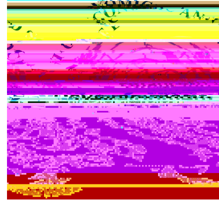


Workshop on Debt, Finance and Emerging Issues in Financial Integration

Financing for Development Office (FFD), DESA
8 and 9 April 2008

Regulatory Choices for Low-Income Countries in a World of Increasing Financial Integration

Layna Mosley

Regulatory Choices for Low-IncRme CountrR 1 0 0 1 376.53qer8(r) Tj 1 0 0 1 366Wm (u)
Increasing Financial Integration

Layna Mosley
Associate Professor
Dept. of Political Science
University of North Carolina
Chapel Hill, NC
email: mosl

In recent months, participants in private capital markets have expressed enthusiasm regarding the economic situation in many African nations. An increase in rates of economic growth, coupled with continued liquidity in global capital markets, has

integration on national economies are very contingent; they are contingent on both the type of capital inflows (broadly, short-term and speculative vs. long-term), as well as on the level of regulatory development in the host country. Where governments have develope

account liberalization. I

well as improv

assistance programs remain relatively small. They also may allow – if they are more stable and less cyclical – governme

restrictions on the current and capital accounts (where the latter are measured as the proportion of the last five years without controls), and requirements to surrender export proceeds.[5] The index has a mean of zero and ranges from -2.66 (full capital controls) to 2.66 (complete liberalization). In 1990, the mean index level for sub-Saharan Africa nations was -0.84 (with data available for 44 countries). Only Botswana and Sey

and Moza

(1997) have had such ratings for more than a decade, all other gover

and Milesi-Feretti present summary data indicating that, by this *de facto* measure, global financial integration has increased markedly over the last thr

far less than that of the high-income (OECD or non-OECD) nations. In terms of regional averages, African nations are less financial integrated than all regions other than South Asia in 1990. Following an increase in integration during the first half of that decade, integration declines in the late 1990s; by 2004, the average level of integration in Africa is only marginally greater (1.25 percent, versus 1.16 percent) than it was in 1990.

Data on the size of national financial sectors (from Beck et al 2000) offer a similar picture: while financial sector development in Africa has expanded in recent years, it still lags noticeably behind that observed in emerging market economies. Figure 3a plots the average level of bank deposits in national economies, again scaled to GDP. For African nations, this level expands gradually over time; but even in 2005, t

g

of gains from liberalization; premature opening also may make reversals of capital flows

institutions often is interactive and contingent, rather than independent. Applying this lesson to financial liberalization in developing countries, then, we might expect that the governance of, and incentives for, foreign direct investment will differ between countries with large natural resource endowments and those whose productive advantages stem from an abundant labor force. Or we might expect

If financial system deposits from these exporters – today's petrodollars – decline, banks will have less capital to lend, generating a contraction in the financial system, as well as the potential for problems with non-performing loans. More generally, then, the exposure of national economies to factors beyond their control – global market sentiment, financial sector problems in developed markets, or commodity price swings – suggests a cautious response to the current enthusiasm for investment in Africa, and continued attention to the management and sustainability of public debt (i.e. Le Manchec 2008).

III. Regulatory Issues in African

avoid implementing certain standards. Political will, then, often is essential to compliance and implementation. Moreover, capacity also plays a role: compliance may be particularly problematic when rules, and the subjects they govern, are highly technical. This is often true of rules related to finance: the staff of regulatory agencies may lack the technical expertise necessary to supervise private actors adequately. And, even when supervisory capacity is high, private market participants may find means of circumventing regulations – following the letter, but not the spirit, of the law.

For African nations, both the will *and* the capacity to enact and implement regulatory measures are central to realizing many of the benefits associated with financial openness. What does recent evidence suggest about the extent of regulatory capacity in African nations, both in general

ter

their middle-income counterparts, we might wonder about how prepared such countries are for the rigors of financial market openness.

