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Report No. 17249

IMPLEMENTATION COMPLETION REPORT

REPUBLIC OF GHANA

SECOND FINANCIAL SECTOR ADJUSTMENT CREDIT

- FINSAC II

(CR. 2318-GH)

December 22, 1997

Private Sector & Finance
Africa Region

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CURRENCY EQUIVALENTS

Currency Unit	= Cedi
US $1.00	= Cedis 2,000 (July 1997)

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

ADB	African Development Bank
BOG	Bank of Ghana
FINSAC II	Second Financial Sector Adjustment Credit
FINSAC I	Financial Sector Adjustment Credit
GCB	Ghana Commercial Bank
GSE	Ghana Stock Exchange
ICAG	Institute of Chartered Accountants of Ghana
NBFI	Non-Bank Financial Institutions
NPART	Non-Performing Assets Recovery Trust
NSCB	National Savings and Credit Bank
SAC	Structural Adjustment Credit
SSB	Social Security Bank
SSNIT	Social Security and National Investment Trust

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GHANA

SECOND FINANCIAL SECTOR ADJUSTMENT CREDIT

- FINSAC II

(CR. 2318-GH)

PREFACE

This is the Implementation Completion Report (ICR) for the Second Financial Sector Adjustment Credit (FINSAC II) in Ghana for which IDA Credit 2318-GH in the amount of SDR 74.0 million (US$100 million equivalent at appraisal) was approved on December 19, 1991, and made effective on May 14, 1992. Cofinancing was provided by the Swiss Government in the form of a grant of Swiss Francs 15 million (US$10.1 million equivalent), administered by IDA.

The credit was closed on March 31, 1997, two years after the original closing date of March 31, 1995. An undisbursed amount of SDR 2.6 million equivalent has been canceled.

The ICR was prepared by an IDA mission which visited Ghana in September 1997. The borrower contributed to the preparation of the ICR by arranging field visits and meetings, and providing data information and comments on the draft report.

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IMPLEMENTATION COMPLETION REPORT

GOVERNMENT OF GHANA

SECOND FINANCIAL SECTOR ADJUSTMENT CREDIT - FINSAC II

(CR. 2318-GH)

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EVALUATION SUMMARY

Introduction (Part I)

1. The Second Financial Sector Adjustment Credit (FINSAC II) was a continuation of FINSAC I, implemented during 1988-1991. The first credit, approved in FY 1988 for an amount of US$106.6 million equivalent, supported an initial sector adjustment program for addressing a near-crisis situation in the financial sector, brought about by a severely distressed banking system. The performance of FINSAC I was reviewed in Project Completion Report (PCR) No. 14158 dated March 29, 1995. The second credit, FINSAC II, for US$100 million equivalent, was approved on December 19, 1991, and closed on March 31, 1997. The two credits were cofinanced by the Swiss Government and Overseas Economic Cooperation Fund of Japan. Both credits were the subject of Performance Audit Report (PAR) No. 16789 dated June 25, 1997

2. At the time the first FINSAC program was conceptualized (1988), the formal financial system in Ghana was dominated by state-owned banks, which were all experiencing financial and operational difficulties to varying degrees. Banking concentration was heavy, with the largest bank (the state-owned Ghana Commercial Bank) accounting for almost one-half of total system assets. The Bank of Ghana (BOG) had oversight responsibility for the financial system, but was constrained by inadequate statutory autonomy, the absence of an appropriate regulatory and prudential framework, as well as its own limited institutional capacity, notably in the key area of banking supervision. BOG lent heavily to the Government, and the banking system to state enterprises. The money market was embryonic, and the capital market practically non-existent.

Program Objectives and Design (Part II)

3. As a follow-on operation, FINSAC II was designed with the dual purpose of (a) consolidating previous achievements by continuing and completing a number of unfinished tasks; and (b) removing some remaining policy distortions in the financial sector and introducing additional sector reforms. This design is reflected in the program's main objectives, to (1) increase financial intermediation by reducing its costs, through (i) adequate remuneration of reserves imposed on the banks and deposited with the central bank; and (ii) reduction of the corporate tax on financial institutions to the level applicable to other sectors; (2) strengthen the central bank in its statutory autonomy, financial condition and institutional capacity; (3) complete the bank restructuring program started under the first credit; (4) pursue the recovery of assets transferred from distressed banks to the Non-Performing Assets Recovery Trust (NPART); (5) prepare a program for divestiture of public sector shareholdings in banks, and implement the program's first phase covering the three largest banks; (6) develop non-bank financial institutions, starting with the establishment of an

appropriate regulatory and prudential framework for their operations; and (7) pursue the upgrading of professional skills, through the continuation of training programs, and further institutional capacity building including the establishment of the National Banking College. The program's design and sequencing, and its links to the initial sector adjustment program supported by FINSAC I, were appropriate. For example, the restructuring of distressed banks was initiated under the first program as a pre-requisite for their subsequent attempt at privatization under the second. Also, the formal banking system, insolvent and requiring priority attention in the late 1980s, was the main focus of the first credit, leaving the non-bank financial system to be addressed under the second.

4. The broadening of the scope of FINSAC II, however, stopped short of macroeconomic objectives (i.e. the achievement of macroeconomic stability), which were pursued under other Bank operations (SAC I and SAC II) and IMF programs (ESAFs) under implementation during the period. Hence, the macroeconomic framework was not the subject of specific or direct conditionality under FINSAC II, beyond a general stipulation in the Credit Agreement (as condition of tranche releases) regarding "the consistency of the macroeconomic framework with the objectives of this program". With hindsight, given the impact of macroeconomic instability on the financial sector, perhaps more specific macroeconomic conditionality would have been appropriate

Achievement of Objectives (Part III)

5. The complexity of the reform program, in particular that of the banking divestiture scheme, resulted in some implementation delay, partly on account of the Government's deliberate and systematic approach to program implementation. The delay notwithstanding, the specific program objectives, by and large, were satisfactorily achieved (Appendix A: Policy Matrix):

(a) *Removal of remaining policy distortions in financial sector*. The underlying objectives were to reduce the intermediation cost of the banking system, and thereby increase financial intermediation, and to achieve tax equality across sectors. These were achieved through: (1) the payment since 1991 by BOG of market interest rates on reserves (previously non-remunerated) deposited by banks; and (2) the gradual lowering during 1992-1994 of the corporate tax on financial institutions from 50 to 35 per cent, the same level applicable to corporations in other sectors.

(b) *The Strengthening of the Central Bank.* The revised Bank of Ghana Act of 1992 significantly enhanced its statutory autonomy, role and responsibilities. BOG's financial condition was considerably improved with the transfer to the Government of accumulated foreign exchange losses and the discontinuation of quasi-fiscal, non-central banking activities (e.g., development finance, equity participations, subsidized credits). BOG has carried out a major reorganization of its structure, improved its operational capacity in most major areas, and installed a comprehensive computerized system;

(c) *The Bank Restructuring and Divestiture Program.* The bank restructuring program started under FINSAC I was substantially completed under this operation. Six of the seven restructured banks have begun since 1992 to operate profitably and in compliance with prevailing prudential regulations (e.g., capital adequacy, liquidity). The successful restructuring enabled the Government to initiate the first phase of the banking divestiture program, covering the three largest state-owned banks (GCB, SSB, NSCB), in fulfillment of a condition for third tranche release. SSB and NSCB were merged in 1993 as a step prior to the subsequent privatization of the new SSB in early 1997. The privatization of GCB, although not yet fully completed, is now in its final stage. A foreign financial-cum-industrial group has entered into an agreement for the acquisition of 40 percent of its share capital, which is to be finalized pending the fulfillment of a number of specified actions, while 41 per cent of GCB's shares are presently held by domestic private investors. SSB's shares have been traded on the Ghana Stock Exchange since September 1995 while that of GCB has been traded since May 1996. The second phase of divestiture, dealing with the remaining 4 smaller state-owned banks (ADB, BHC, NIB, and Coop Bank), accounting together for less than 3 per cent of system assets, is scheduled to start shortly, beginning with a merger of ADB and Coop Bank.

