

OE D Précis



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Restructuring Senegal's Ailing Banks

Senegal's first World Bank-supported Financial Sector Adjustment Program (approved in 1989 and closed in 1992) succeeded in restructuring the banking sector. The restructuring followed nationwide financial reforms adopted by the West African Monetary Union (UMOA) and was the forerunner for similar operations in other countries of the union. The reforms led to the closing of weak banks and helped strengthen viable banks through a program of partial privatization and financial restructuring. Although the program failed in collecting nonperforming loans, particularly from large borrowers, it succeeded in helping the remaining banks become solvent.

In Senegal, the reform of the banking sector took place at the same time as the country's fourth structural adjustment program, and about three years before the CFA franc devaluation. The delay in the exchange rate adjustment severely undermined the other policy reforms being undertaken under the structural adjustment operation. But it proved fortuitous that the banking reforms had just been completed when the government carried out the devaluation in 1994. The banks were in relatively good shape, thus enabling the financial sector to remain calm during the adjustment. The experience once again highlights the importance of a strong banking sector in countries undergoing adjustment.

During the 1980s the seven countries of West African Monetary Union were mired in economic and financial crises. In sev-

eral countries, the problems in the banking sector were also acute. But for the union, the most critical case was Senegal's, which accounted for one-fifth of the combined GDP of the union and more than a fourth of its bad loans. In 1988, Senegal's nonperforming loans made up half the value of the country's total loans, the equivalent of 3.7 times the sum of capital and reserves held by the country's banks.

But neither Senegal's nor any of the other member countries' financial crisis could be addressed without first correcting the banking, credit, and monetary policies of the union's central bank: Banque Centrale des Etats de l'Afrique de l'Ouest. In 1989 members of the Council of Ministers of UMOA agreed on a regional reform program, inspired by an earlier proposal made by the World Bank. The reform measures:

- closed loopholes to established limits on credit by bringing crop credits and refinancing of government guaranteed loans under the central bank's ceilings, and by abolishing preferential borrowing costs.
- strengthened bank supervision by giving the central bank sole responsibility for defining accounting standards, setting prudential ratios, and supervising banks in all member countries.
- liberalized credit allocations by progressively abolishing sector and bank-by-bank allocation of credit

and by liberalizing prior authorization mechanisms. Banks that did not meet the prudential ratio risked losing their license. Finally, the program abolished the dual interest rates (a discount rate for loans targeted for priority sectors and a normal rate) replacing them by a single rate fixed to the Paris money market rate. Though an improvement, the reform did not fully liberalize the interest rate, which remains for the next financial adjustment to complete.

The Senegalese reform of the banking sector followed the regional reforms and was supported by IDA through a \$45 million financial sector adjustment credit, with \$34 million cofinancing provided by France and \$33 million by the United States. While the key decisions on credit, banking, and monetary policies were taken up by UMOA, reforms in Senegal focused on restructuring the country's ailing banks to prevent the collapse of

**Performance audit report: "Senegal: The Fourth Structural Adjustment Credit and Financial Sector Adjustment Credit," by Gerardo Sicut, Report No. 14818, June 1995. Performance audit reports are available to Bank executive directors and staff from the Internal Documents Unit and from Regional Information Services Centers. Précis written by Farah Ebrahimi.*

the banking system. The reforms ran parallel with Senegal's fourth structural adjustment program, also supported by the Bank. While the financial sector reforms largely succeeded, SAL IV mostly failed, primarily because the government failed to devalue the CFA franc on time.

Implementation

Two principles guided Senegal's banking reforms: first, that no bank should survive unless it could become profitable, solvent, and liquid after the restructuring; and second, that the surviving banks should be able to allocate credit on the basis of economic rather than political considerations. For this purpose, the government's share in any bank was not to exceed 25 percent. Added to this, restructuring had to take place without losing the confidence of the public. Hence it was necessary to recover bad loans and to compensate the depositors of the liquidated banks.

Restructuring

Out of Senegal's 11 commercial banks, 8 were distressed. Of the eight, five were closed. The healthy part of their portfolio was too small to form the basis of a new bank. The sound portion of their assets was liquidated and together with an equivalent amount of deposits distributed among the operational banks. The assets of two other distressed banks were sufficient to form two new banks. A single liquidating company, Société Nationale de Recouvrement (SNR), was established to take over and collect the nonperforming loans of the distressed banks. After a protracted startup period, SNR became operational in 1991.

Senegal's two specialized banks—the national agricultural credit bank and the housing bank—were not fully restructured even though the reforms called for government divestiture. No taker was found to buy the agricultural credit bank's government shares, which exceeded the 25 percent limit. Based on the restructuring criteria, the bank should have been closed, but at the time, there was no substitute for providing credit to the rural population. Both banks still have poor loan portfolios. Two privately owned banks were given time to recapitalize, and after failing in their attempt, were also closed.

Financial workout

The total cost of the banking crisis was about CFAF 250 billion (about \$830 million), equivalent to 17 percent of Senegal's GDP. Since most of the cost had to be shouldered by the state, which did not have the money, it was necessary to find a borrowing scheme whose debt service could be borne by the treasury over time. The workout scheme proposed three sources for the funds: (1) CFAF 126 billion through rescheduling of the debt due by the distressed banks to the monetary union's central bank; (2) CFAF 38 billion from IDA, France, and the United States; and (3) CFAF 32 billion to be recovered from nonperforming assets. The latter proved a major weakness of the program.

The financial adjustment operation wanted to convey the message that debtors would be pursued, even if well connected, but SNR was unable to recover bad debts, especially from large borrowers. With the bad loans transferred from the banks to the facility, the problem of loan recovery became

SNR's, reducing pressure on the newly restructured banks.

Outcome

The financial sector reforms made most of the domestic banks in Senegal solvent. Five commercial banks emerged from the restructuring, all of which fully satisfied the reform criteria. In 1994, the government carried out a devaluation of the CFA franc, an adjustment that should have been undertaken earlier. But the restructuring of the banks was useful when the devaluation took place, because it enabled the banking and financial sectors to remain relatively calm during devaluation. The banks were thus able to respond more positively to the benefits of the adjustment.

Weaknesses remain, however. The monetary union needs to fully liberalize interest rates, and the agricultural bank still needs to be restructured. Although the banking sector is healthier, for it to remain so depends largely on instilling economic criteria for bank lending to ensure repayment, as well as on the success of structural adjustment—a process still in progress.

Conclusions

The financial adjustment program was well focused, both in its objectives and instruments. The program was a sound example of regional reforms being translated into a concrete sector reform within one country. It also provided an example of how the Bank can play a significant role in supporting regional reforms affecting a group of countries. The restructuring of the banks enabled them to respond positively to opportunities when the adjustment took place.

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