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## 2017

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# Lex:lead Group annual scholarship competition

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# How can banking regulatory laws reduce poverty and support economic development?

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## Introduction

Access to finance and financial services is one of the fundamental keys to poverty reduction or intermediation and business facilitation. Banks significantly contribute to economic development, which is an indispensable element in poverty reduction. Cross-country comparisons show the importance of a well-developed banking sector for achieving both long-term economic growth and the reduction of poverty. Countries with better-developed banking systems and capital markets have shown higher growth rates.<sup>1</sup>

This essay will discuss how banking regulatory laws can reduce poverty and support economic development. It will begin by postulating on the nature of economic development, poverty and banking regulatory laws, respectively, to the question at hand, describing their interrelations where necessary. Then, it will explain the ways in which banking regulatory laws can reduce poverty and support economic development.

## Banking: nature and regulation

A bank, according to *Black's Law Dictionary*, is a financial establishment for the deposit, loan, exchange and transmission of funds.<sup>2</sup> 'Banking laws' is the broad term for laws that regulate the banking sector of the economy. '[A bank] occupies a strategic position in the economic system of any country, it is the purveyor and enforcer of government's fiscal and monetary policies.'<sup>3</sup> Regulators create rules for financial institutions like banks to foster financial stability and protect those who use financial services.

Regulation of the banking sector is primarily a matter of national jurisdiction although international regulation takes place to a limited extent. The Bank for International Settlements (BIS) is an example

of an international regulator that operates by consensual agreements between central banks. As a vehicle for central banks, the BIS produced the Basel frameworks, which describe the minimum standards for capital adequacy, among other things.<sup>4</sup> Domestic banking regulatory laws are codified in national constitutions and statutes. In Zambia, for example, banking regulatory law can be found in, among other statutes, The Banking and Financial Services Act, The Bank of Zambia Foreign Currency Regulations and the Bank of Zambia Credit Guarantee Scheme Regulations.<sup>5</sup> In South Africa, banking regulations are found in its Code of Banking Practice, Financial Advisory and Intermediary Services Act, National Credit Act and others. In Nigeria over two-dozen legislative acts regulate the operation of banks, ranging from loans, guarantees, currency matters to development financing.<sup>6</sup>

It is virtually impossible to run any economy without finance as it is an essential fulcrum to all modern-day countries. A sound financial system that is properly regulated is therefore critical to economic development and poverty reduction. The wide variety and specificity of banking regulations goes a long way in showing the great efforts that managers of economies put into applying legislative measures to support and sustain a buoyant economy by plugging loopholes and redressing weaknesses. This demonstrates a recognition of the central and fundamental role that banks play in economic development.<sup>7</sup>

## Poverty reduction and economic development

The World Bank Development Report 2000 defines poverty as:

'an unacceptable deprivation in human wellbeing that can compromise both

physiological and social deprivation. Physiological deprivation involves the non-fulfillment of basic material or biological needs, including inadequate nutrition, health, education, and shelter. A person can be considered poor if he or she is unable to secure the goods and services necessary to meet basic material needs. The concept of physiological deprivation is thus closely related to, but can extend beyond, low monetary income and consumption levels. Social deprivation widens the concept of deprivation to include risk, vulnerability, lack of autonomy, powerlessness, and lack of self respect.<sup>8</sup>

Poverty reduction has been the subject of considerable discussion by economists the world over. A number of measures can be used to achieve poverty reduction, which aim to enable the poor to create wealth for themselves.

Economic development can be defined as 'an increase in the economic standard of living of a country's population, with constant growth from a stagnant state to a higher level of equilibrium. It implies changes in income, saving and investment along with accelerating changes in the socio-economic structure of a country.'<sup>9</sup> Economic development is closely related to but distinct from economic growth, economic growth being merely an increase over time in the per capita output of material goods. Economic development is a much broader concept, an essential but not sole element of which is economic growth. Economic growth (which is a key element of economic development) is the most powerful instrument for reducing poverty and improving people's quality of life in developing countries. However, the extent to which a given rate of economic growth affects poverty levels is influenced by the institutional structures and policy environment that exist in particular countries.<sup>10</sup> A major determinant of financial sector performance is the prudent financial regulation and supervision environment within which the financial institutions operate.