(d) *Recovery of Assets.* The Non-Performing Assets Recovery Trust (NPART) was set-up as a Government agency in 1989 with a 6-year statutory life and with the mandate to recover as much as possible of the non-performing assets transferred from distressed banks. An action program was formulated, which set for an "aggregate recovery target" of 18 billion Cedis, based on a review of NPART's portfolio. By the time NPART closed down on June 30, 1997, it had recovered 19.6 billion Cedis, or about 10 per cent above the initial target, representing a satisfactory performance;

(e) *Development of Non-Bank Financial Institutions.* The Non-Bank Financial Institutions Act promulgated in January 1993, provides an appropriate regulatory and prudential framework for the operations of this category of financial intermediaries, which previously had been largely unregulated. The extensive review preceding this legislation also served as a basis for the preparation of a separate Bank project (Non-Bank Financial Institutions Assistance Project, approved in 1996), currently under implementation;

(f) *Upgrading professional skills.* The National Banking College was established in April 1994 and has since conducted a continuing series of banking courses. Other professional entities and training institutions, including the Ghana Stock Exchange, the Ghana Institute of Bankers, the Institute of Chartered Accountants and the National Insurance Commission, have also provided continuing technical services and training opportunities for the local business community on relevant professional subjects, with technical assistance from FINSAC II.

Program Sustainability (Part IV)

6. There are good prospects for sustaining the reforms of the FINSAC programs. As with financial sector adjustment in other countries, bank restructuring is usually the component most difficult to sustain in view of the inherent risk of restructured banks relapsing into distress, usually on account of non-performing loans in their portfolios. In the case of Ghana and FINSAC, the completion of the privatization of the three largest banks enhances the prospects for sustainability. Other achievements include: the strengthening of the regulatory and prudential framework for banking operations; the strengthened autonomy, financial condition and institutional capacity of

BOG; the development, albeit at a slow pace, of the money market and capital market; and the continuing effective operation of those entities forming part of the financial infrastructure (e.g., the stock exchange, training institutions).

Bank and Borrower Performance (Parts V, VI)

7. The performance of the Bank in preparing and supervising the credit was satisfactory. Thanks to its extensive initial sector work, the Bank made major conceptual inputs into the formulation of the reform programs and thereafter continued a meaningful policy dialogue with the Government throughout program implementation. Notwithstanding some implementation delay, which mainly reflected the Government's systematic and deliberate approach to banking divestiture, the performance of the Borrower and of program implementation agencies, notably BOG, has been satisfactory.

Assessment of Outcome (Part VII)

8. The outcome of FINSAC II is satisfactory, especially with regard to specific, institutional objectives. Those that have been achieved include bank restructuring and privatization, establishing and enforcing an appropriate legal/regulatory framework for the financial sector (including both the formal banking system and NBFIs), improved banking oversight, building up institutions forming part of the financial infrastructure (e.g., GSE), strengthening the central bank, fostering the money and capital market, and upgrading professional expertise. On the other hand, the broader objective of financial deepening remains to be achieved. Significant increases in deposit mobilization and credit expansion will be realized only with the improved performance of the real sector.

Future Operations (Part VIII)

9. It will be important to continue monitoring the situation and performance of banking institutions, in particular the condition of their loan portfolios. This will be undertaken by the central bank, whose banking supervision capacity is now adequate and is expected to further improve as it gains more practical experience over time. The monitoring of the broad performance of the financial sector (e.g., savings mobilization, financial deepening) will be undertaken through ongoing Bank macroeconomic operations (SACs), IMF programs and sector work. The continuation of limited technical assistance, on a gradually diminishing scale, is advisable.

Lessons Learned (Part IX)

10. Of the lessons drawn from this operation, the three key ones are:

- Financial Sector Adjustment Loans (FSALs) should be relied upon mainly to achieve specific sectoral objectives (e.g., bank restructuring, bank privatization, regulatory and prudential reforms; institutional capacity building). Broader macrofinancial objectives (e.g., financial deepening; savings mobilization) would be more appropriately pursued under Bank macroeconomic operations (SALs) and IMF programs (ESAFs). Hence, the importance of ensuring the complementarity and coordination of these two types of programs, in terms of design, monitoring and supervision;

- Meaningful progress in financial deepening and intermediation depends both on sector-specific factors (e.g., efficiency of banking system) and on macroeconomic performance (inflation rate; fiscal balance). In the best circumstances, progress is likely to be gradual and incremental.

- In setting conditionalities (i.e., for tranche release) relating to privatizations, there is a need for flexibility regarding timetables/deadlines, since actual completion depends on factors (e.g., market condition) outside the Borrower's control. Rigid compliance with pre-established timetables could lead to sub-optional privatizations, or otherwise unnecessarily delay disbursement.

GHANA

SECOND FINANCIAL SECTOR ADJUSTMENT CREDIT

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PART I. INTRODUCTION

A. Overview

1. The Second Financial Sector Adjustment Credit (FINSAC II) was a continuation of FINSAC I, implemented during 1988-1991. The first credit, approved in FY 1988 for an amount of US$106.6 million equivalent, supported an initial sector adjustment program for addressing a near-crisis situation in the financial sector, brought about by a severely distressed banking system. The performance of FINSAC I was reviewed in Project Completion Report (PCR) No. 14158 dated March 29, 1995. The second credit, FINSAC II, for US$100 million equivalent, was approved on December 19, 1991, and closed on March 31, 1997. The two credits were cofinanced by the Swiss Government and Overseas Economic Cooperation Fund of Japan. Both credits were the subject of Performance Audit Report (PAR) No. 16789 dated June 25, 1997.

B. Recent Economic Developments

2. Ghana's political liberalization during 1992-96 has been accompanied by growing fiscal difficulties and greater private sector interest. On the one hand, an across-the-board wage increase of 80 per cent for civil servants in 1992 worsened the fiscal balance and increased inflationary pressure. On the other hand, the liberal political atmosphere and vigorous Government efforts to promote the private sector since the adoption of the Economic Recovery Program (ERP) in 1983, have enhanced investor interest, even if this is not yet reflected in actual private investment.

3. Real GDP grew by 5.2 per cent in 1996, led by a good agricultural harvest (for the second consecutive year) and a bumper cocoa crop. Domestic savings and private investment remained low, in part due to falling public savings and rising public borrowing. Notwithstanding a fiscal slippage in the second half of 1996, inflation, on a year-on-year basis, fell from 71 per cent in December 1995 to 33 per cent in December 1996 and to 29 per cent in May 1997. This was due in part to the delayed effect of monetary and fiscal restraint in the first half of 1996, to low food prices, to postponed adjustments in tariffs (petroleum and power), and to foreign exchange interventions reducing the nominal depreciation of the cedi. On the external front, the current account deficit was larger than expected, foreign exchange reserves lower than budgeted, and medium-term non-concessional external borrowing higher than planned.

4. On the fiscal front, the deficit worsened to 5.2 per cent of GDP in 1996 from 2.8 per cent in 1995. The bulk of the slippage was due to overruns in development expenditure, though shortfalls in revenue from imports, petroleum and on-tax-sources also contributed. As a result, Government borrowed domestically to service its higher interest bill, arising mainly from a high nominal interest rate on accumulated and new domestic debt. This poor fiscal out-turn in 1996 came on top of several years of fiscal imbalances rising interest obligations. On a year-on-year basis, inflation rose from 13 per cent in end-1992 to 25 per cent, 34 per cent, and 71 per cent in 1993, 1994, and 1995,

respectively, while the Government's interest obligations climbed from 2.2 per cent of GDP in 1992 to 4.4 per cent of GDP in 1995.

C. The Financial Sector

5. The Ghanaian financial sector was in severe distress in 1985. This situation was a serious constraint to economic growth which had begun to show promising signs of recovery under the ERP. A major financial sector review was carried out in 1987, which identified a large number of sector deficiencies. These included an insolvent banking system dominated by state-owned banks and saddled with large non-performing loans and excessive intermediation costs; a low level of financial intermediation reflecting a poor record in domestic resource mobilization; inefficient credit allocation partly on account of Central Bank-directed interest rates and sectoral credit targets; the virtual absence of a money market and capital market; and the weakness of the supervision of the banking system by BOG and the overall inadequacies of the regulatory framework.

