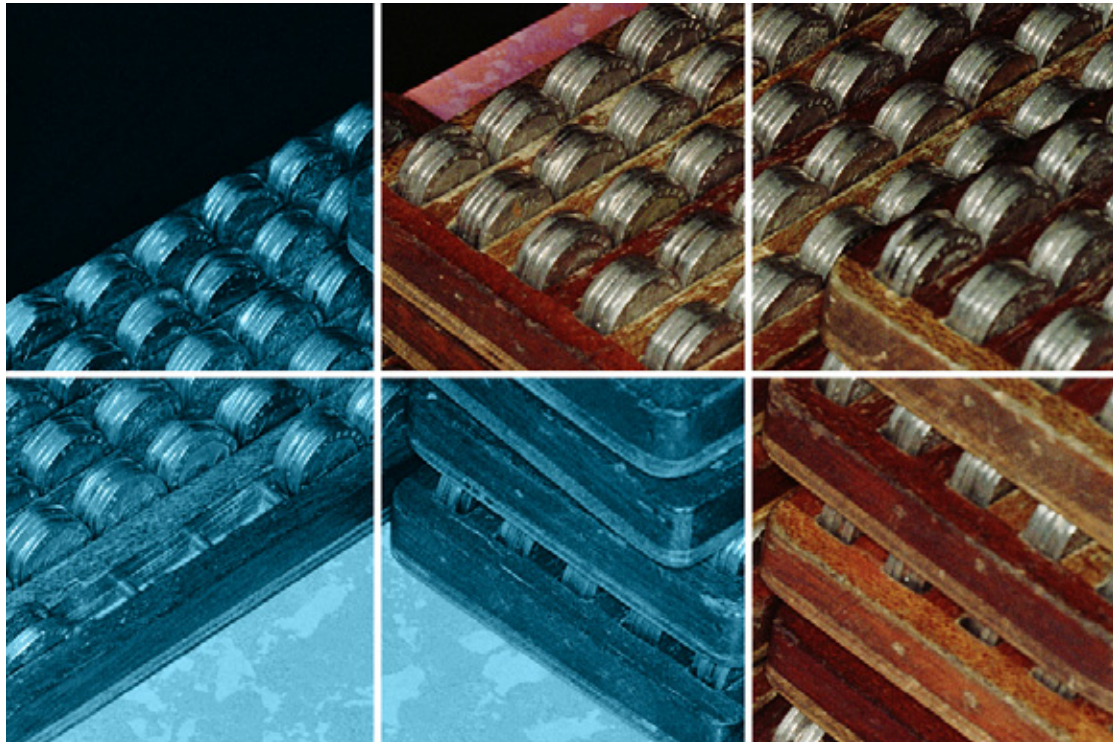


Sustainability Impact Assessment (SIA) of the EU-ACP Economic Partnership Agreements

Phase Three



Financial Services in Central Africa

Final Report

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This report is one of a series of “Sustainability Impact Assessment” (SIA) reports coordinated by PricewaterhouseCoopers on behalf of the European Commission, Directorate General for Trade, under a five-year framework contract.¹

The third phase of this project covers three sector studies in three African-Caribbean-Pacific (ACP) regions: Horticulture in Eastern and Southern Africa (ESA); Rules of Origin in the Southern African Development Community Group (SADC Group) and Financial Services in central Africa.

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Executive summary

This is the Final Report of the Sustainability Impact Assessment (SIA) of a prospective Economic Partnership Agreement (EPA) between the Central African group of African, Caribbean and Pacific countries (ACP) and the European Union (EU). The Central African countries included in this configuration are: Cameroon, Central African Republic (CAR), Chad, Congo (Brazzaville), Equatorial Guinea, Gabon, Democratic Republic of Congo (DRC) and Sao Tomé and Príncipe (STP). The negotiations include financial services. This SIA examines how the EPA negotiations can contribute to regional integration in the Central African region and support liberalisation in the financial services sector to encourage sustainability.

The EPA being negotiated between the EU and Central Africa is consistent with the new regionalism that, given the reality of globalization, seeks to enhance regional integration among countries in the South through partnerships between regional trading blocks. The EPA negotiations are structured to ensure consistency with WTO rules. They examine economic complementarities among countries at uneven levels of development and flows of foreign direct investment (FDI). Stability, predictability and transparency in rules are important to build trust, improve prospects and increase foreign investment in the Central African region. It is also necessary to reinforce regional economic integration because preferences to the EU market are increasingly being eroded through parallel, multilateral and bilateral, liberalisation efforts. The EPA is being negotiated as emerging economies try to develop valuable primary resources, such as oil (CEMAC countries and STP) and minerals (DRC). The EPA will provide funds to support sustainable development efforts as liberalisation occurs.

The EPA is expected to have financial (trade, taxation, competitiveness), social and environmental impacts on the Central African countries as it moves to strengthen regional economic integration. Impacts will affect both goods and services. The EPA will have short, medium and long-term costs linked to declining duty-based revenues, competition from imported EU goods, and the distortion of trade flows. The challenges associated with the EPA (and its reciprocal market access provisions) which the Central African region must face, include:

- An increase in the current account deficit. Most Central African countries have duty-free access to the EU market for their exports but maintain some protection against imports of goods from the EU. Increased foreign capital will be required to balance the trade deficit.

- A loss of duty-based revenues in line with reforms already underway at the CEMAC level. Without alternative revenues, levels of public goods and services could be reduced.
- The generation of transition costs in the short and medium-terms. Adjustment to this implies restructuring and imposes costs on the labour market.
- An increased risk of “de-industrialization” in several substitution activities because of new competition from EU goods.

The EPA offers several benefits that may accrue in the short and medium-terms, including:

- A reduction in the costs of imports which will increase the profitability and the competitiveness of local firms which import equipment and inputs from the EU.
- Stability in terms of trade liberalisation which will make the gains achieved by the EPA permanent, and provides certainty in rules related to trade and investment (which should disproportionately benefit investment in the financial services sector).
- Cost-savings which should benefit consumers (provided savings are not absorbed by intermediaries) resulting from a growth in trade, economies of scale and increased competition.
- Static and dynamic productivity gains based on structural reforms, including sound macroeconomic policies, increased investment in physical infrastructure, improvement in the quality of human resources and a strategy to develop comparative advantage in the region. Productivity gains should strengthen long-term growth.
- An expanding regional market; internal duties within CEMAC will be lower than protectionist measures targeting third-party countries.

The impacts of an EPA on trade in financial services can be assessed through trade creation or diversion effects that result from the dismantling of regulatory trade barriers that limit access to services. Dismantling could be measured by the degree of market liberalisation and a comparison to national treatment. Trade creation effects are linked to an increase in imports of financial services. Trade diversion effects result from the replacement of foreign non-EU financial services by EU-based financial services. Given that access to the CEMAC financial services market is free and that there are no restrictions on national treatment, trade creation and diversion effects are expected to be quite limited. Nonetheless, CEMAC does regulate access to its market in terms of approval, risk management practices and the harmonization of banking and insurance services.

In terms of financial services linked to trade and investment, the EPA may play a facilitating role. But development of these services may be asymmetric. For example, Central African companies pay higher freight insurance fees to foreign insurance companies than they do to Central African insurance companies, although many Central African firms prefer foreign insurance companies.

Central African insurance companies and banks have limited access to the EU market because of regulatory obstacles. Under reciprocity, development opportunities will remain limited. However, Central African insurance companies and banks can potentially gain market share for financial transfers from clients in the EU, who are of Central African origin.

Acronyms

ACP	Africa Caribbean and Pacific Group of States
ATM	Automated teller machine
BCEAO	<i>Banque centrale des états de l'Afrique de l'ouest</i>
BICA	<i>Banque internationale de Centre Afrique</i>
BPMC	<i>Banque populaire Maroco-Centrafricaine</i>
BVMAC	<i>Bourse des valeurs mobilières d'Afrique centrale</i>
CAR	Central African Republic
CBC	Commercial Bank of Cameroon
CBCA	Commercial Bank of Central Africa
CEEAC	Economic Community of Central African States
CEMAC	<i>Communauté économique et monétaire de l'Afrique centrale</i>
CET	common external tariff
CIMA	Inter-African Conference of Insurance Markets
CMC	<i>Crédit mutuel de Centrafrique</i>
COBAC	Central African Banking Commission
COMESA	Common Market of Eastern and Southern Africa
COSUMAF	<i>Commission de surveillance du marché financier d'Afrique centrale</i>
DRC	Democratic Republic of Congo
DSE	Douala Stock Exchange
EIA	environmental impact assessment
EPA	Economic Partnership Agreement
EU	European Union
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GNP	gross national products
HDI	Human Development Index
ICT	Information and Communication Technologies
LDC	Least Developed Country
NGO	non-governmental organisation
OECD	Organisation for Economic Cooperation and Development
OHADA	<i>Organisation pour l'harmonisation en Afrique du droit des affaires</i>
PPP	public-private partnership
STP	Sao Tomé and Principe
SIA	Sustainability Impact Assessment
SME	small and medium-sized enterprise
SOCOFIN	<i>Société congolaise de financement</i>
SWOT	Strength, Weaknesses, Opportunities and Threats
UDEAC	<i>Union douanière et économique de l'Afrique centrale</i>
UEAC	<i>Union des états de l'Afrique centrale</i> (Central African Economic Union)
UNEP	United Nations Environment Programme
VAT	value-added tax
WTO	World Trade Organisation
XAF	CFA franc

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1. Introduction

Negotiations regarding an EPA between the EU and the Central African countries were launched on 4 October 2003. The Executive Secretary of CEMAC has been mandated to prepare the EPA negotiations in conjunction with the Secretariat General of the Economic Community of Central African States (CEEAC). A Regional Coordinating Committee has been established by the Council of Ministers of the *Union des états de l'Afrique centrale* (UEAC), charged with preparing and concluding the EPA. CEMAC and the EU adopted a *joint road map* for the EPA negotiations on 16 July 2004 specifying, *inter alia*, the timetable for negotiations and the subjects to be examined, including such trade measures as trade in services and financial services.

At a general level, the over-arching goal of the EPA is to promote regional economic development and integration by enhancing cooperation in trade-related areas. It will create a WTO-compatible free trade area between CEMAC (including STP and DRC) and the EU over a 12-year period beginning on 1 January 2008. While giving priority to economic development, it will facilitate the process of regional integration in Central Africa by promoting cooperation in trade-related areas and improved competitiveness and capacity building.

This SIA seeks to assess the impact of the liberalization of financial services. For the countries of Central Africa, the EPA negotiations provide an opportunity to support the ongoing harmonisation of financial markets in a structured process. Having open integrated markets is of vital importance for the countries of Central Africa if they are to pursue development at home and engage in global trade. The EPA negotiations are both an incentive and a catalyst for regional integration.

This SIA examines both a baseline (existing rules) and an EPA scenario (the possible results of negotiations) and assesses the impacts of trade liberalization on economic, social and environmental sustainability. Using a SWOT analysis, it includes policy recommendations to reinforce current strengths and develop potential opportunities and to mitigate any potential weaknesses of, or threats to, sustainability. The ultimate objective of the SIA is to encourage trade between the Central African countries and the EU that supports economic, social and environmental sustainability.

The countries in the region are supportive of the regional dimension in the approach to the EPA; LDCs in the region would prefer to negotiate with the Central African EPA configuration than fall back on the “Everything But Arms” Initiative (EBA). But there are some concerns with respect

to the negotiations. Some countries in the Central African region are on the verge of bankruptcy and/or suffering from internal conflicts. These countries are not in a strong negotiating position. The DRC and Sao Tomé and Príncipe (STP) are not members of CEMAC and, even with the 12-year EPA implementation period, issues regarding harmonisation and coordination will affect their participation in the negotiations.

1.1 Regional integration in Central Africa

The process of regional integration is relatively well-advanced in the Central African region for financial operations and banking regulations. However, in other areas it is under-developed due to weak institutional capacity of regional bodies and physical barriers (transportation and communication networks). In addition the customs union is troubled by persistent fraud and smuggling activities. For example, some landlocked countries such as CAR typically only collect one-quarter of the customs duties they are owed because of widespread smuggling that occurs along the porous borders. There is a gap between the advanced rules for regional integration and the behaviour on the ground. The latter continues to encourage the fragmentation of national markets. However banks, insurance and regulatory bodies operate on a regional basis. Relations between the CEMAC and DRC are mostly informal particularly for coffee and diamonds although they are hampered by the different currency regimes and by the high levels of monetary and political instability in DRC.

