Implications of Cross-Border Banking for Financial Integration in the West African Sub-Region

P. J. Obaseki[*]

Abstract

The paper sets out to review developments in cross-border banking in the West African Sub-region and implications of the growth of cross-border banking institutions for financial integration in West Africa. The paper noted that initial efforts at cross-border banking in the sub-region were led by Ecobank Transnational Incorporated with the active support of the Economic Community of West African States (ECOWAS), which acquired substantial shares in the bank. Regional approach to cross-border banking and financial integration in the sub-region has complemented the market approach facilitated by private enterprise. Regional efforts have been intensified but problems remain with the numerous barriers to the free movement of goods, services and capital. While cross-border banking can facilitate financial integration, there are a number of implications which require policy remedial actions and safeguards for the benefits of cross-border banking to be enjoyed by both home and host economies. The safeguards are in the areas of cooperation between home and host regulators and supervisors to ensure that cross-border banks are comprehensively supervised as well as ensure that risks are identified and analyzed wherever they occurred. The exchange of information between regulators and application of risk-based consolidated supervision is necessary to contain systemic risks. The paper concluded that the issue is not to halt financial globalization but, to put in place, mechanisms that will detect banking crises before they occur; and when they do occur, to apply remedial actions to contain and reverse the problems.

I. Introduction

Cross-border banking is the provision of banking services by a non-resident entity to residents of a host community. Such transactions are in most cases undertaken between and among contiguous countries. However, the advent of multinational banks with reach across the globe has made such qualification largely unnecessary. Cross-border banking can be very useful in facilitating financial integration among countries. It also serves as an important catalyst for financial integration which is usually seen as

[*] Mr P. J. Obaseki is a Deputy Director and Special Assistant in the Office of the Deputy Governor, Economic Policy, Central Bank of Nigeria. The views expressed in this paper are those of the author and do not necessarily represent the views of the CBN or its policies.

necessary for improved profitability for business as well as for raising the general welfare of the people. In the normal course of business activities among economic agents, different forms of payment instruments emerged culminating ultimately in the development of banking services across countries and jurisdictions. Such developments may sometimes be induced by regional policy. Whether cross-border banking is the product of a conscious effort by governments or the private sector, or it evolved through the normal course of economic interactions, it is nonetheless important because of its usefulness and role in bringing together financial institutions in a diverse number of countries and jurisdictions. The intermediation of financial resources across national boundaries is critical in most instances in allocating funds for facilitating economic activities. Financial integration is in various stages but generally it involves the increased interaction between financial institutions in different countries and jurisdictions in the intermediation process. These institutions include banks, mortgage finance companies, insurance companies, stock exchanges as well as other institutions in the money and capital markets. Financial integration is expected to result in the pooling and transfer of financial resources across countries, thus benefiting from synergy and economies of scale.

Generally, financial integration is beneficial when the financial markets are well developed by all the participants, be they home or host economies. The financial markets are purveyors of resources for facilitating economic growth and development. As a result, their integration across a number of countries confers numerous benefits on the participants. The most important segment of the financial institutions considered critically important for promoting financial integration is banking. In this respect, cross-border banking can provide the channel for intermediating financial resources from one country to another especially if there is some form of integration. Cross-border banking requires the creation of a niche and some competitiveness to be able to perform efficiently in the domestic market and expand outside the shores of the home country. Cross-border banking has a lot of advantages as well as drawbacks which are outweighed by the former. Generally, cross-border banking helps in achieving the best portfolio of investment ultimately. It dissipates risks and improves the return on investment with the best possible risk return trade-off.

Cross-border banking is important in promoting financial integration as the most important component of the financial system in the intermediation process. Although the advantages of cross-border banking are numerous, there are also drawbacks with respect to financial stability issues and unintended negative externalities. It may not be apparent what difficulties may arise in the future once risks have been properly measured and the cross-border banks are efficient and sound. However, what is obvious is that cross-border banking provides scope for large scale operations by banks, in the process, diversifying services and risks as well as improving profitability. Consequently, liquidity is spread across-borders and competition among banks increase, leading to more efficiency and better macroeconomic outcomes. Gradually, a favourable environment for economic growth is created. While shocks can be better absorbed by cross-border banks that are sound, they may also transmit financial risks across borders, through problem generated from the home country or exposure to a resident jurisdiction.

Cross-border banking in West Africa has been a joint initiative between the private sector and the public sector through the auspices of the Economic Community of West African States (ECOWAS). The market driven and ECOWAS initiatives are intended to accelerate the process of financial integration in West Africa. The rest of the paper is organized into five sections. Cross-border banking and financial integration are covered in section 2 while cross-border banking in West Africa is presented in section 3. Implications of cross-border banking for financial integration are discussed in section 4. Recommendations are presented in section 5 while the conclusion is highlighted in section 6.

II. Cross-Border Banking and Financial Integration: Theoretical Issues

Financial integration is a process involving the closer linkages and interaction of institutions providing financial services across countries. This process can be achieved through a number of measures; the most important being market and regional integration approaches. The market approach entails the dependence on the market to provide the impetus for financial integration without formal regional arrangements. The regional approach relies on a formal agreement implemented by a regional institution with the collaboration of member countries.

Whatever framework adopted, there are key facilitators of financial integration. The most important of these is cross-border banking. The integration of the stock exchanges, insurance companies as well as other financial institutions would require bank financing and intermediation. This is without prejudice to the fact that cross-listing of stocks is also an important facilitator of financial integration. Banks' expansion across-borders is underpinned by profit motive and other strategic reasons. Once advantage can be taken of opportunities in other countries, banks would be inclined to extend services to such countries, which is a purely market driven approach.