6. Three commercial banks (Ghana Commercial Bank, Standard Chartered Bank of Ghana and the Barclays Bank of Ghana) accounted for about two-thirds of the banking system's deposits and assets. The Government-owned Ghana Commercial Bank alone controlled about one-half of the banking system's assets and deposits. Both Standard Chartered and Barclays Bank operated under the full control and management of their foreign shareholders, in spite of a minority shareholding by the Government. There were also seven secondary banks (primarily sectoral development finance institutions and a few smaller commercial banks), a small cooperative bank and over 100 rural banks. All but one secondary commercial bank (Bank of Credit and Commerce) were partly or wholly owned by the Government. Thus, the banking system was concentrated and oligopolistic. The Bank of Ghana had oversight responsibility for the financial system but was hampered by its lack of autonomy and institutional capacity. BOG played a significant role in financing government expenditures.

7. The above- diagnosis formed the basis for the adoption of a comprehensive Action Program containing measures aimed at restructuring distressed banks, strengthening the regulatory and supervisory framework, developing financial and capital markets, and more generally, liberalizing the financial sector environment so as to improve the efficiency of resource mobilization and credit allocation. That initial Action Program was supported by FINSAC I and was followed by an enhanced sectoral reform program supported by FINSAC II.

PART II. PROGRAM OBJECTIVES AND DESIGN

8. In 1991, as FINSAC I was nearing completion, the Government had made considerable progress in putting the banking system and financial sector on a sound footing. It recognized, however, that there still existed a substantial remaining agenda comprising several important tasks that needed to be undertaken and/or completed. Under FINSAC II, the Government intended to consolidate the achievements of the initial reform program and move towards the second phase of sector adjustment with an enhanced program of policy and institutional reforms for further deepening, diversifying and strengthening the financial sector. The objectives of FINSAC II were:

- *support the removal of remaining policy distortions in the financial system by*: (1) addressing the disintermediation in the financial system caused by negative real interest rates through a policy of encouraging positive real deposit and lending rates (this included the payment of adequate interest on required commercial bank deposits with BOG and promoting open market operations); (2) increasing competition in the banking system through the divestiture of public sector shareholdings in banks; (3) reducing the high cost of financial intermediation; and (4) lowering the rate of corporate tax on financial institutions to the level applicable to other sectors.

- *enhance the effectiveness of the Central Bank to lead the continuing financial sector reform program by*: (1) developing a sound legal framework for the financial system including legislation for central banking; (2) strengthening the financial condition of BOG and phasing out its non-central banking, quasi-fiscal activities; (3) realigning the organizational structure of BOG to enhance its capacity to formulate and implement monetary policies and financial sector reforms; and (4) improving operational efficiency in the payments system, open market operations, reserves management, bank supervision, research and other central banking activities through computerization and changes in the operational procedures and staff training;

- *continue the bank restructuring program* started under FINSAC I through: (1) preparation for the divestiture of public sector shareholdings in banks; (2) formulation of an appropriate program for monitoring the performance of restructured banks; (3) improving the efficiency of management, accounting and information systems in GCB;

- *initiate a phased program for divestiture/privatization of state-owned banks following their restructuring*;

- *pursue the collection of non-performing assets by the Non-Performing Assets Recovery Trust (NPART),* including setting monitorable targets and a timetable;

- *enhance the effectiveness of non-bank financial institutions* by strengthening prudential regulation and encouraging competition. Steps would include: (1) reviewing the legal and regulatory framework applicable to all non-bank financial institutions and develop new legislative proposals for their regulation and supervision; (2) development of uniform accounting requirements and prudential regulations; and (3) a review of the linkages and prospects for closer interaction between the formal and informal financial systems; and

- *upgrade the professional skills of bankers, accountants and the insurance professionals* through training programs, improving the effectiveness of the National Banking College, strengthening national accounting and auditing capabilities and upgrading the standards and skills of the Auditor General's Office and of the accounting and insurance professions.

9. The strategy for financial sector development underlying the design of both FINSAC I and FINSAC II was appropriate, and relevant to the sector's requirements at their different points in time. The initial adjustment program supported by FINSAC I was basic, limited and rather modest, aiming mainly at resolving a severe banking crisis, and providing a still rudimentary financial system with an essential infrastructure for ensuring the soundness of banking operations. FINSAC II, was more ambitious in its design. Apart from continuing and completing a number of ongoing tasks (e.g., bank restructuring, recovery of non-performing assets, upgrading of professional skills), it contained broader objectives for further deepening, diversifying and strengthening the financial system. The sequencing (between the two successive operations) of some major tasks appeared suitable. For instance, the restructuring of distressed banks was undertaken under FINSAC I as a prior step to the subsequent attempt at their privatization under FINSAC II. Another example was the initial focus, under the first credit, on the formal banking system, which was severely distressed

and required priority attention at the outset, leaving the less urgent task of developing non-bank financial institutions to be addressed under the second program. The broadening of the scope of FINSAC II, however, stopped short of macroeconomic objectives (i.e. the achievement of macroeconomic stability), which were pursued under other Bank operations (SAC I and SAC II) and IMF programs (ESAFs) under implementation during the period. Hence, the macroeconomic framework was not the subject of specific or direct conditionality under FINSAC II, beyond a general stipulation in the Credit Agreement (as condition of tranche releases) regarding "the consistency of the macroeconomic framework with the objectives of this program". With hindsight, given the impact of macroeconomic instability on the financial sector, perhaps more specific macroeconomic conditionality would have been appropriate.

PART III. ACHIEVEMENT OF OBJECTIVES

10. The complexity of the reform program, in particular that of the banking divestiture scheme, has resulted in some implementation delay, partly on account of the Government's deliberate and systematic approach to program implementation. The delay notwithstanding, each of the specific program objectives as listed in paragraph 8 above, by and large, has been satisfactorily achieved (Policy Matrix, Appendix A).

Removal of Remaining Policy Distortions in Financial Sector

11. By the end of FINSAC I's implementation, there had been some improvement in the cost of financial intermediation in Ghana on account of the removal of non-performing assets from the distressed bank's balance sheets, the increased operational efficiency of the restructured banks, and improvements in the payments system. Nevertheless, two remaining sector policy distortions continued to negatively affect the financial intermediation cost, which the FINSAC II program sought to remove:

(a) Taxation of Banks. The corporate tax rate applicable to financial institutions was 50 per cent, compared to 35 per cent for other sectors, thus impacting negatively on the profitability of banks and indirectly on their intermediation cost. As a condition of tranche releases under FINSAC II, the Government during 1992-1994 successively reduced the tax rate from 50 to 45 per cent, 40 and finally to 35 per cent, thus fully aligning it with tax rates applicable to corporations in other sectors. Apart from improving the intermediation cost, this measure also achieved taxation equality across sectors;

(b) Reserve Requirements. Until the early 1990s, the lack of remuneration on bank reserves deposited with the central bank constituted an implicit tax on the banks, also indirectly affecting their intermediation cost. Since 1991, under FINSAC II, BOG has paid market interest rates on cash reserves (in excess of the reserve requirement, currently set at 5 per cent), and adequate interest rates on secondary reserve requirements.

Strengthening of the Central Bank

12. A revised Bank of Ghana Act, which adequately reflects BOG's autonomy, role and responsibilities, was enacted in 1992, as a condition of effectiveness for FINSAC II. BOG phased out its previous quasi-fiscal activities, such as development finance, subsidized lending, equity participation in rural banks, and assumption of the exchange risk on behalf of the Government.

Accumulated foreign exchange losses on BOG's books were transferred to the Government in 1992, which considerably strengthened its balance sheet.

