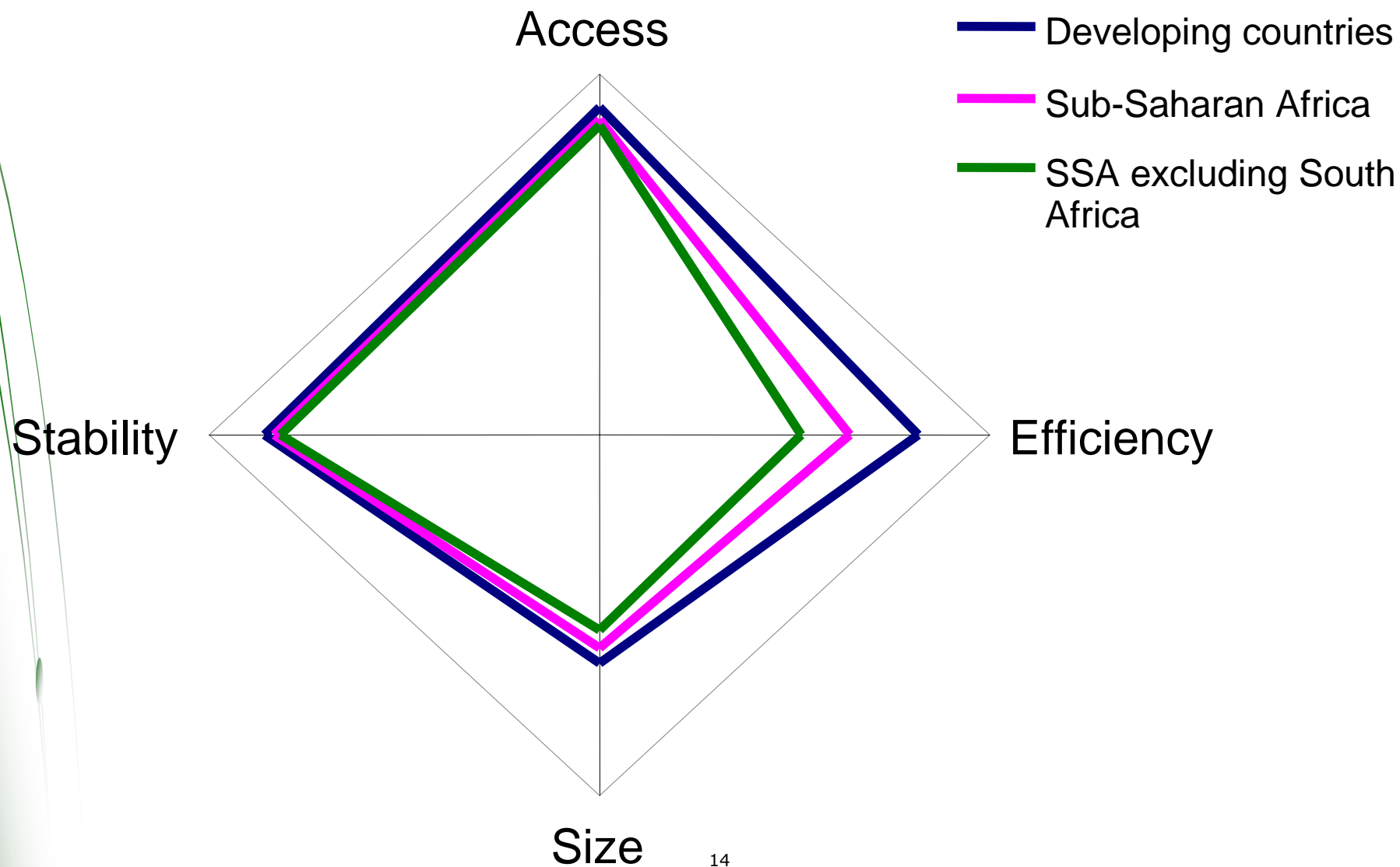


# African Stock Markets Picking Up





# Stock Markets: A difficult area for all developing countries



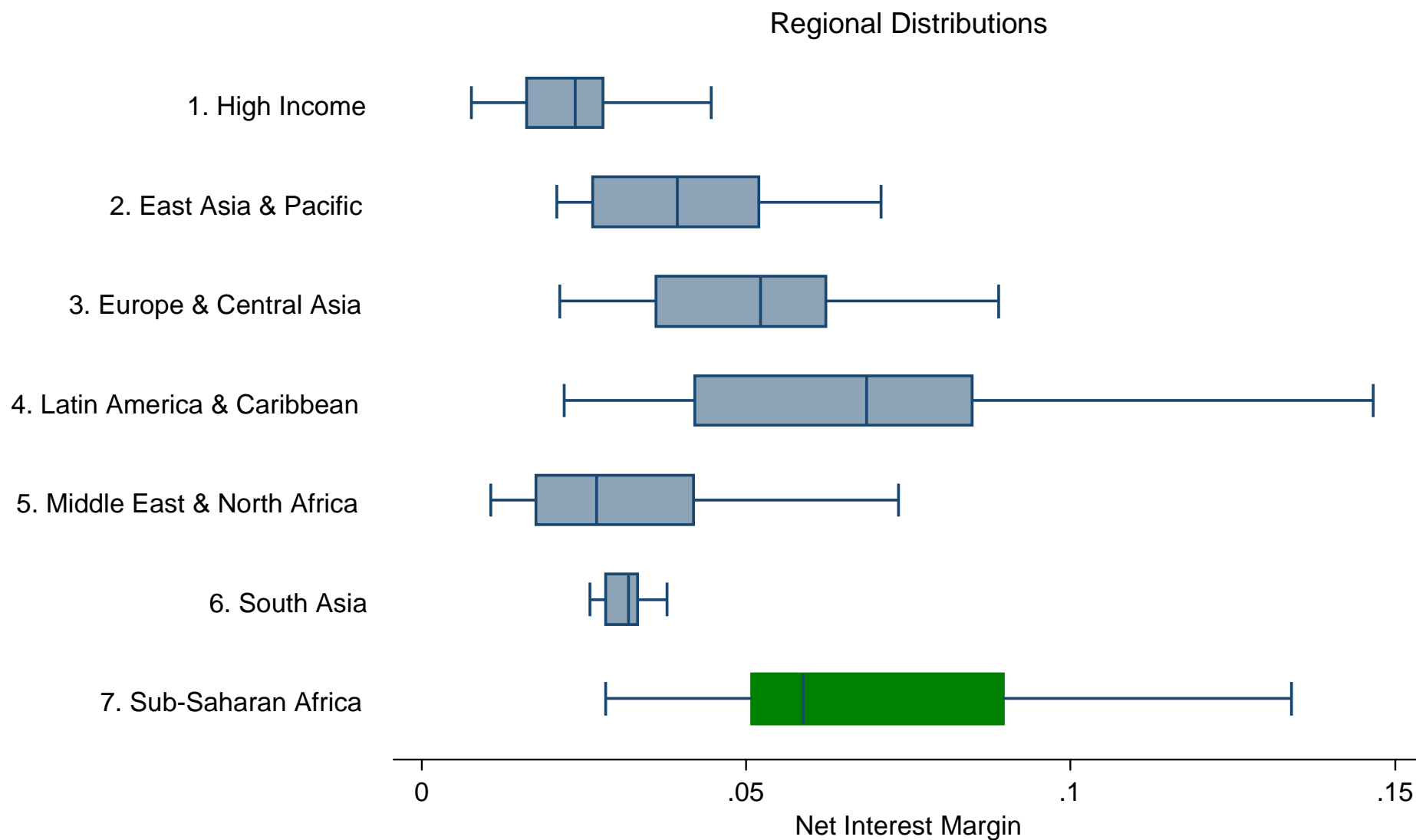


## Many other dimensions to finance

- **Payments (new technologies)**
- **Insurance (including microinsurance)**
- **Pension**