The globalization of capital from the 1980s was helped greatly by rapid financial liberalization and advances in technology, all of which reduced the cost of doing business. The reliance on the market for the efficient allocation of financial resources propelled the reduction in protectionism. Although the market approach could be useful in accelerating cross-border banking and financial integration ultimately, a regional approach could be better and faster especially for developing economies. The arguments for a regional approach is basically that the programmes of financial integration once agreed would be monitored by a regional institution that will be responsible for ensuring that all the signatories implement measures concerning the programme. There is however, a need for the political authorities to be committed to the programme to ensure that it is successfully implemented. In the process of facilitating financial integration, cross-border banking helps in providing a risk-sharing mechanism that enhances portfolio selection. In addition, financial integration is strengthened as financial markets are better integrated and disparities in macroeconomic aggregates, especially asset prices, interest rates, among others, are narrowed. Ultimately, the pursuit of common policies lead to the realization of "Pareto Optimality" as the host and home economies of the banks operating across-borders are better off with none worse off.

There have been a number of studies on the characteristics and nature of international capital flows following the neo and new classical schools but recent attempts have applied the gravity model which has been largely successful in explaining trade flows and their influence on banking activities. The gravity model has been augmented with the role of institutions and politics while not undermining the impact of mature and efficient financial markets. The major findings of Demirguc-Kunt and Huizinga (2004) indicated that: the empirical gravity model is the benchmark used in explaining the volume of international banking activities, conditioned on standard gravity factors (distance, GDP and population); well functioning institutions is a key driving force for international bank flows; foreign banks invest substantially more in countries with uncorrupt bureaucracies, high quality legal system and non-government controlled banking system with politics exerting a first order impact while reforms (democratizations, privatization and power decentralizations) spur foreign bank investment (Papaioannon, 2004). The gravity model as originally conceived was to simulate trade flows but recent evidence has shown that it is also effective in simulating assets trade, relying on geography and information asymmetry. Distance in the model relates to transactions cost in the goods market or information asymmetries in the asset market. The study under review showed that the power of the gravity specification increases sharply when augmented with a measure of the overall quality of the international and political environment. The empirical evidence from the study which used quarterly observations on gross banking transactions from 19 (source) and 51 (recipient) countries from the mid-eighties until 2002 showed that a five per cent decline in political risk in the capital recipient country results in about two per cent rise in bilateral bank lending volume

II.1 Evolution of Cross-Border Banking

Cross-border banking has been an important element of the global financial system. The multinational banks have been in the business for decades, helping in the transmission of capital across countries. The multilateral institutions have also been useful in helping to promote the policy of global economic and financial liberalization which considerably reduced impediments to global capital intermediation. Cross-border banking evolved earlier on market basis with subsequent developments fostered on regional arrangements. For instance, the single market performance of the EU was hinged on the integration of financial markets. Common standards were prescribed and these have continued to be fine-tuned over time. The evolution and development of cross-border banking was considered appropriate as a variable for the EU to achieve full single market.

Market induced cross-border banking has been in vogue for decades and it has produced impressive results such as helping to transfer capital across countries where returns are highest, as well as where the best portfolio can be achieved. With the increased globalization of financial markets since the 1980s, regional integration has not been beneficial to developing countries. Although barriers to international trade and finance have been extensively liberalized, countries still have in place a number of restrictions. In order to mitigate this problem, regional groupings were considered as veritable channels for integrating financial markets across the globe and ultimately for creating the right environment for monetary union which will further provide impetus for increased financial integration. Cross-border banking is, therefore, expected to promote financial integration in the first round effect and eventually lessen the burden of losing monetary policy independence.

Cross-border banking may not provide all the solutions for increasing the intensity of financial integration, especially when the financial markets are underdeveloped and shallow. In East Asia, the underdevelopment of the financial markets and institutions are the primary cause of the lower degree of financial integration in the region. For instance, the bond market in East Asia is underdeveloped and fragmented, necessitating reliance on equity and bank loans for financing (Jong-Wha Lee, 2008). Cross-border banking can be accelerated through the removal of barriers to capital flows. This is mostly possible through multilateral and regional arrangements. Efforts in the multilateral angle are on-going, but those on the regional level appear to be more promising in facilitating overall improvement in cross-border banking and financial integration towards attaining the expected benefits. The symbiotic relationship between cross-border banking and financial integration is established by the fact that the more banking institutions are able to operate outside their home countries through market process the better the prospects for financial integration through the elimination of barriers to trade and financial flows. Cross-border banking and financial integration therefore become mutually reinforcing once the market process is complemented with deliberate efforts at pursuing agreed policy on financial integration.
The need to adopt concerted policy measures to foster cross-border financial services and financial integration has been a top issue in the European Union even after the launch of the euro. As a result of the implications of cross-border banking for financial integration, economic growth and financial stability, there is growing urge that the EU should remove the remaining obstacles to cross-border banking while strengthening cross-border arrangements to ensure financial stability.

Although most of the determinants of cross-border banking relate to the credit worthiness of the countries, quality of institutions and growth opportunities, regional proximity bias including clustering have also been cited as factors in the growth of cross-border banking (Stijn Claessens, 2006:2). The credit worthiness issue is market related while the regional proximity and clustering can be adduced to concerted regional efforts at integrating contiguous regional markets through greater access to banks and other financial institutions. This can be achieved through the progressive dismantling of barriers to entry and capital flows. As a result of weak economic fundamentals of developing economies, cross-border banking penetration is much lower than in developed economies. Even the EU, where the euro was expected to foster greater integration of financial markets, cross-border banking is still beset with a number of problems. Cross-border supervisory issues involving financial stability are also being tackled. That is useful lesson to developing economies where cross-border banking is still at a very low level.