13. Under FINSAC II, BOG carried out a review of its organizational structure and has implemented a more streamlined and functional structure. The new structure consolidates the previous 19 departments into six functional departments. Suitable personnel were recruited to staff some key positions in the new structure, along with changes in managerial arrangements and the development of work plans for the new departments. A study on human resource needs and the skills mix requirements for the senior levels of BOG has been carried out by outside consultants. Annual training programs have been developed for 1993 and beyond. FINSAC II also provided equipment, hardware and software for banking supervision, research, foreign exchange management, accounting, human resource planning and training, general management and technical assistance for a comprehensive computerized system.

Bank Restructuring

14. Under FINSAC I and II, the approach to bank restructuring was systematic and comprehensive, rather than piecemeal and case-by-case. A "general framework" was formulated to provide broad guidelines for the bank restructuring program, including the organizational and financial modalities (e.g., treatment of non-performing assets; cleaning up of balance sheets). The framework established a one-time financial package of measures for each of the seven distressed banks, tailored to their individual requirements, to restore solvency and adequate liquidity to enable them to operate in a sustained manner following their restructuring. Financial restructuring was undertaken in parallel with organizational and managerial changes, and consisted of removing from the bank's portfolios all non-performing loans. Those made to state enterprises or guaranteed by the Government were offset against Government claims (e.g., deposits) or converted into Government liabilities; those made to the private sector were redeemed against interest-bearing Government bonds (called FINSAP bonds) following a process of verification/validation. Non-performing loans were transferred to the Non-Performing Assets Recovery Trust (NPART), for recovery to the extent possible. Individual restructuring plans for six of the seven banks, based on the general framework and following their review by the Bank, were implemented generally successfully during the 1988-1991 period. As a group, these six banks are now operating profitably (albeit partly on account of high-yeild Treasury Bills) and on a sound footing, having improved both the quality of their loan portfolios and their operational efficiency. On the basis of audits done by international accounting firms, and annual inspections by BOG, these six banks have been operating in compliance with all major prudential requirements, (e.g., capital adequacy, liquidity, risk exposure) in recent years (Appendix C). A comparative survey indicated that by 1995, the collective operational performance of the six state-owned restructured banks as a group was similar to that of private sector banks, as measured by standard performance indicators (e.g., operating expenses, loan loss provisions, intermediation cost, return on equity). The only remaining distressed bank is the small Coop Bank, which has not been included in the Government's bank restructuring program, but is scheduled for merger with ADB, as a step prior to the latter's privatization.

Bank Divestiture

15. The privatization of banks was not an objective of FINSAC I. Both the Government and the Bank agreed to first proceed with the restructuring of distressed banks as a pre-requisite for their subsequent privatization. Towards the completion of FINSAC I, the Government decided it was timely to address this remaining major sectoral issue under FINSAC II. It considered private sector ownership of the banking system to be consistent with the liberalization of the Ghanaian financial

sector, and conducive to greater intra-system competition, and thus, to improving operational efficiency and lowering intermediation cost. As with bank restructuring, the approach to bank divestiture was quite systematic and comprehensive. In 1992 a review, aimed at designing a specific proposal for implementing the divestiture program was undertaken by specialized consultants. The review spelled out the methodology, and technical, marketing and financial modalities for divestiture, e.g., phasing, rationalization/mergers, valuation of net worth of banks, respective roles of private placement and public floatation, and other marketing considerations.

16. The banking divestiture program adopted by the Government in 1993 in consultation with the Bank, and based on the above-mentioned consultant review, envisaged a two-phase process, with the first phase covering the three largest banks (GCB, SSB, NSCB), which together accounted for almost two-thirds of banking system assets at the time. The second phase would deal with the remaining four smaller banks. The method chosen for divestiture in the first phase was a two-pronged one, consisting of both (i) an initial public offering (IPO) on the Ghana Stock Exchange aimed at domestic private shareholders; and (ii) a private placement with a "strategic investor", preferably a foreign financial or banking institution with a potential for contribution in managerial and/or banking expertise.

17. To date, the first phase of the banking divestiture program has been substantially and successfully completed. SSB and NSCB were merged (into the new SSB) in 1993 as a step prior to the subsequent privatization of the new bank. The privatization of the new SSB was fully completed in early 1997, with a foreign consortium (comprising reputable banking and financial institutions from Europe and the U.S.) acquiring 53 per cent of its share capital, and the balance held by private domestic shareholders, both institutional and individual. SSB's shares are currently traded on the Ghana Stock Exchange (GSE), and the bank is operating profitably, poised for further expansion. SSB has restructured its Board and management to reflect its private sector ownership. The privatization of the largest bank, GCB, is in process. An international industrial-cum-financial group entered into an agreement in November 1996 for the acquisition of 40 per cent of GCB's share capital. This agreement will become definitive upon fulfillment of some specified conditions, including approval by the Government of a proposal by the strategic investor for the management of GCB. While the process for finalizing the privatization of GCB has been somewhat slow, partly on account of the Government's thorough approach, it can now be considered irreversible. In the meantime, domestic private investors have acquired 41 per cent of GCB's shares on the stock market, thus raising its prospective private sector ownership to 81 per cent.

18. Counting GCB as private in anticipation of the expected finalization of its divestiture, the only banks still remaining under state ownership and control would be the four small banks (ADB, BHC, NIB, Coop Bank). These four banks, representing together less than 3 per cent of the banking system assets, are included in the second phase of divestiture, which is getting underway. In light of the recent success of SSB's and GCB's public floatations, the remaining banks (BHC, NIB, ADB after absorbing Coop Bank) are likely to be able to attract domestic private investors, although the search for a suitable strategic investor (a foreign bank), if attempted, is likely to be arduous and time-consuming. The divestiture of NIB which was put on a fast track alongside those of SSB Ltd. and GCB Ltd., proceeded well initially. Five potential Strategic Investors (SI) showed interest. The favored SI, however, withdrew from negotiations at a critical last stage. The process which had to be started all over, has since gathered momentum with several new indications of interest.

Recovery of Non-Performing Assets

19. The 1988 law establishing NPART stipulated that it should carry out its mandate within a finite 6-year timeframe, i.e., by end-1995. To facilitate NPART's collection efforts and expedite the process, a special judicial body (the NPART Tribunal) was established in parallel with NPART. To provide guidance, including a timetable and monitorable targets, for NPART's activities, the Government formulated an action program, agreed with the Bank, which envisaged an "aggregate recovery target" of 18 billion Cedis, based on a review of NPART's portfolio totaling 50 billion Cedis. The aggregate target was sub-divided into 6 annual targets (12 per cent in 1991, 22 per cent in 1992, 26 per cent in 1993, 23 per cent in 1994 and 17 per cent in 1995). On account of some slackening in the pace of recovery by 1995, and to enable NPART to wind up its residual operations, NPART's mandate was extended by 18 months, to June 30, 1997. By that date, NPART had collected a total amount of 19.61 billion Cedis, or about 10 per cent above the initial target, representing a satisfactory performance.[1] A due diligence has been carried out by independent consultants to determine, inter alia, the modalities for disposal (i.e., auction) of residual recoverable assets amounting to some 4 billion Cedis. An audit of NPART's accounts has also been undertaken by independent auditors.

Development of Non-Bank Financial Institutions

20. At FINSAC II's inception, there were a significant number of financial institutions in Ghana which were not regulated by the Banking Law though some of them came under other regulatory or statutory control. These comprised the stock exchange, insurance companies, insurance brokers and agents, the discount houses, a building society, an export finance company plus a number of credit unions, thrifts and savings and loan associations. Regulation of the insurance industry had been shifted to the National Insurance Commission (NIC), which required technical assistance in its new supervisory role, which includes market supervision, monitoring premium levels and payment, competition and solvency. Capital adequacy, solvency and credit standards were all in need of appropriate regulation. Competition had been circumscribed by the Government which, under a 1972 law, still required the government-owned State Insurance Corporation of Ghana to be allocated all Government and state-run business, resulting in over 75 per cent of the non-life business going to one company. The life insurance sector was under-developed and its nurturing, because of the actuarial significance of its premium base, was considered an important factor in the development of the capital markets. As a condition of second tranche release, the Government initiated in 1992 a review of the legal and regulatory framework applicable to all non-bank financial institutions. The review led to the preparation of draft legislation which contains appropriate provisions for the licensing, regulation and supervision of non-bank financial institutions, as well as appropriate accounting, financial and prudential reporting requirements. The Act was promulgated in January 1993, in compliance with a condition of second tranche release. The new NBFI regulatory framework has laid the foundation for the further development of the capital markets, which, however, would not achieve faster growth until the achievement of stable and moderate inflation.

