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WHICH FINANCIAL SYSTEM FOR CONGO?
Gateway for the development of a coherent and
efficient financial system?¹

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**WHICH FINANCIAL SYSTEM FOR CONGO?
Gateway for the development of a coherent and efficient financial system? ¹**

Summary

This think tank evaluates the competitiveness of the Congolese financial system and suggests some leads for the development of a coherent and efficient system. Analyses have demonstrated that the Congolese financial system should be reformed and modernized as several evaluations have sufficiently pointed out that the system is far from competitive. Taking into account the constraints, opportunities and weaknesses shown, the think tank outlines through a strategic analytical approach, the reforms to be put in place for the emergence of an efficient and coherent financial system with the ultimate objective of facilitating the flow of funds from savings to investors and a more efficient allocation of resources for the promotion of economic development and growth.

1. The opinions expressed in this document are attributable to the author and does not commit the United Nations Economic Commission for Africa

Introduction

1. Since 2001, the Government of the Democratic Republic of Congo and the Central Bank of Congo have achieved considerable progress in several respects notably the strengthening of the legal framework of the financial system, the improvement of monetary management, control of hyperinflation and putting in place a sound monetary and budgetary policy for the acceleration of economic growth.
2. In 2001 Laws were enacted on :
 - The new regulation on foreign exchange in 2001 leading to the establishment of an inter-bank foreign exchange market;
 - The opening of foreign exchange bureaux and financial services;
 - The adoption of a floating foreign exchange system in May 2001 and the liberalization of interest rates in June 2001.
3. In 2002 , the government enacted the following new laws:
 - Law 002/2002 on provisions applicable to Savings and Credit Cooperatives;
 - Law 003/2002 on the activities and control of credit institutions;
 - Law 005/2002 on the statutes of the Central Bank to strengthen its independence and authority as well as the regulation and control of financial intermediaries.
4. Finally in 2003, conscious of the increasing role played by micro finance institutions in the finance world, the Central Bank published Directive no. 001 on micro finance institutions.
5. Following the elections in 2006, the Government of the DRC drew up plans for the revitalization of the development process in several sectors of the economy including the strengthening of the financial sector. In order to achieve this goal, the Central Bank of Congo launched several ambitious projects such as continuing the process of formulating legislation and affiliate regulation on microfinance, the strengthening of the surveillance on banking and micro finance sectors, the formulation of laws on e-payments and the modernization of the national payment system. Nonetheless, there are still obstacles in the establishment of a viable and profitable financial sector that can provide access to financial services.
6. The continuation of the reform process in the Congolese financial sector should therefore aim at both establishing the crucial equilibrium for its efficiency and the confidence of the national and foreign economic operators in the Congolese financial institutions. There is need to inject a greater spirit of competition in the system through a strategic management approach to fine tune the related reforms

with the reforms already undertaken in the banking sector for the emergence of a more coherent and efficient financial system.

7. This paper outlines in the first section, the criteria for the competitiveness of a financial system as well as some economic and financial indicators of the DRC before and after the reforms were implemented; the second section evaluates the competitiveness of the Congolese financial system as a whole and underlines from its preceding development process, the structural obstacles hindering its efficiency. The third section outlines the leads that can produce a coherent and efficient financial system.

I. Financial system, competitiveness criteria, economic and financial indicators of the DRC

8. A variety of financial systems exists in different countries. Several countries have both financial markets and banks as mechanisms for the allocation of financial resources.
9. At the extreme end countries like the USA have a market based financial system whereas at the other extreme, countries like Germany have bank based financial systems in which the banks are dominant in the allocation of financial resources. The understanding of the advantages and disadvantages of the different financial systems was the subject of literary reviews with contributions from authors like: ALLEN and GALE {1994, 1999}, GOUX [1994], BOOT [1995] and THAKOR [1996].

Why do countries have different financial systems? Do economies have different needs, resources and technology requiring different financial systems? Do the different financial systems perform different functions or do they constitute the means for the attainment of the same goal? Can it be said that one financial system is better than the other? These are the questions that the authors mentioned above are trying to answer.
10. The aim of this section is no longer to answer these questions. It does not also aim at comparing the efficiency of any of these modes of allocation of financial resources. Its objective is to provide a synthesis of the assessment criteria of their competitiveness as this think tank is to design a framework for the selection of a financial system adapted to the realities of the Congo. This section outlines the development of some economic and financial indicators that justify the selection of complementary reforms that should be operative with due account taken of the current changes in the Congolese economy.

1.1 Financial system and competitiveness criteria

11. According to GOUX {1994}, “ a financial system is a series of mechanisms and actors participating in the financing process of the economy”. The fundamental objectives of any financial system are:
 - the facilitate the flow of funds from savors to investors through a credit system and to facilitate payments through payment mechanisms.
 - the ultimate objective of a financial system is to facilitate an efficient allocation of scarce financial and economic resources for the promotion of economic development and growth to improve living standards.

12. In order to achieve the objectives and seek solutions to issues concerning the allocation of financial resources, the financial system should be properly structured. On the issue of the structure of a national financial system, BARTH, BRUMBAUGH, RAMESH and YAGO{1998} note that the response lies in the appropriate combination of state intervention and market forces. SCHOLTENS {2000} confirms this response and underlines that three factors are crucial in the design of any financial system: the financial markets, the financial institutions and the financial regulation.
13. The review of the financial literature did not directly reveal the competitiveness criteria of the financial systems but the analysis of the competitiveness criteria of international financial centres was relevant in the evaluation of a financial system as it covers and fits in well with the three pillars in the design of a financial system {the financial markets, the financial institutions and the financial regulation}.
14. In McGAHEY et al {1994}, in a world of financial services with ever increasing competition, the countries can improve the attraction of their financial centres{ we are replacing the word centres with systems} by putting in place policies in four dimensional aspects of competitiveness namely: the costs and advantages of a location, the availability of a labour force, human resources, telecommunications, technology, regulation and taxation.
15. MIKDASH {1998} notes that the competitiveness factors of a financial centre are numerous and could be conveniently grouped in two categories: those focused on the whole economy and those which are specific to each financial intermediary.

