

***Impact of financial system reforms on financial development in Algeria******Brahimi Houda******University of Djelfa*****Abstract**

The objective of this paper is to review policy reforms implementation in different time periods by the government of Algeria for financial development, and to show the extent to which these reforms enhanced the Algerian financial sector development by using various financial development indicators of different segments of the Algerian financial sector. It is found that the central bank of Algeria has lost relative importance gradually which led to increase the central bank independence. However, it is urgent to dismantle financial repression and expand the role of competition and free market forces in banking and financial systems.

Key words: financial system, banking system, financial development indicators, Algeria

**الملخص**

تهدف هذه الورقة الى تسليط الضوء على اهم الاصلاحات المالية التي تم تبنيها من قبل الحكومة الجزائرية في اطار النهوض بالقطاع المالي، ومدى مساهمة هذه الاصلاحات في تعزيز وتطوير هذا القطاع ، حيث تم استخدام عدد من مؤشرات التطور المالي التي تمس مختلف جوانب القطاع المالي. وقد اظهرت النتائج ان هذه الاصلاحات تمكنت من تعزيز استقلالية البنك المركزي ، ومع ذلك هناك ضرورة لإزالة الكبح المالي ودعم دور المنافسة وقوى السوق في النظام المالي والبنكي على حد سواء.

الكلمات المفتاحية: النظام المالي، النظام البنكي، مؤشرات التطور المالي، الجزائر

**1- Introduction**

A sound financial system is an essential pillar of every economy. The financial sector mobilizes savings and allocates credits to other sectors to promote economic growth. It provides not only payment services but also enables coping with economic uncertainties by hedging, pooling, sharing, and pricing risks (e.g. via insurances). An efficient financial sector hence reduces the cost and risk of producing and trading goods and services and thus makes an important contribution to raising the standard of living<sup>1</sup>. Some studies have shown that countries with higher levels of financial development grow faster by about 0.7 percentage points a year. In summary, a well-developed financial sector can facilitate growth and a lagging financial sector can drag down or inhibit growth prospects. Government decision makers should therefore facilitate and support the process of financial development and, in addition, eliminate financial repression conditions as an important element of their policy package to stimulate and sustain economic growth<sup>2</sup>.

With increasing global integration, the Algerian banking system and financial system has had to be as a whole strengthened in order to be able to compete. Algeria has had more than a decade of financial sector reforms in order to modernize its financial system and banking system. It is therefore, an appropriate

time to take stock and assess the efficacy of these reforms by answering the following question:

- To what extent the financial sector reforms in Algeria contributed in the financial development?

In the attempt to give effect to the above mentioned problem statement, we put the following hypotheses:

- The financial reforms in Algeria have a significant impact on the structure of the financial sector;
- Financial reforms in Algeria have contributed to the achievement of financial openness;
- Financial reforms in Algeria have reduced the dominance of the public sector in the banking system.

To do so, the financial system development indicators that are introduced by Beck et al.(2009)<sup>3</sup> will be used in this paper to analyze the following segments of financial sector development : (1) size of financial institutions and markets (financial depth), (2) degree to which individuals and firms can and do use financial services (access), (3) efficiency of financial intermediaries and markets in intermediating resources and facilitating financial transactions (efficiency), and (4) stability of financial institutions and markets (stability).

The rest of the paper is organized as follow: the 2<sup>nd</sup> section presents an overview about the financial sector situation in Algeria during the period 1962-1986 and after 1986. For the purpose of this paper in the 3<sup>rd</sup> section, the financial sector development indicators are discussed and analyzed. The 4<sup>th</sup> section contains the finale conclusions which provide a summary of the main finding of the study. The last section represents the policy recommendations which will be suggested according to the main findings.

## 2- Financial sector situation in Algeria

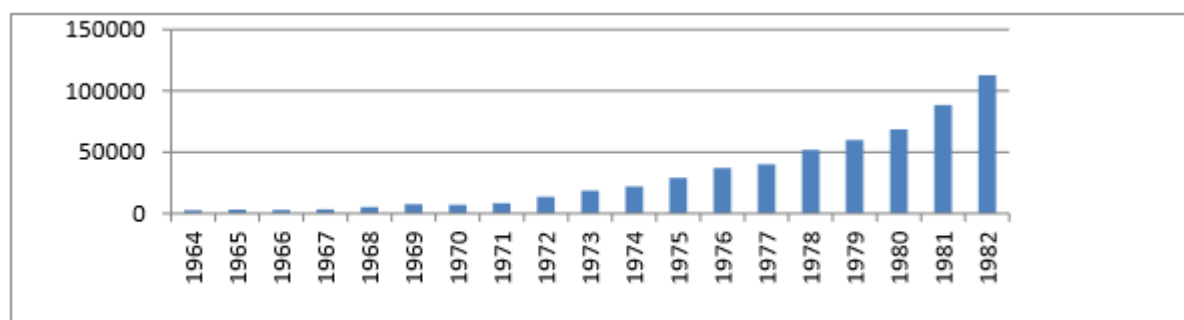
### 2-1 Financial sector situation during 1962-1986