- **Deposit services**
- **Legal and regulatory infrastructure**
- **Provision of financial information**
- **Etc etc.**



# Banking is expensive: Net Interest Margins



Sample size: 142 countries

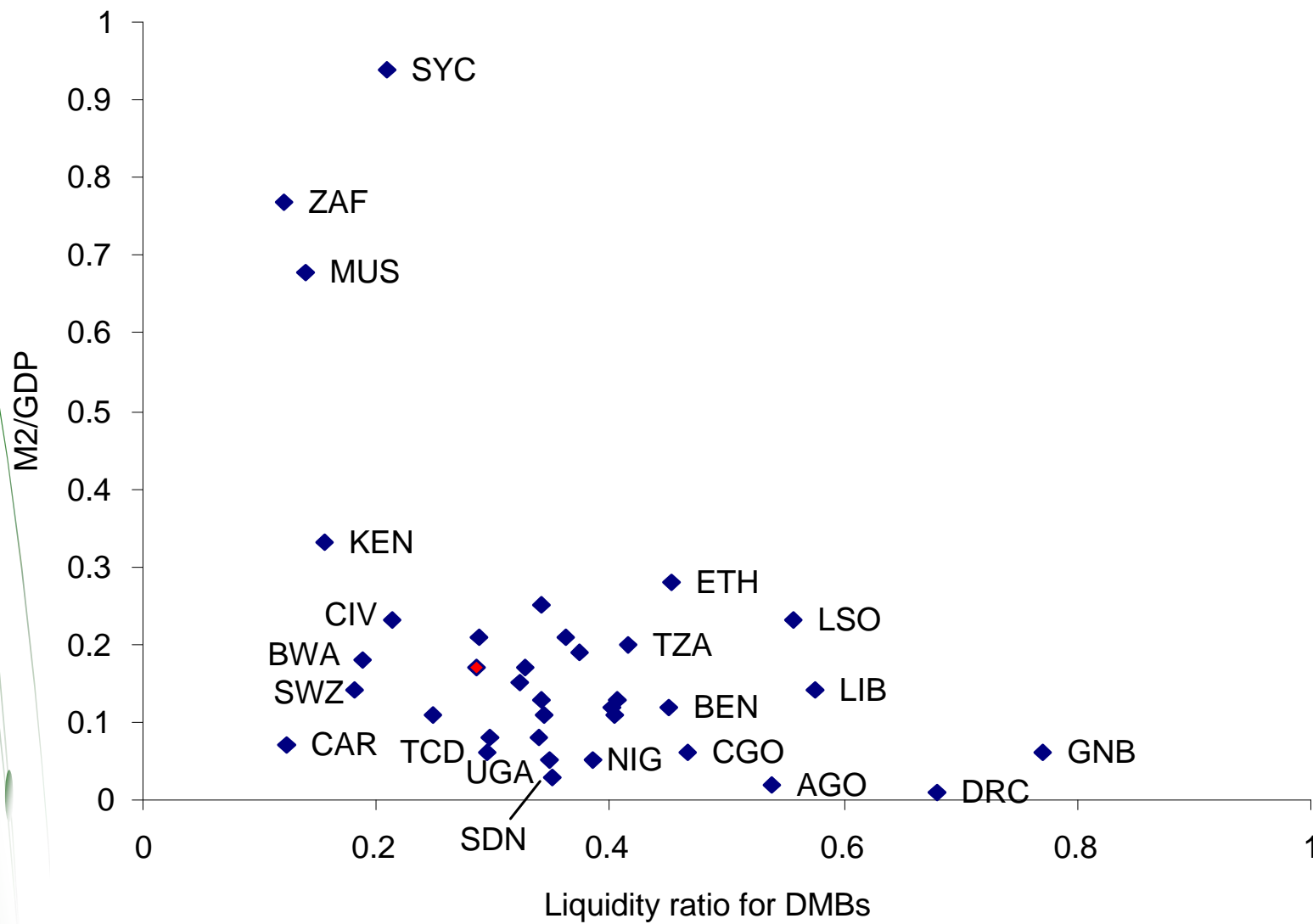
Time period: 2004

Source: Financial Structure Database, 2006 (The World Bank)