Table 1. The competitiveness factors of a financial center

<p>Legal-economic environment</p> <ul style="list-style-type: none">• Market economy with sound and balanced macro-economic management, flexibility of the labour market { employment conditions, working hours, employment rules and laying off etc}, free movement of goods and services, convertible and stable currency.• Transparency, depth, liquidity, diversity and scope of financial markets.• Openness to countries with capital as well as intermediaries and foreign financial networks.• Skilled human resources {experts in finance, brokers, jurists, accountants and other professionals} and modern infrastructures{premises, communications, computerization, airports etc} accessible at competitive cost.• Honest and efficient administration, non discriminatory legal system, regulation and surveillance free of bottlenecks and promoting competition, innovation and prudence, stable and predictable socio-political system.• Fiscal system attractive to financial intermediaries{including the absence or tax reduction at source} and with a network of legal provisions barring double taxation.• Adequate security net {security of deposits, last resort liquidity, information on risks etc}• Quality and relevance of the research activities and the information emanating from specialized enterprises or academic circles.• Attraction of the country { climate, environment, culture, education, languages spoken, housing and offices, business meetings, international transport etc } <p>Specific assets for financial enterprises</p> <ul style="list-style-type: none">• Wide range of products and services• Favourable operational or transaction costs• Probity, competence, experience and good management• The skills and productivity of the multilingual collaborators• Robust and above average performance• Regular communication and continuous flow of reliable and relevant information• Effective competition• Innovative spirit at most to meet the changing and varied needs of the clientele• Non monopolistic institutional cooperation { payment or compensation systems, risk control, information on the financial markets, etc }• Protection of the privacy of the clientele.
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16. Before the evaluation of the competitiveness of the Congolese financial system, let us examine the salient characteristics before and after the reforms were undertaken in 2000.

1.2 Some indicators of the Congolese financial system before and after the reforms

17. The following table shows the evolution of some macroeconomic indicators with an impact on the development of the financial system.

Table 2. Evolution of basic macroeconomic indicators of the DRC

INDICATORS	1980	1990	1994	1998	1999	2001	2002	2003	2003	2005	2006
GDP [1] as %	2.2	-6.6	-3.9	-1.6	-4.4	-2.1	3.5	5.7	6.6	6.5	5.1
Budget Deficit as % of GDP{1}	-0.8	-6.5	-1.7	-6.2	-5.0	-1.7	-2.0	-4.1	-4.0	-3.0	-0.7
Currency [2] %	114	185	3.264	2.690	420	216.7	35	32.3	72.9	24.2	60.4
Inflation [2]	42.1	81.8	23.773	29.1	285	357.3	25.3	12.9	4.0	21.4	13.2
Expected Interest rate [1]	12%	45%	145%	22%	120%	140%	24%	8%	14%	34%	50%
Monetary market rate 1						140%	24%	8%	14%	15%	16%
Rate on current accounts	Na	na	Na	na	na	165%	49%	15%	18%	34%	50%
Appreciation [+] Depreciation[-] [3]	Na	-	-24.6	3.8	168.7	-10.4	-56.2	-13.5	-5.1	-2.1	11.6
Index of exchange in %		74.9									

Sources :

[1] : World Bank [2004], African Development Indicators 2004 Washington DC p.15, 19, and 32, 61-64

[2] I.M.F.[2003], International Financial Statistics, Yearbook 2003. p45,55 and 236.

[3] I.M.F. DRC Country Report No 07/329 data for the years 2001-2006

18. The Congolese financial system has a pyramid structural base with the Central Bank of the Congo at the summit issuing legal tender reference currency and at the base on the one hand the banking and non banking institutions and on the other small informal institutions with no direct relationship with the Central Bank but playing a significant role in the economic sector as well as in the financial system. However, it is dominated by the commercial banks despite the proliferation of micro finance institutions. It is also worthy to examine the evolution of some development and stability indicators of the banking sector in order to evaluate the performance of the reforms that were put in place.

19. BECK, DERMIGUC-KUNT and LEVINE [2000] developed a data base² for the calculation of the indicators of the financial structure of countries and the comparison of the financial development between countries. We copied the qualitative aspects of this data base to determine the evolution of the Congolese financial system. The data can be used as basis for comparison with the evolution in other African countries.

Table 3. : Evolution of the development indicators in the banking system (1980-2006)

INDICATORS	1980	1990	1994	1998	1999	2001	2002	2003	2004	2005	2006
GDP growth in %	2,2	-6,6	-3 ,9	-1,6	-4,4	-2,1	3,5	5,7	6,6	6,5	5,1
Budget Deficit in %	- 0,8	- 6,5	-1,77	- 6,2	-5,0	- 1,7	- 2,0	-4 ,1	-4 ,0	-3,0	-0,7
Money growth	114	185	3.264	2.690	420	216,7	35	32,3	72,9	24,2	60,4
Inflation	42 ,1	81,8	23.773	29,1	285	357,3	25, 3	12,9	4,0	21,4	13,2
Discount main rate	12 %	45 %	145 %	22 %	120 %	140 %	24 %	8 %	14 %	15 %	16 %
Maney market rate						140 %	24 %	8 %	14 %	34 %	50 %
Current account advance rate	nd	nd	nd	nd	nd	165 %	49 %	15 %	18 %	34 %	50 %
Appreciation [+] Depreciation[-] Effectivd exchange index in %	nc	-74 ,9	- 24,6	3,8	168,7	-10,4	-56,2	-13,5	-5,1	-2,1	11,6

Source : Our calculations are for the years before 2001. The other data are taken from the IMF Country Report 007/329 (page 25)

20. In contrast to other African countries where the financial systems are dominated by the commercial banks and the other financial institutions **which control 85 to 05** per cent of the assets of the system, the ratio of the assets of the **Central Bank** compared to the total assets of the financial system is higher than the sum of the corresponding ratios of the commercial banks and other financial institutions of the Congo.

² The database on the website: www.worldbank.org/research/projects/finstructure/database.htm. it comprises the indicators calculated from the international finance statistics published by the international monetary fund for the period 1960-2001 for some countries and 1980-2001 for others. The following four aspects are examined. the scope of the intermediary financing, the intermediation activity as well as the efficiency and structure of the bank market, the penetration by the insurance sector and the activities of the stock exchange market.

21. Between 2001 and 2006, the assets of the financial intermediaries ³ in the real sector reached an average of 22 per cent of GDP from the sampling of countries from Africa Sub Saharian. This shows an improvement in the contribution of the financial sector in the development of productive activities in the various countries. These assets only represent an average of 8 per cent of GDP in the Democratic Republic of the Congo during the same period including the assets of the Central Bank of Congo. Unfortunately, this ratio calculated for the Congo is weak but developing favourably.
22. On refining the preceding ratio through the isolation of the assets of the Central Bank (expressed as credit to government and public enterprises) and only considering that the principal activity is in the channeling of savings towards private investors by the commercial banks and other financial institutions, it has been observed that the contribution of the banking system to the printing of currency is marginal.
23. The volume of credit in Congo is very weak compared to GDP while the money supply focuses only on the issue of currency by the Central Bank of the Congo in contrast to other countries where the bulk of the credit is provided by banks and other financial institutions ⁴.
24. The analysis of deposits in the financial system compared to GDP as well as the degree of focus from the banking sector shows on the one hand that compared to other African countries, the percentage of deposits from individual Congolese in the financial system{ as a proportion of GDP} is very weak and has never exceeded an average 5 per cent. This figure indicates a weak level of financial penetration as well as the prevalence of an informal sector operating basically with cash.
25. On this issue, an IMF report {2003} noted that for a population of 54 million inhabitants, Congo has 35,000 bank accounts with most of them held by businessmen. The regulations on the banking system are limited and only represent 22 per cent of the money supply as at 31st October 2002.
26. In its annual report in 1998 noted that the collapse of several banks and the streamlining of private and quasi public banks accentuate under banking in the country. For a population of 54 million, the banking money supply has only 25 outlets namely 1 outlet for 2 million inhabitants resulting in the fact that there are entire provinces among the eleven in the country without a single outlet.