As part of a broader research project on governance, Kaufman et al (2007) measure six dimensions of governance, using over 30 different indicators. They assess these indicators on a biannual basis, from 1996 to 2000, and annually from 2002 to 2006. The three most relevant dimensions are regulatory quality, rule of law and control of corruption. They do so using a wide arrange

c

there's been little improvement in emerging market average scores on

Table 1: Participation in IMF-Sponsored Data Standards[16]

	SDDS Subscribers	GDDS Subscribers	Total Countries
Income Category			
Low	3	42	56
Lower Middle	16	23	52
Upper Middle	17	16	36

governance score is 59 in East Asia (n=10), 52.5 in Europe and Centra

African A

I use a sample of these ROSCs to highlight some of the issues associated with regulation in African nations, as

Broad Category	Specific Issues
	Banks require greater guidance on prudential requirements (Uganda)
Legal system and corporate governance	Weak corporate governance procedures (Ghana, Mozambique)
	Local firms' financial reporting practices need improvement (Ghana, Madagascar, Mozambique)
	Efficiency

system. But, as the authors of Ghana's ROSC stress, "

Furthermore, the issues identified in Table 3 raise a larger issue regar

global financial standards (see Drezner 2007) and the role of African nations

what extent are the "key codes and standards" promulgated by IFIs and dev

economic official appropriate for African nations? Note that many of these

developed country authorities, or by private sector actors, with little consulta

market and low income stakeholders (see Mosley 2008). Given thedd

focus on codes that are "too advanced" lead to a lack of attention to other, more fundamental regulatory issues?

IV. Recommendations and Conclusions

What does this review suggest regarding policy choices for sub-Saharan African nations? While there are many policy issues related to financial liberalization, sovereign finance and regulatory efforts, three are central:

First, national gov

region, and it has contributed to the development of local debt markets, as well as to Nigeria's exit from Paris and London Club arrangements (Gatz 2008).

More specifically, governments – or their deb

challenge presented by capital account liberalization is that, as extant literature suggests, there is no "one size fits all" means of assessing countries' preparedness to take advantage of the global capital market. Many summary indicators of regulatory efforts and outcomes are crude and, even

or to financial system crises. The result is a chicken and egg problem: openness may increase the efficiency and efficacy of domestic financial systems, but it also raises the specter of financial crises. How, then, to balance between the desire to use liberalization as a fillip to reform, and the interest – as a sequej ET Q q BT /F2 t

References

Beck, Thorsten, Asli Demirgüç-Kunt and Ross Levine. 2000. "A New Database on Financial Development and Structure." *World Bank Economic Review 14*: 597-605. [as revised September 14, 2006; http://econ.worldbank.org/staff/tbeck]

Bhinda, Nils and Matthew Martin. 2005. "Monitoring and Analyzing Foreign Investment: How to Build Sustainable Institutions." *FPC CBP Series No. 1.* London: Debt Relief International.

Calvo, Guillermo A. and Enrique G. Mendoza. 2000. "Rational Herd Behavior and the Globalization of Securities Markets," *Journal of International Economics* 51 (1): 79-113.

Carey, Sabine. 2007. "European Aid: Human Rights versus Bureaucratic Inertia?" *Journal of Peace Re*

Haggard, Stephan and Sylvia Maxfiel

Martin, Matthew (with Cleo Rose-Innes). 2004. "Private Capital Flows to Low-Income Countries: Perception and Reality." Chapter 2 in *Canadian Development Report* 2004.

Mishkin, Frederic. 2006. *The Next Great Globalization: How Disadvantaged Nations Can Harness Their Financial Systems to Get Rich.* Princeton: Princeton University Press.

