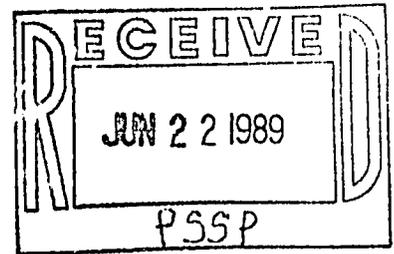


REPUBLIC OF ZAIRE

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PN-ABE-105

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FINANCIAL SECTOR

DEVELOPMENT POLICY STATEMENT

(USAID - GRANT) : ~~to~~ Zaire

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May 1989

## BACKGROUND

1. Since 1983, the economic and financial policy of the GOZ has been conducted with a view toward reinforcing budgetary discipline and regulating the creation of domestic liquidity in order to reduce inflation and the deterioration of the exchange rate. The management of prices and the rate of exchange were intended to create favorable conditions for restoring confidence and ensuring sustainable economic recovery.
2. The overall policy and strategies used consisted of a separation of roles whereby the government decided to devote its efforts to promoting policy incentives and improving the business climate, leaving the main initiative in productive activities to the private sector.
3. Under this liberal policy, the GOZ allowed free pricing by the economic operators for almost every product. All current transactions in external payments were deregulated and decentralized for approved banks. A floating system of exchange was adopted whereby the rate of exchange was dependent on supply and demand in the foreign exchange market. Interest rates on bank loans were no longer fixed by the Central Bank, except for agricultural credit which also lost this privilege as of 1987.
4. All of the steps taken in matters of economic and financial policy were related to the successive agreements signed with the International Monetary Fund. These agreements, in the form of annual programs, included measures related to budgetary adjustment and monetary restrictions with a view to ensuring financial soundness and stability.
5. The results of this overall policy were convincing. Economic activity improved somewhat in 1984 and 1985. The rate of inflation, estimated at over 100% in 1982, was reduced to 39% in 1985. In spite of floating, the depreciation of the rate of exchange was contained at around 30% per year between 1983 and 1985. The balance of payment deficit was reduced, despite the deterioration of the terms of trade and strict compliance with due dates for external debt. Furthermore, the budgetary deficit, estimated at nearly 9% of the G.D.P. at current prices in 1982, represented less than 2% of this aggregate for the period 1983 to 1985.
6. The positive results obtained during 1984 and 1985, however showed the necessity of making structural reforms in order to encourage sustained economic growth and lasting improvement in the standard of living of the population. Therefore, in support of the 1986-1990 five-year Plan, the GOZ, assisted by the World Bank, initiated a process of implementing structural adjustment programs.. Moreover, in 1986 the GOZ and the World Bank agreed upon an Industrial Sector Adjustment Credit (ISAC) which was not implemented until 1987. This sectoral program support credit involved customs reforms to revitalize the manufacturing sector and increase its

contribution to the gross domestic product. During the same year, Zaire entered into a structural adjustment program (SAP 1), defining reforms in several sectors with a view to increasing efficiency.

7. The first comprehensive adjustment program (SAP 1) includes a monetary and financial reform component. Through this component, the GOZ intended to relax controls on the money supply and improve resource mobilization by financial intermediaries in order to finance more productive uses in the medium and long term. Some measures, consistent with the basic elements noted above, were implemented under SAP 1, including the liberalization of the rates of interest on agricultural credit, authorization given to banks to allocate their annual credit ceilings to sectors of their choice, lifting of CCA (Turnover Tax) over agricultural credit, and the establishment of a consultative board on agricultural credit.

8. The adjustment of the financial sector which is being negotiated with the World Bank includes three components: monetary policy, bank supervision, and restructuring of non-bank financial institutions.

9. In this area of monetary policy, the goal will be to use indirect controls and, meanwhile, to improve the mobilization of available resources for productive uses in the medium and long term. Actions will be taken at different levels: the money market, treasury bonds, rediscounting and current account advances to banks, reserve requirements and term credit.

10. The money market should be adjusted by the intervention of the Bank of Zaire to allow the emergence of an optimal rate of interest; the opening of the market to institutional investors is also considered. The Central Bank will exercise its regulating role through the rate and volume of liquidity it supplies.

11. The treasury bond market calls for the harmonization of interest rates (bonds subscribed to by the public and those reserved to banks) and their adjustment according to the development of the money market. The rate of rediscount and that of current bank account advances will also be adjusted based on the same market.

12. The review of the composition of the reserve requirement basis will be aimed at reducing the dichotomy between the need to control liquidity and the objective of encouraging resource mobilization so as to stimulate financial intermediation.