³ The sum of the ratios: Central Bank Assets to GDP +Deposit Money Bank Assets+ Other Financial Institution Assets to GDP.

⁴ The database shows that for the period 1996-2001, the assets of the financial system in the real sector was constituted basically from financing from the Central Bank up to 0.7 %, 3.1%,24%, 31%, 15%,and 1.7% of GDP for the respective years. The other components hardly contributed. The IMF report (2003) op.cit. p.26 notes that the Congolese commercial banks play a limited role in the collection of tax due to government and in the payment of government expenditure.

27. On the degree of penetration by the banking sector, the statistics from the data base indicate a high degree of penetration in a good number of West and Central African countries and thereby showing a low level of competition in the sector. The penetration of the insurance sector { life and non-life} is marginal in the Congo and this applies to a good number of African countries South of the Sahara. The life insurance premium in other African countries did not exceed 5 per cent of GDP.
28. Without stock exchange activities in the Congo, no comparison can be made with other African countries with a stock exchange market. Comparing the overall contribution of the financial sector to GDP formation ⁵, it has been observed that some countries have developed financial activity generating substantial value added with a considerable contribution to GDP formation: Cameroon in Central Africa, Egypt in North Africa, all the countries in the Southern African sample survey as well as Kenya in East Africa.

II. Evaluation of the competitiveness of the Congolese financial system

29. The financial system is currently dominated by the commercial banks. This section is based on the various conclusions from the diagnosis of the Congolese banking system and used for the following:
- to evaluate the overall competitiveness of the financial system after the reforms and
 - to identify the structural obstacles hindering its development so that a proposal can be made in the third section on the type of financial system that is suitable for the DRC.

2.1 Criteria and evaluation of the competitiveness of the financial system

30. In order to constitute our evaluation grid, we are using the MIKDASHI {1998} classification which regroups the competitive factors into two categories: the macroeconomic situation and public policies on the one hand and the specific situation in enterprises on the other.
31. We are specifically including four other factors of competition as demonstrated by McGAHEY et al {1994} namely the advantages and cost of localization, availability of labour force and human resources, regulation and taxation, telecommunications and technology.

⁵ The statistics in the African Statistical Yearbook provides a breakdown of the three traditional sectors (primary, secondary and services) into ten sub sectors. The various contributions to GDP can therefore be calculated and the observation of the importance of the financial sector through a classification.

32. Fifteen criteria were used for the evaluation of the competitiveness factor { nine criteria based on the legal-economic environment and six criteria on the specific situation of financial enterprises}.
33. The evaluation table that follows led to the identification of the principal structural obstacles observed in the past and which are capable of triggering the healthy development of the Congolese financial system.
34. In the light of the salient features arising from the observations, the conclusion has been easily reached that the current Congolese financial system is not competitive.
35. This conclusion points to the need for the design of a development plan for the financial sector which should be modernized taking into account the obstacles hindering its healthy and harmonious development.

Average for Sub-Saharan Africa

Table 4. Evaluation of the competitiveness of the Congolese financial sector

1. LEGAL/ECONOMIC ENVIRONMENT			
EVALUATION CRITERIA	EVALUATION		OBSERVATION of salient features
	Past situation 1990-2002	Current situation 2002 up to now	
Macro-economic management	Lax	Improving	Monetary instability, liquidity crisis, monetary refinancing, dollarisation
Transparency and liquidity of the financial markets	Weak	Weak	Embryonic monetary market, difficulties in honouring due date of the public instruments for short term debt. Capital market .inexistent following the collapse of the development finance institutions that were established

Qualifications of the human resources	Average	Average	Employees not well seasoned in modern techniques and increasingly sophisticated bank operations. The education programmes in the faculties and higher management institutes should be reformed as new subjects and apprenticeship in languages are not adequately integrated.
Advantages and cost of localization communication Rent Local salaries Power cost	High cost Affordable Affordable Affordable	High cost Affordable Affordable Affordable	The various cost can be sustained easily by the enterprises. The major problem is access to remote areas of the country, the roads are in a poor state, the rail is hardly operational, air travel is expensive, maritime transport has obsolete equipment. In short, the communication infrastructure is deplorable.
Supervision Regulation Taxation	Weak Not adapted High	Improving Adapted Lowering of the rate	The regulation for some institutions was updated but the fiscal legislation is old and does not provide special advantages for the financial sector. A slight concession is the lowering of company tax which dropped to 45% as opposed to 50% previously.
Legal system	deteriorated	Slight reform	Political interference, legal and judicial process in the recovery of outstanding debts both

			for institutions and individuals long and expensive. The Trade Tribunals are yet to be very operational
Honesty Efficiency Administration and Political stability	Weak	Weak	Crisis, political instability and wars, civil servants unpaid, corruption and cronyism in the designation of public officials state intervention in financial affairs.

1. LEGAL/ECONOMIC ENVIRONMENT			
CRITERIA	EVALUATION		OBSERVATION of salient features
	Situation 1990-1999	Situation 2000 to present day	
Research and Financial Information Private academic establishment, Public establishment	Scarce Selective Scarce	Scarce Selective Scarce	Not many private enterprise furnish information, the financial institutions practically no publish their balance sheet, the academic institutions and the Central Bank issue general economic publications
Security net	Non existent	Non existent	The stakeholders in the finance world up to now do not enjoy any adequate protection system. The incidents of bank receivership has shown that depositors have always been excluded and it is only afterwards that they try to seek corrective solutions that are not effective.