CEMAC was created largely to strengthen the process of regional economic integration and contribute to development in Central Africa. Compared to a number of regional integration efforts in Africa, CEMAC is relatively well developed as a monetary and customs union with a common external tariff (CET), defined criteria for macroeconomic convergence and an institutional structure for surveillance, as well as an institutional and historic base through which structural reforms can take place to achieve these objectives. For Central African countries, regional integration offers many advantages including the following:²

- it can be an important source of enhanced growth and economic efficiency by locking Central African countries into policy reform;

² See Zafar, Ali and Keiko Kubota. 2003. "Regional Integration in Central Africa: *Key Issues*." Africa Working Paper Series No. 52. The World Bank. June.

- it can provide a framework in which restrictive trade practices can be removed, customs procedures streamlined, macroeconomic policy surveillance increased, and greater fiscal discipline ensured;
- It represents an opportunity for the poorer land-locked economies (Chad and the CAR) whose economic survival depends on the coastal countries.
- A regional grouping in Central Africa could provide a platform for the articulation of the individual country concerns *vis a vis* the rest of the world.

In CEMAC, fiscal policies are conducted independently by each member country, although there have been instances of regional coordination in taxation policies. The member governments have recognized, however, that a regime which combines a common fixed exchange rate in conjunction with national fiscal policies requires macroeconomic convergence and surveillance. The treaty that specified the legal and institutional arrangements of CEMAC created the following bodies:

- Central African Economic Union (*Union économique de l'Afrique centrale* – UEAC) with an Executive Secretariat based in Bangui, CAR.
- The Central African Monetary Union (*Union monétaire de l'Afrique centrale*), which specifies the responsibilities of BEAC, and the Central African Banking Commission (COBAC).

The Customs Union is one of the central pillars of CEMAC. It has established a CET for trade with third countries, and trade inside the Community has been duty free since 1998. The CET has four rates: 5% (for essential goods); 10% (for raw materials and capital goods); 20% (for intermediate goods); and 30% (for consumer goods). In addition to the average CET of 11.8%, several other temporary and excises taxes and a value-added tax (VAT) are applied, leading to an average taxation level of 32%.

The Monetary Union plays a key role in the integration process. There is one central bank, the *Banque des états d'Afrique centrale* (BEAC), a single currency (CFA Franc [XAF]) and defined criteria for macroeconomic convergence.³ The BEAC regulates the sector through its regional

³ In March 1993 the CEMAC countries set up a special committee on multilateral surveillance (*Conseil de convergence*) to ensure fiscal discipline and to promote macroeconomic convergence. The establishment of this Committee was the first step toward a full-fledged multilateral surveillance framework. On a quarterly basis, the Committee conducts regional surveillance which includes a review of the following four fiscal indicators or “criteria for convergence”:

- basic budget balance to be zero or positive;
- the annual rate of inflation to be below 3%;

banking commission, COBAC, which shares responsibility with the national ministries of finance for licensing new banks. There is also a budgetary agreement between the French Treasury (Ministry of Finance) and BEAC with fixed convertibility of the XAF and a *'droit de regard'* by the European Central Bank (ECB). In theory, through the adoption of a single banking licence, a bank licensed in one CEMAC country should be freely able to operate in the CEMAC region.

The provision of a regulatory framework for the sub-region to ensure a good business climate for private and foreign investment is also already conducted partly at the regional level. The *Organisation pour l'harmonisation en Afrique du droit des affaires* (OHADA) was established in 1995 with 16 francophone countries signing on to adopt common business laws in the region. OHADA covers the implementation of uniform acts on commercial legislation, company law, bankruptcy law, secured transaction law, debt collection and arbitration. This was intended, among other things, to create a positive business environment for the development of financial services.

Oversight of the insurance sector is also organized at the regional level by the Inter-African Conference of Insurance Markets (CIMA).¹⁴ Its action is developed in the general framework of the Insurance Code annexed to the CIMA Constitutive Treaty (signed in 1994 and entered into force in 1995) that created a very strict risk-assessment framework for the insurance sector. Along with COBAC, CIMA benefits from the supra-nationality advantage that allows avoiding the constraints of local/national powers weights and potential pressures.

The financial integration includes two regional stock exchanges: BVMAC in Libreville (Gabon) and the Douala Stock Exchange (Cameroon). The main participants are the State, public and semi-public companies and international companies. Oversight is provided by the *Commission de surveillance du marché financier d'Afrique centrale* (COSUMAF).⁴ The rapid growth of the insurance sector is a positive factor in favour of the development of the stock exchanges. Their

-
- total public debt (domestic and foreign) not to exceed 70% of GDP;
 - domestic and foreign arrears (debt) by the administration must not increase, or must be eliminated.

The operation of the multilateral surveillance mechanisms rests with a series of national units with the principal role of collecting national socio-economic data and transmitting periodic national reports to a regional surveillance unit, which reports to the Executive Secretary of CEMAC. The institutional framework that was put in place was designed to enhance the quality of regional surveillance exercise. It was introduced in 2001 to provide a formal mechanism for monitoring convergence. It includes:

- a surveillance unit in each member country (responsible for the compilation of national data)
- a regional surveillance unit (responsible for the compilation of relevant regional data based on national inputs, as well as the preparation of reports on the implementation of the multilateral surveillance)
- a surveillance committee responsible for preparations of meetings of the Council of Ministers
- a Council of Ministers, which is the decision-making body. (Zafar and Kubota).

⁴ See <http://www.cosumaf.org>.

effective functioning favours investments made by insurance companies in the markets, in the short-term through public bonds and in the medium- and long-terms through private debt issues by private companies.

Levels of intra-regional trade are very low, accounting for less than 2% of the total foreign trade of the region. There remain several obstacles to the free movement of goods and services across borders in the Central African region which discourage intra-regional trade, despite the fact that tariffs on goods have fallen since 1994. There is no real regional market for financial services but rather several segmented micro-markets.

Political obstacles and administrative barriers remain, in addition to other challenges related to geography and capacity. A central challenge to realizing the full benefits of a customs union and promoting regional trade and integration is the poor level of transportation infrastructure (primarily road) in the region. This is due in part to the dense forests, insufficient public investment and inadequate maintenance. This is particularly important for Chad and CAR, the two landlocked countries in the region. A second challenge is the relatively primitive level of telecommunications infrastructure. Third, there is a need for improved physical infrastructure at border crossing, and technological capacity, such as computerizing operations at entry points. Along with infrastructure needs to link production areas to markets, operationally and institutionally, the move towards effective integration will have to be supported by other measures such as support for human resources/manpower across the region. Moreover, the fully operational functioning of an internal market may require assistance to certain industries to become more competitive by investing in newer production technologies, specializing in activities where they have a competitive advantage, re-training of human resources and/or forming strategic alliances.

The uneven development of CEMAC countries is particularly clear for the DRC where the high rate of inflation and the damage caused by domestic conflicts strongly reduces competitiveness.⁵ For the purpose of the EPA negotiations, the DRC is included in the Central African Group although it is not a member of CEMAC, but of the Common Market of Eastern and Southern Africa (COMESA). This suggests that the DRC will have to make a choice at some point between the advantages of being associated with CEMAC *versus* COMESA. STP is not a member of CEMAC, but it has close economic ties with the CEMAC countries, and is not a member of any other regional organisation.

⁵ Data challenges also exist as several international statistical data series (IMF for example) are incomplete.

1.2 *Characteristics of the Financial Services Sector in the Central African Region*

The banking sector and financial markets in the Central African region are dominated by foreign banks. (Table 1) The most significant of these are subsidiaries of large French and US banks which have traditionally been active in the coastal countries open to foreign commercial exchange (such as Cameroon and Gabon). Following the economic crisis of the 1980s, these foreign banks contributed to a relatively stable banking system by conforming to COBAC requirements. There are a few small or medium-sized African banks (from other regions) operating in the Central African region. Banks in Cameroon have begun to expand into other countries in the region, including Gabon, Congo, Chad and Equatorial Guinea.

Cameroon, with ten banks, is home to the largest number of banks in the region. Chad has seven banks and Gabon has six. Both Congo and Equatorial Guinea have four banks, and CAR has three. (Table 1) Of the largest 20 banks in the ‘CFA Franc area’, five are based in Cameroon and three are based in Gabon.

The number of regional savings banks is still very low. In Cameroon, the *Caisse d'épargne* is closed because it is in default of payment. The postal network and services are uneven among the countries of the region. In Gabon, the postal network is an important tool for the banking sector and (in conjunction with Western Union) is used for the transfer of funds. In Cameroon, the postal service is very weak.

Table 1: National banking and financial systems in CEMAC countries⁶

		Cameroon	Congo	Gabon	Eq. Guinea	CAR	Chad
Super-vising authorities	BEAC	+	+	+	+	+	+ aide exception 2004
	COBAC	+	+	+	+	+	+
Rate of banking coverage CEMAC = 3.5%		1 facility per 120,000 hab.	1 facility per 120,000 hab.	15%	Improving banking coverage	1 facility per 630,000 hab.	Very weak banking coverage
Public financial sector		Well developed	1 bank	Actively developing		Savings Bank	
Postal service		Real estate credit		Investment Banks: Gabonese		Coopérative Crédit	
Savings bank		Guarantee Funds					
Others							

⁶ Data were unavailable for STP and DRC.

	Cameroon	Congo	Gabon	Eq. Guinea	CAR	Chad
	Credit to SMEs SRC = recovery of credits		Development Bank		mutuel Coopératif gather 90% of microfinance	
Total no. of banks	10	4	6	4	3	7
Deposit banks		3	5			
Development banks			1			
Including foreign banks	5 including the 3 largest	3	4	3	3	2
Credits	2/3 of the credits for the 3 big foreign banks	Current transactions	-	75% current transactions (growing)	Credits larger than deposits in 2004	
Deposits	Concentration in the 3 largest banks			Over-liquidity		
Insurance including life insurance	Weak					

Only three banks in the Central African region provide medium and long-term credit: the Gabonese Development Bank (*Banque de développement du Gabon*), the National Investment Company (Gabon and Cameroon) and SOCOFIN (Congo).

The financial risks in CEMAC countries are lower than those in other African countries.⁷ This is due, in part, to the very low level of convertibility and devaluation risk, favourable budget and balance of payment equilibriums, and the relative strength of the banking system. CAR is the only country (for which data were available) where the average financial risk is considered high, especially in terms of public debt default risk – the government is heavily indebted to the private sector at interest rates of around 10%.⁸ In 2003, Cameroon and Equatorial Guinea were considered

⁷ Financial risk in the CEMAC area can be estimated using four indicators:

- *Sovereign default risk on the public debt* that includes the weight of the public debt (% of GDP), the ratio of the public debt compared to exports of goods and services, the structure and sustainability of public debt reimbursement over the next two years, the state of public debt rescheduling as based on the Club of Paris framework and the Heavily Indebted Poor Countries (HIPC) Initiative.
- *Equilibrium of the budget and balance of payments* include balance of current transactions (% of GDP), government expenditures (% GDP), the domestic savings deficit (% of GDP) and currency reserves compared to monthly imports.
- *Currency inconvertibility and devaluation risks* include membership in a constraining currency area, the frequency and intensity of currency devaluations, the real effective exchange rate (REER) since 1992; a comparative evolution of the REER and government expenditures (% of GDP).

⁸ Local consultation.

the countries with the lowest levels of risk. (Table 2) Since 2003, however, anecdotal evidence suggests Equatorial Guinea has become a higher risk due to the boom in the petroleum sector.