13. The actions to be taken in the area of bank supervision will be aimed at improving the stability of the financial system by defining a set of standards to be followed, and policies governing customers.

14. The purpose of restructuring non-bank financial institutions will be to reinforce the existing system which should include the following actions:

- The definition of a legal and financial framework for cooperatives
- Reorganization of the Fonds de Convention de Développement (Convention Fund for Development) with the possibility of merger with the Agricultural Credit Bank (BCA).
- Opening of the insurance sector to competition and improvement of SONAS (National Insurance Company) management.
- Reorganization of the SOFIDE (Development Financing Company) portfolio.
- Auditing CADEZA (National Saving Bank), INSS (National Social Security Institute) and NBK (New Bank Of Kinshasa) to identify actions for recovery.

#### FINANCIAL SECTOR ANALYSIS

15. The financial sector of Zaire includes the Central Bank, eleven commercial banks and two development banks, SOFIDE and BCA. The non bank financial sector includes two commercial bank branches which specialize in financing construction and real estate, one insurance company (SONAS), one saving institution (CADEZA), one postal account network (CCP), one social security fund (INSS), public financing funds such as Convention Fund for Development, as well as a number of savings cooperatives (COOPEC). This sector is responsible for mobilizing domestic financial resources to finance economic growth, with an emphasis on agriculture and small and medium enterprises.

16. The analysis of the sector's activities reveals that, apart from deposit banks, the non-bank financial institutions remain underdeveloped. However, in spite of their strong performance relative to non-bank financial institutions, the banks have not sufficiently captured the currency in circulation within the economy.

17. The Bank of Zaire's monetary policy actually contains provisions aimed at inducing the Banks to mobilize public savings. From this point of view, the Central Bank linked the distribution of quarterly credit ceilings among banks to the volumes of their respective deposits. Furthermore, to encourage medium and long term resource mobilization, the Central Bank subjected the granting of medium term loans to their partial coverage by deposits of a similar nature.

18. Despite these regulations, it must be recognized that the banks' financial intermediation function did not allow most currency in circulation to be channelled towards them. Currency outside of

banks represents over 50% of the money supply. Term deposits, which constitute security for the investment credits necessary for economic growth, represent less than 10% of overall domestic resources.

19. The poor collection of deposits by the banks is due to several factors, especially rates of interest, which are not attractive enough, considering their being negative compared to inflation, the non-remunerative nature of the reserve requirement, restrictive credit policy, which creates some aversion to bank money, and because the government makes most payments in cash. It is also necessary to take into account the longer delays in processing deposits made by agencies in mining areas, as well as other factors.

20. Given the restrictive character of the credit policy over the past few years, the commercial bank loans were inadequate in real terms. Most credit was provided for short term financing of external trade. The banks granted very little credit for investment, partly because of the lack of appropriate deposits as well as the foreign currency required to cover the imports resulting from such financing. In view of the importance of medium term credit for development and of the interest in the agricultural sector, the GOZ has established credit floors for both sectors which are the minimum bank financing to be granted to them.

21. The cost of credit is high: presently, the rate of interest for borrowers exceeds 60%. Such a situation has an discouraging effect on credit for agricultural production credit, and in general on credit for any productive activity oriented toward external commerce.

22. Term deposits are poorly paid by the banks and the gap between the bank debit and credit rates sometimes reaches over twenty points.

23. Term deposits and treasury bonds are the only possibilities of financial investment. Apart from the real return issue, the development of reported securities in particular and any other securities are handicapped by the lack of a secondary market.

24. The non bank financial institutions in general played an inadequate role of collecting savings and financing development projects.

25. The current functioning of the National Saving Bank (CADEZA) no longer meets its normal role as a savings bank, i.e.: to collect savings, remunerate depositors adequately, and finance general interest sectors (housing, infrastructure). All analyses demonstrate that its geographical distribution no longer matches its actual capacities.

26. SONAS has poor financial results despite its monopoly of insurance in Zaire. Its main activity focuses on the vehicle insurance branch, with its higher operating costs. The other

branches, which offer major potential for expansion, are capable of mobilizing long term savings for development financing.

27. INSS is responsible for collecting contractual savings for development purposes. Unfortunately, it does not play its role of financial intermediary adequately.

28. SOFIDE, which is the Zairian Development Bank, plays an overall efficient role in investment financing. However, it should be noted that it uses external resources in granting loans, the effective cost of which are very high because the exchange risk is assumed by the customer.