#### 2-1-1 Main function of the financial system

Despite the efforts were done by the government to amend the financial system, but still the key function of the financial system was to collect savings at low cost and to channel them to government and public enterprises as well as to priority sectors<sup>4</sup>. The amount of credit extended to government owned corporations was multiplied by 140 over the period 1963-1982. Beginning in 1976, government owned corporations were authorized to use share holders' equity to finance investment to grow or extend capacity. However, as shown by the financial situation of national companies, their low self financing capacity precluded this type of arrangement. Over the period 1967-1986, government-owned corporations operating under lax budgetary constraints and with unlimited access to credit money, were able to confiscate monetary power from the banks, with the latter's role reduced to simply recording transactions. The massive recourse to central bank advances at a discount rate substantially lower than interest rates explains the economy's excessive monetization. The absence of competition between banks due

to the principle of single-bank domiciliation precluded the development of banking based on the notion of risk and solvency<sup>5</sup>.

Figure 1: Banks loans to the economy 1964-1982 (Billions of Algerian Dinar)



Source: compiled by the author based on the data from the Algerian central bank, 2012

## 2-1-2 Bond and equity market

In the early 1980, bond and equity markets were absent from the financial system in Algeria, capital market were nonexistent given the predominant role of state ownership and the absence of legal basis for stock market activity.

## 2-1-3 Banking supervision and prudential regulation<sup>6</sup>

The development of banking supervision and prudential regulation was limited, because the central bank's direct control over the direction and the volume of credit limited the scope for prudential banking supervision. Moreover, inefficiencies of direct controls contributed to build up of nonperforming loans in many banks in Algeria where public enterprises in Algeria accumulated large bank debts. Faced with increasing economic difficulties in the mid 1980, and also influenced by the world wide trend toward financial liberalization and deregulation, Algeria embarked on wide-ranging structural reform programs that included a liberalization of financial systems. Financial sector reforms were also seen as means to strengthen the supply side of the economy and to support other structural reforms such as trade liberalization, reform of the incentive system, and eventually privatization.

## 2-2 Financial sector situation after 1986

After making sure of the modification ineffectiveness that touched the banking system during the seventies (70s) and the beginning of the eighties (80s), reforming the banking system became an obligation in terms of its management method or its functions. In that frame, the law 12-86 dated August 19th, 1986<sup>7</sup>, and the law 06-88 dated January 12th, 1988<sup>8</sup> were issued. The key objectives of the reforms were to reduce direct government intervention and strengthen the role of market forces in the allocation of financial resources, improve the capacity of financial institutions to mobilize domestic saving, enhance the effectiveness of monetary policy instrument, promote competition among banks, and strengthen their financial soundness. Despite of the banking system reforms, it was clear that they were not enough to involve in the free market economy wheel, which led to sign a new law represented in Money and Loan Law (1990)<sup>9</sup>. This law was issued to give the bank of Algeria more independence and control over the monetary policy. The council of money and credit was established, credit controls were reduced, public

and private companies were put on equal footing regarding credit. Also the authorities started the process of freeing the interest rate.

#### 2-2-1 The main reforms after 1986

- Liberalizing interest rate: In Algeria, moves to liberalize interest rates began in 1990.
- Abandoning directed credit: The first steps toward the abandonment of credit rationing were the withdrawal of the treasury from direct investment in state enterprises in 1987, and the transfer of monetary policy responsibilities to the central bank in 1990. Since 1994, the contexts of recapitalization of commercial banks, banks were provided with increased autonomy with respect to operational decisions.
- Move to more market based financing of the budget: The Algerian government instituted in late 1995 a formal auction system to sell negotiable treasury bonds on the money market to banks and non-bank institutions, such as insurance companies.
- Enhancing competition among banks:<sup>10</sup> In Algeria, the domiciliation requirement for bank clients requiring that certain transactions be lodged with specific banks was abandoned, and specialized institutions were permitted to extend their activity into sectors that had been formerly closed to them. Since 1994, foreign participation in the capital of domestic banks is allowed.
- Prudential regulation and banking supervision<sup>11</sup>: Strengthening prudential regulation and bank supervision was crucial to the success of the liberalization and deregulation of financial activities, as market participants were allowed to take greater risks. In Algeria, new banking laws granted increased autonomy to the central bank, and introduced or strengthened prudential regulations in line with international standards. The risk weighted capital adequacy ratios recommended by the Basel committee of the G-10 are to be met by all banks in Algeria by 1999. Detailed restructuring plans are being carried out on the basis of external bank audits, involving recapitalization of some banks and cleaning up of bad loans, in the context of restructuring plans formalized through the signing of performance contracts between the government and the banks. The government took over sizeable nonperforming bank loans to public enterprises.
- Financial system infrastructure modernization project<sup>12</sup>: The performance of bank payment services required substantial improvement in order to strengthen the attractiveness of bank deposits and bank financial intermediation. In the development program approved by the national assembly in August 2007, the government acknowledged the limited progress achieved in the reform of the financial sector and adopted a new strategy and program to:

- ✓ Promote increased private participation in the banking sector through the introduction of new private banks and private minority participation in the capital of existing state owned banks.
- ✓ Pursue a more liberal and pragmatic policy on foreign entry in all segments of financial sector.
- ✓ Promote the development of securities market and other non-bank financial instruments.
- ✓ Pursue the organizational restructuring of the state owned banks

The project was consistent with the bank's country assistance strategy (CAS) for Algeria, dated February 27th, 1996. It supported the CAS objectives by improving the financial system infrastructure that was critically important for a well-functioning financial system within a private sector-led economy. The project was also an integral part of the strategy and plan of the government and the bank of Algeria into the global financial architecture.

#### 2-2-2 Other reforms<sup>13</sup>

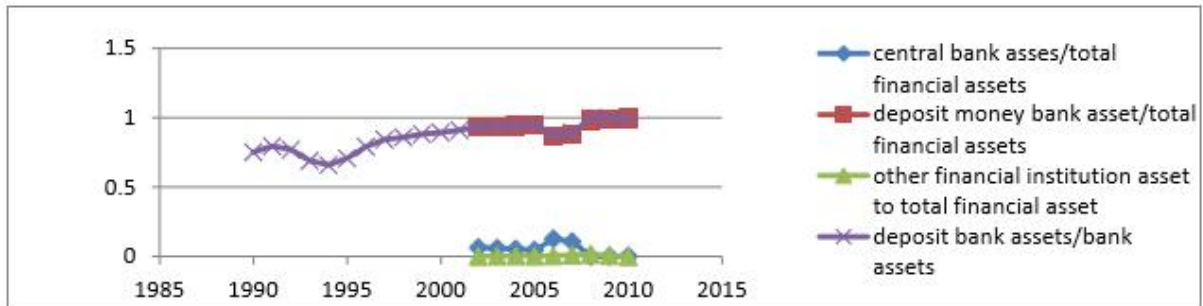
In first half of 2009, the bank of Algeria established a committee of financial stability as well as steering group in charge of monitoring the preparation of the regulatory framework for banks and financial institutions accounting system. In the fourth quarter of 2008, the bank of Algeria modernized the monthly reporting system of banks and financial institutions. The monetary and credit council promulgated a regulation to bring banks accounts and accounting practices in line with international standards in July 2009, and a further regulation related to their publication and of financial statements in October 2009. The framework was completed in December 2009 with a third regulation governing the rules on the evaluation and accounting practices for financial instruments. The bank of Algeria is continuing to develop its ability to detect vulnerabilities in the financial system by further strengthening supervision.

### 3- Analysis of the financial development in Algeria

#### 3-1 The financial intermediaries' size indicators

As shown in the figure 2, the central bank of Algeria has lost relative importance gradually from 2002 to 2006, whereas other deposit money banks have gained relative importance with higher assets ratios. Deposit money banks are now bigger than the central bank and other financial institutions combined in Algeria using this measure. This figure also shows that central bank assets to total financial assets increased during 2006-2007 compared to the previous years since 2002, reaching 12.72% and 10.69% in 2006 and 2007 respectively, and then decreased to 0.11% by 2009, this ratio increased again by 2010. The ratio of deposit money bank assets increased over time (except the periods between 1992-1994 and 2006-2007).

Figure 2: Relative size indicators (%)

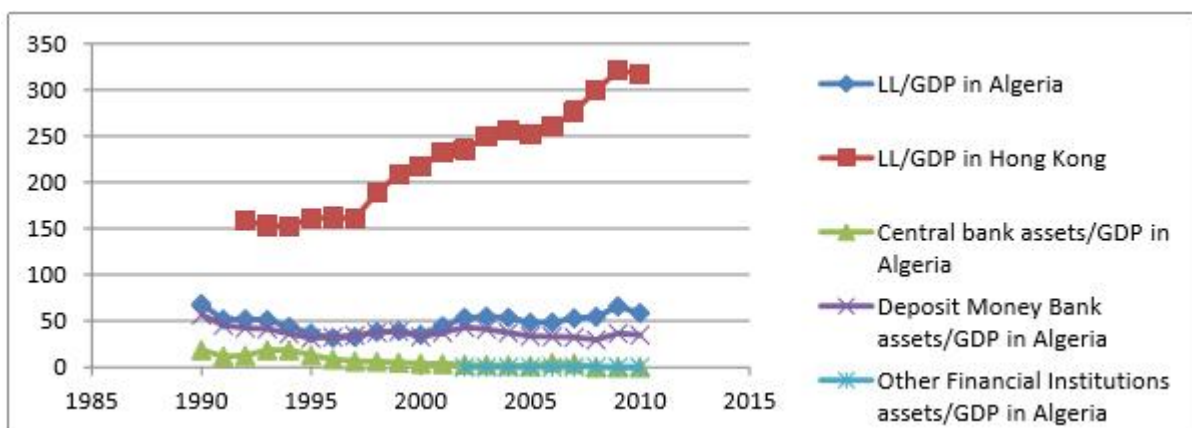
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Source: compiled by the author based on the financial structure database, World Bank, 2012