Table 2: Rating of financial risk in CEMAC, 2003

Country	Public debt default risk	Public budget and payments equilibriums	Convertibility and devaluation risks	'Health' of the banking system	Financial risk rating
Weight	30%	30%	20%	20%	
Cameroon	2.9	3.4	5.6	3.8	4 (moderately high risk)
Congo	2.8	2.8	5.2	3.2	3 (high risk)
Gabon	3.0	3.1	5.2	3.5	3 (high risk)
Equatorial Guinea	3.8	4.7	5.9	3.9	5 (moderate risk)
CAR	1.9	2.6	5.5	2.5	2 (very high risk)
Chad	2.7	2.4	5.6	3.4	3 (high risk)
CEMAC (average)	2.9	3.2	5.5	3.4	3.6 moderately high risk.
Africa (average)	3.0	2.8	4.1	3.0	3.2

Source: Credit Risk.

In some areas of Central Africa, a new micro-financing sector is developing, in response to difficulties associated with accessing credit through traditional banking channels. A distinction exists between the traditional practices (the 'tontines' in Cameroon) and the micro-finance initiatives that were first developed by non-governmental organisations (NGOs) and are now being developed by some international finance agencies.

The difference between the numerous microfinance organizations in Cameroon (where there are over 650) and that fact that there are very few in Gabon can be explained by traditional practices and habits. The legal environment of microfinance is adapted to the diversity of the legal status of the microfinance. However, there is a need for further supervision of the microfinance institutions. Links with the traditional (formal) banking sector are weak and the regrouping of micro units is not sufficient to allow for meaningful regulation and oversight or the development of strong links with the banking sector. However, the BEAC is developing a strategy for the control of the informal finance sector.⁹

In the insurance sector, according to available data, the oil and gas companies have their

⁹ This will be refined with cases studies during the local consultation. It seems to be inspired by existing example of already developed relations between informal finance and commercial banks, in particular in Cameroon. Managers of microfinance institutions rely on the services of a cooperative bank, such as the Union Bank of Cameroon that specializes in this type of financing and centralize the deposits. Therefore, BEAC considers having under its control the activities of the main informal financing organizations in the region.

activities insured by local companies that are foreign owned. Therefore, there is an asymmetry between the oil and gas activity of the insurance companies and their other services, which is evident from the very low levels of insurance brokers.

There are 24 insurance companies in the CEMAC area and this number is growing. Risk insurance (mostly for cars) is unevenly developed. Although it is a legal requirement, it is estimated that only 50% of the cars are insured in Cameroon. Effective enforcement of existing laws would contribute towards the development of the insurance sector and through this, the entire financial services sector. The development potential of this sector is therefore important. Life insurance remains very under-developed, even in Cameroon or Gabon. Since 2002, insurance companies have the obligation to separate these activities from IARD (fire, accident and miscellaneous risk) activities. These risks are therefore managed by specific companies with a minimum capital of 500 millions XAF (EUR 762 000).

2. Consultation

Consultation is used to disseminate information and raise awareness of the EPA and SIA and to obtain substantive input from individuals or groups which might be directly or indirectly affected. There has been extensive consultation in the development of this SIA. Results of the initial or first phase of consultations (January-May 2006), which took place in Paris and in CAR, were reported in the Mid-Term Report. The second phase of consultation (May-July 2006) included a mission to Cameroon: the most economically developed country in the Central African region and home to the headquarters of several major banking and financial institutions.

Consultations were held in Yaoundé with representatives of BEAC, COBAC and local and foreign-owned banks and insurance companies. Other meetings included local representatives from the EU and major national and international donors. Annex 1 contains the names of individuals whose input was sought during the first and second phases of consultation. The following sub-sections describe the issues discussed or raised during this process.

3.1 The banking sector

BEAC plays a key role in the monetary union. It established a regional monetary policy to curb inflation and preserve the value of the CFA Franc. BEAC's monetary policy is distinct from the

fiscal policies of its individual member countries, although they are guided by measures that prevent them from using monetary policy to finance budget deficits. The Governor of the BEAC sets index rates and reserve ratios. But BEAC has a limited refinancing role. Interest rates and reserve ratios have decreased because many banks are overly liquid yet reluctant to provide medium-term financing to SMEs. The general lack of confidence and weak institutional context discourages investment. Over-liquidity could become a problem if BEAC has to pay a yield on it. To avoid paying excessive amounts of return and taking into account the low absorption capacity of Central Africa, BEAC allows the revenue of multinational companies to be invested offshore. If financial markets were more efficient, countries could compensate for this loss in revenues to their respective national treasuries by issuing public debt (bonds). BEAC supports the creation of a harmonized banking and financial law under the OHADA framework.

In the 1990s, COBAC played a key role in the stabilization of CEMAC banking sector. It helps to regulate the banking system by promoting a common accounting and reporting system and harmonizing other rules. The number of bad debts declined sharply after the crisis in the 1980s. Those that remain are limited to CAR banks. The provision rate for bad debts is now close to 80%. This regulatory system has become a regional model. The DRC has contacted COBAC with regard to its accounting and reporting system but, at present, has no plans to harmonize it.

Since 1996, COBAC has also been responsible for the regulation of the microfinance sector. Risk management procedures have been established and a common accounting system is being developed. However, no interest rate policies have been set and the applicable rules are more flexible than they are in the WAEMU zone. Most existing rules were negotiated between 1996 and 2002. They govern all microfinance institutions (whatever their legal status) which publicly and regularly collect deposits and offer credit services. By eliminating those organisations with structural or financial problems, COBAC has reduced the number of microfinance institutions operating in CEMAC from 1,000 to 600.

Overall, the CEMAC banking sector is profitable and highly liquid because of increases in short-term deposits and oil revenues. The return on investment is estimated at 15% to 20%. Banks make most of their margins on intermediation and fund-transfer services. The annual management cost of an account is equivalent to the official monthly minimum wage of €50 and credit activity is generally weak. In addition, most banking activity is generated by a small number of players operating in micro-markets. Intermediation costs remain very high.

The 1980s crisis which led to a CFA France 600 billion (EUR 915 million) liability has been resolved but banking behaviour remains risk averse and the market for banking services is very narrow. In Cameroon, around 10% of the population enjoys banking coverage. Regionally, coverage is only 4%. Electronic banking systems are developing but are still marginal and most transactions are conducted with cash (which prevents the tracing of funds). Most banking activities concern short-term credit linked to short-term deposits. The high volatility of current account deposits and poor guarantees also helps to explain the cautious behaviour of banks. Most medium and long-term productive investments are financed through parent companies outside of the banking sector. The BDEAC is the only development bank in the region. In Cameroon, only one bank (assisted by the Dutch government) offers capital risk and leasing activities and is attempting to establish subsidiaries in France and China.

SMEs were badly affected by the crisis in the 1980s because of their low levels of liquidity. With the exception of working capital, they are not financed by the banking sector. French banks still dominate the region, but there is growing competition from local banks based in Cameroon and Gabon and foreign banks from the US and Morocco. Some local banks have successfully established branches in the CEMAC region but only one local bank has an office in France. There are regulatory barriers preventing local banks from establishing operations in the EU, particularly with regard to governance and transparency.

The microfinance sector plays a critical social and economic role. The sector is characterized by high debt recovery in rural and peri-urban areas. However, recovery rates decline sharply in urban areas, particularly in Douala and Yaoundé. MFIs generally charge a minimum monthly interest rate of 5% to ensure their financial sustainability. In the CEMAC region, the number of people affected by microfinance represents half of all bank customers (500,000 MFIs clients for one million bank accounts). Nonetheless, the volume of deposits and credits in the microfinance sector amounts to only 5% of the value of banking activities. The development of the microfinance sector occurs on an *ad hoc* basis. MFIs are increasingly being integrated into the banking sector through reciprocal investments. Several commercial banks have invested in a network of MFIs. These networks are informal systems (such as the *tontines*) but apply very high rates (generally more than 60% per year). They play a strategic economic role and are used principally to finance daily consumption and social activities (such as weddings).

The development of microfinance in Central Africa implies the need for financial and technical assistance, particularly from the EU. There are already some assistance mechanisms from donors. In Cameroon, the French Development Agency (AFD) granted a US\$1.5 million loan to a network of MFIs (ACEP) to finance small enterprises in urban areas. For donors, it is difficult to respect national rules and to help the numerous micro-projects emerging from civil society. National rules for both large banks and microfinancing organisations are difficult to apply because they do not take day-to-day economic realities into account.

Financial transfers are free in theory within the CEMAC and the CFA Franc areas. However, transfers between CEMAC countries and the EU are hindered by many barriers. Administrative authorization is required for any transfer exceeding FCFA 100 million. In Cameroon, foreign companies have to choose between one of two options when paying tax on revenues: they can pay a 38.5% tax or they can transfer the profits to a foreign country by paying the *taxe sur les revenus transférés* (TSR). This 15% tax (7.5% for French companies under the France-Cameroon Tax Convention) is legally based on profits but, for practical reasons, calculated on turnover. A company is also subject to a 19.25% VAT. Some companies face double taxation. As a result, capital transfers from local capital banks are often directed toward Asian stock exchanges in order to bypass transparency requirements enforced by stock exchanges in the EU. Private financial transfers from households in the EU to the Central African region are low because of the limited number of regional migrants.

3.2 *The insurance sector*

The CIMA plays an important regulatory role in the insurance sector in 15 French-speaking African countries. It lends some stability to the sector even though there are still many small insolvent companies. Vulnerability in the sector is linked to the low capital requirements needed to open an insurance company (only XAF 500 million/EUR 762 000) and to the current pricing of premiums based on legal minimums. The majority of customers are local firms, affluent individuals, civil servants and subsidiaries of foreign companies which offer global insurance and re-insurance services. The market for insurance products is limited because of poor economic conditions and prospects, the lack of an insurance culture and civic spirit, and low rates of life expectancy (which affect life insurance opportunities). The lack of legal rules (compulsory insurance concerns only fire

and building activities) and the weak enforcement of existing rules (only 50% of the cars are insured) also limit market opportunities.

The growth of the regional market for insurance is estimated at 4% to 5% per year. The sector could boost regional financial markets through investments in bonds and equities but insurance companies are hampered by organisation and start-up problems. Opportunities for growth exist through securing debt and the development of an equity market fed by privatization and an increase in capital availability. Improved organisation is a priority for the two regional stock exchanges in Doula and Libreville. Most of their activity is not linked to national territories and the merging of these two stock exchanges should be contemplated over the longer term.

The regional monetary market is working well in CEMAC, both for BEAC tenders and the inter-banking market. The market has grown strongly from FCFA 12.9 billion in April 2005 to FCFA 27.7 billion in April 2006. The BEAC sets the prime interest rate (interest rate on tenders are 5.25%). The maximum debit rate is 15% and the minimum credit rate is 4.25%.

3.3 *The legal context*

The OHADA establishes a common business law that is sound and generally enforced within member states. A possible extension to other countries, such as DRC, may occur in the long-term in the context of the possible integration of the OHADA into the institutional system of the African Union. The building of an appropriate legal framework for cooperative bodies is underway. Legally, OHADA law prevails over national laws and, as a result, there are few jurisdictional conflicts between the Justice and Arbitrage Common Court in Abidjan and national jurisdictions. The BCEAO, however, is reluctant to establish a common law for banking and finance. Practices sometimes differ from reality because of the largely informal and extra-judicial characteristics of many economic activities. Low wages are considered a cause for many of the governance and accountability problems which affect the judiciary.

3.4 *The productive sector*

The financial sector reflects the weak development of the productive sector. It is not competitive. The financial services market is narrow and compartmentalized, and GDP in the region is under XAF 20 billion (EUR 30 million). Company margins are high but this reflects the high risks they take and the costs they have to incur.

Apart from the mining and oil industries, growth expectations are weak. Multinational subsidiaries have minimal relations with the banking sector in Central Africa and often have offshore accounts for their global activities (such as financial accounting and supply chain). In addition, national financial systems are slow to react to new opportunities because of administrative delays and red tape. Even in Cameroon, where the market is the most organized, opportunities are limited.

Industries are not competitive and costs are high. Given low productivity, wages are also high. Only 50 formal companies currently operate in Chad. But new actors are entering the region from Morocco (airline industry) and South Africa and China (mobile phones). However, overall investment is very small. Informal operators have no incentive to register and benefit from banking services because of the associated administrative, legal and financial costs.