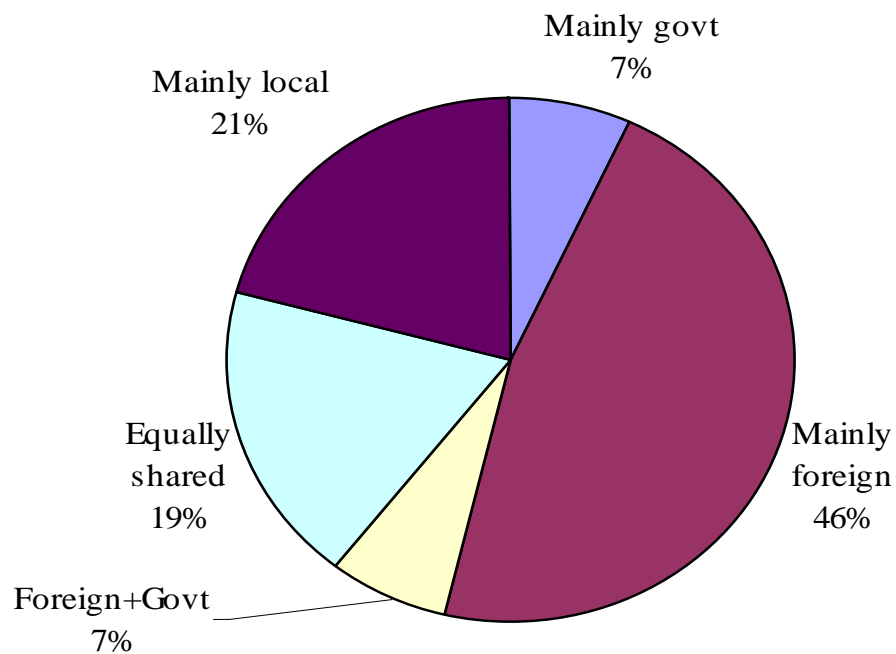
## And African banks are reluctant to lend



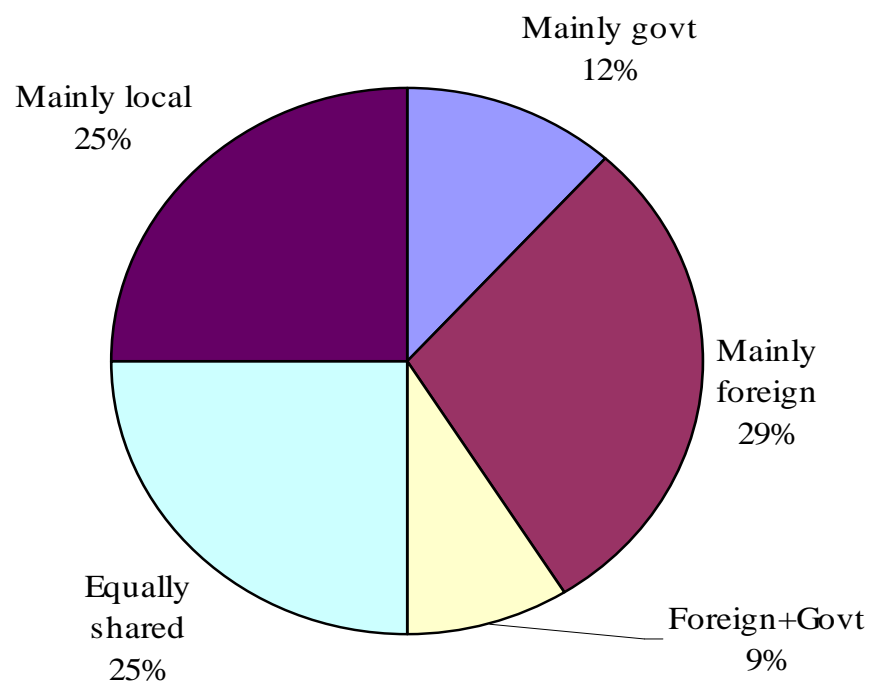


# More and more foreign-owned banking systems: Africa and ROW

Bank ownership (Africa)