Foreign banks entry is desirable for a domestic economy as it improves competition and development of the domestic financial markets. The general development of the host economy and the level of barriers to entry as well as the size of the cross-border banking institutions affect the level of positive externalities and effectiveness of foreign banks. With limited entry, fewer spill-overs seem to arise, suggesting some threshold effect (Claessens and Lee, 2003).

Cross-border banking in the form of entry and capital flows have been facilitated by the removal of trade and exchange controls as well as capital market integration in developed economies. However, in developing economies liberalization has been rather low and cross-border banking has been facilitated by other factors.

The issue of cross-border banking should also be addressed differently, especially in respect of developing economies because of their level of development, infrastructure, regulatory and supervisory capacity as well as governance and the overall financial structure. However, unimpeded foreign entry into the domestic market brings with it improved internal controls and better risk management framework. It also leads to the enhancement of product quality and general improvement of the domestic financial sector culminating in the promotion of financial integration.

II.2 Cross- Border Banking and Financial Stability

In spite of the numerous benefits of cross-border banking, there are a number of moral hazards and problems which could threaten financial stability. As shown by the EU example, regulatory arbitrage may be rampant and prevent the full maximization of the benefits of cross-border banking and financial integration. The characteristics of the EU cross-border arrangement which could be potentially harmful include the provision of a single banking license, reliance upon the home country as the primary provider of deposit insurance and application of the bankruptcy processes and host country responsibility for financial stability and lender-of-last resort (Eisenbeis and Kaufman, 2007). A major problem that arises from cross-border banking is the conflict in the objectives of the host and home regulators. While the host regulator is interested in financial stability, the home regulator is less concerned with what happens in the host country once the home country is perceived to be protected. The EU rule of a single license makes it possible for a bank to be licensed in one EU country and operate anywhere in the EU without other requirements. This may appear good for fostering financial integration but when considered along the provision that the home country is responsible for supervision of cross-border banking, we realise that banks in the economy were subjected to multiple regulatory and supervisory jurisdictions. This may lead to conflict and the attempt to protect national interests without consideration for the interest of all stakeholders.

As more cross-border banks are established, host regulators become somewhat marginalized, especially in the EU where home country regulators are the supervisory and regulatory authorities of banks licensed by them irrespective of where they may be located. The possibility of regulatory arbitrage can arise especially if home country regulatory standards are less stringent than those of host countries. The desire to take advantage of better profit margins may be ethical but the exploitation of benefits from differences in regulatory environments is a major drawback of cross-border banking. It is dangerous because it could precipitate under allocation or uneven allocation of risks which could compromise financial stability. The burden on the host country is enormous with the advent and growth of cross-border banking. The host regulator is expected to be responsible for financial stability issues while the home regulator supplies relevant information to ease the task of the former. However, the home regulator has more facts on financial stability issues involving its branches and operations abroad. This is a dilemma that regulators have tried to deal with through closer collaboration. As has been shown by the current global economic and financial crises, there is no international solution to domestic banking crisis. The problem may be the result of spillover from other countries but the resolution is largely domestic.

Cross-border banking requires adequate deposit protection of the stakeholders in the home country against failure while the host country is left to sort itself out as the preferences of the home and host regulators may not converge for considerable length of time. The resolution of insolvencies and liquidity problems has also become critical issues in relation to the management of cross-border banks. The policy implications of cross-border banking are many but the most important is that cross-border financial linkages have been at the core of the transmission of the on-going crisis that spread from the US to the rest of the world. This has affected the consideration by policy makers in Europe of further harmonization of the regulation of capital markets and banks across Europe as well as measures being discussed by the G7, G20 and Financial Stability Forum to harmonize financial regulations (Sebnem Kalemli-Ozcan et al, 2009b). As shown by the euro zone, financial integration in a monetary union can be facilitated by harmonization of financial markets which would ultimately accelerate cross-border financial activities. Areas that are not yet in a monetary union but plan to go into a union could also reap the benefits of cross-border banking through elimination of barriers.

Elimination of currency risk was a major factor that fostered financial integration in Europe. The fixed exchange rate partly resulted in lower risk, thus encouraging cross-border financial activities. Additional factors are policy harmonization in the legal and regulatory frameworks which are on-going. Cross-border banking can also be promoted through regional arrangements that result in the elimination of entry barriers to foreign banks.

In order to improve the financial markets and enlarge their scale so that they develop economies of scale, opening up of domestic financial markets is necessary through policies that encourage the free flow of capital into and out of the economy as well as easing licensing requirement for foreign ownership of banks in the economy, either through setting up of new banks or purchase of problem banks. In addition, a programme of financial integration with the rest of the world can be embarked upon by removing or reducing capital controls or liberalizing the capital account. Ultimately as propounded by Robert Mundell, the world constitutes the ideal optimum currency area; thus the breaking of barriers to trade and capital flows is ideal for the attainment of the conditions necessary for the creation of a single economic space that defines the critical process towards monetary unification which could boost the chances for increased financial integration. In the EU currently, there is debate on the extent to which the euro has helped in financial integration of Europe. The jury is still out but there is emerging consensus that there are still national controls on free movement of capital which should be abolished for cross-border banking to accelerate in the EU. The experience of EU shows that the process of financial integration through competitive engagement of banking institutions in jurisdictions other than their home of origin can be long and difficult unless there are concerted regional policy initiatives to remove the impediments to cross-border location of financial institutions and cross-border sale of financial services. The benefits of cross-border banking are many but the impediments are also enormous while there are implications in the areas of sub-based and consolidated supervision which can compromise financial stability.