The ratio of other financial institution assets to total financial assets is very modest barely 1%, but in spite of this, the dominance of banks deposits in the financial system in Algeria is a good sign. Because, according to king and Levine (1993)<sup>14</sup> and beck, Levine, and Loayza (2000)<sup>15</sup>, countries where deposit money banks have a large role in financial intermediation than central banks, can be considered as having higher levels of financial development; but this is not absolute, because we must analyze the development of the financial system from different points to be able to judge the extent to which the Algerian financial system is developed.

Concerning the absolute size measures (figure 3), the continuous decline of central bank assets to GDP shows a decreasing importance and increasing independence of the central bank in the economy, after the issuance of the credit and money law 1990. Deposit money bank/GDP and LL/GDP indicated almost the same fluctuation, and considering that Algeria is bank-based financial system, deposit money banks and liquid liabilities play a great role in the economy, but although a higher ratio of broad money (or M2) to GDP is generally associated with greater financial liquidity and depth, the ratio may decline rather than rise as a financial system develops because people have more alternatives to invest in longer- term or less liquid financial instruments<sup>16</sup>, Comparing to Hong Kong, that occupied the first rank concerning the performance of LL/GDP index, it is noticed that Algeria is still far from the financial development level, according to this index. Indicator value average of this index during the period (1990-2010) is 47.10%, while in Hong Kong is 224.40% during the same period.

Figure 3: Absolute size indicators (%)



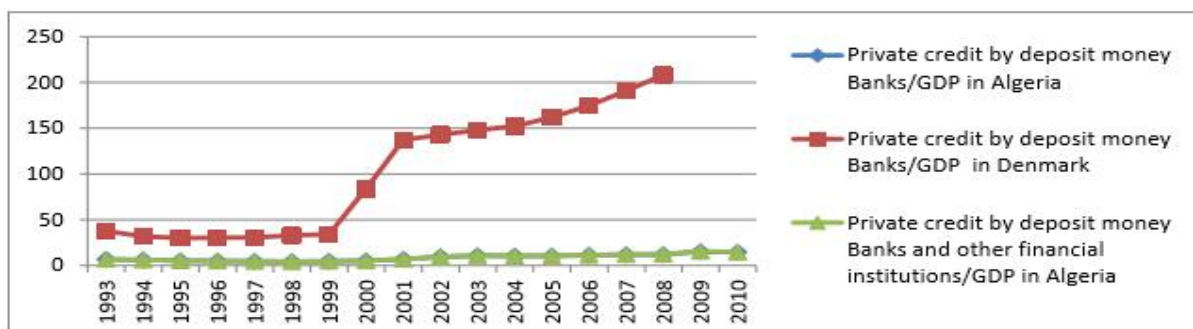
Source: compiled by the author based on the financial structure database, World Bank, 2012

The other financial institutions include the stock market, corporate bond market, insurance companies, pension funds, and mutual funds. However, they play a minor role in the Algerian economy.

### 3-2 The financial intermediaries' activity indicators

Private credit by deposit money banks and other financial institutions to GDP show that Algeria's deposit money banks have improved using this measure during the last decade; moreover, deposit money banks are significantly more active than other financial institutions. Comparing the private sector credit by deposit money banks as a percentage of GDP in Algeria to the same index in Denmark considering that Denmark realized the best result in this measure according to "The financial Development Report of 2012". It is clear that the contribution of the private credit by the deposit money banks in the Algerian economy is very modest, private credit average amount during the period 1990-2008 was about 12.62%, whereas this amount exceeded 90% in Denmark (see figure 4). This reflects the inefficiency of credit allocation, in addition to the difficulty to obtain fund in Algeria, the depth of credit information index in 2011 reached the value of 3, which denotes the weakens of this index<sup>17</sup>.