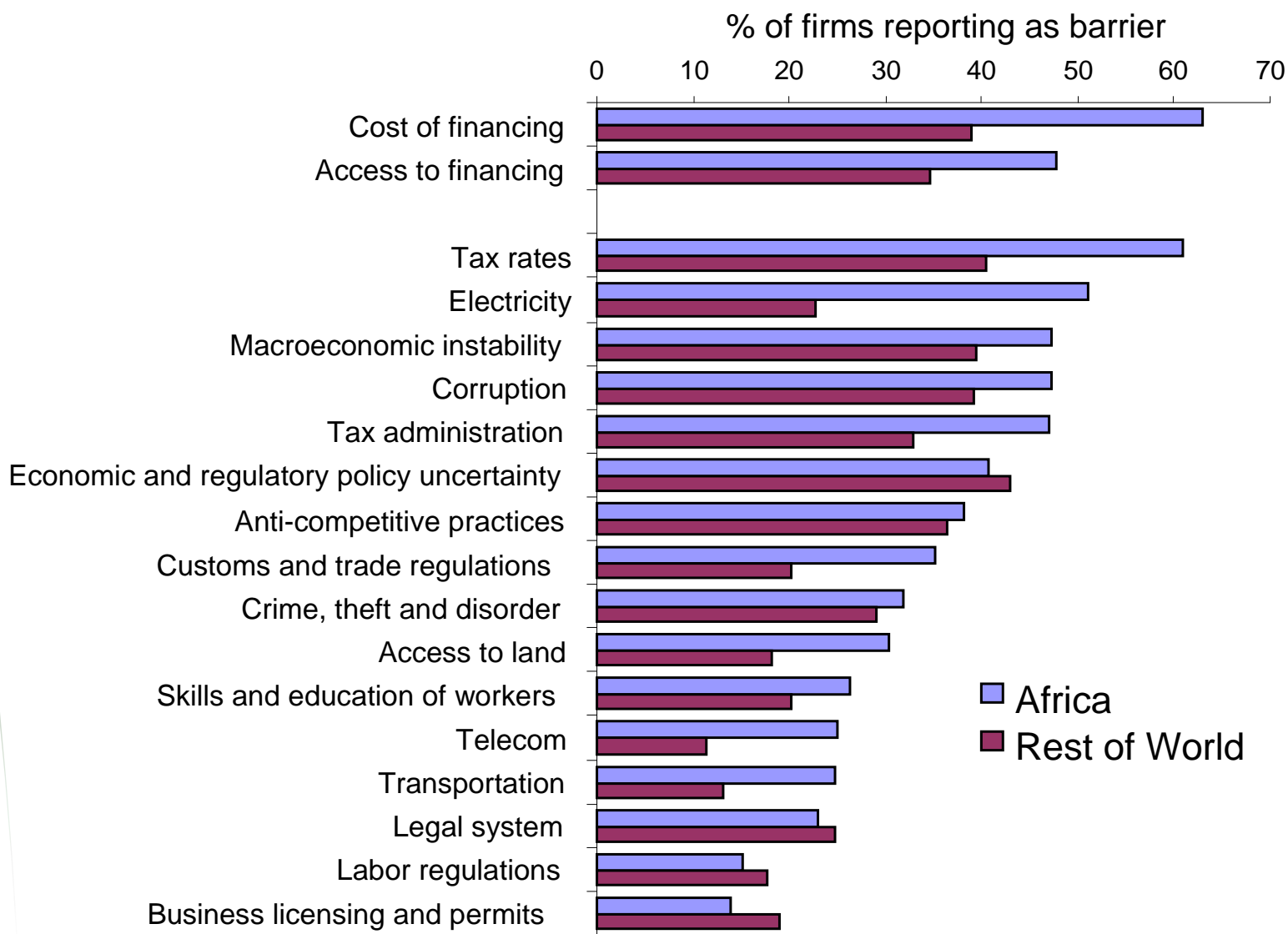


Bank ownership (Rest of Developing World)