2. CHARACTERISTICS OF FINANCIAL ENTERPRISES			
Wide range of products and services	Reduced	Reduced	The websites of some banks show the similarities and the lack of products on offer.
Cost of operation and transaction	high	high	Cost of financial operations considered high by customers both in the formal and informal sectors. The intermediary margins taken by the banks are very high.
Effective competition	absent	absent	High concentration of activities and standard products on offer. Insurance monopoly of the pensions system which is obsolete and not viable.
Probity, skills, experience and good management	average	average	Major doubtful portfolio as a result of inadequate diversification of risks and low selectivity of customers.
Technical know-how	weak	weak	The technical know-how and language skills are a function of training. The development

			<p>coefficient of the Congolese banking sector show low productivity in factor production.</p> <p>Monopoly on non-viable insurances.</p>
Innovative spirit	Absent	Absent	<p>The formal sector institutions have not been able at most to satisfy the needs of their customers resulting in customers turning easily towards the financial pyramids at the beginning of the 1990s, This was due to the lack of innovative financial measure to attract savings of customers</p>

1.1 Structural obstacles in the efficiency of the Congolese financial system

36. Table 2.2 regroups the principal obstacles hindering the efficiency of the Congolese financial system into four categories as shown in our evaluation.

Table 5: Summary of structural obstacles hindering the efficiency of the Congolese financial system

I. Deterioration of the macro environment	II. Enterprise governance
The deterioration of the judicial apparatus.. judgments,	The weakness of the internal management of enterprises.. lack of professionalism and technical

<p>compromising, in some cases the functioning and survival of the financial institutions found guilty, the judicial action on guarantees for bad debts compromised.</p>	<p>skills, increase in risk manage, absence of strategic vision and diversification of products, weakness in the viability of sector enterprises, insufficient control of recurrent expenditure and excessive personnel with doubtful qualifications.</p>
<p>III. Weaknesses in the regulatory and supervision framework in sector enterprises</p>	<p>IV. Market structure</p>
<ul style="list-style-type: none"> - the absence of supervision instruments in several segments of the financial sector: insurance, pensions, leasing, installment purchases etc - some degree of efficiency in bank supervision, lax in the implementation and respect for prudential regulations. - modest reliability in the accounts and financial data provided in the absence of harmonized sector accountancy plans; - Lack of enough skilled personnel - Lack of appropriate computer equipment and monitoring tool 	<ul style="list-style-type: none"> - the fragmentation of the credit and insurance markets - lack of depth and diversification of financial products..; - the monopolistic structure of the insurance sector and lack of competition. - oligarchic structure of the banking sector with high degree of focus. - lack of professional bodies and consultancy bodies that could be considered auxiliary and crucial to the activities of the financial sector. - generalized preference for the use of cash as means of payment.

37. Taking into account the overall evaluation of the competitiveness of the Congolese financial system and the structural obstacles identified, what is the type of financial

system suitable for the Democratic Republic of the Congo and how to establish a coherent and efficient financial system?

III Gateway for the development of a coherent and efficient financial system

38. In a strategic think tank, the evaluation of the competitiveness is generally at the end of the analytic phases of the internal and external environment and should be followed by the design of a strategy that should produce a sustainable competitive advantage [HAX and MAJLUF {1996}]. The design of a strategy and action plans should respond to the need for change and improvement with an attempt to capitalize on the opportunities offered and adequately address the constraints, strengthen the gains and neutralize the weaknesses.
39. Our contribution on the Congolese financial system will focus on proposals for the establishment of a coherent and efficient financial system. We are putting forward four proposals for the selection of a suitable financial system for Congo, the need for the formulation of a development plan for the financial sector, the establishment of a structure for the improvement of the management capacity of human capital and the need for a single supervision structure in the financial sector.

3.1 The selection of a suitable financial system

40. Without going into the theory of the definition of the design and architecture of a financial system, it is crucial to recall that the analysis of the topology of the financial systems shows two extremes- the market based financial systems in which the financial markets play an important role and the bank based financial system in which the banks dominate in the allocation of financial resources. The current trend in the countries undergoing reform is towards a market based financial system.
41. In the present Congolese economy, the country lacks a critical mass of enterprises, institutions, mechanisms and legislation for the establishment of a stock exchange. Investors possess limited information on enterprises and households still lack capacity to incur losses that can support investments in shares. Furthermore, for most of the population access to a healthy banking system should constitute the first phase in establishing relations with the financial intermediation and to contribute to the improvement of the culture of credit. The institutional investors which should play a central role in the management of financial markets do not exist. The establishment of financial markets requires a more elaborate legal system and as long as the legal infrastructure remains at a stage where it is still unable to respect conventions, it will be judicious not to direct all efforts towards the establishment of a market based financial system.

42. With the conclusion of the evaluation of the competitiveness and the observations cited previously serving as guide in the road towards the attainment of an efficient financial system, it is suggested to recommend that Congo should establish a 'bank based' rather than a 'market based' financial system. A financial system based on credit and dominated by the financial institutions is ideal for the attainment of the first phase. After the attainment of a degree of banking by the country and the financial intermediation improved with greater access to financial services excluded in the formal system, it is expected that with the increasing needs for finance and capital, the system will develop towards a 'market based' financial system.
43. Finally, taking into account the literacy level of the population and the development objectives of the financial system, the financial system should not be modeled on the Western type but it should be rather a bank based system with a focus on deep-rooted informal practices.
44. Indeed, the trend should not focus too much on the computerization of services particularly in the rural areas. Bank managers, microfinance and cooperative institutions should continue to establish special contacts, follow-up relations and sometimes personal relations with their clientele. The maintenance of regular contacts with the clientele is an opportunity provided to the network of institutions to be set up :on the one hand for the distribution of a series of simple products adapted to the needs of the clientele and on the other to ensure ownership of existing best practices and informal mechanisms. In brief, the special relation between institutions and customers is indispensable.

3.2. The need for a development plan for the financial sector

45. CAPRIO, ATIYAS and HANSON [1994] note that the authorities concerned in the reform of the financial sector should in the first place reflect on the type of the desirable interventions for their societies and then consider how to move from the present to the desired situation.
46. It is our view that the design of what is desirable should be done within the framework of a sector development plan and targeting the three components in the architecture of a financial system which we consider as focus in strategic planning. These are the financial institutions, the financial regulation and the financial markets.