There is debate about whether banks are overly cautious in providing medium-term financing to SMEs or whether economic, legal and institutional conditions make these investments too risky. According to several operators, it would be possible to increase the mandatory reserves of banks at the BEAC and to pay more fixed-term deposits. For the banks, SME financing implies specific mechanisms backed by public funds (guarantee or regional funds) and the creation of mutual guarantee companies. The stabilization of the economic and institutional environment is necessary to enhance the transformation of short-term deposits into medium-term lending. In addition, the payment of yields on fixed term deposits may lead to the excessive cost of credit for SMEs.

3.5 Financial support from donor organisations

Debt cancellation under the framework of the Heavily Indebted Poor Countries (HIPC) Initiative has had positive economic and financial effects on Central African countries. Cameroon reached the decision point on 17 June 2006 and was able to cancel EUR 2.7 billion or 99% of its public debt. In addition, a Development and Debt Reduction Contract (C2D) has been signed with France to finance development projects in education, health and infrastructure. Chad and Congo are also eligible for this initiative. The reduction of public debt will stimulate the economy and boost to financial markets (despite the considerable heterogeneity between Central African countries with respect to the enforcement of the regional rules).

Donor organizations have several financial tools at their disposal: debt cancellation financing, low-interest loans, investments in local companies and banks, support to MFI networks or

capital risk. Their accountability criteria must respect the rules of their country of origin. These rules are very difficult to enforce in Central Africa. For instance, EU rules for tenders are extremely strict. In addition, regulation in the EU is very strict with respect to African banks because some of their operations lack transparency governance and others have a reputation for money laundering. It is very difficult for European banks to support Central African operators and, thus, very difficult for the latter to enter EU markets.

3. Trade measures

The most likely scenario for an EPA is that it will have the following features:

- 100% liberalisation (elimination of duties and quotas) for access to the EU of Central African goods and 80% liberalisation for access to Central Africa of European goods; this asymmetry is compatible with article 24 of the GATT (which seeks a substantial liberalisation of trade or around 90%);
- a 12-year liberalisation agenda to be implemented between 2008 and 2020.

With regard to their relationship with the EU, however, EPA impacts will differ with the choice of member states between the EBA Initiative (possibly for such LDCs as Equatorial Guinea, CAR, STP and Chad) or an improved GSP regime (possibly for such non-LDCs as Cameroon, Congo and Gabon). All Central African countries appear to favour an EPA.

4.1 *Financial services*

The efficiency and productivity of service industries are important for the overall competitiveness of economies and their ability to raise living standards on a sustained basis. In particular, the availability, cost and quality of modern intermediate services, such as financial services, can affect the competitiveness of products in all sectors in both domestic and foreign markets. The “Financial Services Sector” is defined by the General Agreement on Trade in Services (GATS) to encompass “insurance (and insurance-related) services” and “banking and other financial services”.¹⁰ Despite the fact that financial services tend to be market-seeking, and may not contribute to foreign exchange earnings, their full economic value should include the welfare effects of better service provision for consumers and spill-over effects on other economic activities. This broader consideration, including the indirect impacts of financial services on export competitiveness, regional integration and diversification, is an important component in the overall consideration of the potential economic, social and environmental impacts of both the baseline situation and an EPA in this sector.

¹⁰ Insurance and insurance-related services cover life and non-life insurance, reinsurance, insurance intermediation such as brokerage and agency services, and services auxiliary to insurance such as consultancy and actuarial services. Banking includes all the traditional services provided by banks such as acceptance of deposits, lending of all types, and payment and money transmission services. (These services are presumed to be on offer to both the formal and informal sectors). Other financial services include trading in foreign exchange, derivatives and all kinds of securities, securities underwriting, money broking, asset management, settlement and clearing services, provision and transfer of financial information, and advisory and other auxiliary financial services.

The four “modes of services trade” defined by the General Agreement on Trade in Services (GATS) are: Mode 1: The cross border supply of services (mode 1); consumption abroad (mode 2); commercial presence (mode 3); and, the presence of natural persons (mode 4). The two most important modes for financial services trade between Central African countries and the EU are modes 1 and 3.

Mode 1 includes the delivery of financial services by EU companies in the Central African region, or by a Central African company to the EU. This consists primarily of the transfer of funds, which is an important activity, although current levels of transfers are difficult to estimate.¹¹ As for the EU, an ‘approval’ (granted by the COBAC) is required to transfer funds (whereas such an approval is not necessary in most of the other EU countries, notably for funds being transferred from the EU to the CEMAC region. For funds transferred within the CEMAC region, or from Central Africa to the EU, the cross-border transfer of funds is reserved to the banks. In practice, these transfers are dominated, at present, by Western Union, but it is required to have a designated outlet in the main commercial banks, and not an independent office.

Mode 3 – commercial presence – involves serving foreign markets by setting up local operations (such as banks or insurance companies) through foreign direct investment (FDI) or by using non-equity arrangements (such as licensing). The financial services industry has traditionally accounted for the largest share of services FDI in all regions of the globe. (UNCTAD 2004) This type of FDI has the potential to enhance directly and indirectly the efficiency, productivity and supply capacity of host-country industries, thereby benefiting the economy as a whole.

In the Central African region, financial services are not as important as other services at present. It is difficult obtaining disaggregated data on services trade, and in particular, specific levels of services trade that currently exists between the EU and the Central African countries. Data collected by the IMF is incomplete and available at a relatively high level of aggregation. Nevertheless, the data presented in Tables 3 and 4 provide a global picture of the relative weight of the importance of financial services for both the imports and exports of Central African countries.

In terms of imports, in 1990, financial services account for less than 10% of the imports of commercial services by the countries of the region, where data is available. By 2004, for the two countries where data is available, there had been a significant gain by the Congo (from 1.6% to 8.1% of total imports of commercial services), and a marginal gain in Gabon. Nevertheless, for all the countries in the region transportation services is the most significant import although a shift towards

¹¹ In this sub-sector, the CEMAC regulation similar to regulation in France, but differs from that in the EU.

financial services between 1990 and 2004 in Congo appear to have occurred, at least in part at the expense of transport services, whose share declined in that period.

Table 3: Structure of Central African service imports

	Commercial service imports		Transport		Travel		Insurance and Financial Services		Computer, information, communication and other commercial services	
	\$ million		% of commercial services		% of commercial services		% of commercial services		% of commercial services	
	1990	2004	1990	2004	1990	2004	1990	2004	1990	2004
Cameroon	1,018	..	45.3	..	27.5	..	7.2	..	20.1	..
CAR	166	..	49.7	..	30.6	..	8.9	..	20.1	..
Chad	223	..	45.1	..	31.2	..	4.4	..	19.2	..
Congo	748	537	18.4	12.6	15.2	9.8	1.6	8.1	64.9	69.6
DRC	..	..	..	..	..	..	..	..	..	..
Eq. Guinea	..	..	..	..	..	..	..	..	..	..
Gabon	984	821	23.2	32.3	13.9	23.6	5.3	5.7	57.6	38.4
STP	..	..	..	..	..	..	..	..	..	..

Source: World Bank, World Development Indicators 2006. Notes: (..) indicates no data available; "Computer, information, communication and other commercial services" includes telecommunication services.

In terms of exports, in 1999 Cameroon exported the largest amount of commercial services in 1990, followed by Gabon. Service exports from the region were dominated by transportation services in all countries except for Chad and Gabon, where information and other services were dominant. The export of financial services was marginal for all countries in the region with the exception of CAR where it made up a significant proportion of exports, but where exports of commercial services in general are extremely low. By 2004 the proportion of exports of financial services had grown substantially for Gabon at the expense of transport services, although the overall value of exports of commercial services had declined substantially.

Table 4: Structure of Central African service exports

	Commercial service imports		Transport		Travel		Insurance and Financial Services		Computer, information, communication and other commercial services	
	\$ million		% of commercial services		% of commercial services		% of commercial services		% of commercial services	
	1990	2004	1990	2004	1990	2004	1990	2004	1990	2004
Cameroon	369	..	42.6	..	14.4	..	9.4	..	33.6	..
CAR	17	..	50.9	..	16.0	..	18.8	..	14.3	..
Chad	23	..	18.4	..	34.1	..	0.2	..	47.3	..
Congo	65	79	53.9	3.6	12.9	25.1	..	0.7	33.2	70.6
DRC	..	..	..	..	..	..	..	..	..	..
Eq. Guinea	..	..	..	..	..	..	..	..	..	..
Gabon	214	167	33.4	50.7	1.4	8.7	5.8	30.8	59.4	9.8
STP	..	..	..	..	..	..	..	..	..	..

Source: World Bank, World Development Indicators 2006. Notes: (..) indicates no data available. "Computer, information, communication and other commercial services" includes telecommunication services.

4.2 *Foreign direct investment*

FDI is a second trade measure that is being considered under the EU-Central African EPA negotiations and that is relevant for financial services, beyond its direct relevance for mode 3 delivery of banking and insurance services. Indirectly, the increased commercial presence of EU financial services providers could have spill-over impacts on other economic sectors, and may encourage investment in additional areas related either to goods or services.

Trade measures and particularly financial services are closely linked to investment flows. On one hand, trade measures which objectives are to attract and regulate FDI have important effects on trade flows as most of the trade is made by international firms. On the other hand, trade measures such as trade facilitation may have an impact on FDI flows. There is therefore a need to clarify between FDI (long-term, sustainable interest for investor) and portfolio investment (with different form of control of capital and motivations from shareholders) but this distinction is ignored by most of the CEMAC members States and the CEMAC Investment Charter.¹²

National authorities in Central African countries have sought to attract FDI by providing companies with incentives such as favourable tax treatment. However, fiscal incentives included in the investment codes have not played an important role.¹³ In general, low levels of economic development in the region are a constraint to FDI outside of the primary resource sectors. There is very little FDI linked to market-seeking strategies and even less directed towards cost-cutting through outsourcing. The main factors explaining the weak ability of the CEMAC region to attract FDI include the following: potential political unrest; a weak business environment; lack of physical infrastructure; weak capacity of human capital; high financial intermediation costs; weakness of the industrial fabric; weak management of opportunities and mitigation of external shocks; and, high levels of risk.¹⁴

There are also constraints related to the high level of taxes, administrative delays for setting up private companies, high costs of imports (transportation costs), technical barriers such as intellectual/industrial property issues; poor marketing strategies to highlight opportunities; and, related to financial services directly, a lack of adequate financing for investment. Moreover, there are ‘bottlenecks’ in terms of capacity and governance that constrain the integration process and the full application of regional decisions at the national level.

¹² Dec 1999, règlement N° 17/99/CEMAC-020-CM-03

¹³ OECD 2000.

¹⁴ Michalet 2005.

4.3 *Other services*

Additional related trade measures that are relevant are other services areas that may be included in an EPA. A lack of investment in services generally both by national governments and through FDI contributes to the poor business climate in the Central African region, above and beyond any impact of financial services. Therefore, the extent to which related services sectors are treated in an EPA will impact on the ability of countries in the region to increase investment to promote diversification and development through, *inter alia*, the delivery of financial services. The development of strong, legally-binding commitments in related services could stimulate overall investment and provide investors with a business climate in which the basic support services for production and international trade, such as transportation and communications (in addition to financial services), would be available at competitive prices. FDI in intermediate services such as transport and telecommunications services can work in synergy with the availability of financial services to directly and indirectly help producers become more efficient and encourage the development of financial services.

The CEMAC recently published a region Strategy for Development of the ICT sector (e-CEMAC 2010) that includes development of the telecommunication infrastructures, drafting of a national ICT Strategy in each CEMAC countries, development of e-governance both at the regional and national levels, capacity building actions plan for both public servants, private sector managers and non-governmental organisations (NGOs), and a programme of support to the ICT sector at the regional level by the creation of a regional network of ICT professionals.¹⁵ The main problem faced by the CEMAC countries is the poor and uneven development of the infrastructure. While the coastal countries may benefit from the access to the fibre-optic cable SAT3, access remains the main factor impeding the development of the ICT sector in the land-lock countries like Chad and CAR. Costs remain high and the Central African countries do not benefit from some competitive advantages in terms of workforce quality, geographic locale, and technical capacity that allow the development of these services. They are not competitive compared to emerging countries, such as Morocco and India.

