

AERC PARTICIPATION IN THE IMF/WORLD BANK SPRING MEETINGS 21-26 APRIL, 2010

“Setting the G20 Agenda and Participating in Post-Crisis Bank Regulatory Reform: Africa’s Voice, Effective Participation and Issues”

Executive Summary

The African Economic Research Consortium (AERC) participated in the International Monetary Fund (IMF)/World Bank (WB) Spring Meetings in Washington DC on 21-26 April 2010. The participation was aimed at taking forward the key observations made by senior policy makers at the SPS XII (Mombasa, 21-24 March 2010) and effectively to raise attention on Africa’s input into the ongoing international regulatory architecture. Six main issues were distilled from these meetings and plausible recommendations were made. It is reassuring to see that many stakeholders are highly committed to advancing the interests of Africa in global debates, especially in the G20, so the main message here is that the AERC, together with partners such as the African Development Bank (AfDB) and the Committee of 10 (C10), should capitalize on this momentum to advance Africa’s cause in the global arena.

Background

The AERC Senior Policy Seminar XII (SPS XII), held in Mombasa on 21-24 March 2010, was organized around the theme of “Bank Regulatory Reforms in Africa: Enhancing Bank Competition and Intermediation Efficiency”. Policy-oriented papers, culled out of technical research conducted under a project sponsored and managed by the African Development Bank (AfDB), formed the basis of the discussions at the SPS-XII. Following the seminar event, it was suggested that the AERC should explore ways to take advantage of the IMF/WB 2010 Spring Meetings in Washington to raise attention on the issues of banking regulation and Africa’s input into the global debates. Prof. Victor Murinde of University of Birmingham (an expert in the area of banking regulation, who was involved as an author and in managing the technical aspects of the AfDB research project as well as the papers presented at the SPS XII) was represented the AERC at the DC meetings.

Main Meetings and Events

During the IMF/WB 2010 Spring Meetings in Washington D.C., the AERC and AfDB participated in a joint Brookings – Korea Development Institute – Centre for International Governance Innovation (CIGI) conference on institutional innovations and setting the agenda for future G20 summits. The AERC and AfDB also met with high level stakeholders in Washington DC policy circles, including Governor Daniel Tarullo of the Federal Reserve Bank, US Treasury Assistant Secretary, Marisa Lago, and staff in Senator Kerry’s office, notably Heidi Crebo-Rediker of the US Senate Committee on Foreign Relations and Shannon Smith who is responsible for Africa’s Affairs. Further meetings were held with Senator Brad Lager’s staff, including Nilmini Rubin and Kezia McKeague. Strategies on the way forward were explored with Ernest Aryeetey and colleagues at the Brookings Africa Growth Initiative, Colin Bradford of Brookings and CIGI, and Jo Marie Griesgraber of the New Rules for Global Finance. Also, the AERC participated in a panel discussion on the future of the World Bank, convened by the Civil Society Organisation (CSO).

The Issues

The key points discussed can be summarised under six ideas.

1. Africa's access and participation in setting the agenda for G20 meetings

The most immediate action is to secure access for Africa to the G20 meetings in Korea in November this year so that Africa is represented and can effectively participate in the development agenda of these meetings. Also, access is being sought to the forthcoming G8 meetings in Canada, which feed forward into the G20 meetings in Korea. The Africa Growth Institute at Brookings and CIGI are exploring the modality of access to these meetings.

This action recognises that while the G20 goes beyond the initial G8 in membership and mandate, Africa and other lowest income countries are still excluded from participation and setting the agenda for the G20 as well as directly shaping the intensity of the debate on procedures and policy strategies for the key development challenges. The G20 has to show that the transition from G8 governance of the world marks a genuine step forward; the G20 cannot be dominated by 20 countries which represent the bulk of GDP but not most of the world's population - the world's poorest countries that strive for development opportunities, including adequate financing.

A number of ideas have been explored on the issues of representation. The key idea is that Africa is included in the permanent membership of G20. The Brookings Africa Growth Institute indicated its interest in working with the AERC, AfDB and other interested stakeholders to advance the voice of Africa in the G20.

2. Africa's voice in post-crisis bank regulatory reform

The most immediate action is to secure Africa's access to, and voice in, the ongoing international architecture of bank regulation in terms of the proposed enhancements of the Basel II framework and the framework for adherence to international standards by the Financial Stability Board (FSB).

The financial crisis put to a severe test the Basel II framework that integrated traditional bank lending and capital market activities, especially during the transition from Basel I to Basel II for many African countries – which are now virtually at a cross-roads. Although the crisis has checked the momentum of regulatory reforms in Africa, it has not derailed ongoing work. But the rules of the regulatory game are changing globally and African countries are articulating what they need from the new bank regulation architecture. It is useful to note that in past regulatory reforms Africa had no say, and recent reforms of international regulatory bodies leave African countries virtually voiceless (e.g. Africa has 1/44 members of the FSB).