III. Cross - Border Banking in West Africa

Cross-border banking in West Africa has benefited from both the market and regional approaches to financial integration. International banks have being operating in West Africa since the colonial era. However, real attempt at financial integration among the countries in the sub-region commenced with the establishment of the Economic Community of West African States (ECOWAS) in 1975. The programme of financial market integration was articulated with the transformation of the West African Clearing House (WACH) into the West African Monetary Agency (WAMA) in 1987 to pursue the monetary integration of West Africa through a process of macroeconomic convergence.

The harmonization of economic policy in respect of payments system as well as the liberalization of financial flows towards reducing the non-convertibility of the national currencies was a major object of the monetary unification programme. The WAMA was to implement a multilateral payments arrangement for the ECOWAS and facilitate the process leading to the introduction of a common currency as well as the setting up of a common central bank that will implement a common monetary policy. The ECOWAS was to pursue the issue of trade integration leading to a customs union and a single economic space. These were to be undertaken in parallel and simultaneously with the monetary cooperation agenda of WAMA, while the ECOWAS Secretariat was expected to play a coordinating role in ensuring the comprehensive implementation of the sub-regional integration programme.

To initiate cross-border banking through private initiative, the Federation of West African Chambers of Commerce floated the idea of the Ecobank Transnational Incorporated (ETI) with the active support of the ECOWAS. In October 1985, the ETI was incorporated with an authorized capital of US$100 million. The initial paid-up capital of the ETI of US$32 million was raised from over 1,500 individuals and institutions from West African countries. The largest shareholder was the ECOWAS Fund for Cooperation, Compensation and Development (ECOWAS Fund).

The ETI commenced operations with its first subsidiary in Togo in March 1988. Currently, the regional banking institution has over 600 branches and offices in twenty seven (27) west, central and east and southern African countries namely Benin, Burkina Faso, Burundi, Cape Verde, Cameroun, Central African Republic, Chad, Congo Brazzaville, Democratic Republic of Congo, Côte d'Ivoire, Gabon, The Gambia, Ghana, Guinea, Guinea Bissau, Kenya, Liberia, Malawi, Mali, Niger, Nigeria, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone and Togo. The Group plans to open new subsidiaries and branches in other Middle African countries. It has obtained licenses to operate on the two Stock Exchanges in Central Africa: the Douala Stock Exchange in Cameroun and the Libreville Exchange in Gabon. It also intends to open representative offices and branches in international financial centers with substantial trade relations with Africa (See Ecobank webpage).

The Ecobank project has been relatively successful in improving banking services in West Africa as well as helping to offer financial services across the sub-region and the African continent. The Ecobank project was the first major attempt at cross-border banking in West Africa through indigenous initiatives. The banking reforms in Nigeria which led to the consolidation and recapitalization of banks in 2005 resulted in a surge in cross-border banking in West Africa, with Nigerian banks locating branches across the sub-region. In addition, Nigerian banks have established branches in other African countries outside the West African sub-region. Nigerian banks operate in The Gambia, Ghana, Sierra Leone, Liberia, Uganda, Democratic Republic of the Congo, etc with transnational branches and continental offices in Europe and the United States. There are also Nigerian sponsored banks operating as home institutions in a number of West, Southern and East African countries.

The ECOWAS Monetary Cooperation Programme (EMCP) was designed with the objective of creating a harmonized monetary system for the ECOWAS through the observance of a set of convergence criteria intended to strengthen the macroeconomic fundamentals of the member states. A stable system of exchange rate management, that would support an efficient payments system, was to be devised with the ultimate goal of a single monetary zone and a common central bank that would implement a single monetary policy for the sub-region. According to the initial understanding, the EMCP was scheduled to be operationalised in 1992. A five-year period commencing from the launching of the programme in 1987 was set aside to enable the member countries to prepare for the single monetary zone. During the period, the institutional and policy frameworks for the single currency project were to be put in place; in addition to the surveillance of member countries' economies. The target date could not be realized; thus the authorities of the ECOWAS finally agreed on 2000 as the end of the transitional period for monetary union. This was revised to 2004, 2005 and recently to 2015.

The transitional period ending in 2000 was to be used to undertake prior activities related to economic adjustments and reforms. The measures to be undertaken were of short, medium and long-term nature. In the short-term (1991 – 1994), it was expected that the West African Clearing House (WACH) would be strengthened, to improve its payments mechanism and boost intra-regional trade. The specific short-term measures included: clearing of settlement arrears in the WACH; introduction of new payments instruments, the ECOWAS Travellers' cheques and Bills of Exchange; introduction of a credit guarantee Fund; transformation of the WACH into a specialized agency of the ECOWAS, and elimination of non-tariff barriers of monetary nature to payments, trade and cross-border investments.

In the medium term (1994 – 1997), regional currency convertibility was to be achieved as an intermediate objective of the EMCP. The measures for the attainment of regional currency convertibility were to be completed under the medium-term. These measures included; exchange rate re-alignment and harmonization; adoption of an ECOWAS exchange rate mechanism (ERM); liberalization of exchange controls, current and capital account liberalization within the sub-region, maintenance of fiscal discipline; and adoption of market-oriented approach to monetary management. The application of a set of macroeconomic convergence criteria was to commence at this stage of the EMCP, especially the exchange rate component.