21. The NBFI sector remains dominated by a single institution, the Social Security and National Investment Trust (SSNIT), which was set up in 1972 to manage the country's social security system covering every worker both in the private sector and the civil service. SSNIT's assets are equivalent to about 20 per cent of those of the banking system (1994). Until 1990, SSNIT's investment activities were constrained by inappropriate Government policies, such as the requirement to invest

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[1] The total includes a small portion of recoveries of the Cooperative Bank non-performing assets which were not included in the original target of 18 billion cedis.

its assets mainly in Government bonds or stocks with low or negative returns. In view of the magnitude of SSNIT, and its potential role in mobilizing long-term investment capital, a study was undertaken under FINSAC II in 1993, which generally ascertained the soundness of its financial condition, and made a number of recommendations for further improvements (e.g., in investment portfolio management), which have been adopted by SSNIT.

Upgrading Professional Skills

22. The extensive training programs for bankers, accountants and insurance professionals, started under FINSAC I, were continued under FINSAC II. The National Banking College was established in April 1994 as a corporate entity, and has conducted a series of banking courses starting in July 1994. The Institute of Chartered Accountants of Ghana (ICAG) has been providing advisory and technical information and services to its membership in the field of accounting, including professional examinations. The Ghana Stock Exchange has organized periodic seminars and workshops for the local business community on relevant professional subjects, as has the National Insurance Commission for insurance companies.

PART IV. PROGRAM SUSTAINABILITY

23. There are good prospects for sustaining the results of the reforms and actions under the FINSAC credits. Amongst these actions, the one with the highest risk of non-sustainability would appear to be the bank restructuring program, on account of the inherent possibility of restructured banks relapsing into distress (usually on account of the re-emergence of non-performing loans), as has been observed in many other countries. For GCB, SSB and NSCB in particular, their privatizations, coupled with vigilant supervision by the central bank, should enhance sustainability. The successful restructuring of the three state-owned banks is expected to take hold or even to solidify, as evidenced by their continuing improvements in recent years. However, high treasury bill yields have undoubtedly facilitated the financial restructuring of these banks by contributing to high profits. Ultimately, the banks' sustainability will depend on their ability to maintain the quality of their loan portfolios. In addition, their medium-term prospects will largely depend on the performance of their borrowers, namely real sector enterprises including SMEs, in particular their capacity for withstanding current and projected levels of interest rates and exchange rates.

24. Other achievements which enhance the sustainability of the reforms include the strengthening of the central bank and improved banking oversight; the shift of the banking system from predominantly public to private sector ownership; the broadening of the banking system with the entry of several new, private, banks including some non-traditional banks (e.g. merchant banks, mortgage banks), which should result in increased intra-system competition; the establishment of NBFIs following the enactment of the new regulatory framework; the creation of an essential financial infrastructure (e.g, the stock exchange, the national insurance commission); and the build-up of professional skills through training and the establishment of training entities (e.g., the National Banking College).

PART V. BANK PERFORMANCE

25. The Bank's performance in the preparation and supervision of FINSAC II was satisfactory. The extensive financial sector review preceding the preparation of the initial operation led to a meaningful policy dialogue with Government officials, which continued through the implementation of the two successive credits, and provided major conceptual inputs into the two Statements of Financial Policy which formed the basis for the reforms undertaken. The Bank's performance during

program implementation was satisfactory. The policy dialogue continued during implementation of FINSAC II as part of supervision work, particularly in connection with the fulfillment of second and third tranche releases. Supervision work for this credit has been intensive, amounting to 185 staff weeks for the period from FY 1992 through closing on March 31,1997. This worked out to a supervision coefficient of about 30 staff weeks per year, which reflects recognition of the complexity, and commensurate supervision requirements, of the program. However, more attention could have been placed during supervision on the macroeconomic environment and its impact on financial sector reforms.

PART VI. BORROWER PERFORMANCE

26. The performance of the Government and of program implementation agencies, notably that of Bank of Ghana, was satisfactory. The implementation delay, which required a two-year extension of the closing date to March 31, 1997, was attributable partly to an under-estimation, by both the Government and the Bank, of the time-consuming nature of the complex banking divestiture program, which constituted a specific condition for third tranche release. This delay also reflected the Government's systematic approach to the privatization of banks, rather than responding to timetable pressure, and appears justified in light of results. In view of the multiplicity of program components, coordination of the various implementation entities was essential, and was adequately undertaken by the FINSAP Secretariat, established for that purpose, with logistical support under the credit. Admittedly, the weak macroeconomic performance during FINSAC II's implementation period could suggest less than satisfactory borrower performance. However, as noted above, specific macroeconomic conditionality was not a feature of FINSAC II.

PART VII. ASSESSMENT OF OUTCOME

27. The credit's outcome is satisfactory. Despite some delays, virtually all the components of the two credits were effectively implemented, resulting in a significant change in Ghana's financial system compared to its situation at program outset. Financial sector policies have been liberalized and modernized with the removal of interest rate controls, credit ceilings and sectoral targets. An appropriate legal, regulatory and prudential framework has been established, providing a sound basis for banking operations. BOG, the central bank, has significantly strengthened its financial condition, institutional autonomy and operational capacity, notably in the area of banking supervision (although more time is required for banking supervision to acquire the practical experience required to be fully effective).

28. The banking system has gradually expanded to now include 18 banks (as of mid-1997), not including 7 other institutions in the process of establishment or awaiting their banking license. There is no formal or statutory distinction in the Banking Law between categories of banking (i.e., commercial, development, merchant banking), and all deposit-taking banks are subject to the same prudential regulations, and the supervisory responsibility of BOG. In practice, most banks are engaged in a broad spectrum of banking operations, as universal banks. Some newly-established banks have a distinct investment/merchant banking avocation and seek to specialize to some extent in corporate banking, venture capital, underwriting, etc.

29. Total assets of the banking system expanded by 31.7 per cent in 1995 and 34.5 per cent in 1996 (to 2,649 billion Cedis), roughly in line with inflation. Credit by the banking system to the private sector, after growing slowly until 1994, increased sharply by 50 per cent in 1995 to 393 billion Cedis, and further by 70 per cent in 1996 to 681 billion Cedis. As a result of this expansion, and the entry of new banks, the previously heavy concentration has been significantly reduced, with

the largest bank (GCB) now accounting for 26.6 percent of total system assets, compared to 50 per cent in the late 1980s. The ownership of banks, previously predominantly public, has become virtually wholly private as a result of divestiture. Counting GCB (whose privatization to date is partial and in the process of completion) as private, alongside SSB/NSCB (whose privatization is completed), the four small remaining state-owned banks (ADB, BHC, NIB, Coop Bank) represent less than 3 per cent of total system assets. The banking system has become much more open to competition through private sector ownership, the recent entry of new banking institutions including some non-traditional banks, and the emergence of non-bank financial intermediaries.

30. The enactment of the NBFI Law of 1993 has been followed by some diversification and expansion of the non-bank financial sector, which however remains small, contributing about 24 per cent of the country's total financial assets. Of this, about 11 per cent is from the state-owned Social Security and National Insurance Trust (SSNIT) and 4 per cent from the stock exchange. The Ghana Stock Exchange (GSE) has built up a requisite organizational structure and capacity, although its activities remain limited, with only 20 companies listed. Notwithstanding the still modest scale of its operations, GSE is performing an essential function in developing the nascent capital market, and specifically in providing a vehicle for the divestiture of public sector shareholdings in banks (GCB, SSB/NSCB) and other state enterprises. The insurance industry remains dominated by two state-owned corporations, but has seen the entry of 16 privately-owned companies. Other NBFIs include building societies, unit trusts, one venture capital company, two discount houses, and three leasing companies (as of 1996). The NBFI Law subjects non-bank financial institutions to the oversight of BOG, just as commercial banks, but under a separate set of regulatory and prudential requirements.