29. The saving and loans cooperatives play a significant role in the collection of household savings. But their role in financing development is limited; cooperative credit is still mainly consumption-oriented financing.

30. Overall, financial intermediation in Zaire is controlled by an inflation of budgetary origin, the high level of which renders negligible the return on savings held in the form of deposits, and the development of financial instruments as well as non-bank financial institutions.

#### OBJECTIVES AND ACTION PLAN

31. In the context of financial sector development, the Conseil Executif intends to pursue the objectives of developing the capacity of commercial banks to attract savings, and of stimulating banking and non-banking financial institutions to mobilize long term resources for the development of the private sector. In this regard, improvements in resource allocation and an increase in savings are essential components of the country's overall economic policy. This policy should lead to an improved business environment and an increase in private sector activity.

32. With the prospect of lower rates of inflation resulting from budgetary discipline on the part of the GOZ, the Central Bank intends to promote the emergence of a market-determined interest rate which it will influence through adjustments in the money supply. In this context, the Bank of Zaire's objective is to play the role of buyer and seller of last resort in the money market. Moreover, the GOZ intends to continue its policy of allowing commercial banks to set their interest rates on deposits and loans freely, in response to market forces.

33. The GOZ is taking concrete steps to reach these objectives. First, in 1989, the GOZ intends to limit its budget deficit to 3.4 percent of the Gross Domestic Product. Second, it intends to reduce inflation by the month of December 1989 to an annualized rate of less than 75 percent. Third, it will raise the ceiling on credit that commercial banks may allocate to private enterprises. Fourth, during the second half of 1989, it aims to attain positive real

interest rates on loans made by the Bank of Zaire. The Bank of Zaire has already increased its nominal interest rate to 45 percent in January 1989, and then to 60 percent in April 1989.

34. Positive real interest rates should help commercial banks to increase term deposits. Accordingly, financial resources mobilized by the commercial banks should increase steadily towards a target growth rate of 4 percent per year by 1994. In addition, the GOZ will encourage the banks to finance a wider range of enterprises than at present in terms of their size, the nature of their activities and their geographic location. A Financial Sector Working Group comprised of designated representatives of the Government of Zaire and the United States Agency for International Development will monitor the utilization of funds made available to commercial banks and importers under the Private Sector Support Program. This group also will identify steps to be taken to increase credit to private enterprises, particularly medium and small enterprises.

35. In order to help the banks to mobilize more resources, the GOZ plans to replace administrative credit ceiling (direct controls) with indirect controls on credit. The objective of a more active participation by commercial banks in the money market also implies a revision of the reserve requirement policy. The reduction of required reserves will increase the funds available for commercial bank lending and thereby help to finance development. Actions aimed at reducing reserve requirements, to minimum levels necessary for stability and efficient growth of the banking system, and replacing administrative credit ceilings will be examined by the Financial Sector Working Group.

36. Since current reserve requirements impose excessive opportunity costs on commercial banks, the commercial banks will be allowed to hold most of their required reserves in the form of treasury bonds paying market interest rates. The GOZ will take steps to insure the availability of such treasury bonds. The issue of payment of interest on required reserves maintained at the Bank of Zaire will be studied by the Financial Sector Working Group. The GOZ also intends to finance most of its budget deficit from the market at market-determined rates of interest.

37. The development of government financial instruments also implies the development of a secondary market for these instruments. The GOZ will examine the possibility of developing such a market. The Financial Sector Working Group will support this effort through appropriate studies.

38. In order for the money market to become more active and competitive, the Central Bank should open the market to non-banking financial institutions which also would benefit from new investment alternatives. The mechanisms for opening up the money market to such new institutions will be studied by the Financial Sector Working Group.

39. To improve the contribution of non-bank financial institutions to the development of the financial sector requires their restructuring. The terms of reference for this restructuring must be considered on a case by case basis. The Financial Sector Working Group will contribute to these studies.

40. The GOZ, which accepts the principle of increasing bank deposits, will undertake an evaluation of all actions aimed at reducing the proportion of money held outside the banking system.

41. In summary, the GOZ believes that all actions designed to improve the efficiency and potential of the financial sector must follow the policies for financial sector recovery to be implemented in the context of the forthcoming Policy Framework Paper.

42. The Financial Sector Working Group, established jointly by the Bank of Zaire and the U.S. Agency for International Development, will provide a forum for research, analysis and discussion of financial sector policy issues. It will also be a forum for continued monitoring of program progress and for developing performance criteria upon which future USAID contributions will depend.

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