

1. BEFORE FILLING OUT THIS FORM, READ THE ATTACHED INSTRUCTIONS.
2. USE LETTER QUALITY TYPE, NOT DOT MATRIX TYPE.

IDENTIFICATION DATA

A. Reporting A.I.D. Unit:
Mission or AID/W Office BANJUL, THE GAMBIA
(ES# _____)

B. Was Evaluation Scheduled in Current FY Annual Evaluation Plan?
Yes Slipped Ad Hoc
Evaluation Plan Submission Date: FY

C. Evaluation Timing
Interim Final
Ex Post Other

D. Activity or Activities Evaluated (List the following information for project(s) or program(s) evaluated; if not applicable, list title and date for the evaluation report.)

Project No.	Project / Program	First PROAG or Equivalent (FY)	Most Recent PACD (Mo/Yr)	Planned LOP Cost (000)	Amount Obligated to Date (000)
635-0234	Financial Sector Restructuring (FSR) Project Assistance	---	3/95	1800	1800
635-0233	Financial Sector Restructuring (FSR) Non-Project Assistance	---	12/94	5000	5000

ACTIONS

E. Action Decisions Approved By Mission or AID/W Office Director

Action(s) Required

INTEREST RATES

- * Use period averages for Bank reserve and liquidity compliance requirements.
- * Permit foreign-currency bank accounts.
- * Reduce T-Bill sales.
- * Reduce minimum T-Bills denomination.
- * Exempt government securities from bank capital adequacy standards.

BANKING INDUSTRY COMPETITION

- * Give special consideration for licensing of majority local ownership banks.
- * Avoid in-depth supervision and regulation of NGO's and NBFI involved in finance.

CONFIDENCE IN LEGAL SYSTEM

- * Dispose of Asset Management Recovery Corporation portfolio quickly through negotiation.
- * Supply Sheriff with resources to perform job.

ALTERNATIVE FINANCIAL INSTITUTIONS

- * Reduce the minimum start-up capital requirement for rural banks.
- * Open regional Central Bank offices to service rural banks.
- * Enact stronger regulation of the Insurance sector to enforce capitalization requirements.

Name of Officer Responsible for Action

Date Action to be Completed

Central Bank	Reviewing
Central Bank	Reviewing
Central Bank	Completed
Central Bank	Completed
Central Bank	Reviewing
Central Bank /Finance	Reviewing
Central Bank	Accepted/ In place
AMRC	Accepted
Justice	In Budget
Central Bank	Reviewing
Central Bank	Reviewing
Finance	Reviewing

APPROVALS

F. Date of Mission Or AID/W Office Review Of Evaluation: (Month) (Day) (Year)
11 1 1994

G. Approvals of Evaluation Summary And Action Decisions: Fred Witthans/Nancy McKay, Rose Marie Depp

Name (Typed)	Project/Program Officer	Representative of Borrower/Grantee	Evaluation Officer	Mission of AID/W Office Director
Signature	<u>N. M. McKay</u>		<u>F. Witthans</u>	<u>R. M. Depp</u>
Date	<u>3/20/95</u>		<u>11/30/94</u>	<u>5/2/95</u>

The purpose of the FSR program is to improve the efficiency of financial intermediation in promoting savings and investment and in allocating savings to their most productive uses. This evaluation (2/94-3/94) was conducted by a team from Development Alternatives Inc. (DAI). The team studied the financial sector and their final report provides guidance to the Government of The Gambia (GOTG) and to donors on what additional reforms or institutional changes are needed to improve financial intermediation and to achieve the overall FSR program purpose. The team reviewed project documents and interviewed over 50 people in The Gambia from the business, government and professional communities. There was widespread recognition that USAID projects contributed to the improvement of the economic environment and the reforms implemented had a positive impact on the lives of Gambian citizens.

Major Issues Addressed by the Consultants:

- o interest rate levels;
- o banking industry competition;
- o lenders confidence in the legal system; and
- o alternative financial institutions or financial instruments needed to accelerate development in the financial sector.