In the long-term period (1997 – 2000, originally 1994 – 1997), all adjustment measures to facilitate the convergence of exchange rates and harmonization of monetary policy were to be completed. This period, which would ultimately, usher in a single monetary zone for the ECOWAS was the period of macroeconomic transformation and consolidation, as the implementation of a set of primary and secondary macroeconomic convergence criteria were to be intensified. The successful implementation of the convergence programme and the performance of member countries in respect of the attainment of the stipulated criteria would determine the feasibility of the single monetary zone.

Apart from the strides made by the banking institutions to independently expand their operations across West Africa through market process, the regional integration institutions in the West African sub-region have also been useful in fostering greater market integration through policy harmonization and advocacy. As stated earlier, the ECOWAS played a key role in the establishment of the Ecobank and doubles as a major shareholder. The ECOWAS has a policy of financial integration towards the creation of a common market. This is expected to be facilitated through the reduction of barriers to entry and location of businesses by enterprises originating from the sub-region. The intention is to increase sub-regional trade and capital flows. The quest for financial integration in West Africa is driven by the need to make finance available and accessible across border for a more efficient allocation that will promote growth and reduce poverty, thus helping to attain a principal object of the ECOWAS.

The removal of barriers to financial flows is thus a major building bloc for integrating the financial markets in West Africa through regional efforts to complement the market-driven cross-border activities of a few banks that have been able on their own efforts, to surmount the obstacles to cross-border location. The realization of monetary union would not automatically guarantee financial integration unless national and regional policy are directed at strengthening the process through the development of sound national financial markets and political commitment to eliminate obstacles to cross-border financial flows. These are now mandates of the ECOWAS and its two sub-zones, the Union Economique et Monetaire Ouest Africaine (UEMOA) and the West African Monetary Zone (WAMZ) towards achieving the single market programme for the West African sub-region.

The slow pace of attainment of the convergence criteria for monetary union has been adduced to a number of factors including the poor implementation of economic policies as well as negative exogenous shocks and inadequate political will to undertake necessary measures with focus on regional agenda. The slow pace of macroeconomic convergence has also compromised efforts at financial integration. Cross-border financial services could not increase significantly as a result of slow rate of economic growth and low intra-regional trade activities.

Cross-border banking in West Africa is not substantial. It follows the relatively low level of financial development. The small and fragmented markets are not able to provide the required push for significant cross-border expansion of financial services. Apart from Nigeria with banking institutions operating in more than three countries in the sub-region, other ECOWAS countries do not have banks with branches in more than one other ECOWAS country. Also, of the 21 foreign banks operating in the WAMZ, only six can be found in more than one WAMZ country. This concentration does not make room for effective cross-border banking and the reaping of the benefits in respect of lower cost of service provision, efficiency in resource allocation and optimal spread of risks as well as the diversification of product offering through competition.

There are seven international/cross-border banks in the UEMOA, Societe Generale (14.5 per cent of market share), BNP Paribas (11.9 per cent), AFH/BoA (9.4 per cent), Ecobank

(8.7 per cent), Belgolaise (4.6 per cent), Calyon (4.0 per cent), Citigroup (2.5 per cent). The banks are mainly of French origin and their operations are controlled from France while they are supervised by the UEMOA Banking Commission as home supervisor. International/ cross-border banks operating in the WAMZ include Standard Chartered bank, Guarantee Trust Bank, First International bank, Ecobank, Societe General bank, International Commercial bank (a Malaysian bank with Ghana/Malaysia as home supervisor). Ecobank is the most dominant followed by Standard Chartered bank.

The banking reform in Nigeria improved the competitiveness of the banks as they are now better placed to satisfy the listing conditions in other ECOWAS countries as a result of their increased capital base. On the other hand, other West African countries' banks are not in a position to conveniently satisfy the conditions for the granting of a license to operate banking business in Nigeria as a result of the large capital requirement.

III.1 Challenges to Cross-Border Banking in West Africa

The peculiar nature of banking in West Africa is the low direct interface between the banks. Although the banks in the UEMOA are regulated by a common banking commission, there is little cross relationship among the countries' banking institutions. The situation is worse in respect of correspondence relationship between the WAMZ and UEMOA banks, where interface is almost nonexistent. The foreign banks that dominate the banking landscape of the UEMOA and the largely indigenous banks in the WAMZ, especially from the structure of banking in Nigeria, execute payment instructions overseas. There is not yet a framework developed for the direct remittance of funds between ECOWAS countries. There are, however, moves to develop direct links through mobile banking before a formalized regional correspondent banking approach is adopted. Cross-border banking is taking place in West Africa, albeit, at a very low level, through market approach with sets of different rules across jurisdictions. With the harmonization of rules and concerted regional approach, cross-border banking and financial integration would become more efficient and useful for reducing cost of banking services, increasing competition and strengthening corporate governance and improving the general well-being of the peoples of the sub-region. These are not without challenges but efforts should be made to implement a programme that will mitigate perceived difficulties.

The ECOWAS programme of monetary cooperation has suffered a number of setbacks as the timetable for the attainment of a single monetary zone has been adjusted and the date postponed several times to enable member countries satisfy the conditions for monetary union. The slow pace of macroeconomic convergence has also affected the programme of financial integration. On the issues of payments system development and harmonization of banking supervision, steady progress is being made. It is hoped that sustained improvement in these areas will facilitate the growth of cross-border banking in the sub-region and further boost financial integration.

