



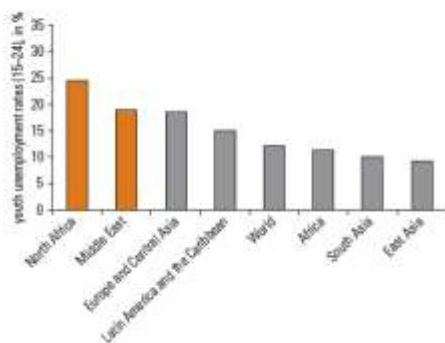
## Financial Access and Stability: A ROAD MAP FOR THE MIDDLE EAST AND NORTH AFRICA

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**Introduction:** The political turmoil that spread through the Middle East and North Africa (MENA) region in early 2011 revealed deep-seated frustrations and a sense of political, social, and economic exclusion, especially within the region's large young populations. The political turmoil—the “Arab spring”—prompted a renewed search for the causes of the region's political and economic malaise and calls for political and economic reforms.

Figure 1

Youth (Ages 15–24) Unemployment Rates, by World Region, 2008



Source: ILO 2008.

The factors that triggered the turmoil were predominantly political, but the underlying economic factors were equally important. The events revealed the incapacity of most MENA

countries to generate sufficient growth, employment opportunities (Figure 1), and housing for their large and young populations. The full report on which this Quick Note is based argues that MENA's financial systems contributed significantly to these unsatisfactory outcomes by failing to provide affordable access to finance to large segments of the enterprise and household sectors. The financial sector is part of the problem and therefore needs to be part of the solution. Any effort to develop a new growth agenda for the region will need to include a significant component of financial sector reforms.

**Diagnosing MENA's Financial sector Challenges:** This Quick Note is based on the finance flagship report with the same title which provides a diagnostic of financial development in the Middle East and North Africa (MENA) region and proposes a roadmap for expanding access to finance while preserving financial stability. The companion flagship report on private sector development—*From Privilege to Competition*, published in 2009—had identified some of the main obstacles to competition in MENA, including restricted access to finance. The finance flagship examines in greater detail the access-to-finance problems that hinder private sector participation and constrain competition and growth in the region. Both flagship reports provide coherent and comprehensive analyses of the challenges faced by MENA policy makers and propose consistent and complementary agendas for promoting growth and employment in the region.

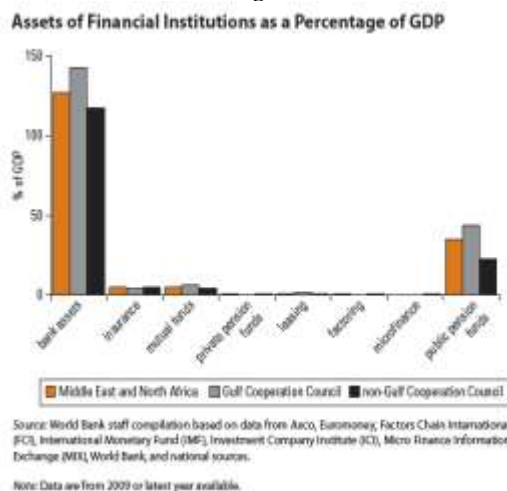
<sup>1</sup> Senior Advisor, Financial and Private Sector Development Vice Presidency, The World Bank. The full report is available at [Worldbank.org/MENA](http://Worldbank.org/MENA) and was prepared by a team led by Roberto R. Rocha, principal author, and comprising Zsofia Arvai (principal coauthor) and Subika Farazi. Kevin Carey and Cedric Mousset provided contributions and Diego Sourrouille and Rimal Kacem provided research assistance.

**Financial Sector Reforms in MENA:** Over the past decade, many countries in the region have implemented financial reforms to strengthen their banking systems and promote financial development. These reforms have not been deep and most financial systems remain undiversified, uncompetitive, and exclusive.

Banks are large but have focused on large and well-connected enterprises and failed to provide access to large segments of the population and the enterprise sector, including lending for small and medium enterprises and housing. Poor access has contributed to the slow growth of per capita incomes and the limited employment opportunities and housing for MENA's young and growing populations.

MENA banks dominate the region's financial landscape (Figure 2), with average assets amounting to 130 percent of gross domestic product (GDP). Most other segments of the financial sector remain undeveloped. On average, insurance companies and mutual funds account for less than 5 percent of GDP, leasing and factoring amount to less than 1 percent of GDP, and private pension funds are negligible. The microfinance sector is very small with outstanding microcredit accounting for just 0.2 percent of GDP. Equity markets are large in some countries, but market capitalization is dominated by financial and infrastructure companies. Listings of firms in industry and services are restricted. Private fixed-income instruments, such as corporate and mortgage-backed bonds, remain limited.

Figure 2



**Banking Systems in MENA and Access to Finance:** The region's banking systems are generally well capitalized, and generally weathered the effects of the global financial crisis well, although the recent political turmoil is putting pressure on several non-Gulf Cooperation Council (GCC) countries, especially those directly affected by the Arab Spring. Credit recovery may prove slower than expected in these countries, especially those directly affected by political unrest. However, the extent and breadth of the recovery is possibly an even more important question for MENA's long term performance than the speed of recovery. Large segments of the household and enterprise sectors may remain deprived of credit because MENA's financial systems are not inclusive. Banking systems may be large and generally well capitalized, but the region also has the highest loan concentration ratios in the world, reflecting the focus of banks on large and well-connected enterprises (Figure 3). A large share of the population does not have access to financial services, especially in remote areas. Small and medium enterprise finance and microfinance are not well developed in most countries (Figures 4 and 5), and housing finance is still in a nascent stage. These deficiencies have limited the growth performance of MENA countries and hindered their capacity to generate employment and housing for the young.