Figure 4: The evolution of private credit by deposit money banks as a ratio of GDP



Source: compiled by the author based on the financial structure database, World Bank, 2012

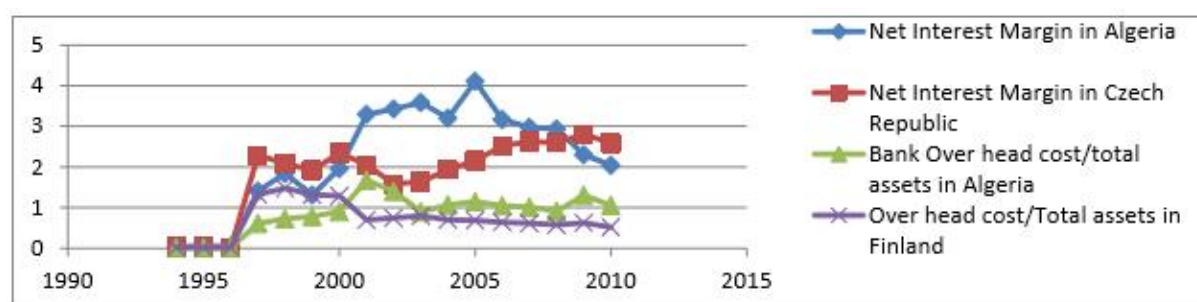
### 3-3 Efficiency indicators

Through comparing profitability indicator between Algeria and Czech Republic, taking into account that Czech Republic occupied the first rank in this indicator which includes net interest margin(NIM) according to "The Financial Development Report of 2012". The net interest margin average in Algeria reached 2.21 during the period 1994-2010. This value is higher than the net interest margin value in Czech Republic which estimated to 1.83 in the same period, this is due to the dominance of the state owned banks in Algeria which in turn led to the lack of competition. On the other hand, the bank overhead cost (OC) average in Algeria is estimated to 0.85% during the period 1994-2010, and it is slightly higher than the realized cost average in Finland that occupied the first rank in this indicator, which is approximately estimated to 0.7% in the same period. The relatively low overhead cost in Algeria does not reflect the efficiency of the Algerian financial institutions; since recent literature suggests that banking sector development has significant and positive effects on firm innovation in countries with lower government ownership of banks<sup>18</sup>, this does not exist in Algeria, as the public

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banks' overall share in total assets represents about 75% while private banks' represents 18%.

Figure 5: Efficiency indicators



Source: compiled by the author based on the financial structure database, World Bank, 2012

### 3-4 Market structure indicators

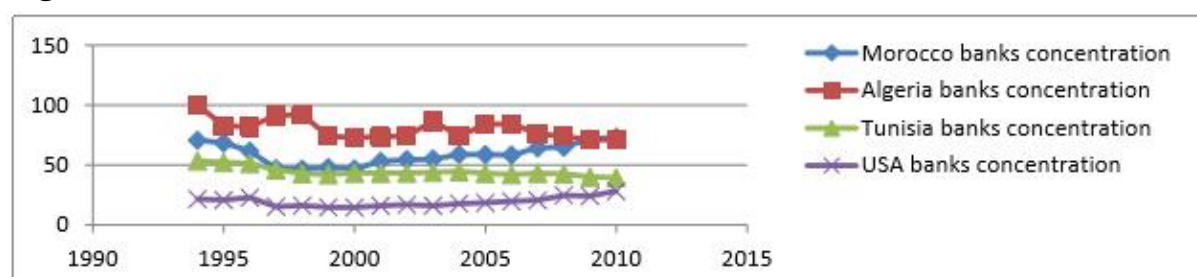
As can be seen in figure 6, concentration measure has decreased during the last decade, particularly after 1998 which is the beginning year of the licensing of the private banks. The failure of the largest private bank in late 2002 exposed collapse of confidence in the private banks, and therefore caused the monopoly of the public banks. Since 2006, the concentration measure has decreased steadily because of the expansion of the foreign owned institutions that have locked in new customers with quality services and product innovation which in turn caused increased competition. However this measure is still very high with around 75% of total assets belonging to the three largest banks which all are government-owned banks, -and this is clear regarding to the high interest rate spread particularly in the recent years (see table 1) - , especially in comparison with Tunisia with around 41.94% total assets belonging the three largest, USA with concentration average of 20%, and Morocco with 55.52%.

Table 1: interest rate spread in Algeria

| 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|------|------|------|------|------|------|------|------|------|
| 4    | 1.8  | 4.5  | 3.1  | 2.4  | 2.5  | 2.5  | 3.3  | 3.3  |
| 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |      |
| 2.9  | 4.4  | 6.1  | 6.3  | 6.3  | 6.3  | 6.3  | 6.3  |      |

Source: world Bank, 2012

Figure 6: Concentration measure



Source: compiled by the author based on the financial structure database, World Bank, 2012