31. While the two FINSAC programs have satisfactorily achieved most of their specific institutional objectives, their <u>broad impact on the financial sector</u> has been limited. Financial intermediation performance has been mixed (Appendix B). Financial deepening, as reflected in the M2/GDP ratio, has remained flat throughout the 1988-1996 period, actually declining from 19.5 per cent in 1994 to 17.2 per cent in 1996. Currency held outside the banking system remains high and has even increased recently, to about 70 per cent in 1995, as a ratio to deposits. Credit to the private sector by the banking system, after stagnating during the 1988-1994 period, expanded rapidly in 1995 and further in 1996, by 69 per cent (or 23 per cent in real terms), to 732 billion Cedis, which however still represents a low ratio of about 10 per cent of GDP. The foregoing reflects a low level of financial intermediation, even in relation to other developing countries in sub-Saharan Africa and elsewhere. This modest performance in financial intermediation has taken place in spite of the financial liberalization measures undertaken under FINSAC I and II. The macroeconomic and other factors accounting for such a situation appear to warrant an in-depth analysis. There is some evidence that actual savings and investments in Ghana are higher than are captured in national accounts. Also, financial intermediation and savings mobilization by the informal financial system do not appear to be reflected in monetary statistics. The achievement of more significant and faster progress in <u>financial intermediation</u> in Ghana in the years ahead is likely to depend on the success of macroeconomic management (notably the maintenance of stable and moderate inflation) and other factors outside the financial sector (e.g. the performance of the real sectors), as much as on the banking system itself. With respect to the Ghanaian banking system, its capacity for increasing its contributions to financial intermediation is expected to continue to improve. Realistically, however, any future gains in financial intermediation deriving from an improved banking system, are likely to be gradual and incremental, in Ghana as elsewhere. Furthermore, banking prudence dictates that a banking system that is undergoing restructuring, or that has barely completed the process (as is the case of Ghana), should not be expected nor encouraged to aggressively expand its activities, since this might jeopardize the outcome of successful restructuring. Such a banking system should rather

focus on consolidation (or even retrenchment) and internal strengthening for a period of time, during which its capacity for meaningfully increasing financial intermediation is necessarily limited.

PART VIII. FUTURE OPERATIONS

32. The banking system is now operating on a much sounder financial footing following the restructuring of distressed banks, and largely under private sector management. It will be important to continue monitoring closely the condition and performance of banking institutions (in particular, their loan portfolios) so as to be alert to any possible deterioration. This task is expected to be led by BOG. Limited technical assistance will continue to be required for: BOG, for further improving its bank supervision, monetary policy management, and financial markets expertise; the National Banking College, the Ghana Institute of Bankers, and the Institute of Chartered Accountants, and for further institutional capacity building. The ongoing NBFI Technical Assistance Project provides a suitable vehicle for continuing technical support to and monitoring the situation of non-bank financial institutions, including the stock exchange, insurance companies and other non-bank intermediaries.

33. In the context of economic and sector work, it would be desirable for the Bank to carry out (jointly with Ghanaian authorities) in-depth studies covering: (a) the operational efficiency of the banking system, as measured by standard performance indicators (e.g., intermediation costs, employee productivity per asset), to be periodically updated; (b) the scope and prospects for increasing financial deepening and savings mobilization; and (c) the need and/or desirability of establishing specialized banking institutions oriented to poverty alleviation (which is not, and should not be, the normal objective of commercial banks).

34. Ultimately, the prospects of the Ghanaian banking system will largely depend on those of enterprises in the real sectors, who borrow from the banks. A review of the financial condition and prospects of corporate enterprises including SMEs (especially in relation to current and projected levels of interest rates and exchange rates), would therefore help a better assessment of the medium-term prospects of the banking system.

PART IX. KEY LESSONS LEARNED

35. The main lessons from FINSAC implementation include:

- Financial Sector Adjustment Loans (FSALs) should be relied upon mainly to achieve specific, institutional and regulatory objectives, such as bank restructuring and privatization, financial infrastructure and prudential reforms. However, while broader macrofinancial objectives (financial deepening; savings mobilization) are more appropriately pursued under other Bank/IMF macroeconomic programs (SALs, ESAFs), they should not be ignored in free standing FSALs. This points to the need to closely link/coordinate these sectoral and macroeconomic programs (in terms of program design, and supervision), so as to obtain optimal results. The incorporation of a financial sector adjustment component within a SAL (as is done in some countries) appears to facilitate the coordination between macroeconomic and specific financial sector issues;

- Macroeconomic stability is difficult to achieve in the absence of a sound banking system and an adequate financial infrastructure. Therefore, financial sector reforms, especially bank restructuring, should not be postponed pending the achievement of macroeconomic stability, but should be attempted as early as necessary. Experience worldwide also indicates that delays in resolving banking distress always results in increasing its fiscal costs;

- In most circumstances, successful and sustainable financial sector adjustment is likely to require more than a one-shot operation, but rather a series (of two or more) over time. Even once the need for resource transfer (from Bank to country, for recapitalizing insolvent banks, etc.) has been met, the need for selective institutional support and technical assistance is likely to continue.

- Meaningful progress in financial deepening and intermediation depends both on sector-specific factors (e.g., efficiency of banking system) and macroeconomic performance (inflation rate; fiscal balance). In the best circumstances, progress is likely to be gradual and incremental;

- A banking system just completing its successful restructuring (as in Ghana) should be expected to undergo an adequate period of consolidation and internal strengthening, before gradually expanding its activities and seeking meaningful contributions to financial deepening. To do otherwise may jeopardize the outcome of restructuring.

- The ultimate objective of restructuring distressed state-owned banks should normally be their subsequent privatization. The sustainability of restructured banks is not evident until completion of their privatization.

- In setting conditionalities (i.e., for tranche release) relating to the privatization of state banks (and other state enterprises), there is a need for flexibility regarding the timetable and/or deadlines, since actual completion depends on factors (e.g., market conditions) outside the Borrower's control. Rigid compliance with a pre-established timetable could lead to sub-optimal privatizations. While speed is a consideration, in some circumstances, the Borrower's "best efforts" may provide an appropriate basis for determining compliance; and

- It may be operationally useful for the Bank to undertake a cross-country comparative review of the relative effectiveness (as measured by amounts recovered in relation to assets) of the alternative modalities for recovering the non-performing assets of distressed or failed banks.

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TABLE 1: Summary of Assessments

A. ACHIEVEMENT OF OBJECTIVES	Substantial	Partial	Negligible	Not Applicable
Macroeconomic policies		✓		
Sector policies	✓			
Financial objectives	✓			
Institutional development	✓			
Physical objectives				✓
Poverty reduction				✓
Gender concerns				✓
Other social objectives				✓
Environmental objectives				✓
Public sector management		✓		
Private sector development		✓		
Other (specify)				
B. PROJECT SUSTAINABILITY	**Likely**	**Unlikely**	**Uncertain**	
	✓			
B. BANK PERFORMANCE	**Highly Satisfactory**	**Satisfactory**	**Deficient**	
Identification		✓		
Preparation assistance		✓		
Appraisal		✓		
Supervision		✓		
D. BORROWER PERFORMANCE	**Highly Satisfactory**	**Satisfactory**	**Deficient**	
Preparation		✓		
Implementation		✓		
Covenant Compliance		✓		
Operation		✓		
E. ASSESSMENT OF OUTCOME	**Highly Satisfactory**	**Satisfactory**	**Deficient**	
		✓		

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TABLE 2: Related Bank Loans/Credits

