Role of trade in financial services to economic growth and development: Ghana’s Experience

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at

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Outline

- Background
- Interest rate control and directed credit regime
- Outcomes of interest rate control and directed credit policies
- Financial sector reforms
- Role of trade in financial services
- Summary and Conclusion
<table>
<thead>
<tr>
<th></th>
<th>Dec-00</th>
<th>Dec-10</th>
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</thead>
<tbody>
<tr>
<td><strong>Number of Institutions</strong></td>
<td><strong>% of total assets</strong></td>
<td><strong>Number of Institutions</strong></td>
</tr>
<tr>
<td><strong>Commercial banks:</strong></td>
<td></td>
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<tr>
<td>Private</td>
<td>10</td>
<td>21</td>
</tr>
<tr>
<td>Domestic</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>Foreign</td>
<td>5</td>
<td>13</td>
</tr>
<tr>
<td>State</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Rural Banks</td>
<td>113</td>
<td>135</td>
</tr>
<tr>
<td>Savings and loans companies</td>
<td>8</td>
<td>19</td>
</tr>
<tr>
<td>Mortgage finance companies</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Insurance companies</td>
<td>22</td>
<td>42</td>
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<tr>
<td>Securities firms</td>
<td>35</td>
<td>92</td>
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<tr>
<td>Leasing and finance companies</td>
<td>21</td>
<td>27</td>
</tr>
<tr>
<td>Pension funds</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total financial sector assets to GDP</strong></td>
<td><strong>56.7</strong></td>
<td><strong>52.1</strong></td>
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</table>
The current state of the Ghanaian banking system is best appreciated reviewing these phases:

- Banking in the Colonia Era: 1890-1945
- The post war Era: 1945 – 1960
- Banking in a Closed Economy: 1960-1983
- Banking in the Structural adjustment era: 1983 – 2000
- Banking in self initiated reforms: 2000-2010
Background

- Three banks,
  - British Bank of West Africa (1897 now SCB) and
  - Dominion, Colonial and Overseas (1917 now BBG) with
  - Post Office Savings Bank (1887) operated in Ghana before independence.
Purpose of Colonial Banks

- Serve expatriate staff working in Ghana.
- Neglect of the indigenous people in the provision of financial services.
- Based only in the city centres.
- Farmers, fishermen and cottage industries have no access to credit.
Interest rate control and directed credit regime (1960 -1983)

- Priority sectors for investment
  - Modernisation of agriculture
  - Industrialization
  - State Banks

- State Banks
  - Ghana Commercial Bank – 1953
  - National Investment Bank – 1963
  - Agricultural Development Bank - 1965
Interest rate control and directed credit regime (1960 – 1983)

- Credit Control regulation of 1964
  Bank of Ghana’s approval for loan exceeding GH₵1 (less than $5) to sectors other than industry and agriculture
  Cash Reserve ratio of 48%
  Nostro balances backed by 100% deposit with BOG

- Price controls – Interest Rate and Exchange Rate Controls
  - Exchange Rates and Interest rates were administratively controlled by the Bank of Ghana and controls imposed on the asset allocations of banks such as sectoral credit directives
Interest rate control and directed credit regime (1960 – 1983)

- Lending rates for secured facilities were fixed between 6.5% and 7% in 1965 and 6.5% and 10% for unsecured facilities.
- Savings deposit interest rate was fixed between 3% and 3.5% from 1960 to 1966 and revised downwards to between 2.5% and 3.5% in 1968.
Interest rate control and directed credit regime (1960 – 1983)

- Inflation was however higher than nominal deposit interest rates and real interest rate were negative between 1960 and 1983.
- Bank of Ghana in 1969 put a limit on the amount of bank loans for imports, construction, services and other sectors and loans were not to be higher than 10 percent of 1968 positions.
Outcome of Directed credit policies

- Source of growth of bank credit was from public institutions and enterprises and government borrowings
- Erosion of banks’ capital due to high non-performing loans and was 4.4 percent of GDP
- Required ceiling targets were unmet by 64 percent
Outcome of Directed credit policies

- Fiscal Dominance
  Persistent fiscal deficits financed by monetary accommodation
  Strong inertial inflation expectations embedded in the economy due to high inflation and exchange rate volatility
The Direct Control policies failed to achieve the intended objectives:

- Private sector credit as a percentage of GDP was 8.20% in 1970 (28.93% as of April 2012)
- Non performing loans ratio was 41% in 1989 (13% as of May 2012)
- Public sector banks became insolvent by non performing assets and had to be restructured
- Bank for Housing and Construction and Cooperative Banks were liquidated in year 2000 due to insolvency
Results of Direct Control Policies

- Financial depth as measured by M2+/GDP was 19% in 1970 (45.80% in April 2012)
- Erosion of capital of banks due to continuous losses
- Low savings rate due to negative real interest rates (average real savings rate was negative 23.40% in 1975)
- Bank Deposit to GDP was 12.40% in 1970 (54.3% in April 2012)
The main lessons learnt from the Direct Control Policies were:

Direct Controls policies created incentives for rent-seeking / Kalabule
EROSION of social capital – Banking thrives on trust and with erosion of trust it was difficult for banks to intermediate effectively

Ghanaians developed an aversion for financial savings
Banks developed an aversion to lending
The results of these developments were:
  - Low intermediation
  - Low growth
  - High Inflation
The Financial Sector Adjustment Programme (FINSAP) supported by the IMF/World Bank in 1987 led to:

- Removal of control on deposit interest rates and lending rates.
- Central Bank credit allocation directives were discontinued and
- Banks were allowed to determine their own charges and fees in 1990.
One of the diagnoses of the problem of the financial sector was the unbridled government ownership.

- Encouraged political interference in the operations of these banks.

The government in its attempt to encourage competition in the banking sector sold its shares in commercial banks in 1992.
IMF/World Bank Assisted Financial Sector Reforms

- Ghana Commercial Bank, Ghana’s largest commercial bank’s shares were offloaded on the Ghana Stock Exchange (GSE).
- The government in its attempt to deepen the financial market promulgated the Financial Institutions (Non-Banking) Law (PNDCL 328) in 1993 to regulate the operations of savings and loans companies, finance companies, credit unions, leasing companies and mortgage...
IMF/World Bank Assisted Financial Sector Reforms

- Rural /Community Banks
- Securities Industry Law was passed in 1993 which paved the way for Securities Regulatory Commission
  - Surveillance over the securities market
  - Orderly, fair and equitable dealings in securities
  - Licence and authorise unit trust, mutual funds
In house Initiated Reforms
(2002 -2008)

- BOG has in the recent past introduced a number of policy reforms to among others:
  - Promote efficiency, competition in the banking system and deepen the financial system;
  - Enhance transparency and competitiveness of the interbank money market.
  - Enhance the development of the capital market.
  - Reduce Asymmetric Information
In house Initiated Reforms (2002 -2008)

- Asymmetry Information (credit information and trust)
- Credit Reporting Act 2008
- Publication of APRs and bank charges
- Borrowers and Lenders Act 2008
- Know Your Customer (KYC)
- Anti-Money Laundering Act 2008
- Establishment of Collateral Registry
In house Initiated Reforms (2002 -2008)

- Other Reforms
  - Abolition of secondary reserve requirements
  - Non-resident participation in domestic government securities and passage of Foreign Exchange Act 2006
  - Payments systems Act 2003 (ACH, GHIPSS and RTGS)
In house Initiated Reforms (2002-2008)

- National Pension Act 2008
- Insurance Act 2006
- Banking Act 2004 and Banking Amendment Act 2007 – Offshore Banking
- Central Securities Depository Act 2007
Role of trade in financial services

- Ghana allowed entry of foreign banks as part of financial sector reform in 1987
- Foreign banks controlled 54% of banking sector asset as at April 2012 and introduced various innovative products:
  - Cashless Account, Saturday banking, ATM and other electronic products
- Quality service delivery makes foreign banks preferred choice
Letters of credit issued by DMBs for external trade