In May 2005, member States of the WAMZ committed themselves to the establishment of a single economic space through the abolition of all barriers relating to the free movement of persons, capital, goods, and services within the Zone and in particular to ensure: convertibility and trading among the WAMZ currencies not later than December 2006; full capital account convertibility not later than December 2007; cross-listing of stocks and securities in the WAMZ to be implemented not later than December 2006; full participation in the ECOWAS Common External Tariff by December 2007; compliance with the ECOWAS Customs Union by December 2008; and the review of mercantile laws with a view to facilitating smooth operation of financial institutions and intermediaries across WAMZ countries.

The main risks facing the financial sector are related to the supervisory arrangements, the payments system, and the monetary accommodation of fiscal policy. Outstanding regulatory challenges are in the areas of consolidated supervision, systems to identify, monitor, manage and control market risks, introduction of risk management, international accounting standards, harmonization of prudential ratios and regulations on loan loss provisions, suspension of interest and charges on unrecoverable debts, as well as directives on credit policy, internal control and corporate governance. Further challenges are the market risk, other risks, anti-money laundering, consolidated supervision, and remedial measures. In addition, meeting the new accord which is about to kick-off will be a tall order as the countries will have to first comply with the preliminary requirements.

Monetary policy effectiveness is constrained by fiscal deficits in many member countries. The expansionary fiscal stance of governments supported by borrowing from the banking system has continued to be a major problem. The accommodation of the deficits by the central bank has continued to undermine the effectiveness of interest rate as a tool of economic management, while inflation continues on an upward trend. The heavy borrowing by government has continued to crowd out the private sector and has undermined the development of the financial markets. Although Ghana and Nigeria have Stock Exchanges, and Sierra Leone is being assisted by the Commonwealth Secretariat to establish one, financial integration is far from the norm required for a unified monetary union.

IV. Implications of Cross - Border Banking for Financial Integration

The critical issues in international bank financing/investment relate to cost and exchange risks. Corruption, poor corporate governance, undue delay in concluding bilateral financial transactions as well as unnecessary bottlenecks and compromised judicial process increase the cost and risk to international financial transactions; thus limiting the volume of such transactions. The negative effects of corruption, inadequate property rights, and investor protection on economic growth and growth volatility have been established by Knack et al (1995); Mauro (1995) and Acemoglu *et al* (2003). Overall, the conclusion was that countries with poor institutions are only able to attract low foreign capital and participate less actively in cross-border lending and borrowing.

a. Financial Stability

Measures of financial soundness generally improve with cross-border diversification of banks. However, there are financial stability concerns, especially for large banks that are diversified across-borders. Such banks may become very similar with correlated incomes and therefore susceptible to vulnerability of large common shocks and spillover effects, making severe crisis difficult to contain. The financial innovations that changed the global financial landscape and resulted in the boom that was brutally stemmed by the financial crisis which intensified from September 2008, made it possible for banks to adopt new risk management techniques. Banks could choose the risks they want to hold and those they want to distribute and transfer through cross-border activities. The model of originating and distributing risks requires efficient markets to be successful. The liquidity of financial markets and ability to package the risks are critical success factors. This model of risk management which may be a beneficial outcome of cross-border banking and financial integration may precipitate financial instability especially if financial markets are not efficient and the cross-border entity suffers financial distress in the home economy.

b. Regulatory Harmonization

The preferences of supervisors may not converge on a regional level, especially as the EU has revealed. This may result in prudential regulation and supervision which is not Pareto Optimal and could precipitate unhealthy competition which may be counter-productive. With the convergence of regulators' preferences for profit and stability, the general welfare of the population could be enhanced as more comprehensive information can be exchanged.

Although deposit guarantee or insurance provides opportunities for positive externalities in crisis periods, it generates moral hazards in normal times. Thus, the implied trade-off requires an optimal model of profitability of banks and stability of the financial system. Regulatory arbitrage may be allowed to persist, especially if the home country regulator is not under stress and is benefiting from the situation. Regulatory competition could produce better regulation but the speed could be affected by accountability and transparency of the political governance system as well as cultural factors.

The cost of cross-border banking crisis resolution would be high in a regional setting where rules and regulations have not been streamlined and coordination and cooperation are weak. There is the possibility of inefficiency as incentives to assemble relevant information for regulatory supervision is low. Thus, it is absolutely necessary that prudential regulation and supervision are tight in a globalizing setting. However, the raging debate and emerging conclusion that more generous deposit insurance is associated with higher probability of systemic banking crisis as banks expand lending beyond normal limits (Demirguc-Kunt and Huizinga, 2004) is relevant for due consideration against the future, but this has not been a problem in the West African sub-region.

In order to reduce regulatory arbitrage and competition among regulators, without distorting the financial markets, regulatory harmonization as experienced in the EU has set a lower bound on safety and soundness and has made regulatory coordination possible among countries; although the process is not very perfect (Hardy and Nieto, 2008). Improved and efficient supervision coordinated across jurisdictions, especially those that are contiguous will obviate the need for very generous deposit insurance. It is imperative to harmonize macroeconomic and financial policy as well as micro and macro-prudential policy so as to reduce the negative spillovers and externalities of financial crisis arising from cross-border banking transactions while internalizing the positive externalities which often go unnoticed.

There is need to distinguish between symmetric and asymmetric countries or jurisdictions in the analysis of the best strategies to adopt to effectively and efficiently manage cross-border financial exposures. In respect of symmetric countries that have identical preference functions for bank profitability and financial sector safety, full coordination of prudential regulation and supervision as well as deposit insurance; cap on deposit guarantees, especially where coordinated prudential supervision is weak would lead to financial stability. However, for asymmetric countries, it may be useful if both supervision and deposit guarantee levels are determined collectively and streamlined across jurisdictions.

