



# SUB-SAHARAN AFRICA

## FINANCIAL SECTOR CHALLENGES

Anne-Marie Gulde, Catherine Pattillo, and Jakob Christensen  
with Kevin Carey and Smita Wagh

I n t e r n a t i o n a l   M o n e t a r y   F u n d

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Production: IMF Multimedia Services Division  
Cover design: Luisa Menjivar and Massoud Etemadi  
Typesetting: Alicia Etchebarne-Bourdin

**Cataloging-in-Publication Data**

Sub-Saharan Africa: financial sector challenges/Ane-Marie Gulde, Catherine Pattillo, and Jakob Christensen, with Kevin Carey and Smita Wagh—[Washington, D.C.]: International Monetary Fund, c2006.

p. cm.

ISBN 1-58906-565-4

Includes bibliographical references.

1. Finance—Africa, Sub-Saharan. 2. Financial institutions—Africa, Sub-Saharan. 3. Financial services industry—Africa, Sub-Saharan. 4. Monetary policy—Africa, Sub-Saharan. I. Pattillo, Catherine A. (Catherine Anne). II. Christensen, Jakob. III. International Monetary Fund.

HG187.5A357G85 2006

Price: US\$19.00

Please send orders to:

International Monetary Fund, Publication Services  
700 19th Street, N.W., Washington, D.C. 20431, USA  
Tel.: (202) 623-7430 • Telefax: (202) 623-7201  
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The following conventions are used in this publication:

- In tables, a blank cell indicates “not applicable,” ellipsis points (. . .) indicate “not available,” and 0 or 0.0 indicates “zero” or “negligible.” Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 2005–06 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2006/06) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY2006).
- “Billion” means a thousand million; “trillion” means a thousand billion.
- “Basis points” refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

As used in this publication, the term “country” does not in all cases refer to territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

Some of the documents cited and referenced in this report were not available to the public at the time of publication of this report. Under the current policy on public access to the IMF’s archives, some of these documents will become available five years after their issuance. They may be referenced as EBS/YY/NN and SM/YY/NN, where EBS and SM indicate the series and YY indicates the year of issue. Certain other documents are to become available 10 or 20 years after their issuance, depending on the series.

# Preface

Building efficient and sound financial sectors in sub-Saharan Africa (SSA) is vital for poverty reduction and growth. This book discusses the main obstacles and challenges that financial structures pose for SSA economies, and the financial reform agenda. An earlier, shorter version of this book's material appeared in the May 2006 issue of the *Regional Economic Outlook: Sub-Saharan Africa*, which was prepared in the Policy Wing of the IMF's African Department under the direction of Benedicte Vibe Christensen, Deputy Director. Dmitry Gershenson, Amadou Sy, Charles Yartey, and Behrouz Guerami made substantial contributions to the book. Gustavo Ramirez provided research assistance, Anne Grant provided editorial assistance, and Suresh Gulati and Ena Baldwin were responsible for document production. In the IMF's External Relations Department, Archana Kumar edited the manuscript and James McEuen coordinated production of the publication.

The book benefited from comments from staff in the African Department and other departments of the IMF. The authors would like to thank their colleagues in the IMF, World Bank, and academia for useful discussions on financial sector issues, and for sharing data. Opinions expressed in the book are those of the authors and do not necessarily represent the views of the IMF, its Executive Directors, or the authorities of the countries covered in the study.



## Introduction

**F**inancial sectors in low-income sub-Saharan Africa (SSA) are among the world's least developed (see Appendix 3, Table A1). The range of institutions is narrow, and assets in most low-income African countries are smaller than those held by a single medium-sized bank in an advanced economy. Most people do not have access to even basic payment services or savings accounts, and the largest part of the productive sector cannot obtain credit. Some middle-income African countries perform notably better, however.

The absence of deep, efficient financial markets constrains economic growth. Limited access to finance lowers welfare and hinders poverty alleviation and the emergence of an economically active middle class. Finally, implementing monetary policy in the context of shallow markets is costly and inefficient.

Financial development increases economic growth through a number of channels. Finance mobilizes and pools savings; produces information on possible investments so that resources can be channeled to their most productive use; monitors the use of funds; facilitates the trading, diversification, and management of risk; and eases the exchange of goods and services (Levine, 1997, 2004). Empirical studies confirm that countries with better-functioning financial systems grow faster, and that the result does not seem to be driven by reverse causality. The link between finance and growth operates importantly through overcoming external financing constraints that otherwise hinder firm expansion. Among SSA countries other

than oil producers, the most financially developed economies grew the fastest between 1960 and 2004 (Appendix 3, Figure A1). Because it is a high-risk environment, exposed to terms-of-trade shocks and a volatile climate, SSA would benefit from financial development facilitating greater risk sharing through portfolio diversification, consumption smoothing, and insurance. Finally, access to formal financial institutions could help surmount inefficient and costly strategies for coping with risk and obtaining capital (Collier and Gunning, 1999).

Financial development also helps reduce poverty. Theory suggests that financial development reduces credit constraints on the poor—for whom financial market imperfections are particularly binding (Galor and Zeira, 1993). The mechanisms are wide-ranging: from alleviating credit constraints, so that households can invest in education, to insuring against shocks. Finance can also allow small firms and individuals to make use of new growth opportunities that arise when markets open.

This book argues that deeper and more efficient financial markets will improve Africa's economic prospects. Based on a review of the key features of financial systems, it discusses the main obstacles and challenges that financial structures pose for African economies. It then reviews ongoing reform efforts, and the extent to which they have already set in motion changes for the better. Recognizing that a vast reform agenda remains, the book concludes by discussing steps that could address major shortcomings.