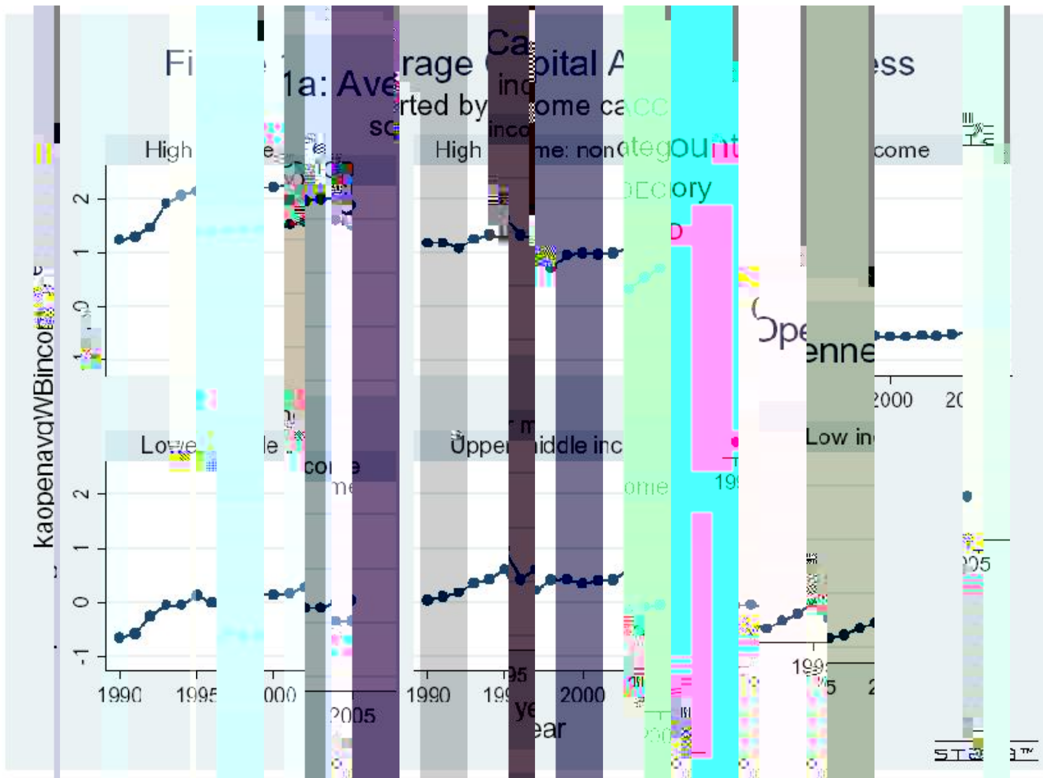
Mitchell, Ronald B. 1994. "Regime Design Matters: International Oil Pollution and Treaty Compliance." *International Organization* 48, vol. 3, pp. 425-458.

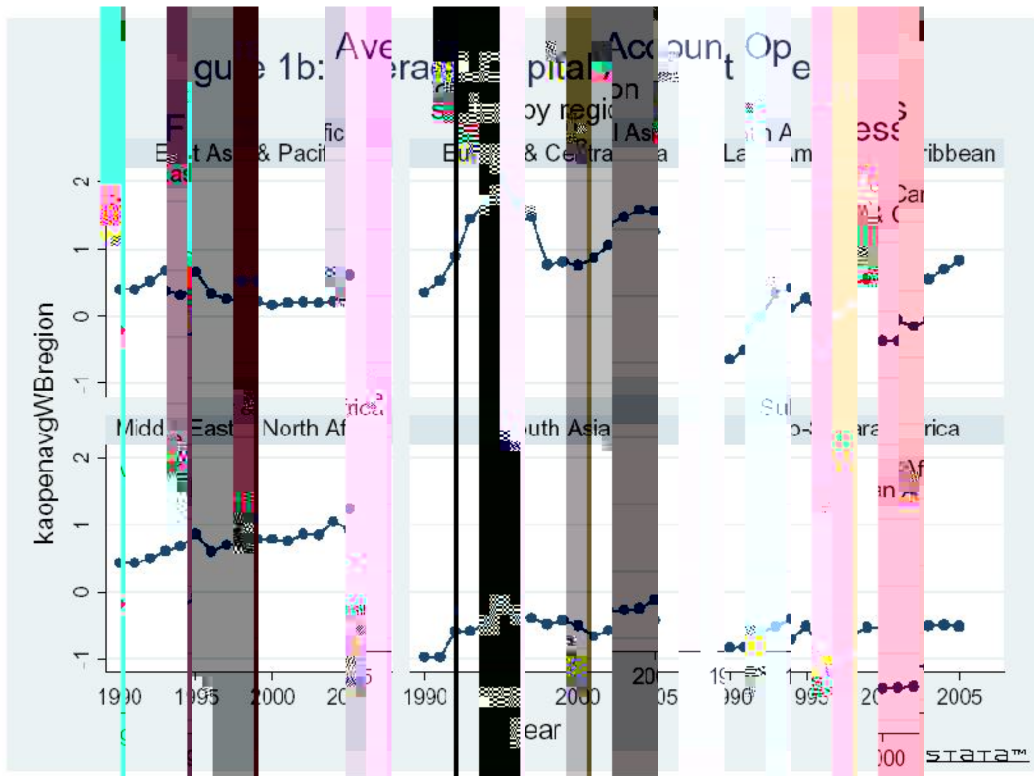
Mosley, Layna. 2003. *Global Capital and National Governments.* Cambridge: Cambridge University Press.