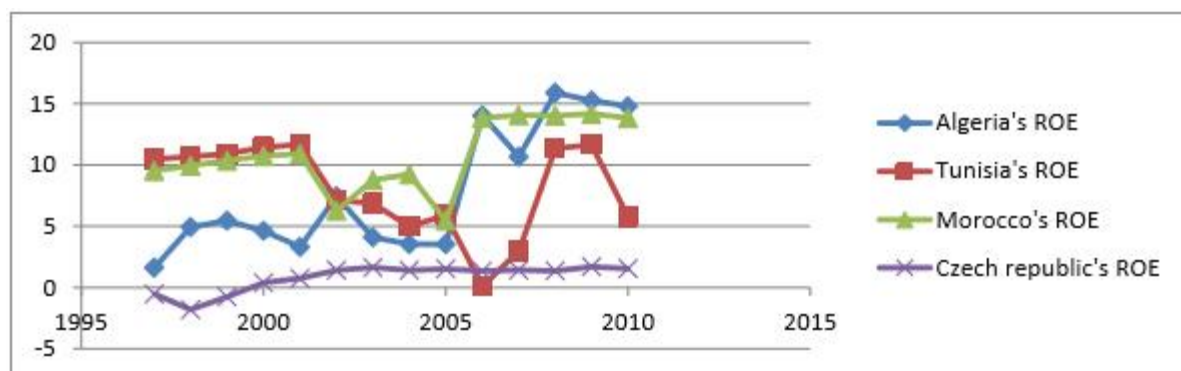
### 3-5 Profitability indicators

ROE in Algeria have been volatile with an increasing trend over time (figure 7), after 2008 ROE is experiencing a decrease due to the increase in shareholders' equity in the private and public banks; this increase was bigger than its activity

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which in turn led to lower the leverage of these institutions<sup>19</sup>. Although the increasing trend of ROE during the period (1997-2010), but the average of ROE which is estimated to 7.79% is low comparing to Czech republic's ROE - which is according to the financial development report 2012 occupied the first rank regarding the aggregate profitability index which includes ROE and ROA-which is estimated to 09.27%, and other countries in the region like Morocco which is estimated to 10.78% and Tunisia with 7.98%.

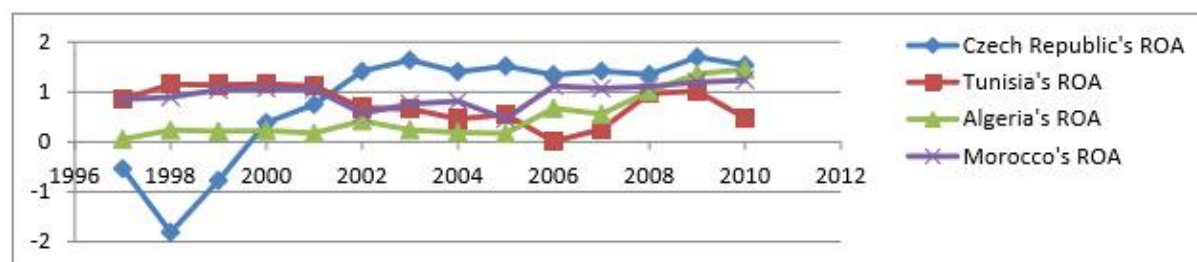
Figure 7: Return on equity (ROE) indicator



Source: compiled by the author based on the financial structure database, World Bank, 2012

ROA have been also volatile with an increasing trend over time (figure 8), this indicates that banks have significantly improved their efficiency in recent years. This is because of the private sector banks which are subsidiaries of international banks and therefore are full owned by foreign capital. Notwithstanding this, the Algerian banking institutions' ROA is still unpretentious with an average of 0.49% in the period (1997-2010) compared to 0.80% in Czech Republic, Tunisia with 0.74% and Morocco with 0.94%.

Figure 8: Return on asset (ROA) indicator



Source: compiled by the author based on the financial structure database, World Bank, 2012

### 3-6 Financial access indicators

The table 2 shows the change in access indicators in the period 2004-2011 in Algeria and in other regions. All the indicators show that there are sharp differences between Algeria and the other regions. According to the data of both commercial bank branches per 1000 adults and ATMs per 100000 adults, Algeria has known values lower than MENA countries average and the lowest values among Tunisia and Morocco. But the data in table 2 gives only part of the picture in that it provides information about the supply, but not the actual use of financial services. Data for deposit account with commercial banks per 1000 adults, loan accounts with commercial banks per 1000 adults provide better indicators of actual

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usage (table 3), these data also show that Algeria has known the lowest values compared to both Jordan and Oman. Comparison with other group of countries and other North African countries is not possible as the data are not available, however access to finance in Algeria remains a significant constraint on enterprises, since 50% of firms identify the constraint as being the major problem. Insufficient suitable collateral is among the main reasons for difficult access to finance, with financial institutions being reluctant to accept movable property as collateral<sup>20</sup>. The lack of a reliable credit reporting system compared with other MENA countries is also considered to be one of the main factors hindering access to finance<sup>21</sup>.