The transparency of cross-border or offshore banking institutions could be weak as a result of supervisory gaps. The inability of home and host supervisors to work together to prevent the spillover of financial instability as a result of different preferences may be a major hindrance of comprehensive consolidated supervision of cross-border banking institutions. There may be hitches in the full implementation and observance of the minimum standards for the comprehensive consolidated supervision of international banking institutions, the principles of which are that: all international banks should be supervised by a home country authority that capably performs consolidated supervision; the creation of a cross-border banking establishment should receive the prior consent of both the home country and host country authority: home country authorities should possess the right to gather information from cross-border banking establishments; and if the host country determines that many of these three principles/standards is not being met, it could impose restrictive measures or prohibit the establishment of banking offices/branches (BIS, 1996). The third and fourth principles or standards are the most difficult to observe especially in respect of banking institutions in developing and emerging economies. The sharing of supervisory information may not be as smooth as expected because the host country is free to withhold market sensitive information. In addition, the home country may not fully inform the host supervisor on the status of an originating cross-border bank that could contribute to financial instability in the host economy.

The concordant principle that no banking institution should be allowed to escape supervision may be undermined if adequate arrangements and understanding are not in place for comprehensive consolidated risk-based supervision. If the home supervisor is not able to access relevant information from offshore and cross-border banking institutions, it may be difficult to implement a policy of comprehensive consolidated supervision effectively.

Another potential area of concern is that inadequate and under-regulation by home country and host country supervisors can create supervisory gaps and, thus, undermine financial stability. To stem this problem, there should be cooperation and collaboration among supervisors in ensuring that the minimum standards for comprehensive consolidated supervision are satisfied.

c. Streamlining the Deployment of ICT Infrastructure

For the successful implementation of cross-border banking, it is important that the deployment of information and communication technology infrastructure between the home country and the host country interface with each other. The establishment of a unified, integrated ICT framework linking the various activities and processes together across distributed locations is imperative. This will facilitate efficient resource use as well as reduce transactions cost and time. It will also encourage participants in cross-border trade to settle transactions on real time basis, thus making market conditions easier to manage.

d. Cross-Border Banking and International Crime

Accompanying cross-border banking and financial integration is increased banking transactions with the attendant challenge of exposure to international crimes especially, money laundering. Thus, the adoption of a common platform for information sharing in the area of cross-border economic crimes would be an important element of forestalling banking system fraud across-borders.

e. Deployment of Human Resources

Another issue that comes to the fore is the deployment of human capital. There is the tendency to concentrate the recruitment of staff of off-shore banks from the home country. A situation where the management of the biggest banks in a host country is largely made up of "foreigners" has implications for financial system stability. This could create an area of friction between the home country and the host country.

f. Provision of Wider Pool of Financial Resources

There are positive and negative consequences of cross-border banking. When well organized, regulated and supervised, it confers a number of advantages on host and home economies. The host economy benefits from a wider pool of resources which could be intermediated for economic growth and development. In respect of the home economy it provides a wider sphere for generating income from capital investment. Cross-border banking, by helping to intermediate capital across-borders, facilitates economic growth by intermediating funds from surplus to resource scare centers. The elimination of obstacles to cross-border banking will further enhance the chances of boosting economic growth and development. Cross-border banking could facilitate further advances in financial integration in West Africa once the remaining obstacles to the movement of goods, services and capital are removed and the single market programme of the WAMA and ECOWAS is respected by all and fully implemented.

g. Diffusing Risk Concentration

Cross-border banking in West Africa will help greatly in reducing risk concentration by diversifying risks and spreading them across the sub-region. The spread and diversification of risk would help in improved profitability selection, with optimum risk and return balance. The spread and diversification of risk could become problematic if supervisors, both home and host do not undertake their assignments diligently. Lax regulation and supervision, as well as improper disclosure of information which could lead to supervisory arbitrage threaten financial stability. The spread of cross-border banking in the sub-region without adequate regulatory and supervisory framework could undermine financial stability across the sub-region with dire consequences for economic growth and development.

Consolidated and cross-border supervision would require strengthening and enforcing by the home and host countries in order to make cross-border banking useful for facilitating economic growth through robust financial intermediation. Collaboration among supervisors/regulators as well as information sharing is key to strengthening sub-based consolidated supervision.

V. Recommendations

In order to stabilize the financial systems globally and prevent systemic distress, national supervisors, under the auspices of the Bank for International Settlements, have fashioned out a supervisory framework considered appropriate to properly safeguard against risks and ensure good quality assets and capital adequacy by banks. The Basel Committee on Banking Supervision and the Offshore Group of Banking Supervisors have collaborated in this endeavour. The Group has continued to work on "Minimum Standards for the Supervision of International Banking Groups and their Cross-Border Establishments". The Group made 29 recommendations in 1992, aimed at improving and facilitating prudential supervision of banking risks with a view towards soundness of credit institutions as well as the stability of financial systems as a whole (BIS, 1996), through sub-based comprehensive consolidated supervision.

Conditions for improved foreign bank capital inflow and cross-border transactions include: removing inefficient bureaucracies, tackling corruption comprehensively, above the board legal system, structural economic reforms, privatization, improved public procurement system as well as exchange rate stability. Others include: institutional competence and a transparent and efficient legal system. The regional integration institutions would have to continuously monitor the development on cross-border banking and financial integration in the sub-region with a view to improving the regional framework for collaboration in cross-border banking. Nigerian banks have expanded across the country's border into a number of countries in West Africa and a few other countries in Africa, Europe and the USA. There is need for accelerating the pace of risk-based consolidated supervision to ensure that these banking institutions that have become financial supermarkets are fully monitored and all risks assessed where ever they are booked in the operations of these institutions.