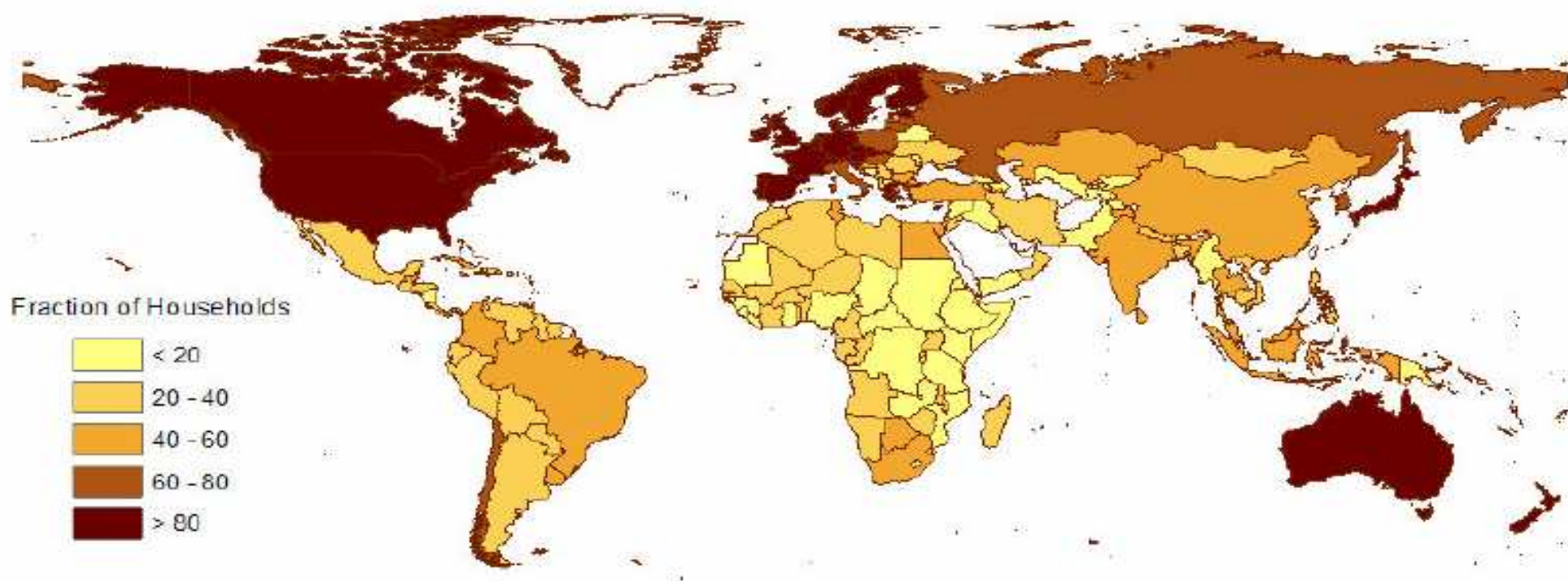




## Firms demand better financing: Africa and Rest of World



## Access to Finance: % of households

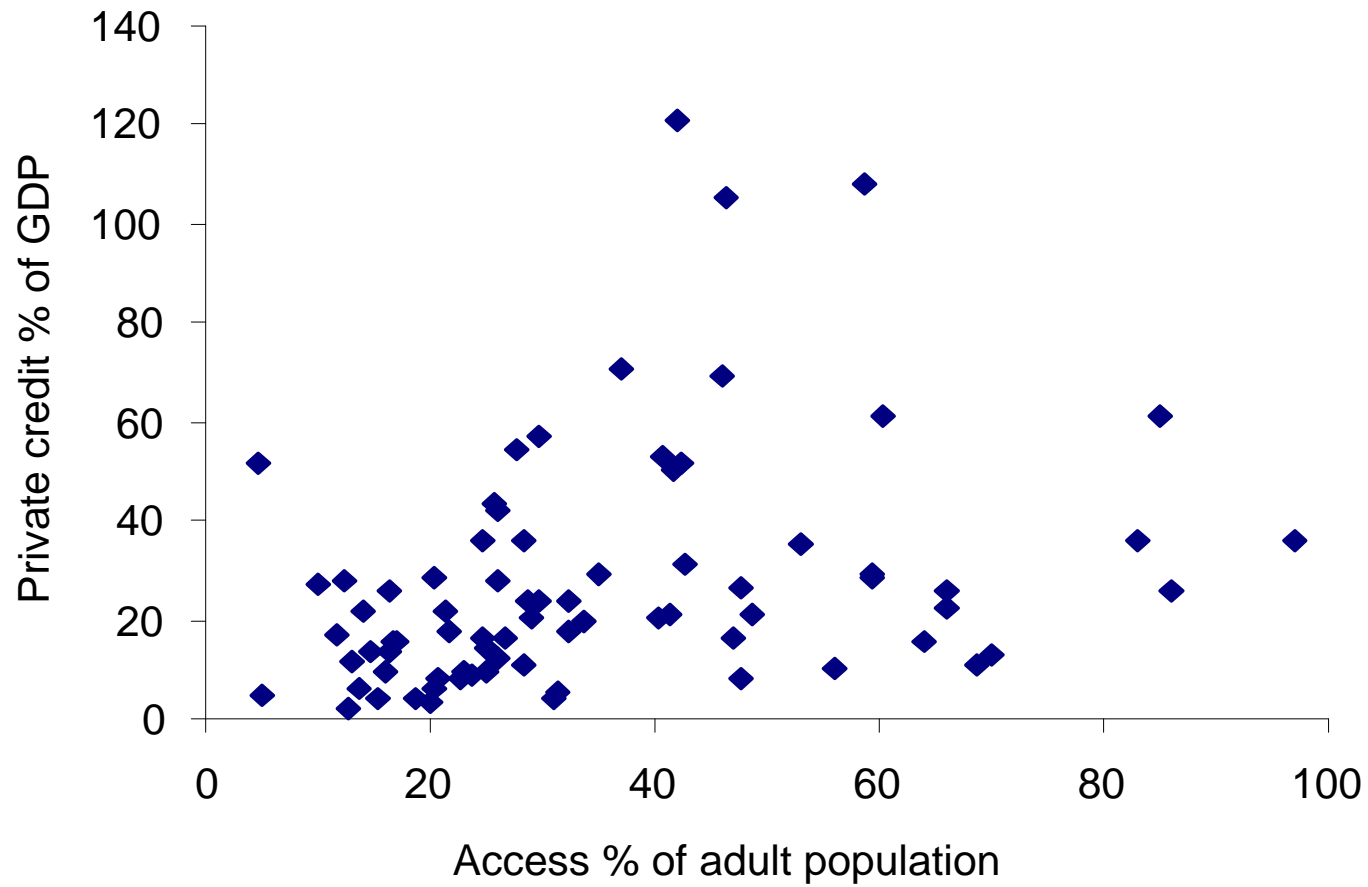


Map 1: *Composite Measure of Access to Financial Services*

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



# Financial access vs. financial depth





## **Approaches (1): Modernism (vs. Activism)**

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

**Better legal protection for creditors including**

- procedures for collecting on collateral (including leasing)**
- judicial efficiency and probity**

**Clarify land ownership (good for collateral)**

**Improve information**

- credit bureaux**
- accounting (and auditing)**

**Better protections for investors in stock exchange**

**Strengthen prudential supervision of banks; AML/CFT**

**Liberalize entry**

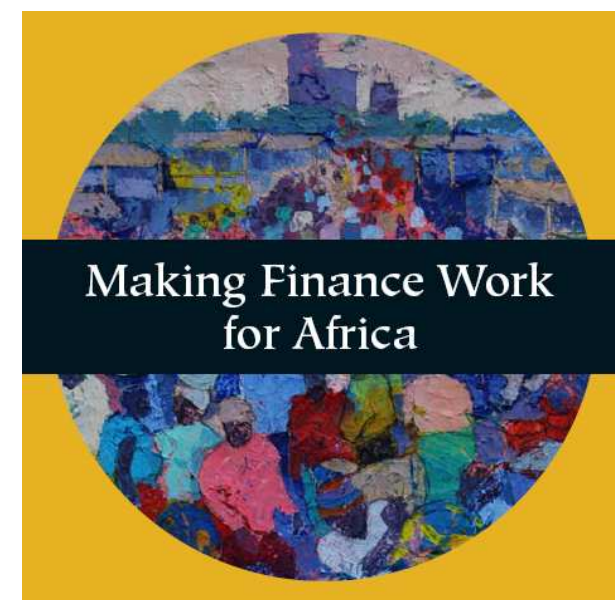
**Land issues: not just a question of better land registration**