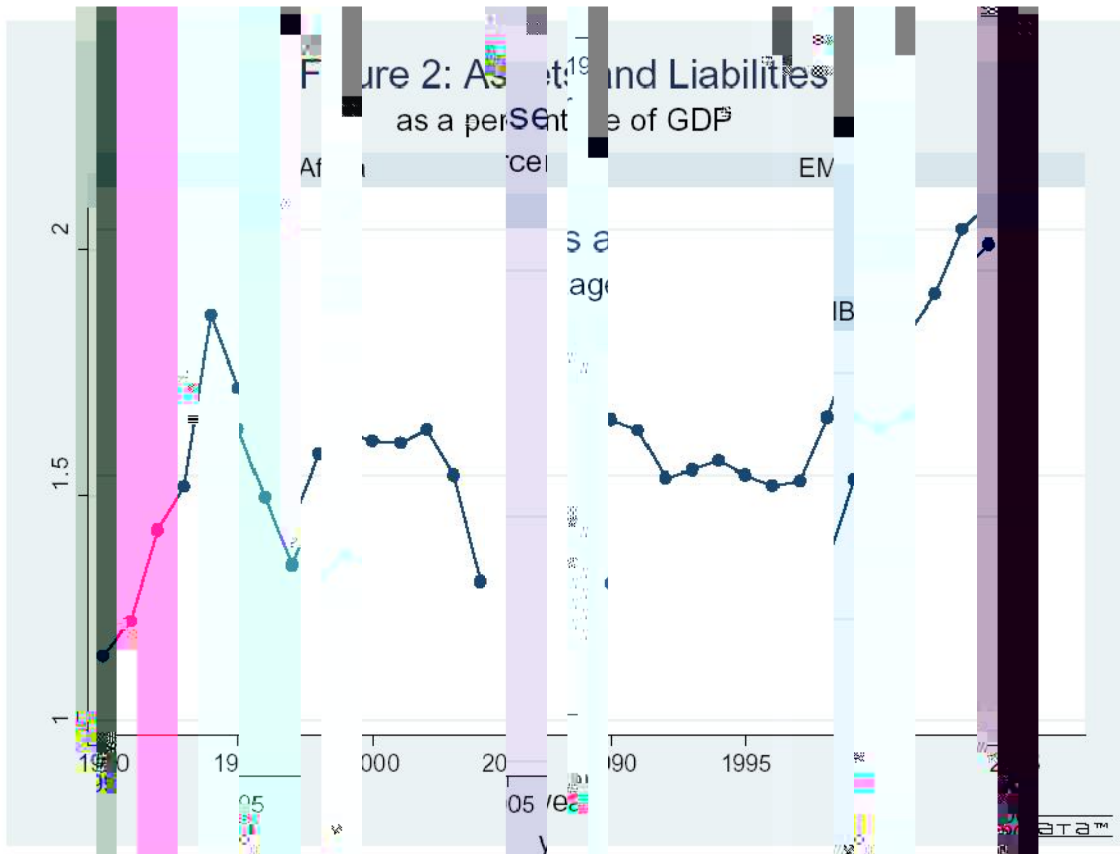
Mosley, Layna. 2004. "Attempting Global Standards? National Governments, International Finan

Stiglitz, Joseph. 2002. *Globalization and Its Discontents.* New York: Norton.