![Bar chart showing millions of dollars for each year from 2000 to 2011. The values range from 306.49 million in 2000 to 2,178.02 million in 2011.](image-url)
Banks credit for Import and Export trade 1970 - 2011
<table>
<thead>
<tr>
<th>Sectors</th>
<th>1963-1986</th>
<th>1987-2010</th>
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<tbody>
<tr>
<td></td>
<td>$\alpha$</td>
<td>$\beta_1$</td>
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<tr>
<td>Agriculture</td>
<td>-3.750</td>
<td>5.150</td>
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<tr>
<td>Mining &amp; Quarrying</td>
<td>-4.809</td>
<td>5.559</td>
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<tr>
<td>Manufacturing</td>
<td>-3.438</td>
<td>4.993</td>
</tr>
<tr>
<td>Construction</td>
<td>-2.876</td>
<td>4.410</td>
</tr>
<tr>
<td>Electricity, Gas &amp; Water</td>
<td>-3.821</td>
<td>4.146</td>
</tr>
<tr>
<td>Commerce &amp; Finance</td>
<td>-2.514</td>
<td>4.564</td>
</tr>
<tr>
<td>Import Trade</td>
<td>-2.510</td>
<td>4.104</td>
</tr>
<tr>
<td>Export Trade</td>
<td>-2.764</td>
<td>4.301</td>
</tr>
<tr>
<td>Others</td>
<td>-2.870</td>
<td>4.621</td>
</tr>
<tr>
<td>Transport, Storage &amp;</td>
<td>-4.294</td>
<td>4.994</td>
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<tr>
<td>Communication</td>
<td>-2.732</td>
<td>4.160</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>-2.687</td>
<td>3.896</td>
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<td>Dec-00</td>
<td>Dec-01</td>
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<tr>
<td><strong>Market Share (Top 5 banks)</strong></td>
<td>77.6</td>
<td>77.6</td>
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<tr>
<td><strong>Gini Concentration Index</strong></td>
<td>60.7</td>
<td>60.4</td>
</tr>
<tr>
<td><strong>Herfindahl Index</strong></td>
<td>1,413.7</td>
<td>1,466.6</td>
</tr>
<tr>
<td><strong>Indicators of Financial Depth and Intermediation</strong></td>
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<tr>
<td><strong>Asset to GDP</strong></td>
<td>43.6</td>
<td>38.1</td>
</tr>
<tr>
<td><strong>Private Sector Credi/GDP</strong></td>
<td>14.1</td>
<td>11.7</td>
</tr>
<tr>
<td><strong>Total Credit to GDP</strong></td>
<td>19.0</td>
<td>16.5</td>
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<tr>
<td><strong>Deposits to GDP</strong></td>
<td>26.8</td>
<td>22.2</td>
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**% of Revised GDP**

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<th>Dec-00</th>
<th>Dec-01</th>
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<th>Dec-04</th>
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<th>Dec-06</th>
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<th>Dec-09</th>
<th>Dec-10</th>
<th>Dec-11</th>
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<tbody>
<tr>
<td><strong>Asset to GDP</strong></td>
<td>27.7</td>
<td>33.7</td>
<td>35.4</td>
<td>38.1</td>
<td>38.8</td>
<td>38.8</td>
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<tr>
<td><strong>Private Sector Credi/GDP</strong></td>
<td>11.2</td>
<td>14.6</td>
<td>16.0</td>
<td>15.6</td>
<td>15.4</td>
<td>15.1</td>
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<tr>
<td><strong>Total Credit to GDP</strong></td>
<td>13.5</td>
<td>17.9</td>
<td>19.8</td>
<td>18.8</td>
<td>17.8</td>
<td>16.5</td>
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<tr>
<td><strong>Deposits to GDP</strong></td>
<td>18.1</td>
<td>21.2</td>
<td>23.0</td>
<td>24.3</td>
<td>26.4</td>
<td>28.1</td>
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</table>
Conclusion

- The banking landscape has become competitive
- Increased intermediation and improved loan quality
- Banks’ trade finance with respect to establishment of letters of credits was $2.2 billion in 2011 compared with $300 million in 2000
Conclusion

- Private sector credit to GDP was 4.7 percent in 1990 as against 27.6 in 2011.

- Credit to export sub sector was GHC4.7million ($2m) in 1970 compared with GHC 1.13 billion ($735m) in 2011.
Conclusion

- Opening access to a wider segment of the population
  - Banks’ branch network increased from 295 in 2003 to 850 as at April 2012
  - Non-bank financial institutions were 257 in 2000 and 615 in December 2010
- Creating new asset classes and products such as consumer loans, mortgages, ATM services, online telephone and internet banking
Conclusion

THESE ARE THE FRUITS OF FINANCIAL SECTOR LIBERALIZATION AND SOUND POLICIES

GHANA: TOP GLOBAL REFORMER IN IMPROVING ACCESS TO CREDIT-
WORLD BANK & IFC 2011