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

**Basel 2 bank regulation would be counterproductive**

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

**Etc: see *Making Finance Work for Africa*  
Beck & Honohan, World Bank (2007)**





## Approaches (2): Activism (vs. Modernism)

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

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

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

- To be patient, take risks, experiment with new technology including enhanced use of soft information/relationship lending**
- To take up the “fight for an inclusive financial system” (example: South Africa financial sector charter, 2003)**





## Activism presupposes governance (1)

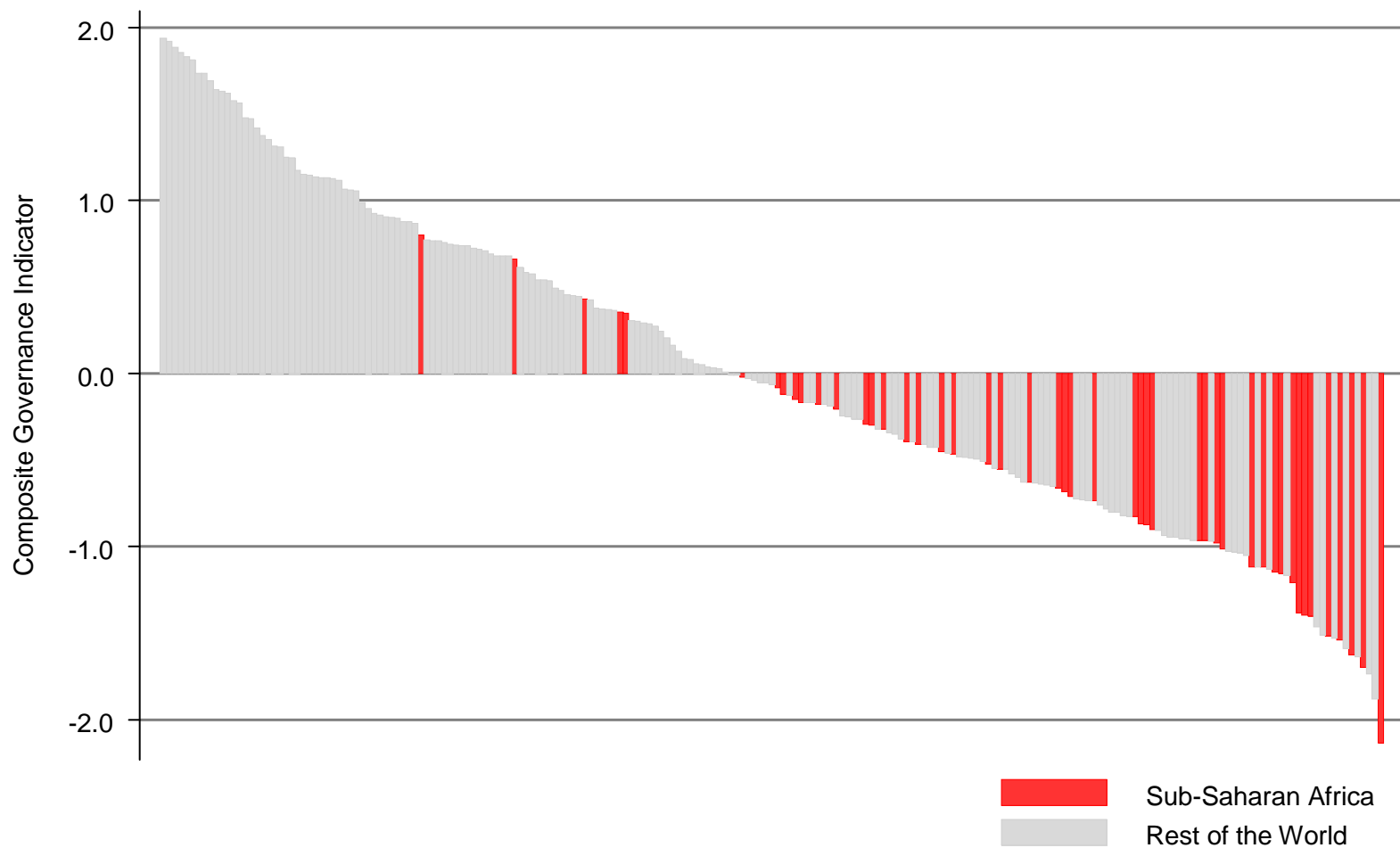
**Activists are not restrained by immediate market pressures; they have chosen to plough money and effort into endeavours that the market has turned down.**