### **How banking regulatory law can reduce poverty and support economic development**

#### *Deposit insurance*

Banking regulatory laws can support economic development by encouraging

savings through deposit insurance. In times of bank failures, people can lose their savings without remedy. This can result in people losing confidence in the banking system and opting for alternative ways to keep their money, thus reducing the mobilisation of funds for economic development. The reluctance of people to save their money within the banking system usually leads to a general decline in national savings and in capital formation.<sup>11</sup>

Deposit insurance is a guarantee that all or part of a depositor's debt with a bank will be honoured in the event of bankruptcy.<sup>12</sup> When depositor's funds are secure, the banking system is able to win the confidence of individuals to save money in banks, which can then be mobilised and reallocated to higher-return activities and investments thereby boosting economic development. This economic development in turn translates into poverty reduction. Further, when poor people have the confidence (in addition to the ability) to save money, a culture of saving gradually grows, allowing for national capital formation over time and an enhanced income earning capacity for the individual, who can build assets and found micro-enterprises, fostering an entrepreneurial spirit and reducing poverty. The establishment of an effective depositor protection scheme assists in early bank resolutions while providing protection to the most vulnerable.<sup>13</sup>

#### *Encourage competition*

According to Claessens and Laeven, '[m]ore competitive banking systems are better in providing financing to financially dependent firms. There is support for the view that more competition may reduce hold up problems and lower the cost of financial intermediation, making financially dependent firms more willing to seek (and better able to obtain) external financing'.<sup>14</sup> Banking regulatory laws can encourage healthy competition and avoid monopolies in the banking sector by providing an opportunity for a number of financial service providers to operate freely. When there is a healthy competition in the banking system, the cost of financial intermediation is lowered and businesses are able to use financial services and invest in activities that can support a country's economic development and poverty reduction efforts.

### Control on bank charges and interest rates

Through the use of banking regulations, bank charges and interest rates can be controlled to protect people from over-exploitation and undue profit maximisation by banks to the detriment of small businesses. Banking regulatory laws can support economic development and reduce poverty by protecting businesses and individuals from exploitation by financial institutions arising from uncontrolled bank charges and interest rates. The regulation of bank charges and interest rates can afford reasonable transaction costs, giving individuals and businesses an opportunity to thrive and contribute positively to economic development.

### Minimum capital requirements

Banks need capital to act as a buffer or cushion in the event of losses. Banking regulatory laws require banks to have more capital than liabilities in order to operate. This requirement, if properly enforced, can protect the bank from bankruptcy and the disruption that it may bring to the financial system. This requirement can save a country from bank failures and the consequent losses of deposits and financial stability. Capital requirements aim to strengthen banks against economic shocks in order to ensure normal financial activities and stability.

Another way in which banking regulations can support economic growth is by making sure that funds are channelled to critical sectors of the economy and not only profitable ones.<sup>15</sup> Critical sectors such as education and agriculture help to raise people's standards of living and to reduce poverty.

### Conclusion

Having established that finance is the backbone of every economy and the critical as well as pivotal role that a properly regulated banking system plays in economic development and poverty reduction, this essay has shown the ways in which banking regulatory laws can support economic development and reduce poverty. To attain sustainable economic development and success in any poverty reduction strategy, governments must cease to overlook the role that a well-regulated banking system can play and make an effort to properly develop and enforce these laws.

### Notes

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# How can banking regulatory law reduce poverty and support economic development?

## Introduction

In September 2000, during the United Nations Millennium Summit, around 150 world leaders and high-ranking officials adopted the Millennium Declaration, committing their nations to a new global partnership to reduce extreme poverty, striving to ‘free all men, women, and children from the abject and dehumanizing conditions of extreme poverty’ before the year 2015.<sup>1</sup> But, by September 2015, it was clear that very little headway had been made in eradicating global poverty. Thus was born the 2030 Agenda for Sustainable Development, which seeks, among other things, a world with no poverty, zero hunger and decent work and economic growth.<sup>2</sup> Unless governments and institutions implement proper, effective and efficient policies, this vision to eradicate poverty and promote economic wellbeing by 2030 will again not be achieved. In order to prevent another 15-year renewal of world commitment to poverty reduction, all stakeholders must work to make Agenda 2030 a reality. The challenges of economic development and poverty alleviation are so vast that we need to marshal all resources and assistance in public, private, academic, social and philanthropic spheres.<sup>3</sup>

This article focuses on the role that banks and financial institutions can play to contribute to reducing poverty and promoting economic development. More specifically, the article explores how banking regulatory law can be used in the fight against poverty. The article first looks at the meaning of poverty and economic development and what accounts for poverty in developing and emerging economies like Africa. Then, the article gives an overview of the existing banking regulatory laws and regulators, with emphasis on a few African countries. The article then suggests various ways in which banking regulatory law can be used as a tool

to oblige banks and financial institutions to assist in reducing poverty, enhancing economic development and promoting the general economic wellbeing of world citizens.