1. Institutional viewpoint

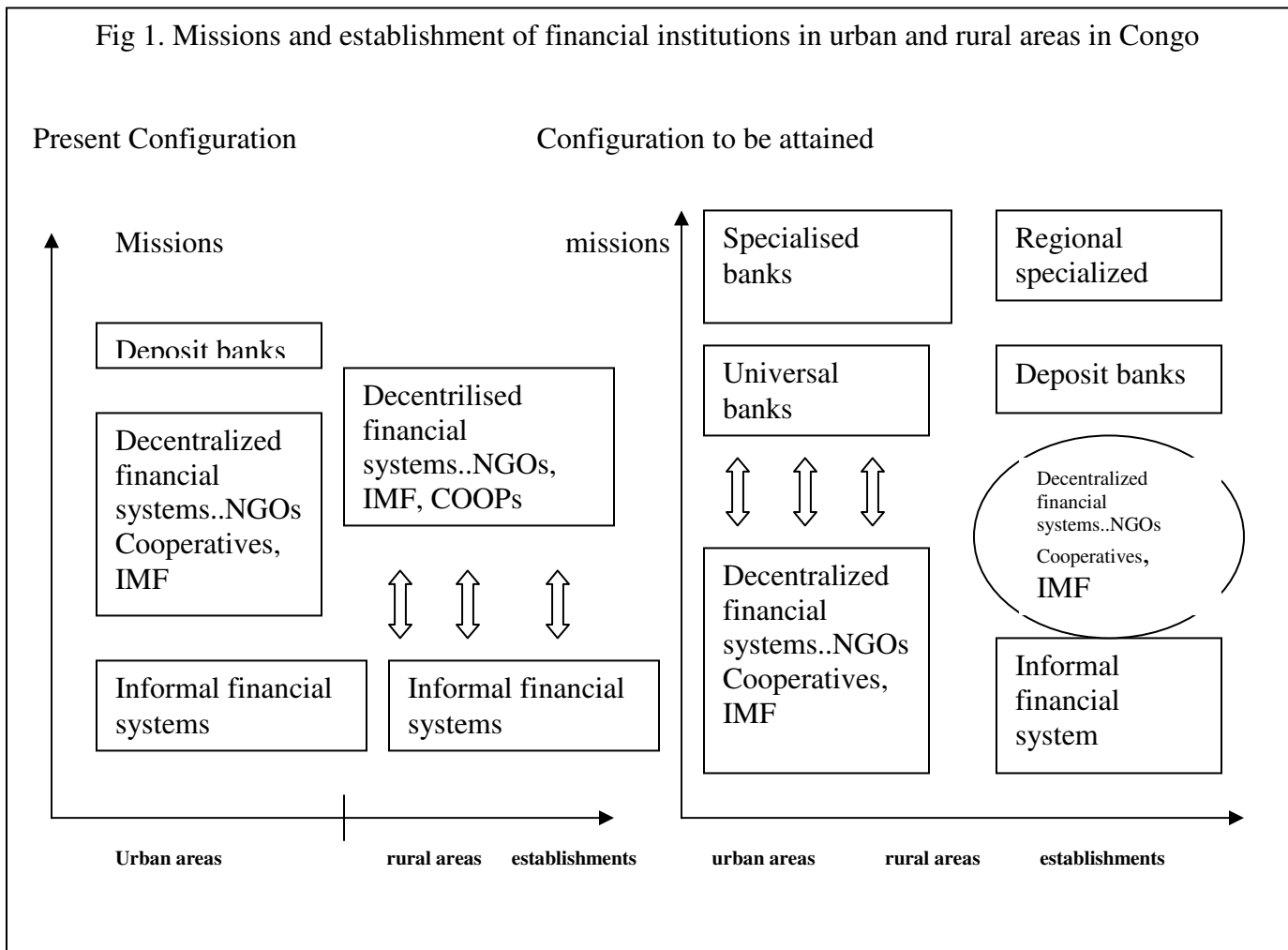
47. The development plan should map out the scope of the missions of institutions that wish to be part of the new Congolese financial system to meet the needs of operators and to determine the degree of required sophistication in the future financial landscape. The design of the scope of the mission should be the following:

- to provide a list of financial products that would be available to meet the needs of operators from already existing products and survey the needs of potential actors. At the moment, several segments of the Congolese financial system are not properly served. These include the following segments: leasing, savings, supervision agencies, various insurances, financial engineering, management of assets, post office account, social security institutions, building loans and housing financing, financing installment purchases, institutions managing payments other than through cash;
- to establish the geographic scope of markets so that the institutions could be close to the people to instill a spirit of competition which is presently lacking so much :
- to form into groups and reclassify financial activities into homogenous categories and associate them with various types of institutions. These are the strategic activities on which efforts should be focused.

48. Apart from the already existing financial institutions, it is crucial to make provisions for some financial institutions:

- For the promotion of long term capital mobilization;
- For semi formal institutions that can be operative and integrated into the rest of the system;
- For provincial and specialized institutions with limited objectives or established in specific geographic areas to be close to the people so that in areas where there are only informal systems, confidence could be placed on formal institutions. These formal institutions should possess traditional mechanisms of solidarity for the collection of savings and finance small scale activities required by each province to stimulate the economic process.

Fig 1. Missions and establishment of financial institutions in urban and rural areas in Congo



49. Consequently, reasoning in an area { missions of the institutions-geographic location], our proposal for a bank based financial system should take into account the present set up with the objective of attaining the following minimal configuration:

In the urban areas :

- Deposit banks which currently specialized in the financing of external trade and revolving funds for manufacturing industries should be **universal banks** by diversifying their supply of products and services: in counseling and finance consulting, participation in private enterprises and micro finance institutions, the development of simple saving products for individual customers { pass or savings books}, issue of short term negotiable loans { certificates of deposit}, the **development** of instruments for risk coverage on interest rates and foreign exchange.

- In the face of the collapse of development banks, new specialized institutions should be established to mobilize long term resources. The objective will focus on the provision of medium and long term credit with a multiplier effect in the economic development of the country. These specialised banks can also provide funding for urban SMEs and households⁶ (leasing of equipment, building loans, housing financing, instalment sales).

In the rural areas:

- Major banking groups in Kinshasa and in the major cities could possess limited number of establishments country wide⁷ by setting up branches { deposit banks with a regional or sub regional mission} aimed at basically neesserving: manufacturing enterprises {international import-export trade and revolving fund requirements}, the SMEs and households operating in the areas where they have chosen to be established. On the one hand these banks should imitate the practices in the decentralized financial systems to reduce the risk resulting from informational symmetry⁸ and on the other to develop links and cooperation with micro finance institutions, cooperatives, NGOs and informal structures⁹.
- The specialized banks should not compete with local deposit banks and the decentralized financial system {for savings mobilization} and should possess long term resources to focus on some types of credit: building

⁶ However, in the urban areas in Congo the measures aimed at improving the flow of information on SME borrowers and households should include auditing at moderate cost for the SMEs and the thorny issue of the improvement of the registry office.

⁷ Although under banking exists presently in the country and the new measures should aim at narrowing the gap between bank-population, our concern for the establishment of banks within geographic limits is based on an objective: to limit the establishment (as in the past) without foresight and the strategic analysis in the establishment of branches which in the long run proved unprofitable and the bankruptcy can threaten the headquarters and even the overall banking system.