**Willie Sutton effect**

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



# Governance issues

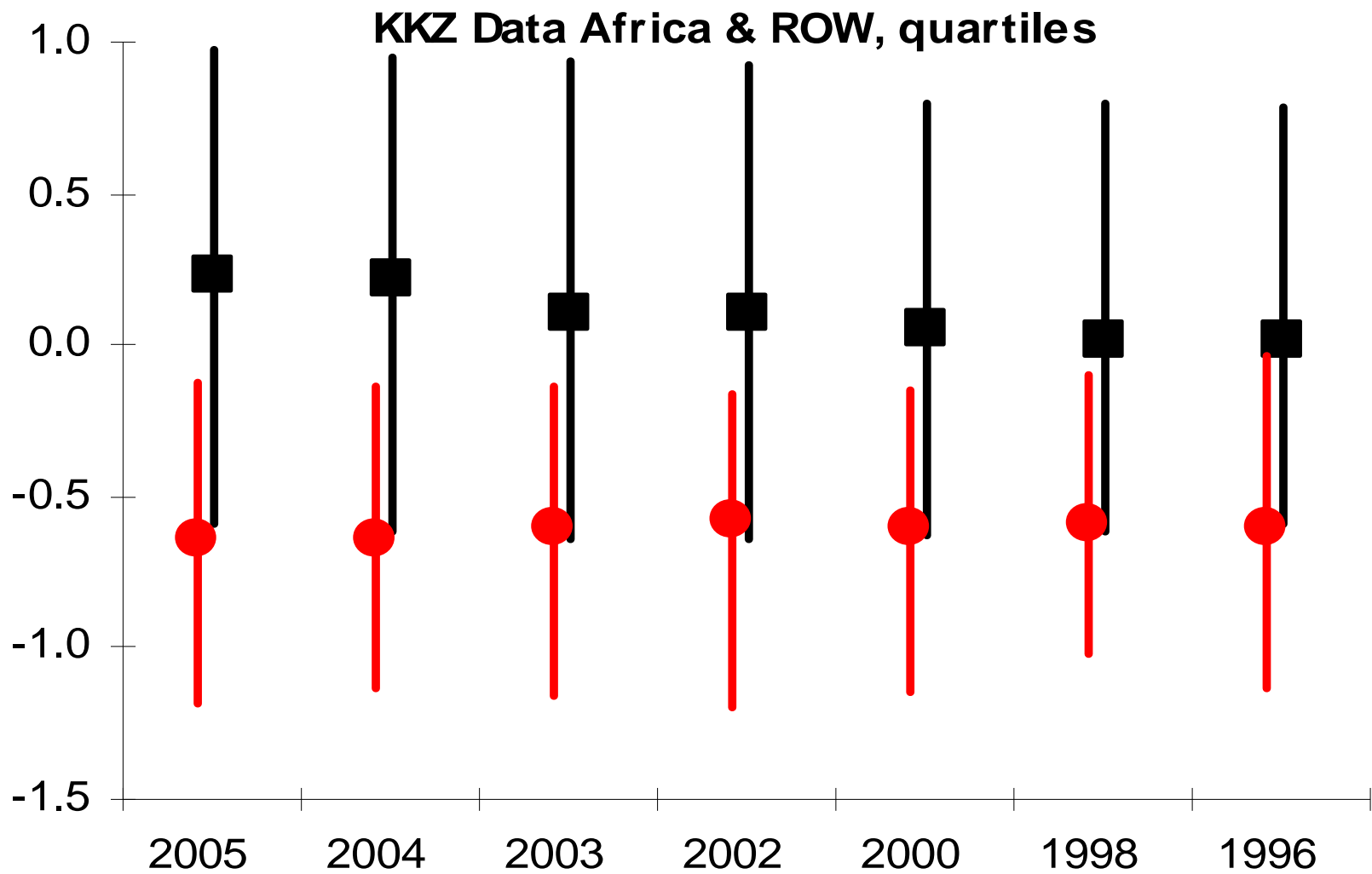


Sample size: 209 countries  
Time period: 2004

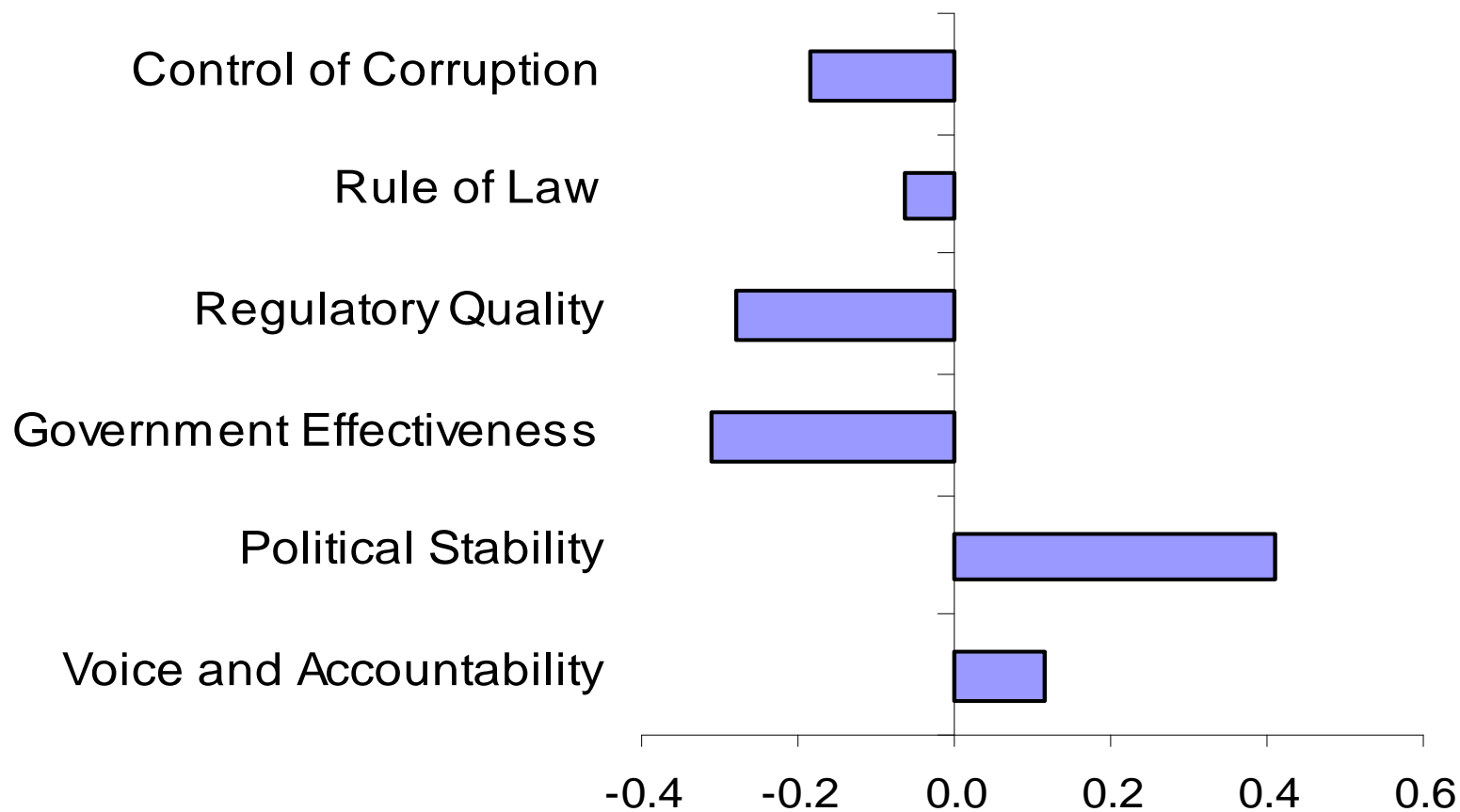
Source: D. Kaufmann, A. Kraay, and M. Mastruzzi (2005). Governance Matters IV