The AERC and AfDB commend the African Committee of 10 (C-10), which represents African Finance Ministers and Central Bank Governors, as an effective representation in the

ongoing work on Basel reform and the innovations in the FSB. The C-10 is active post-crisis and represents the best efforts by African countries to deal with the peculiarities of financial regulation and the development financing agendas of these countries. It is hoped that the AfDB, as Secretariat of the C-10, is facilitating Africa's inputs into the discussion on banking regulation reforms that are coordinated by the FSB and the Basel Committee.

3. *Africa's role in sharing information for transnational regulation*

Africa takes this role seriously, which arises from cross-border supervision, to reduce information asymmetry and non-convergence of national and international regulation, especially where large foreign banks are heavily involved in small poor economies. Specifically, Africa cannot effectively regulate foreign bank subsidiaries without strong information-sharing with home regulators. Here, the key to effective cross-border supervision is information symmetry by sharing data between home-host supervisors and co-operation, by exploring mechanisms such as MoUs. As a lead, the US should sign MoUs to share information among US and host-country African supervisors. At the meeting, Governor Daniel Tarullo of the Federal Reserve Board also stressed the importance of information-sharing, especially by forging partnerships with friends of Africa and advocates of the interests of developing countries in general.

This point arises from evidence from research which shows that cross-border banking in Africa is growing in importance (e.g. foreign banks from Europe, US, India; also growth of intra-African banking groups, from South Africa, Nigeria, Kenya, Morocco, etc.).

The point also arises from the experience in Africa that, before the financial crisis, Africa was repeatedly hit by the collapse of global banks (BCCI, Meridien) due to inadequate home-country regulation, poor communication of problems by regulatory authorities, and attempts by banks to hide problems in bank branches in low income countries, including Africa. Also, past African banking crises have been exacerbated by export of bank capital to tax havens.

4. *Risk weighting in the design of new regulatory architecture*

The financial crisis exposed the unreliability of risk weights produced by the key rating agencies (S&P, Moodys and Fitch Rating) as a market-discipline component of bank regulation. Bank risk was undervalued.

Post-crisis, the issue of regulating credit rating agencies to avoid exacerbating financial instability is on the discussion table, especially in African countries that do not have the capacity to generate their own risk rating metrics. But, one key unresolved issue is how to measure and assign risk weights to the mix of banking services, both in small and large banking markets. Specifically for Africa, regulation needs to allow for flexibility in remodelling risk-weighted assets, especially where foreign banks dominate; for example, giving project finance a higher risk weight as opposed to say, residential mortgage lending, may influence how credit is allocated in the real economy and hence address the issue of making access to finance easier in Africa.

It was proposed that the AERC and AfDB should continue to look into this issue and produce prototype models, information notes and policy briefs in order to inform the ongoing discussions within the C-10 and the broader international forums.

5. *Development-sensitive regulatory: Supervision of microfinance banking in Africa*

Microfinance banking is the fastest growing sector in Africa and one with the greatest potential for: (i) private sector development, including SMEs; and (ii) poverty reduction. Incorporating microfinance banking (also community banking) into the regulatory framework reduces opportunities for rogue traders and provides social protection for clients.

It was suggested that the AERC and AfDB should lead the work on this topic in order to inform the ongoing discussions within the C-10, and hence as part of influencing the architecture of bank regulation by Basel and the FSB.

6. *Contingent fund for future financial crises*

At the meeting with Governor Daniel Tarullo of the Federal Reserve Board, the issue of funding for bank bailouts was discussed. In particular, the issue is that African countries are not in a position to finance large bailout plan in the event of major bank failures.

One proposal under discussion is to introduce a Financial Transactions Tax on bank balance sheets in order to build a fund against the contingent liability that arises when banks fail, given insight from global financial crisis. The proposal may be appealing for Africa for two reasons. First, for African economies, the option of bank bail-outs is not only inadequate, but it is also not feasible. Second, Africa recognises the need to be part of international harmonisation of the financial transactions tax in order to eliminate the possibility of banks getting involved in regulatory arbitrage and tax arbitrage, especially by global banks which are ‘too big to fail’ and may threaten the stability of banking systems in small economies.

Concluding Observation

All in all, it is reassuring to see that many stakeholders are highly committed to advancing the interests of Africa and other developing countries in the global debates especially in the G20. The AERC, AfDB and the C10 should capitalize on this momentum to advance Africa’s cause in the global arena.