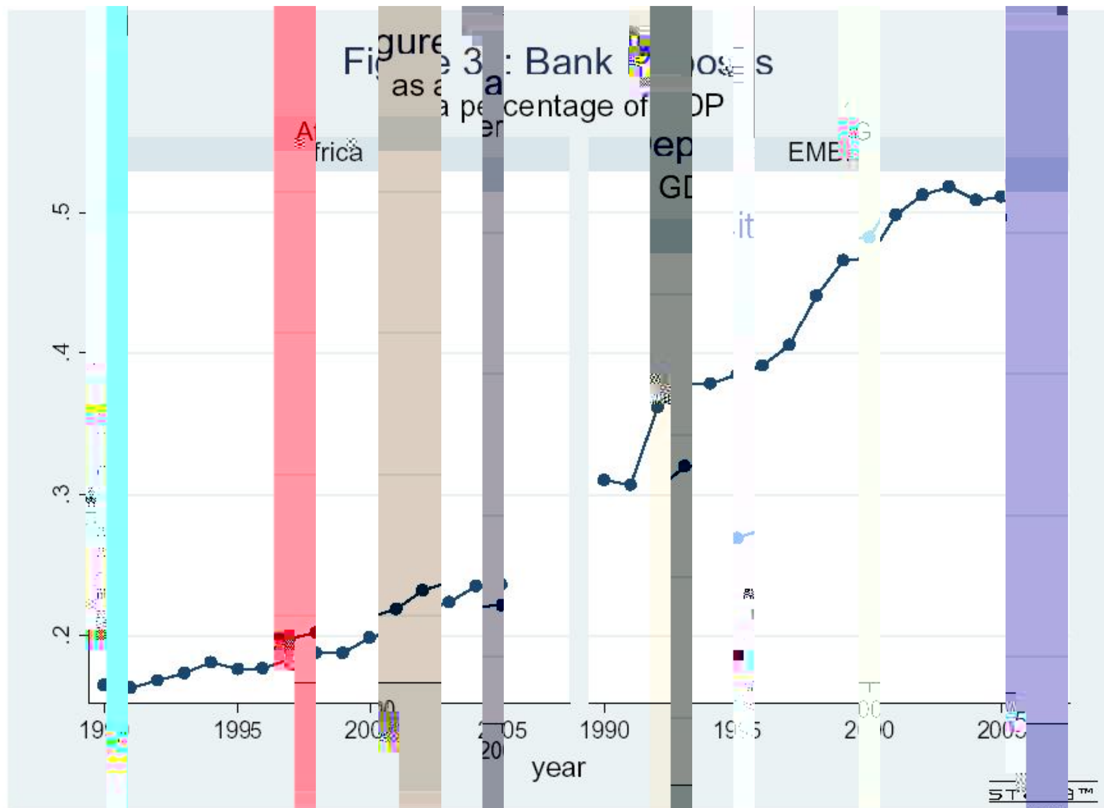
Underhill, Geoffrey R. D. and Xiaoke Zhang. Eds. 2003. *In*