¹⁵ CEMAC, *e.CEMAC 2010 – Etude pour la définition d'un Programme Régional de développement des Technologies de l'Information et de la Communication*, Octobre.

4. Sustainability issues

This section presents relevant issues to consider in assessing economic, social and environmental sustainability in the baseline and the EPA scenarios. (Table 5) They are limited in total number, but in aggregate provide overall coverage of key sustainability issues balanced between economic development, environmental protection and social development. Under each pillar, themes are identified which, together, capture the essence of sustainable development. Within these broader themes variables are identified to provide information about a phenomenon or underlying situation. These variables are meant to approximate the impacts on sustainability and the change, under an EPA scenario, for sustainable development. Whether these indicators can be accurately measured to quantify elements of performance in specific sectors depends on data availability. Even where there are well documented measurements of variables at the country level, they do not exist at the sector level. Therefore, evidence presented in the literature will be used, accompanied by qualitative analysis.

Table 5: Major sustainability themes and variables

Theme	Variable(s)	Relevance	Source
Economic			
Trade	Levels of imports and exports of services		World Bank, World Development Indicators National statistics offices EU
Economic Performance	Contribution to GDP Overall value added of services	The services sector accounts for over two thirds of gross domestic product (GDP) and employment in the EU, which is the world's major exporter and importer of services and a major investor around the world. Moreover, the EU is home to some of the world's leading financial services companies, with a particular dominance in TNCs related to the Insurance Sector. In sub-Saharan Africa services are considered as a significant and growing sector but Central Africa, with less than one-third of GDP derived from services, is lagging behind the continent and other ACP regions.	National statistics offices Literature World Development Indicators
Investment	Inflows and outflows of FDI	Inflows and outflows of foreign direct investment (FDI) in the Central African region	World Development Indicators UNCTAD World Investment Report Regional Authorities (for CEMAC countries) National Authorities
Security of financial operations	Political risk Number of local / regional armed conflicts. Effectiveness of financial supervision	Armed conflict can affect countries' fiscal accounts by disrupting economic activity, lowering the efficiency to tax administration, and affecting the composition of public spending in a manner that reduces growth. The security of financial operations can also be impeded by the levels of supervision in the financial sector, the efficacy of the risk assessment framework and levels of money laundering.	Credit Risk Regional organisations Consultation COBAC CIMA COSUMAF

Theme	Variable(s)	Relevance	Source
Access to Finance	Rate of banking coverage Access to banking services in rural areas Total number of banks	The access to finance is a crucial factor for the economic development of Central African countries. This is especially important outside the main capital cities where adapted solutions need to be developed (micro-finance).	Regional organisations International Monetary Fund Consultation
Governance	Level of corruption Transparency	Shortcomings in the business environment are amongst the main drawbacks impeding inward FDI and economic development.	Transparency International Index
Social			
Access to credit	Access to banking services in rural areas and for disadvantaged populations	Access to adapted financial solutions is necessary to allow economic development move from a subsistence economy to economic development in remote areas and for disadvantaged populations	Regional institutions IMF Consultation
Equity ownership	Standards of corporate social responsibility	Effective implementation of standards and codes of corporate social responsibility is a key factor to ensure the projects financed will have positive social impacts.	Consultation Literature
Gender	% of women running a business (on total business)	Central Africa countries show some important inequalities between male and female both in terms of education, women presenting much higher rate – generally two times – than male.	
Urbanisation	% of population living in urban areas	In Central African countries, nearly half of the people are living in urban centres with huge concentration in petroleum-producers countries (Gabon, Congo) where economic activity and people concentrate along the coastal zone ports ; this <i>urban concentration</i> will increase in the next 10 years (nearly 60 % of population in each country). This urban exodus will induce severe problems of sanitation, housing, water supply, degradation of the coastal environment and certainly an increase in urban violence. Chad remains an exception, with very a majority of people living in rural area : only one third will be in urban centre in 2015.	World Bank, World Development Indicators Literature
Poverty	Wages/income HDI	The countries in the Central African Region are among the poorest in the world, ranking near or at the bottom of the United Nations Development Programme's (UNDP) Human Development Index (HDI).	UNDP HDI Literature Consultation
Training / Education	Levels of training Transfer of "soft technology" and skills Use of expatriates vs. local managers	The delivery of financial services can transfer "soft technology" including organisational, managerial, information processing and other skills and knowledge. These state-of-the art soft technologies, where properly transferred and deployed can transform the provision of services in the relevant activities and raise skill levels in Central African countries. TNCs in the banking and insurance industries tend to provide training to their employees at various levels. The use of expatriate managers or professional may be regarded as holding back local skills development.	Consultation Literature
Environmental			
Environment assessment/ screening of projects	Existence of Codes of Practice/criteria	There may be indirect impacts associated with the sectors that are impacted most by liberalisation of financial services. Because much of the financial services are presently directed towards the petroleum sector, specific environmental issues associated with that sector are relevant in this SIA.	Consultation Literature

Theme	Variable(s)	Relevance	Source
Access to finance for environmental ly beneficial technologies	Specific financial solutions	These include financial projects developed in the forestry sector under the Kyoto Protocol’s Clean Development Mechanism (CDM).	Consultation Literature
Pricing of the social and environmental risks in the cost of credit	Weight of these variables in the pricing of credit	The Central African region is vulnerable to natural disasters such as rising sea levels caused by climate change and pollution associated with the oil and gas industry.	Consultation Literature

5. Summary findings of the baseline scenario

The baseline scenario, which was developed and presented in the Mid-Term Report, assessed the current state of regional integration in Central Africa and the impacts of the existing state of liberalisation in the financial services sector on economic, environmental and social sustainability. The findings of the baseline analysis are presented in Table 6.

Table 6: Summary of findings from the baseline analysis

Impacts on Trade	Economic Impacts	Social Impacts	Environmental Impacts
<ul style="list-style-type: none"> • Very low levels of trade in services and particularly financial services. • Central African countries are relatively open in practice but no formal commitments under GATS (except for Gabon). • Relatively high levels of investment towards oil and gas sector in specific countries employing “closed loop” financing. 	<ul style="list-style-type: none"> • Low level of contribution of services to GDP in general in the region. • Relatively high cost of credit. • Opportunities for development are limited by small market, high levels of perceived risk, preponderance of short term financing and aggravated by lack of supporting services. • Potential positive impacts of the development of stock exchanges (for investment of the bank liquidity and the States financing) provided institutional problems are solved. 	<ul style="list-style-type: none"> • Low access to traditional banking for rural populations. • Relatively high cost of financial services to consumers. • Low access to credit for much of the population limits opportunities for diversification and development. • Large potential for micro-financing sector which would be positive for SMEs, rural populations and women. • Strong potential for training and education as a result of further development in this sector. 	<ul style="list-style-type: none"> • Economic development in the region is riven by the exploitation of natural resources (hydrocarbons, minerals, woods) that seriously damage the environment. • Standards for Sustainable Financing are developed at the international level but their implementation may distort competition between foreign banks applying them and regional banks that do not and lead to an ‘anti-selection’ effect.

6.EPA scenario analysis

The EPA scenario assesses the sustainability impacts of further liberalisation in the sector (and with related trade measures and development issues) based on the negotiations between the EU and the Central African countries. Article 41.2 of the Cotonou Agreement reaffirms the parties' "respective commitments under the GATS" and underlines "the need for special and differential treatment to ACP suppliers of service". This extends to the commitment for "progressively higher levels of liberalisation of trade in services through successive rounds of negotiation". Liberalisation of services means that a country allows foreign services and their providers to enter its national market and eliminates measures that discriminate between foreign and national services providers (national treatment). An EPA could extend the EU-ACP partnership to reciprocal liberalisation of services consistent with GATS, including asymmetric treatment and a transition period. An EPA could also include intra-regional provisions aimed at fostering the integration of the Central African regional market for services. The European Commission will support countries' efforts to strengthen their services sectors and the regional integration process.

Economic literature indicates that there is a link between long-term economic growth and the development of the financial sector. It has positive effects through three main channels: providing information, reducing the liquidity constraint and diversifying risk. There are several criteria to assess the impacts of EPA, including:

- welfare evolution regarding trade creation and diversion flows;
- institutional stability, credibility and the foreseeable nature of the medium and long-term trade policy;
- development of competitive advantages and diversification of the economy with regard to attracting investment;
- institutional and administrative reforms and transaction costs linked to trade negotiations;
- regional economic integration effects;
- social and environmental impacts.

6.1 The SWOT analysis

The SWOT analysis is a relatively simple analytical tool which addresses an issue and, in the context of the EPA negotiations on financial services, poses the following questions related to sustainability:

- **Strengths.** What are the strengths of the financial services sector in the Central African region? What does it do well?
- **Weaknesses.** What are the main weaknesses of the financial services sector in the Central African region? Can these weaknesses be offset?
- **Opportunities.** What external and other factors provide opportunities for growth?
- **Threats.** What external and other factors might constrain the exploitation of potential opportunities?

The strengths and weaknesses presented in the SWOT analysis (below) were developed in the Mid-Term Report. It is worth noting that the CEMAC monetary union has a strong positive impact on financial services through increased macroeconomic stability in terms of price, foreign exchange and budgetary deficit limitation. It has negative impacts linked to the effects of a deflationary policy which limits demand and currency adjustment to manage external shocks. A division of responsibilities between BEAC and local governments leads to a division in policy-making. This Report examines the opportunities and strengths associated with the EPA negotiations and makes policy recommendations to offset weaknesses and potential threats.

Strengths	Weaknesses
<ul style="list-style-type: none"> • Strong framework in place to support regional integration • Some regional presence of local banks (such as those from Cameroon) • In practice, economies are open to foreign participation in the financial services sector • Strong growth in the petroleum sector and high level of savings in petroleum-producing countries • Monetary Union for CEMAC member countries, emerging regional stock market • Guarantee and convertibility of the CFA Franc by the French Treasury 	<ul style="list-style-type: none"> • Low levels of overall development and widespread poverty • Low levels of macroeconomic convergence, regulatory harmonisation and intra-regional trade • Poor governance in some countries • Low coverage of the banking sector and weak insurance activities • Low access to credit and little medium or long term credit available • Lack of economic diversification • Poor transportation and communication infrastructures • Difficulty to plan financially because of an unstable environment that hinders investment • Indebtedness and “crowding out” effect • High cost of financial and banking services • Unstable business environment and risk of conflicts • Lack of enforcement of existing regulations • Small size of national and regional markets • Micro-financing not sufficiently linked to the banking sector • ‘Dutch disease’ caused by the reliance on volatile extractive industries • Nationalism versus regionalism

Opportunities	Threats
<ul style="list-style-type: none"> • EPA negotiations include a focus on development and capacity building • Commitments to liberalise trade in services, including financial services and related services that can support the development of the financial services sector and other sectors • EPA negotiations could support efforts to increase economic and export diversification 	<ul style="list-style-type: none"> • High perceived levels of risk / unstable business environment • Lack of supporting physical and technological infrastructure • Lack of human and technical capacity • Lack of regional oversight for microfinancing operations • Lack of screening for sustainability of major projects in the region • Discrepancies between land-locked and coastal countries • DRC and STP are not CEMAC members • Potential for unfavourable trade treatment for vital commodities may inhibit diversification

The results of the SWOT analysis provide an indication of where policy recommendations might be most effective with respect to the liberalisation of financial services under an EPA. Such recommendations aim to promote the long-term development of financial services in the region in a way that supports sustainability.

6.2 General impacts expected from EPAs between the EU and Central Africa

An EU-CEMAC EPA would include institutional impacts, impacts on the productive sector and the regional integration process, and social and environmental impacts.

6.2.1 Institutional impacts

The EPA would provide an institutional “anchor” to ensure the stability of trade policies and improve confidence in the regional organisation in Central Africa. Decision makers would benefit from the long-term agenda of the EPA implementation: the evolution of trade rules between 2008 and 2020 will be clear and known in advance (the contents of the EPA will be decided by the end of 2007). An EPA could also have a positive effect on the institutional capacity of the private sector, notably financial agents. It is thus important to associate the financial actors in CEMAC with the negotiation process on financial services.

