



## THE ROLE OF STATE BANKS IN THE MENA REGION

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**Introduction:** The MENA region was generally less affected by the global financial crisis than other regions, though some sub-regions and countries were impacted more than others.

GCC countries, for example, were more impacted because GCC banks were more over-extended compared to non-GCC banks. They had higher loan-to-deposit ratios and were borrowing abroad to sustain a very high rate of credit growth. Moreover, they were also much more exposed to the real estate sector. Thus, when wholesale markets worldwide froze, the funding of GCC banks was immediately affected, while the bursting of the real estate bubble also affected the quality of their assets. In the case of non-GCC countries, banking systems are generally less globally integrated and less dependent on external funding. Therefore, the effects were milder.

Now, three years later, the crisis has subsided and there are signs that credit growth is beginning to recover in many emerging countries. Similarly, we have witnessed a recovery of credit growth in most MENA countries in the last few months, in both the non-GCC and GCC countries. The question is whether state banks played any role in this recovery.

**Role of state banks in the global economic recovery:** In MENA, state banks played a less important role in the recovery as compared to several countries in Latin America and South Asia, as well as China, where state banks played a counter-cyclical role. When private

banks started circumscribing credit, state banks stepped in. The impact of this counter-cyclical role has been widely acknowledged. For example, a recent issue in *The Economist* contained a lengthy article on emerging country banking, acknowledging how state banks had played an important counter-cyclical role in many emerging countries. Given this recent experience, some MENA countries may decide to retain an important role for state banks, including reformist countries such as *Egypt* and *Tunisia* that had been privatizing state banks and allowing the entry of foreign banks over the last decade.

**The importance of state banks in MENA:** Regarding the role of state banks in the financial system, we can classify MENA countries into three broad groups. In the first group of countries, state banks lead the banking system and the financial sector. These countries include *Algeria*, *Libya*, *Iran*, *Iraq*, and *Syria*. It is worth noting that the role of state banks has declined in the past four years in some countries like *Syria*, but they still represent more than 70% of the banking system.

A second group of countries include those where the state banks no longer lead, but still play an important role in the financial system. These countries include *Egypt* and *Tunisia* where state banks still make up a significant portion of the financial sector, accounting for approximately 45% of the banking system in *Egypt*, and about 33% in *Tunisia*. In these two countries, a decision was made that state banks will continue to play an important role. And as we saw with the recent crisis, those governments now may feel that their decision to retain an important role for state banks has been vindicated. In some respects, *Morocco* falls into

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the second grouping, though state banks account for a smaller share of the system.

Finally, a third group of countries are those where private banks lead and the state banks play little or no meaningful role in the financial system. Countries in this group include *Bahrain, Kuwait, Jordan, Lebanon, Oman, and Qatar*.

**The financial crisis has not resulted in fundamental changes in MENA:** While the crisis led to some reconsideration of the role of state banks in some MENA countries, we have not seen a fundamental change in paradigms in the sense of a fundamental revision of the role of the state in the financial system. For example, countries in the second group like *Egypt* or *Tunisia*, have not determined that previous reforms should be reversed and that state banks should now take the lead. In fact, *Tunisia* considers that the ownership structure of its banking system is balanced and should be maintained: i.e. one third state banks, one third private domestic banks, and one third foreign banks. Likewise, with countries in the third group where the banking systems are privately dominated, we do not see a movement to reintroduce state banks.

The situation in MENA contrasts with other regions like Latin America and countries like India where state banks have increased their share because of the crisis. In these cases, state banks increased their share for two reasons: (i) they continued extending credit whereas the private banks contracted lending, and (ii) in some countries, state banks bought insolvent private banks to protect the financial system.

In MENA, we do not see any significant change in market shares between state banks and private banks. At the same time, it is also true that state banks will probably continue to play an role in several MENA countries, not only in the countries in the first group (where they lead the financial sector), but also in the second group (where they do not lead but still retain a significant market share). This situation will not change in the near future, not only because some countries may have decided to retain an important role for state banks, but also because the crisis has frozen the privatization market, or

it is still a poor market in terms of the quality of the buyers and in terms of prices.

**The role of the World Bank in a post-crisis world:** It is important for the World Bank to remain engaged in the post-crisis world. While state banks may have played a counter-cyclical role and may also have contributed to the achievement of some access objectives, their historical performance in most countries has been generally weak. Since many state banks in MENA are expected to remain state-owned for some time, we need to assist governments to ensure that they are well governed, especially in cases where there was a very important public investment made in these banks to ensure their solvency. In this regard, our engagement has taken several forms.

FSAPs<sup>2</sup> provide a basic vehicle for diagnostic and policy dialogue. The issue of governance of state banks in MENA has been recently addressed in several FSAPs, including Egypt, Morocco, and Syria, for example. The FSAP allows for an initial diagnostic of the situation in this area, although it frequently cannot dig deeper, because the team is expected to cover the whole financial sector.

Bank governance assessments provide a much more focused diagnostic of the quality of bank governance. Where state banks are present, the assessment makes an effort to examine the special governance challenges affecting these banks. Recent bank governance assessments in MENA have included Kuwait, Morocco, and Syria. In the last two countries, the team examined the particular governance challenges of state banks. This is a good diagnostic tool, and the Bank has been making an effort to conduct this type of exercise in other MENA countries.

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<sup>2</sup> The [Financial Sector Assessment Program \(FSAP\)](#) is a IMF-World Bank initiative launched in 1999, which provides in-depth examinations of countries' financial sectors. FSAPs assess both the stability of the financial system and its potential contribution to growth and development, and provide recommendations to strengthen the former and maximize the latter. Assessments are done jointly by World Bank and IMF staff in developing and emerging market countries (IBRD countries) and by the IMF alone in advanced economies.

In addition to diagnostic work, the Bank has also made an effort to improve state bank governance and performance by supporting key reforms and policy actions in Development Policy Loans (DPLs), such as the 2005 *Morocco* DPL, and the more recent DPLs in *Egypt* and *Iraq*.

The role of state banks and the associated governance challenges are issues that are being addressed by other regions as well, and this is motivating more analytical efforts inside the World Bank. The financial sector network has recently created a working group that is making an effort to understand what the participation of state banks is today: whether it has increased, what it implies for the future, and what the governance challenges are. The finance team in MENA is part of this working group and is not only benefitting from the experiences of other regions, but also contributing to the body of knowledge by sharing its experiences in MENA.

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