## Poverty and economic development: meaning and accounting factors

The World Bank currently defines ‘extreme poverty’ as living on less than \$1.90 per person per day. While for the first time in history only about ten per cent of the world population live in extreme poverty, that still means about 767 million people live below this threshold.<sup>4</sup> And, although the poverty rate worldwide has reduced, progress has been uneven. The World Bank estimates that the majority of the progress is centred in South and East Asia, with China, Indonesia and India leading in growth. Meanwhile, in sub-Saharan Africa, more than all the other regions combined, around 389 million people are still below the \$1.90 daily threshold. Access to good schools, healthcare, electricity, safe water and other critical services remains out of reach for many people, often determined by socioeconomic status, gender, ethnicity and geography.<sup>5</sup> The causative factors of poverty are no secret: rapid population growth, unequal income distribution, deep-seated corruption, low education standards, and the pernicious effects of war and conflict.<sup>6</sup>

For the purposes of this article, ‘economic development’ is defined as efforts that seek to improve the economic wellbeing and quality of life for a community by creating or retaining jobs and supporting or growing incomes and the tax base. Unlike economic growth, economic development does not merely mean an increase in GDP; economic development means improvement in the economic wellbeing and quality of life of a community by creating or retaining jobs and

supporting or growing incomes and the tax base.<sup>7</sup> True economic development in any country is reflected in the quality of life of the citizenry. It encompasses improvements in indicators such as literacy rates, life expectancy and poverty rates. It also takes into account important aspects such as leisure time, environmental quality, freedom and social justice.<sup>8</sup>

### **Banks and the banking regulatory system**

A bank is described as a financial institution that accepts deposits from its customers, uses such deposits for investment, pays out when required, exchanges currency and makes loans at interest.<sup>9</sup> This is a wide definition that seemingly encompasses commercial banks, rural banks, development banks and even – although this is arguable – the mobile banking business that is fast developing across Africa.

Statutes, regulations and instruments typically set up the banking regulatory system in most countries. The industry is regulated primarily by the country's central bank.<sup>10</sup> For example, the South African Reserve Bank (SARB), the Central Bank of Nigeria (CBN) and the Bank of Ghana (BoG) are the main supervisory and regulatory authorities in matters relating to banking business in South Africa, Nigeria and Ghana respectively.<sup>11</sup> Regulation usually covers licensing, capitalisation and liquidity requirements, ownership and control, depositor (savings) protection schemes and auditing requirements, among other matters. These regulatory bodies also have the mandate to propose reforms to laws and regulations. It is this mandate that can be exercised by banking regulatory bodies to push banks into assisting in the creation of a poverty-free world.

### **Banking regulatory law: a potential tool for poverty reduction and the promotion of economic development**

Banks are often regarded as the life force of an economy and the heart of free market economies. They play a key role in providing internal and external funding sources for a country by issuing loans to individuals and companies and acting as a 'safe-box' for depositors. In this regard, banks have the potential to fuel economic development, raise people's standard of living and reduce poverty.<sup>12</sup> But leaving individual banks to make individual corporate decisions to join

the poverty eradication fight would probably take decades or centuries. They must be drawn into the fight; but how? Through banking regulatory law. Below are some suggested ways of making banking regulatory law a strong tool in poverty alleviation and economic development.

If there is one canker facing developing and emerging countries, it is corruption. Corrupt politicians and public officials engage in shady business deals to siphon off huge public sums through anonymous shell companies to offshore tax havens. In 2013, the Africa Progress Panel, led by former UN Secretary-General Kofi Annan, reported on corrupt mining deals in the copper and cobalt-rich Katanga region of the Democratic Republic of the Congo. The deal involved the sale of a Congolese mining company, facilitated by banks and offshore entities. The report estimated that the Democratic Republic of the Congo may have lost \$1.36bn in potential revenues between 2010 and 2012 as a result.<sup>13</sup> That sum is almost twice the combined annual health and education budget of the country.

Most kickbacks and other proceeds from corrupt activities go through banks. For example, Teodorin Obiang, the son of the President of Equatorial Guinea, reportedly used banks in Paris and the United States to funnel funds in order to purchase mansions and art collections worth millions of dollars despite earning an official monthly salary of less than \$7,000.<sup>14</sup> The simple truth is that some banks do accept dirty money. Banking regulatory law can fix banks with new obligations of openness and transparency. Anti-money laundering laws and regulations should be strictly enforced.