An EPA could also have positive institutional effects in terms of governance: first, by encouraging the regional integration process and the transfer of responsibilities from national public agents (exposed to national/community pressures) to regional agents (more independent) and, second, by fostering multilateral surveillance mechanisms.

The framework adopted by Central African countries for the EPA negotiations (CEMAC + DRC and STP) could support stronger institutional linkages between STP and DRC, on the one hand, and Central African organisations (such as CEMAC and OHADA), on the other hand.

6.2.2 Impacts on the productive sector

Companies which export to the regional market or the EU and those that import significant quantities of intermediary goods and equipment will benefit from an EPA. However, companies which produce import substitutes will not benefit. Central African firms are, in general, not competitive.

In order to become competitive in the EU market, companies must upgrade their production in terms of value-added, quality and consistency with international standards. This may be achievable for the agro-industrial and some other industrial sectors. But meeting these goals requires deeper integration at the regional economic level. More specifically, it requires the building of a network of SMEs and sub-contracting companies and the development of a regional supply chain prior to 2020. This, in turn, implies the need to develop a financial system adapted to the risk-taking strategy of investors in the productive sector.

The liberalization and privatisation process offers the opportunity to diversify partners in the EU and elsewhere. Proactive and innovative strategies are required. Enhanced international specialization is possible through the development of:

- territorial competitive advantages (availability and cost of the production factors, agglomeration effects);
- competitive advantages transferred by multinational companies (such as patents, brands, organisation, logistics and standards);
- competitive advantages implemented by national and regional decision makers (rules, institutional, social, environmental and economic policies).

Emerging areas of comparative advantage could be reinforced in the short term by protectionist policies for “infant industries”. They should also be sustained by specific financial supports to encourage the necessary adjustments and upgrading processes. These measures should be temporary and removed once the affected industries achieve an adequate level of development.

6.2.3 Impacts on regional integration

The EPA should reinforce regional integration and support the growth of national markets. But several obstacles remain. The regional integration process is complicated by specific arrangements for managing oil revenues in petroleum-producing countries. They want to preserve their sovereignty in this area and have a preference for international bilateral relationships. Moreover, the level of development in the region is varied. The co-existence of LDCs and middle-income countries could limit rather than deepen regional economic integration.

The region has some advantages with respect to financial services because it has achieved an important degree of regional integration for services and investment. The liberalisation and deepening of financial services results from the ongoing regional integration process in Central Africa. The BEAC, COBAC and CIMA play an important role in setting monetary and exchange rate policies.

The operation account of the CFA Franc zone¹⁶ plays an important role as a regional integration mechanism. It helps reduce the instability brought about by foreign exchange fluctuations. It also guarantees the convertibility of the CFA Franc and encourages regional trade and financial exchanges.

The main obstacles to regional integration in the CEMAC region are the lack of infrastructure, the weakness of intra-zone trade, limited economic complementarities, the asymmetries between coastal and land-locked countries, endemic civil wars and competition for regional leadership among participating countries.

Currency convertibility is a positive factor for the development of trade. A more efficient organisation of financial settlements in the CEMAC area could be achieved by re-establishing a compensation mechanism between the CEMAC area and the DRC. The excess balance of the CEMAC area is structural but the EU may support the compensation process.

More generally, the positive impact of regional financial organisations on the development of financial activity in the region is limited by the weakness of the money market. BEAC allows foreign-owned resident banks to invest their liquidity outside of CEMAC. If these funds were with the BEAC, it would have to pay interest on them. However, it is necessary to encourage banks to

¹⁶ « Foreign assets of member countries of the CFA Franc zone – resulting from their public or private export and import operations as well as from financial transfers of operators – are centralized (for at least 65 % of the amount) in a specific operation account at the French Treasury. Centralisation allows France to underwrite conversions of the CFA Franc. » ... (author's translation)
(<http://www.izf.net/izf/Institutions/Institutions/Zone/MecanismeMonetaire.htm>)

invest in the region. In all developed economies, public bonds (issued for short, medium and long-terms) provide opportunities for banks seeking to invest liquidity without risk. Public bonds are also an instrument for private banks to manage their liquidity and for central banks to control it through open market policies.

In active financial markets, the interest rates on public bonds help to establish interest rates for other financial instruments. In Central Africa, the absence of an active money market is a major obstacle to the sound functioning of the Douala and Libreville stock exchanges. Bank portfolios which include public bonds are crucial to the development of these markets. The management of the banking portfolios (with their set deadlines) facilitate transactions that influence daily stock exchange activities. The money market is the basic component of an active financial market.

Consultation shows that BEAC management is in favour of issuing public bonds. The EPA would provide a favourable environment for this. BEAC considers that local banks would readily subscribe to public bonds, as was the case for the first 'public borrowing' issued on the Douala Stock Exchange.

An EPA would reduce public revenues based on customs duties. Its effect will be limited due to the relatively small volume of trade. But it would be possible for CEMAC members to maintain levels of public revenues by issuing public bonds.

Given the favourable financial situation resulting from oil sector revenues, public debt (owed mostly to national or regional banks) may help counterbalance the interest paid in foreign currencies to foreign creditors. Public debt restructuring would reduce public expenditures in countries which issue such bonds.

The issuing of public bonds also provides central banks with an additional tool to control liquidity in the banking sector. BEAC currently uses legal reserve limits to control excess liquidity. But larger volumes of liquidity would require it to raise legal reserve limits to excessively high levels. If the private banks held an important share of their liquidity as public bonds issued by CEMAC states, BEAC may conduct an open-market policy by selling or buying bonds in the money market. BEAC could better manage the overall liquidity in the regional economy if it was able to manage bank liquidity.

6.2.4 Social and environmental impacts

Nearly 90% of the population in the Central African region does not have access to any financial or insurance services. Microfinance and insurance could play a central role in the struggle against poverty. Development of microfinance would have an importance positive impact on women as most micro-financed projects are led and developed by women who are their main beneficiaries. The level of default in the microfinance sector is very low compared to the official/traditional finance services sector. Microfinance represents a unique opportunity for agents or households deprived of access to traditional financial services to invest in a small business, to rise above poverty or subsistence lifestyles and/or to finance social/family events, which reinforce a sense of community. The EPA should be compatible with, and support, Millennium Development Goals and national and regional Poverty Reduction Strategies (PRSP).

It is also worth noting that the level of corruption is generally lower among female as compared to male managers. There is a need for basic capacity building programs for women in terms of small project management (before the granting of the microfinancing). It may have positive long-term effects on the education of children.

Complying with the necessary standards for access to the EU market while accounting for environmental costs in the process of international specialisation are strategic issues in the EPA negotiations. The Clean Development Mechanism may be a positive factor for the financing of environmental-friendly projects (such as hydroelectric energy, reforestation).

With the EPA, environmental standards will become an important factor in determining the competitiveness of Central African goods destined for the EU. Trade liberalisation induced by the EPA should include the environmental costs of the specialisation, such as the negative externalities linked to oil exploitation projects, deforestation associated with wood exports or water consumption for cotton-exporting countries. These specific social and environmental costs must be considered by Central African countries when they choose their sectors of specialisation.

The EPA also needs to account for the instability often linked to the oil resources. High prices for petroleum are an underlying cause of the so-called 'Dutch disease' that is characterized by a real exchange rate appreciation, a loss of external competitiveness and the development of a 'non-tradable' sector at the expense of the 'tradable' sector. More generally, the exploitation of oil resources can lead to macroeconomic instability. It can favour 'rent-seeking' as opposed to investment strategies and can exacerbate civil wars and other conflicts. It can be a 'malediction' if resources are not managed wisely and non-productive expenses are incurred. If managed wisely, however, it may stabilize the economic conjuncture in the medium term.

6.3 *Specific effects of the EPA related to the financial services*

6.3.1 Impact of financial liberalisation

The liberalisation of trade in financial services is expected to benefit emerging economies in the central African region through two channels:

- Positive effects are expected in terms of competition, cost reduction, quality improvements and innovation. The liberalisation of financial services will improve household welfare and business productivity and competitiveness by positively impacting the development of credit and investment. This will allow savings to be transformed into investment, to share risks and to transform them. The current cost of financial intermediation and the lack of financing for new business ventures are major obstacles to social and economic development in Central Africa. CEMAC countries are characterised by low rates of savings, a very narrow market for financial services and a very low rate of banking density rate (there is one bank for every 250,000 individuals).
- Liberalisation may trigger much needed inflows of capital.
- Financial liberalisation can also influence growth. It can increase the efficiency of the intermediation process, the productive use of capital, the rate of savings and investment (by attracting FDI).

Investment, trade and financial functions are strongly interdependent. Measures aimed at regulating FDI may affect trade flows. Measures affecting trade may positively or negatively impact flows of FDI.

One needs to consider the specific context of Central African economies and macroeconomic volatility in order to manage the pace of trade liberalisation and develop appropriate financial and risk management regulations.

An EPA is only relevant to the formal sector, which directly impacts only 10% to 20% of the total population. It is unlikely to have any effect on informal activities and will only have a limited impact on the banking sector. But an EPA is needed to improve the institutional environment and encourage economic development.

An EPA should encourage reciprocity. It should allow African banks to establish in the EU in order to provide services to migrants and ease financial transfers. An EPA could also encourage

trade and, through it, help to develop banking activities linked to external trade. One priority is to implement a financial system that would favour the development of a network of innovative SMEs.

Liberalisation linked to an EPA would have very limited impacts on the insurance sector which is regulated at the regional level. The development of the insurance sector is a direct function of several factors: the level of economic development that improves the creditworthiness of clients, the institutional environment that creates rising insurance obligations, dispute settlement provisions and the central role of the state.

6.3.2 Effects of an EPA compared to effects of other types of financial liberalisation

The impacts of an EPA on the financial services sector can be compared to other unilateral, intra-regional or multilateral financial liberalization processes. There is a need to assess the gap between official trade policies and measures and their effective level of implementation.

Costs and advantages of unilateral financial liberalisation

Following the 1994 devaluation, Structural Adjustment Programs (SAPs) and regional reform inside CEMAC triggered an important evolution toward financial liberalisation. Previously, the financial system was characterised by a high level of debt, different interest rates among sectors, a “crowding out” effect, bank insolvency and an inefficient allocation of resources. During the 1980s, financial liberalisation was characterised by a variety of factors: privatisation and increasing competition; the lowering of interest rates; revenue effects (between creditors and debtors), substitution effects (between saving and consumption) and capital attractiveness; a reduction of quantitative controls; the removal of capital controls; the elimination of barriers to entry; an improvement in supervision and regulation; an increase in private deposits and higher levels of bank profitability and liquidity; fewer crowding out effects related to Treasury and public/para public companies over-indebtedness; the removal of bad debts from banking portfolios; and emerging microfinance.

The consequences were mixed for banks and insurance companies. They recorded strong profits but were highly liquid and concentrated their efforts on less risky activities and investments

in a few sectors, such as oil and agro-industrial, and on 'bankable' populations. They also maintained a clear preference for short-term operations.

Costs and advantages of multilateral financial liberalisation

Internationally, the conjunction of several processes, including deregulation, de-compartmentalisation of national markets, disintermediation or the increased use of securities instead of bank loans, and progress in financial and telecommunication engineering, led to a financial globalisation effect that led to an overall decrease in transaction costs and improved inter-connectivity between markets.

Central African countries did not benefit significantly from the positive effects of financial globalisation. They do not have access to bank credit or private financing and are dependant on internal financing by international companies or public development aid. Multilateral liberalisation could have positive impacts. Article 12 of GATS deals with 12 sectors, including the financial sector and business services. Under Article 16, a country that notifies a sector has to open its national market to all providers, independent of origin. Under Article 17, a country has to apply national treatment to all public or private providers.