Major Findings and Conclusions:

- o Interest rates are too high for investments to be financed domestically, but the rates are in line with those being charged in similar LDC's.
- o High interest rates on loans and the concentration of most bank branches in the greater Banjul area indicate that there is room for additional competition, especially in the rural areas. Increased competition may result in higher default rates on loans.
- o Lenders **DO NOT** have confidence in the legal system. The credibility of the Gambian Judiciary and the GOTG was substantially reduced due to its well publicized inactivity in supporting debt recovery.
- o Privately owned single branch savings and loan institutions in the rural areas should be licensed by the Central Bank. These banks will become the primary conduit of formal financial services in the rural area.
- o Alternative financial institutions and instruments to be introduced should include a mortgage lending market, electronic or wire transfer service, semi-formal debt market, and urban marketplace credit programs. These institutions and instruments will accelerate financial development.

COSTS

I. Evaluation Costs

1. Evaluation Team		Contract Number OR	Contract Cost OR	Source of Funds
Name	Affiliation	TDY Person Days	TDY Cost (U.S. \$)	
Dan Heldridge	DAI	34 days		DFA
Mack Ott	DAI	34 days		DFA
Benjamin Carr	DAI	24 days		DFA

2. Mission/Office Professional Staff
Person-Days (Estimate) 5

3. GOTG

15

2

SUMMARY

J. Summary of Evaluation Findings - Conclusions and Recommendations (Try not to exceed the three (3) pages provided)

Address the following items:

- Purpose of evaluation and methodology used
- Purpose of activity(ies) evaluated
- Findings and conclusions (relate to questions)
- Principal recommendations
- Lessons learned

Mission or Office

BANJUL, THE GAMBIA

Date This Summary Prepared:

MAY 1994

Title And Date Of Full Evaluation Report:

THE GAMBIAN FINANCIAL ENVIRONMENT
AND IT'S ABILITY TO SUPPORT SUSTAINED

The purpose of this report was to provide guidance to the GOTG and to donors on what additional reforms or institutional changes are needed to improve financial intermediation in The Gambia. The objectives of the FSR program included the elimination of credit controls, establishment of policies of indirect monetary control and effective bank supervision, privatization of the Gambia Commercial and Development Bank (GCDB), adherence to a repayment schedule for nonperforming loans in GCDB's portfolio, and enactment of legal reforms. The consultants determined that the FSR project was largely successful in its goals. Government involvement in banking and credit was reduced.

"Most of the objective milestones set out in the FSR have been attained, including elimination of credit controls, establishment of policies of indirect monetary control and effective bank supervision, privatization of the Gambia Commercial and Development Bank, establishment of the AMRC, and enactment of other legal reforms. Unfortunately, progress on AMRC debt recovery and adherence to repayment schedules, enhancement of lender collateral security and mobilization of savings have not been attained."

In 1985 The Gambia began implementing its "Economic Reform Program" which was designed to stabilize and restructure the economy. Since then, The Gambia has become a favored country by the international donor community. Official and unofficial donor assistance from 1986-92 has averaged 16.8 percent of GDP. This substantial donor support has allowed the GOTG to boldly undertake economic reforms with the support of aid flows, while taking a leisurely approach to implementing controversial reforms. The positive reforms enacted include liberalized internal and external financial markets, floating exchange rates, and an indirect system of monetary control.

The research methodologies used included a review of previous studies of the financial sector especially those funded under FSR; interviews with over 50 people from the Gambian business, government, and professional communities; and analysis of data related to the economy and to commercial banks obtained from the IMF and from several ministries.

SPECIFIC ISSUES ADDRESSED DURING THE STUDY INCLUDED

I. INTEREST RATE

The consensus in the business and donor communities in The Gambia is that loan interest rates are too high to support broad based sustainable economic growth. The prime lending rates of the largest bank in The Gambia have averaged from a high of 25% in 1987 to the current rate of 19%. Although interest rates in The Gambia may initially appear to be high, they are in line with those charged in other LDC countries under similar IMF financial restructuring programs, and do not appear to be excessive after taking into consideration the costs associated with lending. Notwithstanding the justification for the high rates, they are still too high for prime borrowers.