# Governance issues

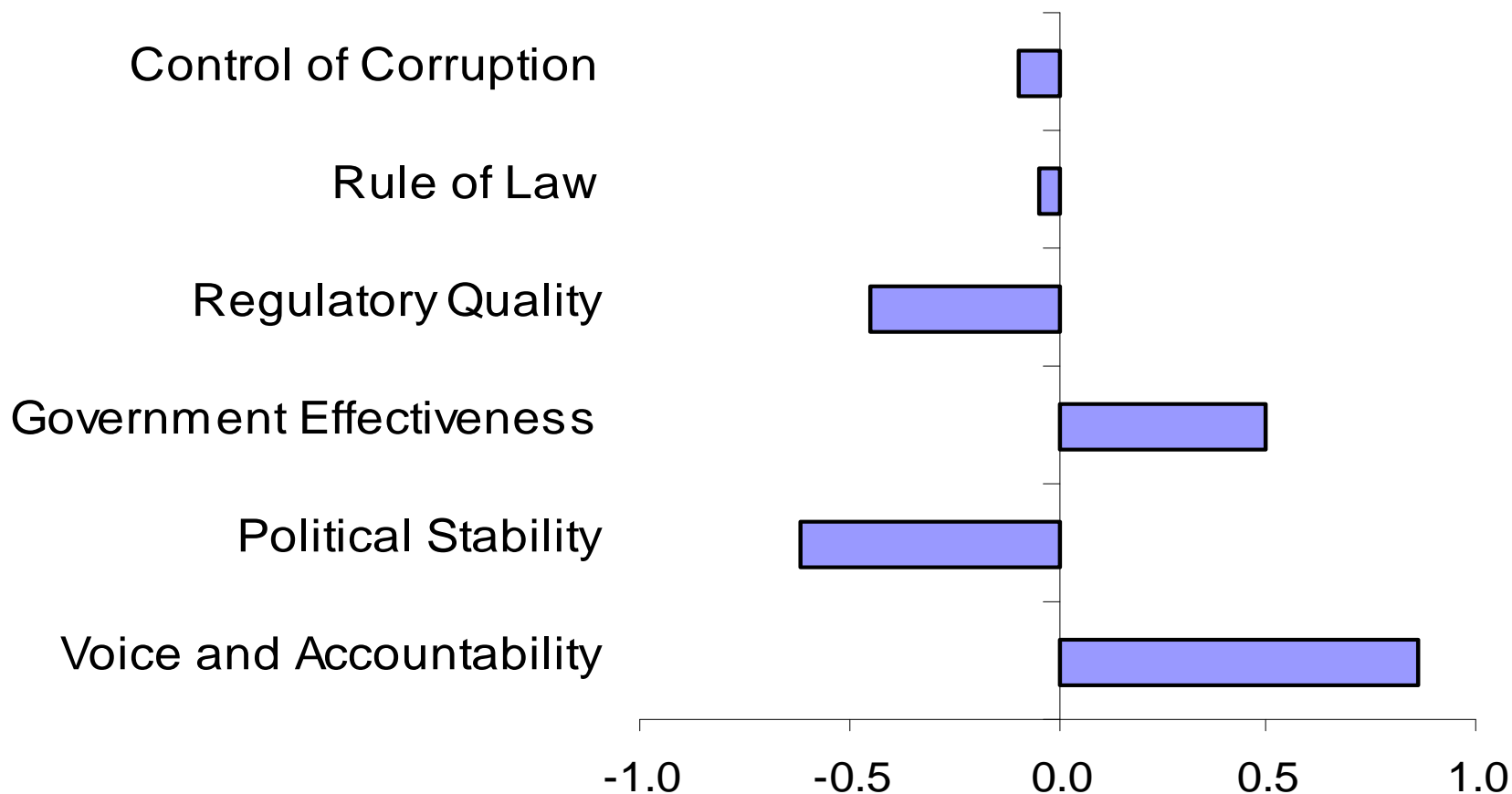


## Africa: Change in ratings median 1998-2005





### Nigeria: Change in ratings 1998-2005





- **Financial sector development can be a powerful agent for growth and transformation**
- **Nigeria has plenty of headroom here**
- **“Open access” should be the watchword**
  - helped by technology and**
  - by nimble regulation**
- **Achieving this requires a champion who will fight for access when necessary against the vested interests of incumbents**