⁸ The difficulties in the collection of reliable information for risk management generally inhibits the formal institutions to serve segments of households and SMEs. The decentralised financial systems and the formal institutions have already developed their own information and the social network and as a result monopolise the activities in these segments. The banks can take advantage of the measures generally in place

⁹ As the extension of activities in the household and SME segments is often considered risky by banks, it is more efficient to encourage them to link up with institutions using appropriate methods rather than expect them to provide loans directly for example:

- the provision of a line of credit to a micro finance institution, a cooperative, an NGO or to a grouping of informal agents for micro credit will be more reasonable than the provision of micro credit directly by the bank itself. The savings collectors and credit providers can in turn provide credit to their customers if they have access to credit from commercial banks with increased activities so that they can mobilize savings to be deposited in banks;
- the deposit banks can propose appropriate savings to SFD and informal associations for the placement of surpluses;
- the establishment of central regional or local risk units (for joint management by the specialized banks, deposit banks and SFD) to prepare an overall list of customers that have received credit as well as loan defaulters.

loans, leasing of small equipment for SMEs, households and social groups and the financing of purchases by installments. However, close cooperation will be crucial with the deposit banks, the micro finance institutions, cooperatives and NGOs as well as the management of risk portfolio.

2. Viewpoint on regulation

50. The legal and regulatory environment is a crucial factor in the architecture of a financial system and indeed a prerequisite for the healthy development of the institutions and financial markets.

51. In order to achieve this goal, the authorities should within the framework of the development of the financial system:

- establish legal and regulatory structures to promote the development of a competitive and properly functioning financial system. This objective will be attained through the establishment of transparent relations between the government and the financial system, through the harmonization of laws on the financial sector to address any possible source of conflict of interest and through the strengthening off the role of the private sector in the financial sector.
- formulate framework laws governing and monitoring the various segments of the financial sector taking into account their characteristics and clearly define the supervision authorities of these segments.. As the regulatory framework is an essential factor in the architecture to facilitate the integration of the national financial system with the rest of the world through competition, the credibility of the institutions of the various sub sectors will be linked to the efficiency of the applicable prudential rules. Therefore, several aspects of these prudential rules should be aligned with rules practiced in other countries and complemented with very demanding requirements as far as possible on information disclosure and ethics.
- improve the accounting system, auditing and the disclosure of financial information to promote the rules of trade laws, financial transactions and good governance. The ultimate objective in this respect is the development of a culture of transparency, responsibility and the establishment of financial forecasts.

3. From the viewpoint of the financial markets

52. The diversification of funding sources is imperative in a situation in which the banking system cannot satisfy the capital requirement of Congolese enterprises.

53. It is therefore imperative that the country possesses an insurance sector and a pension scheme which should adequately address the security of business and individuals in the case of disaster and future hazards. As investment institutions, the institutions in this sector will at the same time provide long term capital in the real sector of the economy with need for investors.
54. Beyond a banking system limiting its activities to the provision of short term and external trade funding with the informal savings financial systems and credit and insurance as the only force, the flexibility does not compensate for the inadequacies as some recommend the enlargement of the general framework for the financing the economy through the establishment of a stock exchange for securities in the Congo. The idea is welcome but it leads to questions on the following issues:
- the prevalence of a conducive business environment for investors and the development of the right of possession: this environment is based on a major prerequisite namely the improvement of the legal provisions and respect for contractual agreements.
 - the evaluation of national savings that can be placed in the stock exchange and the insurance of a liquidity market. The target of the stock exchange should be as extensive as possible but such a structure might stumble against the unequal distribution of wealth which is concentrated in the hands of few Congolese families. The question therefore arise as to how to plan the establishment of a financial market with a handful of people with capital and capital besides in foreign banks or widely spread over in the informal sector.
55. Proving that there are a number of economic operators with sufficient volume of resources for such a market to be viable, two other questions will arise:
- the issue of mentality and culture of holders of capital in Congo. Having spent so much time in the informal sector, the holders of capital are often little inclined to lose grip over their savings for a long time and do not make projections over time.
 - the issue of liquidity : in view of the past experience, liquidity holders fear to put their money at the disposal of potential investors without assurance of possessing that cash in case of need. Should emphasis be placed on the share market or in this case which enterprises shall issue the shares to be acquired? Who will be the financial market stakeholders? As a result of the crisis of confidence on public issues and with the experience on short term securities { the case of treasury bonds, deposit certificates] and participation on government bonds will be less likely and can only be made possible if Congolese savers are assured that the issues emanate from institutions with credibility.

- the transparency of the financial situation of enterprises on the market : In order to operate effectively a market requires information for forecast and the rational calculation of risks. There is a serious problem still of information for the assessment of enterprises and assets for other investors whereas commercial banks which should be the privileged holders are still to constitute a solid base.
 - the question relating to the privatization of public enterprises: this burning issue has still not been resolved by politicians. Some suspect that others wish with the assistance of foreign partners to increase funds that they had embezzled to acquire enterprises whose collapse they spearheaded while they were state representatives or policy makers.
56. It is our opinion that the planned establishment of a stock exchange market should be the ultimate objective and an ideal on which further thought should be given. At present, it is urgent to revitalize the existing financial institutions capable of becoming first choice stakeholders in the future stock exchange market. The think tank should focus at the appropriate time on the scope of this stock exchange, the planning of its implementation taking into account the realities of the environment and defining the participation criteria, the tasks, the functions and the remuneration system.
57. If at the end some relevant criteria are not put in place for the setting up of a stock exchange for securities for Congo and the option of a regionalization removed like in some countries, in this case it will be vital to prepare the future actors on issues which determine success in a stock exchange which is open to world wide networks namely technology , quality of information, the quality of services, punctuality and respect for commitments undertaken. In this respect, Congolese have a lot to learn.

3.3. The opening of the financial service market

58. Reading the three focuses of strategic planning and especially on institutions, there is an attempt to believe that we are recommending an endogenous development based essentially on the establishment of institutions funded by nationals, designing 'local' products that are adapted to the needs of nationals without opening up to foreigners. This viewpoint can be an option that some {policy makers or others} might attempt to lay emphasis on taking into account the fact that the institutions existing up to now have specialized in the supply of products and services not necessarily in line with the needs of customers.
59. However, taking into account the lack of technical know-how by some national holders of capital and their ability to participate in activities aimed at being developed, there is an obvious risk that the development and the modernization plan of the sector will not be implemented.