Table 2: Commercial bank branches per 1000 adults and ATMs per 100000 adults

|                    | Commercial bank branches per 1000 adults |       |       |        |        |        |        |       |
|--------------------|------------------------------------------|-------|-------|--------|--------|--------|--------|-------|
|                    | 2004                                     | 2005  | 2006  | 2007   | 2008   | 2009   | 2010   | 2011  |
| Advanced economies | 40.72                                    | 40.09 | 40.04 | 39.59  | 39.55  | 38.35  | 37.22  | 38.22 |
| Developing Asia    | 9.32                                     | 9.37  | 9.29  | 9.75   | 9.74   | 10.08  | 10.50  | 10.70 |
| MENA countries     | 12.53                                    | 12.32 | 11.93 | 11.71  | 12.06  | 12.60  | 13.38  | 15.36 |
| Algeria            | 4.81                                     | 4.80  | 5.02  | 5.13   | 5.30   | 5.26   | 5.08   | 5.28  |
| Tunisia            | 11.95                                    | 12.23 | 13.02 | 13.74  | 14.48  | 15.04  | 16.55  | 17.21 |
| Morocco            | 9.86                                     | 10.57 | 11.44 | 12.60  | 14.16  | 19.62  | 20.89  | 22.31 |
|                    | ATMs per 100000 adults                   |       |       |        |        |        |        |       |
|                    | 2004                                     | 2005  | 2006  | 2007   | 2008   | 2009   | 2010   | 2011  |
| Advanced economies | 91.36                                    | 92.54 | 96.06 | 101.06 | 103.51 | 104.79 | 100.66 | 96.63 |
| Developing Asia    | 8.02                                     | 8.82  | 10.18 | 12.21  | 14.41  | 17.03  | 19.22  | 20.07 |
| MENA countries     | 13.21                                    | 15.73 | 16.17 | 18.41  | 18.97  | 21.75  | 27.31  | 33.29 |
| Algeria            | 1.29                                     | 1.53  | 2.42  | 3.77   | 4.25   | 5.39   | 5.99   | 6.55  |
| Tunisia            | 8.48                                     | 9.76  | 10.97 | 14.10  | 15.55  | 17.93  | 20.67  | 22.02 |
| Morocco            | 8.31                                     | 14.79 | 12.80 | 14.24  | 16.28  | 18.30  | 19.76  | 21.84 |

Source: IMF, financial access survey, 2012

Table 3: Deposit and Loan accounts with commercial banks per 1000 adults

|         | Deposit accounts with commercial banks per 1000 adults |        |        |        |        |         |         |         |
|---------|--------------------------------------------------------|--------|--------|--------|--------|---------|---------|---------|
|         | 2004                                                   | 2005   | 2006   | 2007   | 2008   | 2009    | 2010    | 2011    |
| Algeria | 635.03                                                 | 645.47 | 677.23 | 721.07 | 717.73 | 512.93  | 502.80  | 512.86  |
| Jordan  | 795.8                                                  | 825.20 | 869.10 | 892.3  | 918.69 | 934.39  | 749.01  | 773.49  |
| Oman    | 654.04                                                 | 711.52 | 780.38 | 861.61 | 948.76 | 1006.19 | 1083.13 | 1281.65 |
|         | Loan accounts with commercial banks per 1000 adults    |        |        |        |        |         |         |         |
|         | 2004                                                   | 2005   | 2006   | 2007   | 2008   | 2009    | 2010    | 2011    |
| Algeria |                                                        | 24.69  | 24.51  | 28.94  | 30.78  | 48.92   | 48.05   | 49.10   |
| Jordan  | 150.32                                                 | 156.62 | 160.63 | 168.13 | 162.74 | 207.93  | 187.63  | 197.81  |
| Oman    | 187.80                                                 | 195.98 | 200.45 | 213.70 | 274.16 | 398.37  | 328.59  | 358.36  |

Source: IMF, financial access survey, 2012

## 3-7 Financial stability indicators

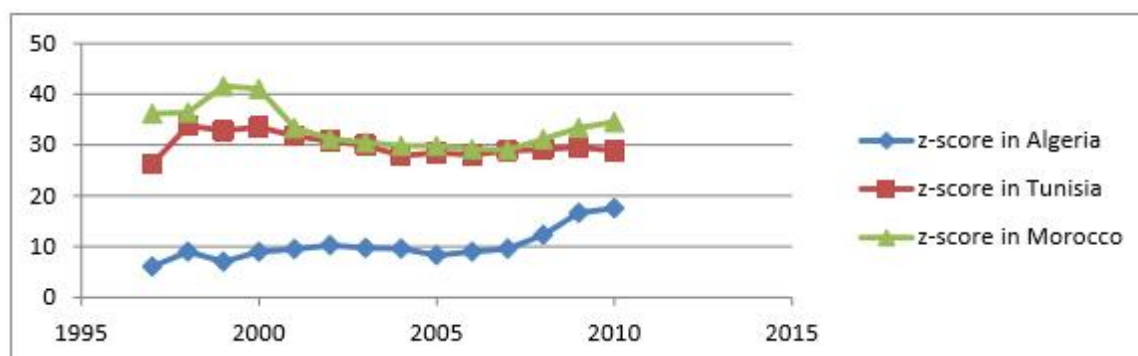
## - Z-score

Z-score which indicates the number of standard deviations that a bank's return on assets has to drop in order to deplete equity has been increasing over the recent years in Algeria from 8.29 in 2005 to around 17.53 in 2010 (figure 9), but it is still lower than both of Tunisia and Morocco with an average of 29.97 and 33.35

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respectively over the period (1997-2010) while Algeria with only 10.24 which indicate higher probability of insolvency.