The research team believes that a combination of a reduction in the inflation rate and the loan default rate would have the most significant impact in reducing the interest rates charged by banks. Interest rates can be further reduced by decreasing banking administrative costs, including the company tax, the capital and liquidity reserve requirements, and high costs associated with inefficiency of banks. In addition, a lower business tax rate would reduce the contribution that an asset must provide to be attractive.

Some banks fail to use sensible loan pricing, ignoring a borrower's risk profile, and charge almost identical interest rates to all borrowers. Loan pricing should be a function of risk, reward and overhead.

RECOMMENDATIONS FOR REDUCING INTEREST RATES

- A. Credit and interest decisions of commercial banks should be independent from the Central Bank (CB).
- B. Change reserve and liquidity compliance requirements to period averages (biweekly or monthly) instead of daily.
- C. Establish an interbank market with the CB acting as broker/intermediary to maintain anonymity between buyers and sellers of interbank deposits. Exempt interbank deposits from reserve requirements.
- D. Exempt securities of the GOTG from the capital adequacy standards and reduce the weight for off-balance sheet items to the BIS weight of 20%. Clarify the period over which these standards are to be met.
- E. Allow commercial banks to offer foreign-currency denominated deposit accounts and provide forward cover against the dalasis.
- F. Lower the company tax from 50% to 35%.
- G. Reduce Treasury Bill sales to correspond with reduced fiscal and external deficits.
- H. Increase private non-bank purchases of T-bills by lowering minimum size from D5000 to D1000 and aggressively market them by offering T-bills on a convenient and well publicized basis to private savers through CB.

II. DISCUSSION OF THE BANKING INDUSTRY AND COMPETITION

The Gambian banking industry consists of four commercial banks, all majority foreign-owned, and all concentrating their activities in the greater Banjul area. Most bank loans are extended to the 30 to 40 largest traders in The Gambia and are typically used as a means of attracting the more affluent clientele to their bank.

Due to the lack of confidence in the legal system in enforcement of contracts and aversion to credit risk, banks prefer government securities.

High interest rates and limited branching indicate there is room for additional competition. A locally owned bank is more likely to penetrate the middle market and small business sectors, although the risk of improper lending practices may be higher.

RECOMMENDATIONS FOR INCREASING BANK COMPETITION

- A. Maintain the existing liberal environment for foreign banks, but give special consideration to future banking license applicants who propose majority local ownership. Consider licensing independent, single branch rural banks.
- B. The Banking Supervision Department of the CB should monitor trends in fees and commissions charged by banks since 1992 reforms. Review trends by borrower size, industry, and other factors. Share general trends with the banks.
- C. Encourage interbank trading of reserves and promoting negotiable certificates of deposit which will increase overall liquidity of the banking system.
- D. Encourage commercial banks to price their loans according to risk/reward and overhead on a case-by-case or at least sectoral basis.
- E. Replace the present liquidity rule with more qualitative requirements for liquidity planning to minimize timing risks and improve efficiency and profitability through balance sheet management.
- F. BSD should offer training in basic liquidity management to the commercial banks.
- G. Avoid in-depth supervision and regulation of NGO's and NBF's.
- H. Clarify the definition of "Insolvency" in the new Acts to avoid conflict with bank shareholders and depositors in the event of intervention and to ensure BSD adheres to responsibilities during times of banking crisis.
- I. DO NOT implement Deposit Insurance.
- J. Initiate a credit bureau which is desired by bankers and NGO's.

III. DISCUSSION OF ALTERNATIVE FINANCIAL INSTITUTIONS

The consultants recommended a number of possible alternative financial instruments and services which might contribute to further success in development of the financial sector.