kaopenavgWBincome
year

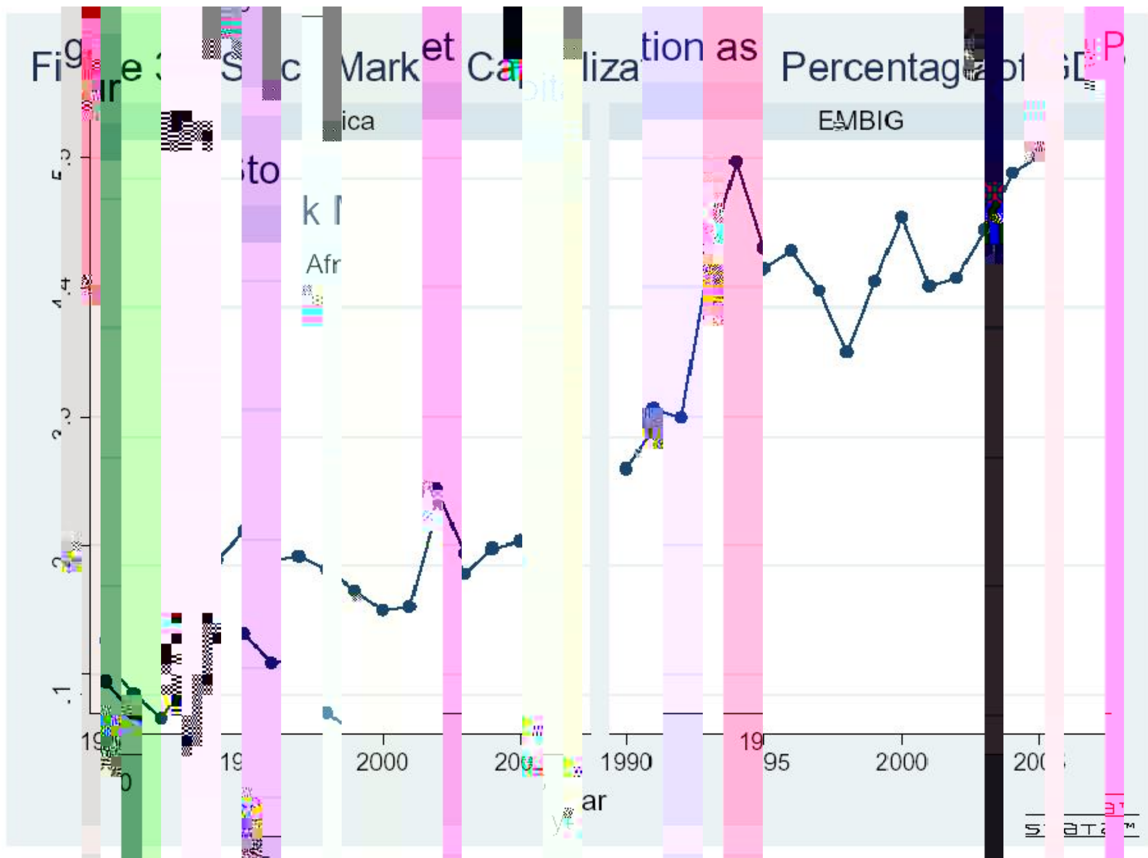

kaopenavgWBregion
year

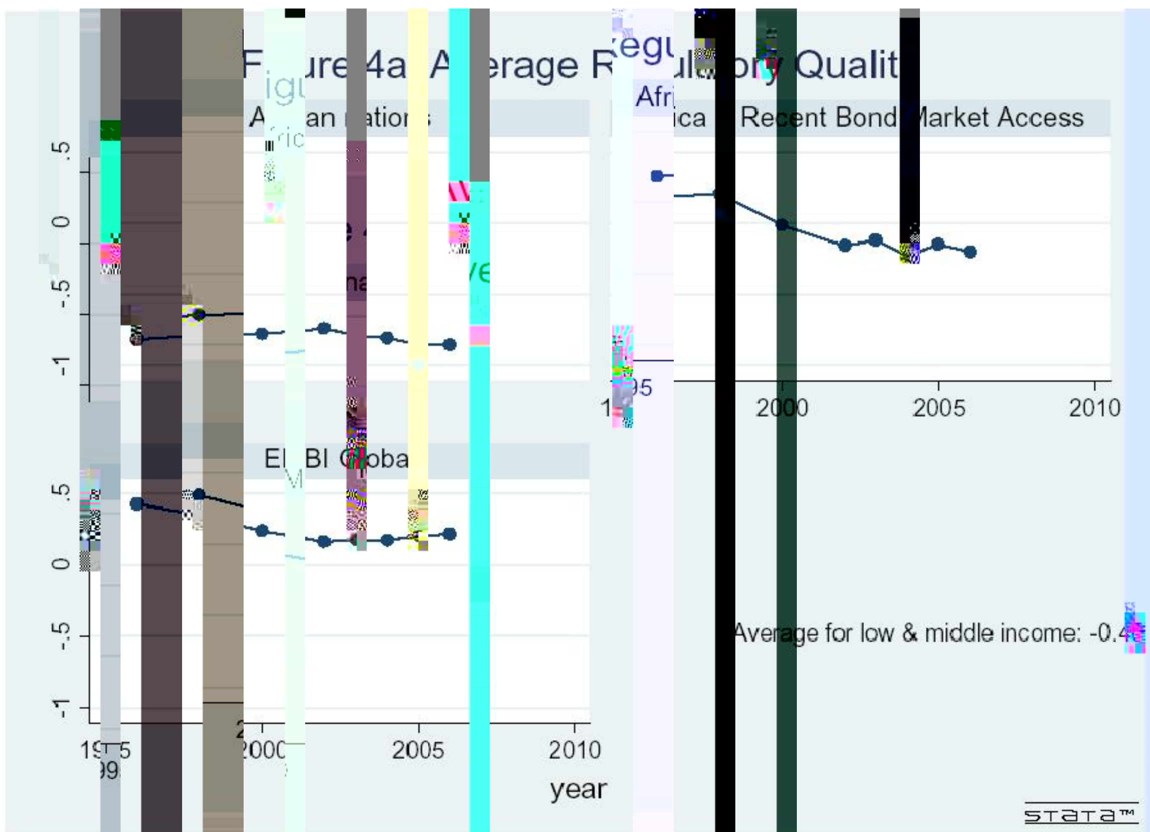


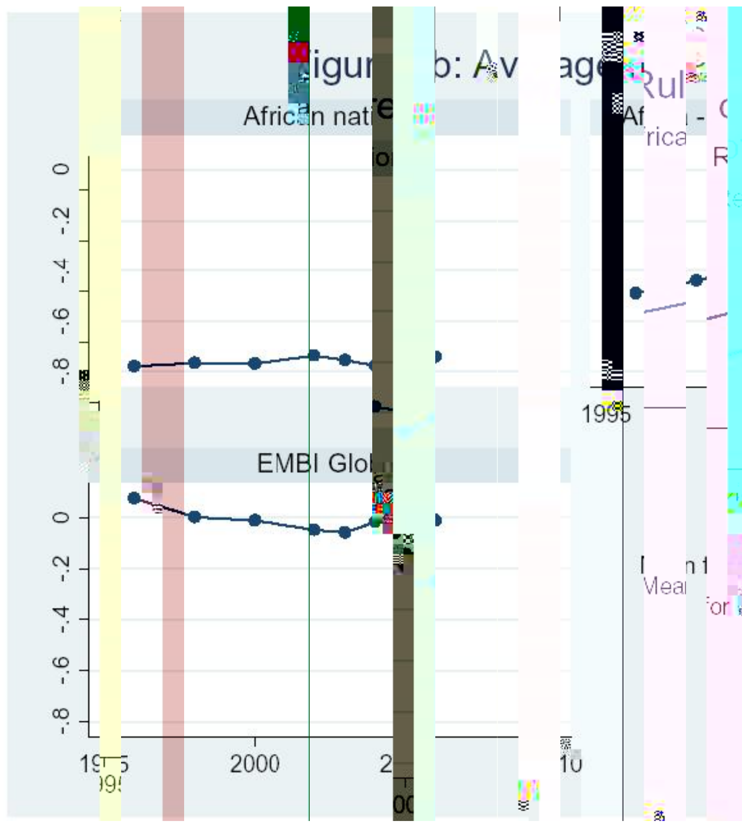
and Liabilities
as a per
e of GDP
EM
2
1.5
1
2000
1995



3
: Bank
s
centage of
DP
frica
EME
.5
.4
.3
.2
1995
1990
year


Percentage
EMBIG
2000
1990
2000
year


Recent Bond Market Access
2000
2005
2010
EMBI Global
2005
2010
year
Average for low & middle income: -0.4


0
-.2
-.4
-.6
-.8
2000
1995