Figure 9: Z-score indicator



Source: compiled by the author based on the financial structure database, World Bank, 2012

#### - Nonperforming loan

The nonperforming loans in Algeria fell steadily, due to continued government's NPLs purchases plan for state-owned enterprises (SOEs)<sup>22</sup>, but it remains high in Algeria at 14.9% of gross loans for the system, reflected mainly poor management and weak supervisory standards, the bulk of them are concentrated within the public banks (16.8% NPL to total loans). Private foreign banks hold a rather limited amount of NPL, which account for 2.6% of their total loans. Provisions for NPL have increased in recent years to 74% in June 2010. NPL in Tunisia continues to represent a significant vulnerability, due to political and economic instability particularly in 2011. Despite that, Tunisia has known lower level of NPL than Algeria over the period (2007-2010). NPL in Morocco have significantly and continuously decreased to the lowest level among both Algeria and Tunisia, this reflects partially the cleanup of balance sheets by writing off old NPL that are fully provisioned and partially some restructuring of problem loans<sup>23</sup>.

Table 4:NPL/gross loan

|                | 2007 | 2008 | 2009 | 2010 | 2011 |
|----------------|------|------|------|------|------|
| <b>Algeria</b> | 22.1 | 15.7 | 14.5 | 14.9 |      |
| <b>Tunisia</b> | 17.6 | 15.5 | 13.2 | 12.1 | 20.0 |
| <b>Morocco</b> | 7.9  | 6    | 5.5  | 4.8  |      |

Source:European investment bank, 2011

#### - Capital adequacy

The minimum capital requirement for financial institutions were raised to USD104 million. As a result, the capital adequacy ratio of Algerian banks rose from 12.9% in 2007 to 22.1% in 2009 and 23.3% in 2010. This indicates that the banking system does not pose short term macroeconomic risk, as it is adequately capitalized and better than both Morocco and Tunisia where the capital adequacy levels are not very high and do therefore not provide enough risk protection. High liquidity ratios in relation to total assets (46% in 2007 compared to 40% in 2005) in Algeria, illustrate the ineffectiveness of the Algerian financial system in channeling excess equity ratio into value-creating projects<sup>24</sup>.

Table 5: capital adequacy ratios

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|                | 2007 | 2008 | 2009 | 2010 | 2011 |
|----------------|------|------|------|------|------|
| <b>Algeria</b> | 12.9 | 16.5 | 22.1 | 23.3 | 20.9 |
| <b>Tunisia</b> |      | 11.2 | 11.8 | 12.3 |      |
| <b>Morocco</b> | 11.6 | 11.7 | 12.4 | 12.6 | 12.5 |

Source: European investment bank, 2011

#### 4- Conclusion

Over the past two decades, Algeria has courageously attempted to modernize its financial system despite social strife and unique challenges posed by the large hydrocarbon sector. However its financial system is still dominated by relatively concentrated and highly oligopolistic commercial bank sectors, and is still controlled by the State. Therefore the weak performance of the financial system can be characterized by the following shortcomings:

- ✓ Bank dominance and heavy public sector presence.
- ✓ Limited financial sector openness.
- ✓ Public banks burdened with inefficiencies and high level of nonperforming loans.
- ✓ A banking sector that fails to exercise its role of intermediation due to very high interest rate spreads which make credit expensive, moreover, deposits are poorly remunerate.
- ✓ Underdeveloped capital markets that remain narrow and illiquid, thereby limiting access to long-term financing and hindering countries' capacities for local debt financing.
- ✓ Nascent institutional investor industry and generally underdeveloped microfinance.
- ✓ Shortcomings in the legal regulatory and supervisory frameworks despite tangible progress.
- ✓ An inadequate regulatory framework which makes for a highly concentrated banking sector, inefficient collateral registry systems that further impede businesses and individuals' access to credit.
- ✓ A largely cash based payment systems that is being modernized.

#### 5- Recommendations

Against the backdrop of an increasingly globalized world, it is urgent to dismantle financial repression and expand the role of competition and free market forces in banking and financial systems through the following policies:

- ✓ Address regulatory bottlenecks by putting in place and enforcing laws aimed at fostering confidence in investors and banks through the creation of credit bureaus that oversee repayment records.
- ✓ Reorganize the banking system through opening the sector to competition, reviewing prudential ratios and putting in place innovative savings and borrowing instruments adapted to local needs.

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- ✓ Develop capital markets and particularly bond markets for long-term financing needs by setting up adequate guarantee schemes against currency and other types of risks.
- ✓ Innovative financial tools that use technology such as mobile banking can also help leapfrog traditional finance services and reach a larger population.

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