6.4 Summary effects of an EPA on financial services in the CEMAC region

Table 7: Summary effects of an EPA on financial services in Central Africa

Domains	Positive effects / Opportunities	Negative effects / Threats
Government revenues	Fiscal transition and lowering of the fiscal burden. Reduction of tax exemptions and enlargement of the tax base. Creation of a VAT to compensate the decrease in taxes.	Strong decrease in public revenues linked to taxes on foreign trade.
Imports of financial services	Very few creation or diversion effects in the financial services trade. Development of banking and insurance activities linked to imports.	Very few negatives impacts.
Exports of financial services	Opening of the EU financial market (reciprocity). Increase of FDI in financial services. Development of banking activities (export credit or insurance), improved quality and financial innovation. Negotiation of rules and standards on financial services in a reciprocity framework. Opportunities for specific Central African banking or insurance companies in the EU.	Few negative effects foreseen. Only a few export opportunities for financial services (ex. e-services).
Productive and financial sector	Improved business productivity and competitiveness. FDI entry, including joint ventures in services. Lower intermediation costs and risk level. Possible development of medium-term credit, for creation of specific financing systems for SMEs and to create a regional development bank for companies. Development of a network of innovative SMEs.	Few risks for the financial services (either oligopolistic in niche markets or already competitive). Likely no impact on the informal activities (at least 70% of total activities). High perceived levels of risk / unstable business environment. Lack of supporting physical and technological infrastructure. Lack of regional oversight for micro-financing operations.
Regional integration	Strengthening financial integration in the CEMAC area (in addition to trade, currency and legal integration). Incentives to harmonize rules between DRC, STP and CEMAC. Strengthening of regional capacity.	Several trade regimes possible (EPA, EBA, GSP+). Conflicting interest between LDCs and non-LDCs. DRC and STP non-CEMAC member countries.
Social	Micro-finance and micro-insurance essential for granting access to financial services for a majority of the population deprived so far. Possible links with the modern financial sector (refinancing, guarantees).	Few effects foreseen in terms of job losses in the sector. Lack of human and technical capacity. Competitiveness of national products in the rural areas only. Risk of lowering the level of public goods and services linked to the loss of public revenues. Risk of geographic imbalance.
Environmental	Financing of environmental-friendly projects (CDM, Kyoto Protocol). Taking into account of the environmental costs in the specialisation strategy.	Risk of increased extraction of non-renewable natural resources, pollution, linked to the increased financing possibilities offered.
Institutional	Partnership and credibility transfer from the EU. Definition of standards and rules as objectives and tolerance of local practices/habits playing a regulation role. Real reciprocity between the EU and Central Africa.	Risk of non-compliance with EU standards and rules with the economic situation of Central African countries.

7. Conclusion

Sustainable development assumes that (1) firms and entrepreneurs can position themselves over the long-term to generate productivity progress with investments (efficiency dimension), (2) countries are willing to create acceptable socio-political compromises, to exert their sovereignty and enforce the rule of law and to promote human resources and build infrastructures (public and political dimension), (3) specific actions are taken to reduce environmental costs, rebuild ecosystems (environmental dimension), and (4) specific actions are taken to reduce poverty by ensuring basic needs in terms of development, education, wealth and nutrition (social dimension).

It is vital that the EPA is accompanied by efforts to finance the development of the financial services sector in Central Africa. Central African countries suffer from general economic under-development that is linked, in part, to their financial under-development. For many individuals, cash represents their only financial asset. There are few financial markets and those that exist are not very active. Only 5% to 10% of the total population is served by banks. For the most part, foreign subsidiaries operating in Central Africa are financed by their parent companies through off-shore mechanisms. Local SMEs have very little access to financing. Only the state and a few private, public and para-public operators benefit from the existing financial system. In fact, it appears that the financial system has been developed in a way that is disjointed from the larger community from a cultural, economic and social perspective. The official institutions suffer from a crisis of legitimacy because they have weak links to the general population. Insurance and banking costs also remain very high.

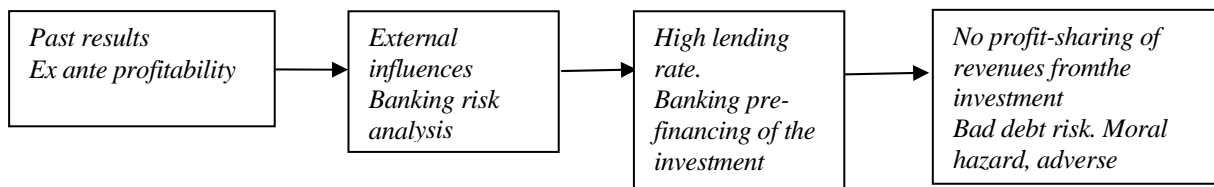
The priority is to develop the link between trade, finance, development and financing of development by reducing fragmentation in the financial services sector and creating a financial system that allows for entrepreneurial risk-taking.

It is necessary to break the 'trap' of economic and financial under-development. On one hand, this includes oligopolistic banks which take few risks. On the other hand, it encompasses the increasingly profitable primary economic sectors (oil and mining), more trade, real estate speculation and a low level of development in the transformation industry (with more value-added). There are, however, some new operators with local capital who are developing activities with local populations and SMEs in addition to large multinational companies.

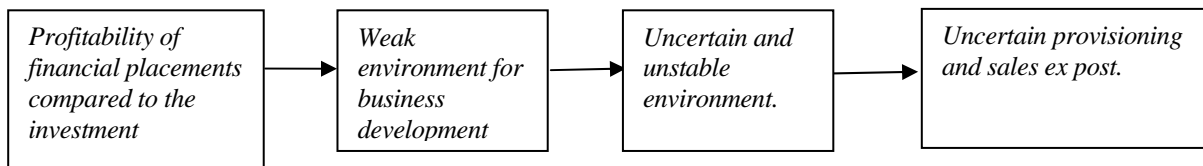
There are four issues that should be considered priorities for an EPA with respect to the financial services sector in Central Africa. They are: inadequate medium-term credit; the development of microfinance and micro-insurance; high costs of intermediaries and institutional weakness; and an uncertain environment and fragmented financial system. These issues are dealt with below.

7.1 *Inadequate medium-term credit*

The weakness of financial intermediation and the differences between economic agents with a financing capacity and those with financing needs may be measured by indicators such as M2/GNP. The *ex ante* profitability sequence of the banks is quite different than – indeed, opposite to – the *ex post* profitability sequence of entrepreneurs.¹⁷ The sequence adopted by the bank is, as follows:



By comparison, the sequence adopted by the entrepreneurs is, as follows:



The differences between these two sequences are most important if the banks have high profitability objectives, if real or anticipated risks are great and if markets are narrow or highly concentrated. Lending decisions by banks are based on personal reputation or relations and are ‘backward-looking’. Banks are not very innovative. They are most interested in developing credit activities, less-risky investments and fee-earning intermediation activities as well as providing short-term loans.

¹⁷ Picoty Cl, Geffroy B (1995), « Degré d’intégration bancaire des PME : une approche par l’organisation industrielle » *Revue économique*, Vol 46, mars.

Entrepreneurs with bankable projects are rare. Given strong uncertainties concerning future potential markets and prices, only a few private actors want to take (and bear) risks with new companies. Private actors benefiting from financing prefer to invest in profitable financial investments and in niche markets. They avoid the visibility that leads to taxation.

Deals between bankers and entrepreneurs are usually for short-term credit. Capacity building programs, such as commercial or industrial development projects, should be conceived and implemented under the EPA with EU support and in collaboration with BEAC and, potentially, with private banks as partners.

Priority should be given to actions which create guarantee systems, provide specific support to SMEs, find alternatives to development banks or relaunch the regional development bank in order to reduce the gap between the financial sector and the realities of financial dealings on the ground.

7.2 The development of microfinance and micro-insurance

Microfinance plays an essential role in poverty reduction and in the financing of micro-projects. Between 80% and 90% of rural and urban populations has no banking coverage. Poor and vulnerable households need to save and build assets to protect themselves from negative economic shocks. In reaction to the dysfunction of the official financial system, informal finance plays a central though less dynamic role in Central Africa than in Western Africa. Informal financial organisations are community institutions based on social or ethnic membership (clan, family, etc.), ‘tontine’ organisations or credit associations, lenders and private banks.¹⁸

These transactions have several specific features, including: predominantly cash payments, a weakness or absence of regulations, small-scale operations, informal ‘asset swapping’, importance of personal relations and community loyalties.¹⁹ The ‘warm money’, creating links and reciprocities, prevails over the ‘cold money’ of the officials that do not create interdependencies. These transactions allow individuals to postpone consumption and realize compulsory savings. Social and cultural proximity and personalisation of relations inspire confidence. The simplicity and flexibility of the procedures and innovations allow the financial services to be adapted to real needs.

¹⁸ Hugon (1996).

¹⁹ Lelart (2005).

There are, however, several limitations. The personalisation of relations reduces the scale of these transactions. Most of the financing is for social expenses and consumption and not risk-taking investment and interest rates are very high (often more than 100% per annum).

Besides informal finance, microfinance plays an essential economic and social role. This often comes from external support (donors, *Crédit mutuel* in France, *Caisse Desjardins* in Canada, or *Raiffeisen* in Germany). It also rests on endogenous dynamics, such as savings and credit cooperatives, solidarity funds, village or community funds and financing companies. Microfinance attempts to break the vicious circle of “low revenues – no or small saving – no possibility of investment – low revenues” by another circle “low revenues – investment credit – growth of the revenues – saving and credit – new investment – new revenues growth”.²⁰ There are two ways that the savings and credit networks can function: first, collecting savings and lending to mutualized agents (like the *Crédit mutuel* or the saving cooperative) or, second, using external financing for credit (for example, rural credit or solidarity credit).

Support for microfinance requires the creation of interfaces between the numerous small operators (who, by definition, act outside or far from strict rules) and the control mechanisms and funding practices of the EU. This requires an adaptation of EU rules and the grouping of micro-units in cooperative associations.

7.3 *High costs of intermediaries and institutional weaknesses*

The cleansing of banks accounts (bad loans) enables developing banks to increase profitability and liquidity but was not accompanied by any development financing. In the orthodox theory on which the financial liberalisation process rests, savings could be explained by economic variables (prices, revenues). The economic actors choose between risks and profitability. The gap between rates for creditors and debtors should, in an open economy, cover costs associated with the mobilisation of funds, management practices and costs of recovering lending, as well as the bank margin cost and the risk premium.

The real interest rate should play a decisive role in balancing savings and investment. The rise of real interest rates leads, first, to complementarity effects (an increase in the amount of funds at the disposal of the investor) and, second, to substitution effects between financial and real assets. It should reduce the gap between the formal and informal sectors.

²⁰ Nowak (1988).

The financial liberalisation process should encourage greater economic efficiency in terms of convergence of financial services, reduction of their costs, better quality and more innovation. By encouraging credit which facilitates investment, the liberalisation of financial services can improve the well-being of households, the productivity and competitiveness of companies. Liberalisation will allow the transformation of liquid assets into fixed ones with a mutualisation and transformation of risk. The legal and institutional environment has been improved in Central Africa and should play a decisive role in the liberalisation of the financial sector.

The cost of financial intermediation, and the weakness of risk-bearing investment financing, remain major obstacles to economic and social development. In sub-Saharan Africa, econometric simulations do not show evidence of financial repression or any significant effects of the real interest rate on the savings rate. Given the characteristics of CEMAC's financial sector, it is important to consider the specific context of the Central African economies. It is necessary to integrate the specific risks linked to macroeconomic instability and to manage the pace of trade and financial liberalization processes together with an adequate level of regulation and rules.

7.4 An uncertain environment and fragmented financial system

Several factors help to explain the limits of financial liberalization. The heterogeneity of financial products and the segmentation of financial circuits are tied to three main factors: the heterogeneity of transactions costs according to the type of project management; the great diversity of risks; and the diversity of credit demand according to the social groups. Depending on the type of actors, financial circuits are strongly segmented in terms of individual power and priorities, the scale of activities and areas.

The difficulty of forecasting is a factor in credit rationing and interest rate fluctuations. When the regulatory environment for the banking sector is insufficient or lacking, it also affects the default risk of specific clients who would accept excessively high interest rates (adverse selection effect).²¹ The effect of interest rates policies depends on a companies' debt rate, its capital costs and the opportunity cost of detention of funds. Asymmetries between formal and informal actors are linked to strong social differentiations and powers.