Figure 3

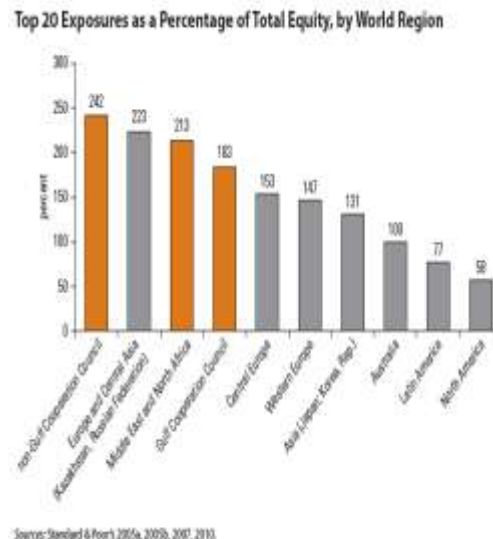
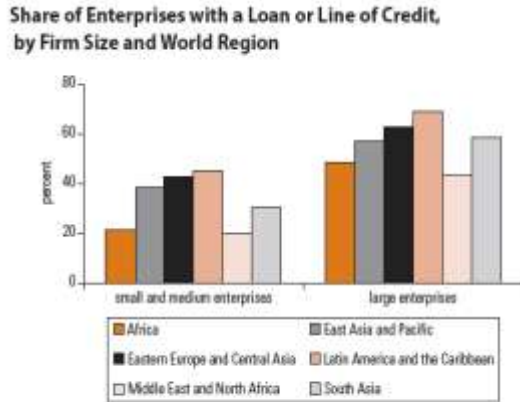


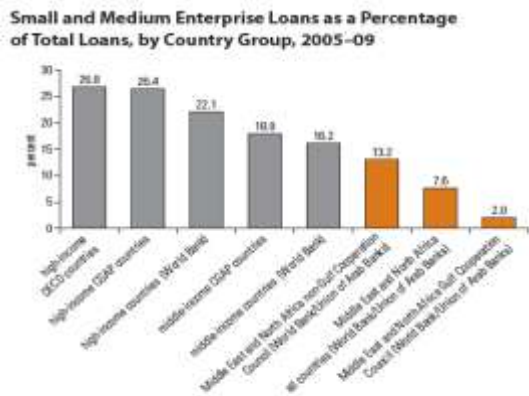
Figure 4



Source: World Bank surveys conducted between 2005 and 2010.

**Factors Inhibiting Access to Finance:** Three interconnected factors account for the poor access to finance. First, the region’s financial infrastructure is still poor: coverage and depth of credit information are still limited, and collateral and insolvency regimes remain extremely deficient. Second, bank competition is weak, because of the dominant position of state banks in some countries, restrictions on license procedures, limited credit information for smaller banks, lack of strict supervision of large exposures and connected lending in many countries, and lack of alternatives to bank finance. Third, nonbanking financing institutions and financial instruments are undeveloped, because of the lack of enabling legislation and the absence of benchmark yield curves, among several other reasons. This lack of development hinders bank competition and prevents the development of adequate funding for sound long-term lending.

Figure 5



Source: World Bank staff compilation based on data from IFC 2010; CGAP 2010; Beck, Demirgüç-Kunt, and Martínez Peria 2009; Rocha and others 2010.

Note: Group averages computed. CGAP = Consultative Group to Assist the Poor.

**The Regional Financial Development Agenda:**

Most MENA countries face a challenging financial development agenda designed to substantially expand access to finance. Strengthening financial infrastructure is the first component of this agenda. Credit information must be strengthened significantly, possibly through the introduction of more private credit bureaus. Collateral regimes must be overhauled, especially for movable assets.

Bank competition must be strengthened with the reduction of the role of state banks in some countries; the review of licensing procedures; the improvement in credit information for small banks; stricter supervision of large exposures and connected lending; the development of alternatives to bank finance (corporate bonds, leasing, factoring); and the introduction of competition agencies.

Nonbank financial institutions and instruments need to be developed through specific and well-articulated reform agendas for each sector and market. Foreign investors should be allowed to play a greater role, as they can boost market development, especially during the period in which private domestic institutional investors are being developed.

**The Financial Stability Agenda:**

The financial development agenda needs to be matched by a financial stability agenda ensuring that financial systems remain resilient as access is expanded and new risks emerge. The financial stability agenda comprises improvements in microprudential supervision (further progress in Basel II implementation, stronger capital buffers in the non-GCC region, stronger supervision of concentration and mismatch risks); substantial improvements in bank governance (more professional and independent boards, stronger board committees, strong and more independent risk management functions); and the strengthening of macroprudential supervision (better institutional arrangements to address systemic risk and crisis management and introduction of a broad set of macroprudential/ countercyclical tools).

It is hoped that implementation of this combined agenda of financial development and stability will increase prosperity in MENA economies in this decade and beyond and contribute to the improved well-being of the region's population.

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