60. Therefore, like the former communist countries of Eastern Europe with banking and financial systems almost controlled by government, the other alternative will be to simply open the financial service market to provide for the entry of seasoned professionals who, alone or in association with other Congolese partners would set up financial institutions. These professionals will bring forward their know-how¹⁰ for use in the financial sector. In an environment that will be competitive, it is certain that rarely will institutions which strategically have strived to do their best will propose products that are not adapted to customers.
61. This alternative requires that the following sequence be adapted prior to the total opening of the financial services market.
- **Modernization of the legal infrastructure:** it is imperative that the host of laws dealing with institutions, mechanisms and products of the finance sector should be revised, harmonized and rationalized. The outdated legislation should be updated and take into account the practices in the world of finance. Furthermore, there is need to update modern laws on bankruptcy of financial institutions, consumer protection from financial products, sector accountancy, supervision and enterprise financial governance should not be swept under the carpet. To this end, the government, the parliament as well as all the operators in the financial world should pursue the discussions and debate on the matter. The modernization of the legal and regulatory framework is a prerequisite which should serve as guarantee to foreign investors against political instability.
 - **Strengthening of the supervision framework:** Congo has an urgent need to build a core of skilled officials for supervision. Supervision does not still exist in the insurance sector as well as in the pension scheme and other segments of the financial sector and even the banking sector requires more know-how and skilled human resources to be effective and to develop its independence. The ideal will therefore be within a period of one to two years following the implementation of a development plan, each segment of the financial sector has an active association of professionals to assist the official supervision bodies in the conduct and improvement of regulations and especially the respect for ethical rules.

¹⁰ From the viewpoint of product design, the market studies to be carried out, the management of risks and assets in the financial set up etc..

3.4 A Structure for improving the management capacity of human capital.

62. The technical know-how and management skills are crucial for the harmonious and healthy development of the financial sector. It has been demonstrated throughout the world that the analysis of the competitiveness factors in financial systems shows that the financial sector of an economy should be run by an increasing number of professionals with sophisticated skills dealing with complex operations in insurance and finance. It is also our opinion that in order to take into account the openness to the world so that highly skilled foreign professionals could be attracted to the Congolese financial sector, it will be out of place for the sector to be regulated by a supervision body with a reduced number of human resources with limited skills. The growth of the financial sector requires therefore the availability of an effective supervision body.
63. These two observations therefore call for the establishment of an infrastructure¹¹ to improve the management capacity of the human capital both in the enterprises of the financial sector and in the existing supervision bodies and /or to be put in place. This gives rise to the proposal for the establishment of a major institute for training in banking, insurance and other related activities to these two sectors that can be called: BANKING AND INSURANCE TRAINING INSTITUTE {BITI}. The subsequent paragraphs will put forward the broad outline of our proposed institute such as its organizational structure, financing and diplomas to be awarded.

1. The organizational structure and education

64. The Board of Directors will comprise the authorities of the institute¹² personalities from the academic world for an endorsement of its academic standards and representatives of professional organizations for an endorsement of its professional standards in the award of diplomas.

65. The teaching staff will comprise academics and professionals with high level qualifications. A mixture of teachers, professionals and academics will be useful for the training of students as the training to be provided by the institute should not be carried out in isolation but should be a reflection of the needs of the various partners and the integration of changing market characteristics.

¹¹ This will forestall the huge cost from training overseas which on the one hand are short courses and on the other only benefiting few handpicked managers. The 2000 Report of the Central Bank of Congo shows in a chapter the various training programmes at home and abroad. The initiative is laudable but the report is silent on the costs and the efficiency of the training provided on the performance of the officers who have received training.

¹² We are thinking of single supervision body for the financial sector and the justification for its establishment are discussed in the following point.

Therefore the minimum academic programme should be discussed in line with the needs of each sector for a design of evolving and not rigid programmes.

66. We envisage that this institute will award academic degree with certification from professional organizations. This practice will enable the graduates to work on their own as intermediaries, managers of related activities in the banking and insurance sectors¹³ and as promoters of micro finance institutions.

2. Financing and Diplomas to be awarded

- The initial funds are expected from sums paid by new entrants for enrolment in training for the award of a diploma¹⁴;
- School fees of students
- The assistance from the government and partners for the institute to begin operating;
- Annually, share of the resources of the supervisory authority.

67. The institute could issue two types of diplomas:

- a specialized diploma in : bank management, management of micro finance institutions, insurance management, accountancy and taxation ; after a training lasting two years after the first degree¹⁵ . The first three semesters will focus on academics while the last semester of the training will consist of an attachment to an enterprise and the drafting of practical work proposing solution to an issue encountered in the enterprise.
- Certificates will be issued to company officials admitted to pursue training modules on some subjects. These certificates will be meant especially for middle and lower level managers in the financial sector. Taking into account the resources available to the authorities and in the event that the resources are inadequate, the training modules will be done as a first phase After the establishment of the complete training programme, the number of selective training programmes will be reduced so that employers would have officials that pursued a full training programme rather than be complacent very often with officials that did the training modules.

¹³ Supervision agency, accountancy and tax firm, brokers and insurance agents, management consultants etc

¹⁴ LUFTALLA. M and OUTREVILLE J.F [1998] ‘ Insurance in the emerging markets’ in the insurance encyclopedia, Economica, Paris, p.155-175, notes in p.169 that ‘ China for example places conditions for its market access not only for non human capital investments on its territory but also in investments in education and specialist training ((for example computer sciences).The sending of expatriates is only a stop gap measure. Permits are only generally granted piecemeal and with the occasional exception, expatriates are not allowed to outstay their welcome’.

¹⁵ Priority will be given to young university graduates with a degree in law, economics and management or a degree in mathematics. Candidates with professional experience in the sector but with a degree other than in the prescribed areas will be accepted by written application.

3.5 A single structure for the supervision of the financial sector

68. Beyond the theoretic and academic debate on the issue of the relevance of the institute with a single supervision structure for the financial sector¹⁶ and the separation or the combination of the conduct of monetary policy and banking supervision by the central bank¹⁷ the option we are proposing for Congo is the establishment of a single supervision structure different from the Central Bank.

69. Our justification for the relevance of the establishment of such a structure for Congo is as follows:

- The Bank of Congo has often been ineffective on bank supervision for many reasons including political pressure and the lack of independence in the implementation of measures and sanctions to be imposed on contentious institutions, on conflict of interest which covers both supervision and management functions¹⁸, the lack of a adequate skilled personnel¹⁹ and the very modest reliability of the accountancy and financial data released by the credit establishments due to the absence of a harmonized bank accountancy plan for the appropriate computer equipment and the lack of monitoring tools;
- The lack of a supervision organ for the insurance sector and it is crucial to reflect on the establishment of this body considering that Congo has opted to liberalize the activities in this sector;
- There is need for the formulation of framework laws for the regulation and supervision of the various segments of the financial sector. In this prospect, the development of several supervision bodies with authority over the segments will constitute an obstacle to the harmonious development of the sector if the supervisors, on certain issues, are in conflict of interest and if the laws that govern their activities are not harmonized.