These important structural factors cannot be modified in an EPA alone. However, an EPA will be implemented over a long-term agenda (2008-2020). It will include scale upgrading as well as institutional capacity strengthening and allow benefits to accrue from financial and technical (capacity building) support in a partnership framework. An EPA could have an important and positive role in reducing uncertainty for actors and favouring a longer-term development agenda.

²¹ Stiglitz and Weiss (1981).

8. Policy recommendations

Policy recommendations were developed following the consultations and SWOT analysis. It is important to combine the advantages of the financial liberalization process with the need to regulate this activity and to develop and implement risk management procedures. Trade and financial liberalisation have to be implemented in a parallel fashion and should include specific measures to prevent financial crisis and systemic risk in Central Africa. Liberalisation also has to be consistent with private sector development.

A clear agenda and timeline are central to managing the necessary transitions resulting from trade and financial liberalization. It will take time to build comparative advantages in the region. Companies and sectors that are affected will require upgrading and adjustment programs.

A prerequisite for external financial liberalization is a strengthening of national and regional financial systems. EU financing is required to compensate for the loss of fiscal revenues (and to help with the development of alternative public revenues), to develop institutional capacity and to finance the upgrades necessary to comply with the EU's technical measures and standards. The EPA liberalisation process will have to be implemented gradually in the Central African region.

8.1 The objectives

Encourage an institutional environment for financial stability

- Foster an institutional environment addressing stability, security, and predictability and create a climate of confidence for savers and investors;
- Encourage financial actors to develop specific instruments for risk coverage and risk reduction;
- Allow economic agents (private firms and banks) to make decisions concerning their operations based on levels of risk that are limited to the inherent risk of their productive activities and not on non-economic factors such as political insecurity or the possibility of conflict.

Financial sustainability

- Improve the rate of loan-recovery to enhance financial sustainability and economic and institutional profitability and to improve savings, investment, productivity and revenue levels.

Sustainable development

- Include environmental protection as one criterion for the granting of loans by banks;
- Improve access to credit for SMEs and marginalised populations and develop specific gender-related capacity building activities;
- Improve access to financial services for the population of the Central African region.

Governance

- Implement corporate governance rules with regard to transparency, accountability and risk alleviation that comply with international standards.

8.2 Trade policy recommendations for negotiators

Adapt the EPA implementation agenda to the realities of the Central African region

The measures and recommendations proposed below should be implemented at two levels that are closely linked to the development of the financial sector:

- At the level of the economic development and good governance of the Central African states, this should encourage political and social stability in the country;
- At the level of the implementing agenda, political insecurity and economic poverty make the development of the financial system inefficient.

It is recommended that negotiators:

- Monitor the results of measures developed and actions implemented at the end of each sequence in order to assess the efficiency of the gradual approach (see proposed criteria below).
- Adapt the liberalization process and development programs to the level of development of states, LDCs or non-LDCs with specific sequences of the liberalisation agendas;
- Implement specific and different treatment for LDCs with adapted liberalization agendas and specific development needs;
- Account for the emergence of a new category of states: the ‘failed or fragile states’, where criteria are no longer based on the level of economic development but more on the capacity

of the state to ensure its sovereign missions (security, territorial integrity, provisions of basic public social services, etc.);

- Negotiate specific and individual agendas for each of these three categories of state;
- Adopt a gradual agenda for the trade liberalization process in the Central African countries, between 2008 and 2020 and regularly monitor its impacts on trade liberalization. Priority monitoring criteria should be the respect and efficiency of the rules implemented and the pre-eminence of regional trade policies on national ones. (see proposed criteria below).

Develop reciprocity for entry into the financial services sector

- Improve reciprocity by adapting the rules of entry into the EU financial sector with the rules applied to EU financial actors entering the Central African Financial Services Market (GATS Mode 3);
- Foster competition in the (nearly monopolistic) market of financial transfers between EU and Central Africa (Mode 1);
- Adapt the rules of entry for foreign banks into the EU market in order to help them specialize in the provision of specific services aimed at the diaspora (transfer activities, financing of joint-ventures projects with originating countries).

Implement regular evaluations (every five or 10 years) of the implementation of the EPA to evaluate the degree of implementation

A preliminary list of criteria for such an evaluation could be proposed. These would include development, environmental and social sustainability and governance. This would have to be completed according to the final contents of the EPA.

- *Criteria in terms of development of the financial services in Central Africa*
 - level of presence of Central African financial services companies in the EU market;
 - level of participation of EU financial actors to the financial and economic development of Central Africa;
 - increased level of banking and access to basic financial services (insurance);
 - existence, activity and liquidity of the financial markets (including monetary market);

- number and liquidity of public bonds on the financial market;
 - degree of transformation of the public debt (foreign/ regional, illiquid/liquid, long-term/short-term);
 - level of presence of Central African financial services companies in the EU market;
 - level of participation of EU financial actors in the financial and economic development of Central Africa;
 - the percentage of the population having access to the financial services, holding a bank account or having subscribed a compulsory insurance (personal, car, housing, etc.);
 - percentage of the medium-term credit of total credit;
 - rate of default.
- *Criteria in terms of social and environmental impacts of the EPA*
 - level of development of micro-finance and linkages with the formal banking industry;
 - evolution of the cost of microfinance credit;
 - number of women with access to microfinance;
 - existence and quality of the capacity building actions (specifically for women) for basic project management skills;
 - development of the social/environmental impacts of granting loans;
 - level of development of the Clean Development Mechanism in Central Africa.
- *Criteria for institutional stability and governance*
 - governance indicators;
 - deepening of regional integration and fulfilment of the CEMAC convergence criteria.
- *Criteria in terms of development of the financial services in Central Africa*
 - level of presence of Central African financial services companies in the EU market;
 - level of participation of EU financial actors in the financial and economic development of Central Africa;

- increased level of banking and access to basic financial services (insurance);
 - existence, activity and liquidity of financial markets (including monetary market);
 - number and liquidity of public bonds on the financial market;
 - degree of transformation of the public debt (foreign/ regional, illiquid/liquid, long-term/short-term);
 - level of presence of Central African financial services companies in the EU market;
 - level of participation of EU financial actors to the financial and economic development of Central Africa;
 - the percentage of the population with access to financial services, holding a bank account or having subscribed a compulsory insurance (personal, car, housing, etc.);
 - percentage of the medium-term credit of total credit;
 - rate of default.
- *Criteria in terms of social and environmental impacts of the EPA*
 - level of development of the microfinance industry and linkages with the classical banking industry;
 - evolution of the microfinance credit cost;
 - number of women having access to microfinance;
 - existence and quality of the capacity building actions (specifically for women) for the basic project management skills;
 - development of the social/environmental impacts in the granting of loans;
 - level of development of the Clean Development Mechanism in Central Africa.
- *Criteria for institutional stability and governance*
 - governance indicators;
 - deepening of regional integration and fulfilment of the CEMAC convergence criteria.

8.3 Sustainable development policy recommendations

Recommendations are also made in terms of sustainable development at the multilateral, regional and national levels. For each level, recommendations are made specifically for the banking, insurance, financial markets and productive sectors, the environment and in terms of capacity building programs.

8.3.1 Multilateral level

For the banking sector

- To encourage local investment of savings currently invested abroad (estimated at 40% of total savings);
- To encourage EU banks with operations in the CEMAC region to form a consortium that will buy large amounts of the public bonds in the most advanced CEMAC member states;
- To use this procedure to enhance the credibility of private companies issuing corporate bonds in the CEMAC area;
- The EU (or the EIB) could grant a guarantee to such an issue of bonds (under criteria of quality control).

For the insurance sector

- To develop new risk financing systems by private insurers in addition to the Multilateral Investment Guarantee Agency (MIGA) and national agencies (OPIC, NEXI, EDC, COFACE, HERMES).

For the financial markets sector

- To consider a reduction in the level of foreign currency reserves transferred by the CEMAC countries to the Operation account of the Franc Area (French Treasury) and adapt existing cooperation mechanisms allowing to avoid international shocks;
- To develop ‘oil funds’ to manage the instability of oil public revenues and reduce the ‘opportunistic strategies’ on the oil prices;
- To issue public bonds to enable the Central African countries to reimburse the external debt.

For the environment and capacity building

- To attract non-oil FDI by enhancing the stability and security of the environment, developing the social, physical and telecommunication infrastructure;
- To enhance and to foster the multilateral public debt relief under Heavily Indebted Poor Countries Initiative.

For the productive sector

- To foster the factors of competitiveness such as the costs of production, infrastructure and logistics as well as the cost of compliance with EU standards (and the ability to comply);
- To enhance trade facilitation by reducing trade barriers, simplifying procedures and shortening delays.
- To seize opportunities offered by the liberalization and privatisation process in the transport and trade arenas, to diversify the production and export into sector with more value-added in the agro-industrial sectors and other industrial sectors and by diversifying foreign (EU) trade partners;
- To support the development of ICT infrastructure and services, including e-money solutions.

8.3.2 Sectoral recommendations to be implemented at the regional level

For the banking sector

- To develop the Development Bank of Central Africa (BDEAC) activities toward the financing of risk-bearing investments with a long-term return rate and networks of SMEs.
- To activate the Compensation and Development Fund created in 2001;
- To implement the rule of single approval allowing a bank approved in one CEMAC country to freely open subsidiaries in another member country;
- To progressively reduce the spread between creditor and debtor banking rates;
- To develop capacity building actions in terms of banking activities by supporting the use of payment cards in the micro-finance sector with the support of BEAC and COBAC;
- To develop the project financing and public or cooperative institutions whose objective

would be to finance SMEs.

For the insurance sector

- To create a regional re-insurance company in the CEMAC framework;
- To support the establishment of a regional insurance market;
- To develop the number of people who subscribe to compulsory insurance, with an agenda for progression.

For the financial markets sector

- To develop the money market, more specifically by establishing a regional market for public debt;
- To sustain the activities of the two existing stock exchanges in Douala and Libreville;
- To develop cooperative activities or a network approach between these stock exchanges with a long-term objective of a merging;
- To support the activity of the money market, basic compartment of a capital market;
- To support the issuing of public debt titles as a factor to encourage the financial market activities and as a substitute to the external debt (high cost of foreign currencies) and also to give the BEAC a useful tool to control bank liquidity;
- To stimulate the participation of insurance companies in the regional stock markets.

For the environment and capacity building

Policy optimizing coordination

- To seize opportunities offered by macroeconomic and financial stability, the very low exchange rate risk and the convertibility of the CFA Franc.

Policy preserving coordination:

- To develop a system of financial crisis prevention (systemic risk);
- To modernize the BEAC payment and settlements systems;
- To re-activate the compensation chamber between the CEMAC and the RDC;
- To define a Community Investment Charter to replace national Investment Codes;
- To accelerate and foster fiscal policy convergence such as a single VAT rate and a

reduction/suppression of tax exemptions;

- To enhance the respect of the convergence criteria for all countries;
- To foster a customs union in terms of harmonization of import taxes, CET, rules of origin, transport cost and efficiency;
- To reinforce the intervention domains of OHADA in terms of an Investment Charter;
- To enhance the security of land and real estate laws with a guarantee granted by insurance companies;
- To develop EU guarantees for the investment of Central African agents' savings in the region instead of abroad.

8.3.3 National level

For the banking sector

- To develop a 'project financing' culture by sustaining capital risk initiatives and specific mechanisms (such as guarantee funds) for financing SMEs by the banks;
- To support the development of microfinance by adapting COBAC Directive (N 01/02/CEMAC/UMAC/COBAC);
- To increase the level of legal reserves for short-term deposits and interest rates for mid-term deposits;
- To develop financial and technical support for the microfinance sector;
- To reduce fragmentation in the banking and insurance sectors by developing links between the modern sector and microfinance and micro-insurance.

For the insurance sector

- To link the microfinance sector to the modern insurance sector through diversification of the services offered: life, health, and other risk insurance;
- To allow the development of small or medium-sized insurances companies through the reduction of the minimum capital as defined by CIMA.

For the environment and capacity building

- To improve the institutional environment and enforcement of rules and regulations (Rule of Law, transparency of financial transactions);
- To develop basic capacity building programs for women in terms of management of small projects (before granting microfinancing) with the long-term objective of positive effects on the education of children.

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