The regulators have enormous role to play in ensuring financial stability in the context of the rapid integration of financial markets, especially the steady rise in cross-border banking. There is need to have in place, a regulatory and supervisory framework that is forward looking and ensures that financial institutions are well managed with adequate capital and risk management systems. In addition, regulatory authorities should ensure that the information they obtain from the banks and additional information used in assessing the status of the banks is adequate for the effectiveness of market discipline. Furthermore, governments should consider the cross-border spillover implications of domestic policy. In this respect home-host cooperation in consolidated and risk-based supervision should be strengthened. Crisis management and resolution procedures should be strengthened as a result of the increasing complexity of cross-border banking. The deployment of a rule-based system with early warning mechanism is most appropriate at this stage of development of the financial markets and in view of the current global financial crisis which was largely caused by.weak risk management and lax supervision. It is, therefore, important that cross-border establishments are effectively supervised through an appropriate framework that eliminates regulatory arbitrage.

The pursuit of financial stability is a shared responsibility. The proper management of risks and the minimization of the threats to financial stability are necessary so that the benefits of cross-border banking and financial integration/globalization can be maximized and Pareto optimality holds. Banks owe it as corporate responsibility to ensure that their actions do not result in negative impacts on other operators in the financial markets, thereby undermining financial stability, by improving the efficiency of their risk management systems in tandem with the increasing sophistication of the financial markets.

The recent global financial and economic crises has demonstrated the powerful interconnectedness of financial markets across the globe, the difficulties of cross-border coordination of prudential supervision and safety nets arrangements and the costs of poor preparation and international rivalry (Hardy and Nieto, 2008). Supervisory and regulatory systems have not been able to cope with the highly sophisticated and complex derivative products through financial engineering which proved to be the albatross that led to the free fall in the financial markets once the sub-prime mortgage problem proved difficult to tackle by the US authorities. The rapid spill over of the financial problems to other climes outside the US was facilitated by the activities of cross-border banks and other financial institutions. This requires the development and implementation of supervisory and regulatory system that is proactive and forward looking.

VI. Conclusions

Cross-border banking is capable of aiding the financial and economic integration of the West African sub-region. However, the process is being hampered by the high level of informal channels of funds transfer as well as the regulatory environment. The slow pace in the implementation of the policy harmonization programme of ECOWAS as well as the slow pace of implementation of policy towards macroeconomic convergence has been identified as factors limiting cross-border banking and financial integration in the sub-region. The UEMOA have been able to surmount the problem of cross-border banking through the adoption of the principle of unique approval for banking license, authorizing banks and financial institutions have been granted a banking license in one country of the Union Economique et Monétaire Ouest Africaine (UEMOA) to carry out banking business in other states of the Union without further authorization. The WAMZ Authority of Heads of State and Government had approved a programme for creating a single economic space involving the quoting of the local currencies in the WAMZ member states, cross-listing of shares throughout the Zone as well as the liberalization of capital accounts preceding the introduction of a common currency in December 2009. The programme could not be implemented as envisaged and the macroeconomic convergence criteria could not be satisfied, leading to the adjustment of date for monetary union to 2015.

The key strategies to maintain financial stability include promoting robust structures, which can absorb shocks; making regular surveillance which will identify threats and fragility, etc.; and undertaking crisis management, when necessary. On financial sector risks, it is crucial to strengthen the supervisory systems in line with the BCPs on due date. This would enable countries to detect and contain systemic risks before they become disastrous. Further efforts should be geared towards upgrading the financial systems to the higher accord, in order to offer the required level playing ground to financial intermediaries in the Zone. The harmonization of financial rules and regulations should be given priority to provide the platform for financial integration.

With respect to the payments system, member countries should step up efforts at implementing the overall zonal strategy, including the implementation of the zonal RTGS. This will support intra-community trade and cross-border transfers, as well as the transmission of the monetary policy of the common central bank. Energy and telecommunication projects for the Zone should be expedited to provide the platform for the operation of the zonal payments system.

Monetary management should be market-driven, while fiscal restraint should be adhered to. This will ensure macroeconomic stability, which would be supportive of financial stability. Effort should be made to harmonize the stock exchanges in the Zone to enable trading across the exchanges and intermediation of long-term funding required by the real sector. Financial courts should be established in the countries to help resolve conflicts arising from business disputes as well as allay the fears of foreign investors.

The removal of obstacles to capital flows, especially through policy collaboration underlined the success of the EU project. The improvement in cross-border banking activities in the EU since the launch of the Euro is an indication of the role regional policy can play in improving the environment for productive cross-border banking. The imperative is not to halt financial globalization but, to put in place, mechanisms that will detect banking problems before they occur; and when they do occur if they cannot be prevented, to apply remedial actions to contain and reverse the problems. It has been canvassed that regulatory and supervisory systems should be strengthened while deposit insurance/guarantees should be put in place to contain the adverse impacts of financial crises in the future, if they cannot be prevented from occurring in the first instance. The issue of moral hazard from a deposit guarantee scheme has been raised but the consensus appears to be the design of optimal regulatory and supervisory framework and deposit insurance that does not unduly raise supervisory cost but reduces the potential moral hazard in deposit guarantee scheme.

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