¹⁶ The following authors can be consulted on the issue: GOODHART and SCHOENMAKER (1995), BRIAULT (1999), TAYLOR and FLEMING (1999), ABRAMS and TAYLOR(2002). Examples of these structures exist throughout the world (Financial Service Authority in the UK, Finansinspektionen (July 1991) in Sweden, Kredittsynet (1986) in Norway, Financial Supervisory Authority (June 1998) in Japan, Financial Supervisory Service(April 1998) in South Korea, Fjamalesfrlrit(Jan 1999) in Island, etc

¹⁷ The arguments for and against the separation and combination of the conduct of monetary policy and banking supervision by a central bank are better examined by GOODHART and SCHOENMAKER (1995)

¹⁸ In some banks under the administrative authority of the Central Bank, it performed both management and supervision roles. The most glaring example is the case of BCCE which went into receivership after being managed for three years by the Central Bank. The trade union officials accused the Central Bank of having accepted receivership at a time when the BCCE was doing well. Therefore the trade unions maintained that if BCCE was poorly managed, the blame was on the Central Bank through its designated officials.

¹⁹ This restates the need for an appropriate training structure for Congo (please see preceding point 5.2.4).

- The country does not still possess a sophisticated financial system and lacks a supervision core of skilled personnel in adequate numbers or major financial resources that can provide each supervision body established with the state of the art infrastructure for the collection and processing of data.
- The goodwill for openness of the Congolese financial sector can attract in the very near future, finance conglomerates that can be supervised on a consolidated basis.

70. From the foregoing it can be inferred that the arguments generally put forward to support the establishment of single supervision bodies²⁰ call for deep thought to consider the option of establishing several supervision bodies or a single body and leading to all logic, the selection of a single structure.

71. The major issue that can lead to the lifting of shields is the separation between bank supervision and the conduct of monetary policy by the Central Bank of Congo. The decision to establish a unified supervision structure might require the removal of the prerogatives of banking supervision from the Central Bank whereas the bank is independent²¹ in the conduct of monetary policy and this independence can also protect the sector from pressure from politicians and parliamentarians as far as bank supervision is concerned.

72. However, It is our considered opinion that in a transitory stage consideration should be given in view of the present state of the Congolese financial system to delegate to the Central Bank of the Congo responsibility for the conduct and supervision of all the financial sector for the following reasons:

- it plays an important role against money laundering, organized crime and financing of terrorism;
- Two of the paragraphs of article 6 of Law no.005/2002 on the missions, operations and other activities of the Central Bank of the Congo state as mission 'to formulate and control the credit establishments, the micro finance institutions and **the other intermediary financiers'**...
- **Promote the development of monetary markets and capital.** The law on the organization and operation of the Central Bank of Congo confers it with the powers to supervise the banks, the share markets, the insurance companies and other institutions which can contribute to the development of the capital market.
- The Congolese financial sector and especially the non-bank finance sector is relatively narrow. This situation does not augur well for the establishment of separate supervision agencies which in the short term can be considered as viable and embodying the prestige of the Central Bank.;

²⁰

²¹

- The competitive advantage in the recruitment of skilled managers attracted by good conditions of service and remuneration, the prestige of working there as well as the guarantee of independence provided by the law are factors that confer on the bank defense mechanisms against political pressure on its supervision role and a breeding ground in the development of supervision skills.

73. After the regulations have been put in place, the consolidated skills for the different areas to be supervised and the growth of the non banking sector attained, the second stage will be the establishment of an independent supervision structure but an offshoot of the Central Bank ²². This body will enjoy the prestige of its parent body as it will comprise to a large extent of officials with vast supervision techniques and sound experience and capable of maintaining independence against politicians. This separation at the end is vital for two reasons:

- the regrouping of all the supervision functions within the Central Bank of Congo can be perceived as giving this institution excessive powers covering several areas;
- the efficiency of the Bank can suffer as a result of these powers and the ineffectiveness of some regulations can tarnish the reputation and credibility of the Central Bank.

74. All the supervised enterprises can seek support from the Central Bank in case of financial difficulties and the shareholders in these enterprises can also think that they should be protected by the Central Bank. The successful separation will reduce the moral hazards and the Central Bank of Congo will be clearly allowed to perform its function of conducting monetary policy, managing the payment system and the last resort lending agency for the banking sector. Concerning the single supervision body, the law that governs it should clearly specify whether it has responsibility for prudential matters [security and health of institutions] as well as consumer protection.

Conclusion

75. This think tank which focused on the leads towards the development of a coherent and efficient Congolese financial system clearly demonstrates that in order to achieve this goal, the country should possess adequate resources.

76. The presence of a coherent and efficient financial sector requires investments in equipment, human resources and structure pointing to the fact that amateurism and inefficiency are out of place in finance. Consequently, the role of the supervision authority is ever crucial and only through close prudential and efficient supervision can avoid the major threats that can confront the Congolese financial system in the future. The inevitable structural adjustments as costly as they are should not be postponed for a long time. On the contrary, the viability of the financial institutions is a prerequisite for the functioning of the financial

system because the robustness of the establishments depend on their wealth and institutions in crisis are dangerously tempted to take excessive risks. It is therefore particularly urgent to re-establish the culture of good governance in the Congolese financial institutions.

77. On the basis of the conclusions of our think tank and the direction taken, we are proposing that some complementary research should be undertaken to further develop the think tank on the Congolese financial system.

78. A first approach can be discussions on: the ways and means of modernizing the payment system and the feasibility of establishing an insurance mechanism for deposits. The re-establishment of the confidence of operators and depositors on the financial and banking system can be attained by these two means. Indeed, the preference for cash is the result of a lack of confidence in the payment system whereas the lack of interest by depositors on issues of bank receivership taking place in an atmosphere of total concern is due to the absence of clearly established rules and criteria that can only be found within the framework of an insurance mechanism for deposits or in the bank guarantee fund.

79. A second approach is the analysis of the liberalization of the insurance sector as well as the pension systems and propose ways and means for these sectors to play the role of investment institution and provide the financial sector with the crucial medium and long term capital for investment.

80. Finally a third approach is the putting in place of appropriate methods and techniques for risk management in the financial institutions. It is our opinion that an empirical study on the present methods being used in the Congolese financial institutions will contribute to targeting retraining programme content and standardization should be designed to improve portfolio management and financial risks in these institutions.

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