1. First Structural Adjustment Credit (SAC I)
   Cr. 1777-GH; FY 1988

2. First Financial Sector Adjustment Credit (FINSAC I)
   Cr. 1911-GH; FY 1990

3. Second Structural Adjustment Credit (SAC II)
   Cr. 2005-GH; FY 1990

4. Private Enterprise and Export Development Project
   Cr. 2502-GH; FY 1993

5. Non-Bank Financial Institutions Assistance Project
   Cr. 2792-GH; FY 1996

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TABLE 3: Project Timetable

Steps in Project Cycle	Date Planned	Actual Date
Identification	1990	1990
Preparation	1990-1991	1990-1991
Appraisal	07/1991	07/1991
Negotiations	11/1991	11/1991
Board Presentation	12/1991	12/19/1991
Signing	02/1992	02/07/1992
Effectiveness	04/1992	05/14/1992
Project Completion	1995-1996	1997
Loan Closing	03/31/1995	03/31/1997

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TABLE 4: Cumulative Estimated and Actual Disbursements
(US$ million)

Fiscal Year	Appraisal Estimate	Actual	Actual as % of Appraisal Estimate
FY 1992	25.00	19.12	76.50
FY 1993	81.92	27.41	33.40
FY 1994	81.92	59.09	72.10
FY 1995	99.91	62.61	62.60
FY 1996	99.91	66.39	66.40
FY 1997	99.91	96.34	96.40

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TABLE 5: Studies Included in Project

Review of regulatory and incentive environment for NBFIs	Completed	Became the basis for the IDA-funded NBFI Project.
Review of insurance industry	Completed	Policies and recommendations were incorporated in IDA-funded NBFI Project.
Study of Social Security and National Investment Trust	Completed	Recommendations for restructuring SSNIT were adopted.
Study on informal financial markets	Completed	Impact is too soon to be determined. The study's findings are under discussion in a microfinance forum.
Proposal for divestiture of public sector share-holding in banks.	Completed	Shares of GCB and SSB were floated on GSE.

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TABLE 6: Status of Legal Covenants

3.01(b)	GOG to furnish progress reports at Bank's request.	Mgmt.	OK	ongoing	ongoing	-
3.03(a)(i)	Implementation of technical assistance program for BOG	Mgmt.	OK	Second Tranche		-
3.03(a)(ii)	Establishment of FINSAC Implementation Secretariat	Mgmt.	OK	Effectiveness		-
3.03(a)(iii)	Provision of technical assistance to Auditor General's Office, ICAG, National Insurance Commission, Ghana Institute of Bankers, GSE, National Banking College	Mgmt.	OK	Second and Third Tranche Releases		-
3.03(a)(iv)	Provision of technical assistance for GCB computerization, the NPART, and restructured banks.	Mgmt.	OK	Second and Third Tranche Releases		-
3.03(a)(v)	Carrying out studies of insurance industry, SSNIT, informal financial sector, non-bank financial institutions.	Policy	OK	Second and Third Tranche Releases		-
3.03(b)	GOG to provide program implementation agencies with adequate facilities; and to recruit/select consultants in accordance with World Bank guidelines	Mgmt.	OK	Ongoing		-
3.04(a)	GOG to maintain and furnish the Bank information on various records, accounts and audits	Mgmt.	OK	Ongoing		-
3.05(a) and (b)	GOG to furnish to Bank audited financial statements of BOG, and others as requested.	Mgmt.	OK	Ongoing		-

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TABLE 7: Bank Resources

Through Appraisal					15.5	
Appraisal - Board					108.5	
Board-Effectiveness					10.8	
Supervision	134.1		135.4		144.0	475.8
Completion					6.0	
TOTAL	134.1		135.4		274.0	475.8

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TABLE 8: Bank Resources

Missions

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Through Appraisal						
Appraisal - Board						
Board - Effectiveness						
Supervision						
	July 11, 1992	4	8.8	financial sector specialist / banking		
	Nov. 19, 1993	3	10.0	financial sector spec./public administration	Satisfactory	Satisfactory
	July 9, 1994	3	0.3	audit/financial economics	Satisfactory	Satisfactory
	Nov. 18, 1994	3	1.1	banking/project management	Satisfactory	Satisfactory
	May 5, 1995	2	2.2	fiancial economics/project management	Satisfactory	Satisfactory
	Dec. 15, 1995	1	3.0	financial sector specialist	Satisfactory	Satisfactory
	May 28, 1996	1	5.3	financial sector specialist	Satisfactory	Satisfactory
Completion	Sept. 1997				Credit closed	
TOTAL						

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POLICY MATRIX

A. Measures to remove policy distortions in the financial system.	
1. Reduce the implicit taxation of banks by remunerating required reserves at a rate of interest closer to the average cost of deposits of the banking system, in the context of the overall liquidity management policies.	1. Since 1991, BOG started paying market interest rates on cash reserves deposited by banks, and adequate interest rates on secondary reserves. Rates are subject to joint review with Bank for adjustment as necessary.
2. Lower the high cost of financial intermediation through lowering corporate tax rates for financial institutions to levels applicable to other sectors.	2. Corporate income tax rates on financial institutions were gradually lowered during 1992-1994 from 50 to 35 per cent, and are now at same level as applicable to other sectors.
3. A project for the phased divestiture of public sector ownership of banks, to promote competition through increased private sector ownership.	3. A two-phase divestiture program was agreed with the Bank. The first phase covering the three largest banks (GCB, SSB, NSCB) commenced in 1993 (second tranche release condition) and was substantially completed by late 1996 (third tranche release condition). SSB and NSCB were merged in 1993 (into new SSB) in preparation for privatization. SSB underwent successful IPO on GSE in September 1995, followed by a private placement with a foreign strategic investor in late 1996, thus completing its privatization. GCB has divested 41% of its share capital to domestic private investors, and has entered into an agreement in late 1996 for a private placement of 40% of its share capital with a foreign strategic investor. This contract is awaiting finalization. The second phase covering the remaining four small banks (ADB, BHC, NIB, Coop Bank), intended to start after completion of the first phase, is underway.

B. Enhance the financial condition and operational effectiveness of the BOG.	
1. Develop a sound legal system for the financial system.	1. The Bank of Ghana Act was enacted in 1992.
2. Strengthen the financial condition of BOG by removing revaluation losses and non-central banking activities.	2. Prior to second tranche release, BOG phased out its previous quasi-fiscal activities, such as development finance, subsidized lending, equity participation in rural bank sand assumption of the exchange risk on behalf of the Government.
3. Institutional strengthening by realigning BOG's organizational structure to enhance its capacity.	3. As a condition of second tranche release, the BOG implemented its new organizational and management structure. The new structure consolidated 19 departments into 6, and several other tasks aimed at enhancing institutional effectiveness were undertaken.
4. Improve operational efficiency through computerization, changes in operating procedures, training to upgrade staff skills and technical assistance.	As condition of third tranche release, work was substantially completed on the development of computerization project for BOG and annual training projects had been developed for 1993 and beyond. Appropriate technical assistance has also continued under FINSAC II for the implementation of BOG's institutional strengthening project.
C. Bank Restructuring and Loan Recovery by NPART.	
1. Commence liquidation of non-viable enterprises in accordance with NPART's action project.	1. Before negotiations, the Government, in consultation with the Bank, developed an action program for the recovery of non-performing assets and for liquidations, including agreed annual recovery targets. In fulfillment of second and third tranche release conditions, NPART's recoveries have been satisfactory, aggregating 19.6 billion Cedis (by march 31, 1997), compared to an initial target of 18 billion Cedis.
2. Consolidate, deepen and streamline the ongoing bank restructuring project started under FINSAC I.	2. Before negotiations, the Government agreed to establish a project, including performance indicators, for monitoring the performance of banks. This monitoring has since been carried out by BOG as part of bank supervision/inspections. For the release of the second tranche, the Government agreed that the BOG would comply with the requirement of annual inspection of banks in accordance with the Banking Law. Since 1993, annual on-site inspections were carried out for all banks operating in Ghana (commercial, development and merchant banks).

