EAST AFRICA

This economic growth zone is emerging as a future hub for banking and financial services. Sarah Orvin explains why

East Africa's status as an economic growth zone, pulling in investment at the same time as pulling down the barriers to trade among the nations of the region, is a good news story that is gaining increasing attention worldwide.

Less well known, perhaps, is its growing emergence as a future hub for banking and other financial services. That may sound counter-intuitive in a region that has yet fully to dismantle old-fashioned exchange controls, yet the evidence is all around.

The International Monetary Fund (IMF) noted with approval this summer the advance of efforts to turn Nairobi into a regional centre for financial services.

And while Kenya, as the economic powerhouse of the five-nation East African Community (EAC), is in the lead in financial services, as with so many other economic activities, its fellow community members – Burundi, Rwanda, Tanzania and Uganda – are looking for ways that they can break into the sector, for instance, by offering complementary services, such as share settlement.

Meanwhile, countries outside the bloc are looking to the EAC for financial services. To take one example, Ethiopia – which currently has very restrictive banking laws – is inching towards liberalisation, and there is talk of a joint venture between local banks and the Co-operative Bank of Kenya.

Financial inclusion

There should be no shortage of bankers ready to talk business. The EAC, again led by Kenya, has a very competitive banking scene, in which global giants such as Citibank, Barclays and Standard Chartered operate alongside local groups such as Equity Bank.

A virtuous circle is in the offing, as the EAC – one of the few regions of the world just now with a solid growth record – supports an expanding financial services sector. So that sector, in turn, should become a source of growth in its own right.

This prospect was noted in the IMF's latest report on Kenya, published on 9 July 2014: "Kenya's expanding financial sector remains robust, and the ongoing process of financial inclusion has opened up the possibility of extending credit at more affordable rates to small- and medium-sized enterprises."

The fund noted also that Kenya is leading the way in bringing its banks and other financial institutions up to developed-world standards of governance. "Efforts to develop Nairobi into a regional hub for financial services have advanced with the strengthening of the Anti-Money Laundering/ Combating the Financing of Terrorism framework and Kenya's recent graduation from the Financial Action Task Force's monitoring process."

The task force is an international standard-setting body for countering abuse of the financial system. Its approval of a country's anti-money-laundering measures is a much sought-after stamp of financial respectability.

There is, of course, some way to go before the EAC's potential as a banking and financial services centre can be realised. The bloc has yet to abolish all capital controls among its members, with some being further advanced than others. Tanzania is still grappling with a legacy of socialist economics and extensive financial controls – it is not so long ago that undercover police officers tried to entrap tourists with the offer of more local currency for their dollars than was available at the official rate.

Indeed, Tanzania's continued scepticism of outside involvement in its economy and consequent protectionism is reflected in the country's 60% limit on foreign equity ownership of companies and total prohibition of foreign investment in the local bond market. But the logic of EAC membership is working to end these controls, and when the financial system is opened up, the cost of capital will come down over time, provided sound economic policies are followed, and investors are going to enjoy better returns from the economy.

Monetary union

May 2014 marked an important step towards the liberalisation and integration of the region's capital markets, with the launch of the East African Payments System. The EAC described the launch as "a remarkable milestone towards the integration of the EAC region's financial sector". It aims to provide secure and effective funds transfer and settlement, and offers "finality and irrevocability of payments".

Further out – perhaps much further – there are plans for a single currency for the EAC, complete with a central bank. Negotiations for an East African monetary union opened in 2011, and the move was heralded as a step towards the creation

Regional file: East Africa

Surface area (incl water): 1.82 million sq km

Population: 143.5 million

GDP: $110.3bn

GDP per capita: $769

SOURCE: EAC *FACTS & FIGURES REPORT (2014)*

Addis Ababa, Ethiopia

SEAN GALLUP/GETTY IMAGES

TOP TIPS FOR DOING BUSINESS IN EAST AFRICA

1

Beware of tax issues. There are constant problems in this area, with a lack of clarity as to what tax rate is paid on securities, when it is paid or who is responsible. Legal issues in general can be very vaguely defined.

2

Have good contacts on the ground. The region is incredibly under-reported on by outside agencies and media. Meet the people yourself and get to know who is well informed about what.

3

The larger official economic figures are probably fudged, so be creative and come up with your own. If you want to know how tourism is faring, call the hotels. It is the same principle with any industry, whether cement or real estate. Get it from the horse's mouth.

of a "powerful and sustainable" economic bloc. The protocol on monetary union envisages harmonised fiscal policies and an end to any remaining exchange controls inside the bloc.

Tanzania, perhaps as a signal of its desire to remain involved in the EAC project, has passed legislation allowing its government to sign up for the single currency as soon as it is in operation.

Needless to say, in light of the up-and-down nature of the euro's 15-year history, there has been no shortage of cautionary tales on offer from outsiders, and it is fair to say that the single currency is some way from fruition, assuming the EAC wishes to continue to pursue it. Furthermore, the unhappy history of allegedly 'binding' economic guidelines in the eurozone casts some doubt on the value of the key economic disciplines on inflation, debt, tax and the convergence of the EAC members' economies to which the protocol is supposed to commit its signatories.

Meanwhile, other countries are trying to join the bloc, with South Sudan showing a keen interest in becoming a member. Should the development of EAC institutions, such as its court of justice and council of ministers, be seen to bring reassurance to investors from outside the bloc, more countries are likely to want to join. Were that to be the case – and it is some way off – then EAC membership would deliver not just access to markets, but an aura of stability and respectability.

Furthermore, the ripple effect from regional success stories can bring benefits across the EAC. Currently, Kenya may be leading the way in financial services but, as the IMF's July report noted, the country's banks can be powerful engines of regional integration.

As the European experience shows, integration can create losers as well as winners. The single market programme saw mergers and closures of steelworks, airlines, car factories and – yes – banks as the national barriers came down. The EAC is not yet a single market and one of the reasons why it is not is the fear that Kenyan businesses and Kenyan workers will outcompete everybody else.

But while such anxieties act as a drag on integration, in financial services and elsewhere, there is a strong countervailing force in the general feeling, among ordinary people as well as officials, that the EAC, by promoting markets and capitalism, can make life better.

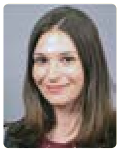
Regulation

There is a long way to go. Despite the successful growth story, interest rates are very high – deservedly so, given the risks lenders run and will continue to run until there is a consistent record of sound economic management. There are also obstacles in terms of financial infrastructure to the growth of financial services – a bank may simply not physically be present in a particular location.

Above all, and despite everything that has been achieved, the real roadblock to growth in all sectors of the EAC economy remains regulation. Take the number of days needed legally to start a business, as calculated by the World Bank. In the US it is five, and in the UK it is 12. By contrast, it takes 32 days in Uganda, 30 days in Kenya and 26 in Tanzania.

Setting an example for the EAC are Rwanda, where it takes two days, and Burundi, where it takes seven.

But there is a lot of optimism in the region and a lot of hard thinking going on, as countries try to work out how they can fit into a single market.



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