Rural banks offer the best opportunity to expand formal financial services into rural areas, providing there are rural investors with sufficient wealth and expertise to establish a small bank. These banks could become providers of liquidity and critical services to NGOs, NBFIs, and other informal intermediaries in the region.

RECOMMENDATIONS FOR NEW FINANCIAL INSTITUTIONS

- A. Establish special regulations for rural banks requiring less minimum start-up capital and limiting the banks to single units.
- B. Open regional CB offices to service banks located in the interior of the Gambia.
- C. Implement regulations for the Insurance sector to enforce capitalization requirements.
- D. **DO NOT** create a new development bank.
- E. Establish a semi-formal debt market, an active mortgage lending market, a marketplace credit program, and wire transfer service.
- F. Examine the programs adopted by labor exporting countries to facilitate funds transfer back to the country of origin.

IV. DISCUSSION OF THE LEGAL SYSTEM

Due to the lack of commitment in AMRC debt recovery and enforcement of Gambian laws, the GOTG's credibility has deteriorated. The GOTG does not have in place, nor enforce, penalties that are predictable, consistent, and transparent for non-compliance of laws.

Commercial banks **DO NOT** have confidence that the legal system will support foreclosure of loans. The banks believe that the Mortgage Act 1992, Sections 18 and 20, which require Court approval to appoint a receiver and to sell pledged collateral, has severely reduced their ability to collect on defaulted loans. This ultimately has resulted in a reduction in bank loans that require mortgage-secured collateral. If the GOTG is committed to a liberal market process of development, private property must be secure and banks must be confident that they can obtain judicial relief when contracts are broken.

The tax system appears to be based on the ease of collection, and not on a systematic analysis of cost and benefit. In addition, the tax rates are too high and the base is too narrow. More direct taxes should be imposed and collected. Enforcement will be the key. Government creditability will follow.

RECOMMENDATIONS FOR IMPROVING THE LEGAL SYSTEM

- A. Dispose of the AMRC portfolio quickly through negotiation.
- B. Rescind Sections 18 and 20 of the Mortgages Act.
- C. Provide the Sheriff with resources to perform his job.
- D. Reduce the company tax rate to 35% and abolish the turnover tax.
- E. Exempt Retained Earnings from the company tax.
- F. Require audited income statements and income tax certificates of payment for annual renewal of business licenses.
- G. Abolish the capital gains tax on securities.

ATTACHMENTS

K. Attachments (List attachments submitted with this Evaluation summary: always attach copy of full evaluation report, even if one was submitted earlier; attach studies, surveys, etc., from "on-going" evaluation, if relevant to the evaluation report.)

1. DAI Report "The Gambian Financial Environment and its Ability to Support Sustained Economic Development"
2. Letter dated 5 September 1994 from the GOTG Central Bank commenting on the study.

COMMENTS

L. Comments By Mission, AID/W Office and Borrower/Grantee On Full Report

In general, the report was adequate. The first section regarding interest rates was more an academic explanation of how interest rates are calculated, than what is actually needed to be done in The Gambia. Much of the report is a transcript of comments expressed by interviewees.

The contractors failed to incorporate corrections to the final draft submitted by the mission, nor were the missions' recommendations taken into consideration.

The consultants recommended that the CB establish an interbank market and exempt deposits from reserve requirements. This was previously attempted and the commercial banks failed to support this market. In regard to rescinding sections 18 and 20 of the Mortgages Act, the mission does not believe this is in the best interest of The Gambia. Although these sections may currently impede enforcement of debt recovery in the eyes of the bankers, laws are written to protect both parties in contracts, not just the creditors.

This evaluation was completed just prior to the July 1994 Coup d'etat in the Gambia. While the Mission shared the report with the Central Bank which reviewed the findings and responded in writing, USAID was simultaneously closing its assistance program as required by Section 508 of the FY 1994 and 1995 of the foreign Assistance Appropriation Acts. Therefore, the actions reflected in this summary represent the status of the recommendations as of the date when assistance to The Gambia was terminated pursuant to statute on March 21, 1995.