ISSUES/ACTIONS	[illegible]
D. Enhance the effectiveness of non-bank financial institutions. 1. Strengthen the legal/regulatory framework, prudential regulation, and the supervision of non-bank financial institutions.	1. In 1992, the Government initiated a review of the legal and regulatory framework for non-bank financial institutions. The review led to the preparation of draft legislation incorporating IDA's comments. The Act was approved by the PNDC and signed in 1993.
2. Improve competition in the insurance industry.	2. For the release of the second tranche, it was agreed that SSNIT would commence the review of its asset/liability position and the actuarial assessment of its pension scheme as well as its role in the capital market. Consultants were appointed to complete the study under terms of reference agreed with IDA and the review was completed in 1993.
E. Develop capacity in the banking and accountancy professions at all levels. 1. Upgrade the professional skills of bankers through the continuation of training projects, and the development of the national banking college.	1. The National Banking College was established in 1994 as a condition of third tranche release, and has since continued its activities. Progress has been achieved in the development and implementation of training for bankers, accountants and insurance professionals.
2. Strengthen national accounting and auditing capabilities and held upgrade the standards and skills of the Auditor General's Office.	2. Despite technical assistance, work with the ICAG and the Auditor General's Office has progressed more slowly than expected.
F. Informal Sector 1. Study the informal financial markets to investigate prospects for closer interaction between the formal and informal financial systems.	1. This study was dropped from the project as informal finance was included in a broader World Bank study (Ghana - Financial Sector Review, Report No. 13423-GH, December 1994) which was discussed with the Government.
G. Administration/Implementation 1. Establish the Project Implementation Unit as a focal point to provide guidance, oversight, coordination and monitoring for all FINSAC related activities.	1. The FINSAP Implementation Secretariat was established prior to Board approval and it has been fulfilling its functions.

APPENDIX B

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SELECTED MACROECONOMIC AND FINANCIAL INDICATORS [1]

Indicators	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
National accounts (as % GDP current market prices)										
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total Consumption	92.7	98.7	102.2	95.0	90.1	91.8	92.1	89.8	87.9	87.4
Gross domestic fixed investment	15.9	12.8	14.8	16.9	18.6	18.7	17.5	19.0	20.0	21.0
- Government investment	8.3	10.3	11.7	14.0	14.7	14.6	11.0	11.8	10.2	10.2
- Private Investment	7.6	2.5	3.1	2.9	3.9	4.1	6.5	7.2	9.8	10.8
Exports (GNFS)	17.0	17.2	21.3	26.7	25.6	27.2	24.6	26.9	28.1	28.6
Imports (GNFS)	25.5	28.8	38.4	38.6	34.2	37.8	34.2	35.7	36.0	37.0
Gross domestic savings	7.3	1.3	-2.2	5.0	9.9	8.2	7.9	101.2	12.1	12.6
Gross national savings	8.9	3.6	0.4	8.1	12.1	10.3	10.1	12.9	15.7	16.9
Memorandum items										
Gross domestic product (US$ million at current prices)	6473	6414	5662	5175	6183	6344	6818	7133	7655	8076
Gross national product per capita (US$, Atlas method)	410	430	400	360	350	360	370	380	400	410
Real annual growth rates (% calculated from 1984 prices)										
-Gross domestic product at market prices	5.3%	3.9	5.0%	3.8%	4.5	5.2%	3.5%	5.0	5.5	5.5%
- Gross Domestic Income	5.4%	3.3	3.8%	5.2%	5.1	3.7%	4.3%	5.5	5.8	5.6%
Real annual per capita growth rates (% calculated from 1984 prices)										
- Gross domestic product at market prices	2.2%	1.0	2.1%	1.1%	1.8	2.4%	0.5%	1.9	2.4	2.4%
- Total consumption	0.8%	4.4	2.5%	-0.6%	0.0	2.0%	- 0.8%	0.9	1.6	2.2%
- Private consumption	0.5%	1.6	-1.3%	0.5%	1.5	2.3%	0.9%	1.5	1.1	2.3%
Monetary indicators										
-M2/GDP (at current market prices)	14.2	18.5	18.0	19.5	17.9	17.2	16.1	15.5	15.4	15.4
- Growth of M2 (%)	27.2	50.3	27.4	46.2	37.5	34.3	23.0	15.7	12.0	12.0
Price indices (1984=100)										
- Merchandise export price index	85	82	76	87	97	89	91	95	99	102
- Merchandise import price index	110	115	116	116	122	123	121	119	120	122
- Merchandise terms of trade index	77	71	65	75	80	72	75	80	83	83
- Real exchange rate (LCU/US$)	307	339	403	493	405	370	360	380	390	400
- Real interest rates (%)	9.7	16.7	7.3	3.0	-25.8	12.4	-	-	-	-
- Consumer price index (annual % growth rate)	18.0	10.1	25.0	24.9	59.5	45.6	27.3	12.8	6.0	6.0
- GDP deflator (annual % growth rate)	20.0	11.2	24.9	29.8	43.4	33.1	26.9	14.6	6.6	6.0

[1] Source: World Bank, Country Assistance Strategy, August 13, 1997.

GHANA
SECOND FINANCIAL SECTOR ADJUSTMENT CREDIT
- FINSAC II
(CREDIT 2318-GH)

SELECTED BANKING SYSTEM DATA [1]

TABLE C-1: Sector Size and Concentration

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Size of sector								
Number of banks	10	12	12	13	14	13	15	18
Banking system assets/GDP	22	19	19	23	33	35	25	25
Concentration (% of total)								
largest bank (GCB)	57	54	52	44	50	44	29	27
of 4 largest banks	83	82	77	72	74	72	67	60
Credit to Private Sector (Cedi billions)	82.8	94.7	188.8	138.9	187.3	273.3	393.3	680.9
Deposits in Banks (Cedis billions)	148.6	175.9	241.7	340.0	438.6	596.1	805.5	1,069.0

TABLE C-2: Capital Adequacy Ratios of Banks

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Below 0%	6	0	1	2	0	0	0	0
1-6%	1	0	1	0	0	0	0	2
7-12%	3	4	6	6	6	6	4	3
13-18%	0	3	2	3	2	1	4	6
19-24%	0	3	1	1	3	3	2	4
25% and above	0	0	2	1	0	1	2	3

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[1] Sources: Bank monitoring reports, Bank staff estimates, Bank of Ghana, FINSAP Secretariat estimates, IFS statistics.

TABLE C- 3: Operating Ratios of Banks (% of Average Total Assets)

Year	*Operating Income*	*Operating Expenses*	*Net Operating Income*	*Loan Loss Provisions*	*Taxes*	*Profit After Tax*	[illegible]
1988	8.2	6.9	1.3	5.3	0.8	-4.8	NA
1989	7.5	7.0	0.5	6.6	0.3	-6.4	NA
1990	9.2	5.2	4.0	3.5	1.2	-0.6	NA
1991	10.9	4.9	6.0	2.8	1.9	1.3	NA
1992	9.0	4.9	4.1	1.5	1.2	1.5	17.1
1993	9.3	4.8	4.5	1.2	1.7	1.6	22.0
1994	15.0	5.2	9.8	1.6	3.1	5.1	52.5
1995	16.0	6.3	9.7	0.6	2.5	6.6	50.7
1996	17.2	6.0	10.1	0.7	2.8	7.5	57.5

TABLE C- 4: Comparison of Public and Private Sector Banks' Intermediation Costs and Returns

	1992	[illegible]	[illegible]	[illegible]	[illegible]
Public Banks					
Operating Expense	4.1	3.4	4.3	6.4	7.0
Loan Loss Provisions	1.6	0.7	2.1	0.2	0.5
Taxes	0.7	1.2	3.4	4.4	3.9
Total Intermediation Cost	6.4	5.3	9.8	11.0	11.4
Return on Equity	8.8	9.2	63.2	57.1	56.7
Private Banks					
Operating Expense	7.2	7.7	7.3	7.7	7.6
Loan Loss Provisions	0.3	0.9	0.5	0.1	0.4
Taxes	2.5	3.1	2.5	2.9	3.0
Total Intermediation Cost	10.0	11.7	10.3	10.7	11.0
Return on Equity	31.6	43.0	52.6	46.9	54.5