There should be a responsibility placed on the boards of directors of banks to provide accurate and truthful financial and regulatory reporting, including mandatory public disclosure of banking transactions. As unorthodox as this may sound, it is submitted that, if one earns money legitimately, one would not be concerned by this transparency regulation. Of course, this would need to be checked and balanced by a sound data protection system. Fixing banks with such an openness policy can help to reduce the huge sums of state funds that are lost through corruption. Monies can easily be traced and recovered and corrupt officials easily prosecuted. Public funds that would otherwise have gone to line a statesman's pocket would be available to build boreholes,

freely distribute cocoa-spraying equipment, conduct research into clean energy, among thousands of other things that would help to reduce poverty.

Alongside a transparency and openness policy would be increased tax revenue. The disclosure would enable the tax-collecting authorities to ascertain how much an individual is really worth as well as how much corporate profit a company makes at the end of the year. People should not be able to avoid paying their dues to society. As tax revenue is among the foremost sources of funding for government projects, an increased tax revenue should correspond proportionally to an increase in projects and development in a country. A corollary of such banking regulation therefore will be the availability of funds to promote education, boost health practices and generally improve the standard of living of citizens in such poverty-ridden and underdeveloped countries.

Banks and financial institutions collect extensive data on their customers, and even on non-customers who stand in as sureties and guarantors for borrowers. This makes banks a rich source of financial data. A World Bank report recently lamented that tracking poverty in Africa is a challenge because the data is insufficient.<sup>15</sup> The President of the World Bank Group, Jim Yong Kim, has also reportedly stated that, 'we will not be able to reach our goal unless we have data to show whether people are actually lifting themselves out of poverty. Collecting good data is one of the most powerful tools to end extreme poverty.'<sup>16</sup>

Credit referencing and reporting can help. Ghana already has a Credit Reporting Act, 2007 (Act 726)<sup>17</sup> although the country still has a long way to go. It is submitted that, as a variant of the proposed banking regulatory laws on openness and transparency, banks may be made to partner with the World Bank and its agencies as well as other organisations which have, as their primary aim, the collection of credible data to help in poverty alleviation. The banks' data can assist in measuring the progress levels across various demographics. We can easily identify which areas of a country – and of the world – still have literacy challenges and are still living in poverty. In that way, the World Bank could easily track the poverty reduction progress, and world donors and aid givers could embark on proper income distribution campaigns to bridge the inequality gap.

Banking regulatory law can also be tailored

to nudge banks into observing their corporate social responsibility (CSR) obligations. The World Business Council for Sustainable Development (WBCSD) has defined CSR as 'the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large'.<sup>18</sup> Admittedly, CSR remains a voluntary concept in most countries and international CSR initiatives are not mandatory.<sup>19</sup> Regarding the role of corporations, there also seems to be a dichotomy between the shareholder primacy norm (which postulates that the company exists for the benefits and interests of its shareholders)<sup>20</sup> and the stakeholder theory (which posits that a company must be managed for the benefit of the wider stakeholders such as employees, suppliers, the community and the environment).<sup>21</sup>

It is submitted, however, that the central banks and regulators of the banking sector may provide CSR targets for banks to achieve within a certain period. Banks that fail to meet such targets may be punished with sanctions and have their licenses suspended. Even if CSR is maintained as a voluntary concept, banking regulatory law can provide incentives that will entice banks to observe their CSR duties geared towards poverty alleviation. In the legal industry, for example, the Law Society of West Australia has Quality Practice Standards (QPS) to ensure that law firms comply with certain requirements designed to improve client satisfaction and avoid wastage. As an incentive, law firms that meet the QPS-approved practices are entitled to a seven per cent discount for the first year on professional indemnity insurance premiums, and a five per cent discount thereafter.<sup>22</sup> Banking regulatory laws could provide a similar incentive. Tax rebates might be granted to banks with a higher CSR observance record, for example. Reduced license renewal fees for such banks could also be used to motivate other banks to help in promoting economic development.

The CSR projects on which banks might embark to reduce poverty and promote economic development are numerous. They could provide funding or low interest rates to companies and non-profits dedicated to promoting education and eradicating hunger and maternal mortality. Banks might decide to invest in schools and institutions that seek to propagate knowledge on the feasible ways and processes in which the Sustainable

Development Goals can be achieved. As part of its CSR initiative, a bank might decide to embark on population control and family planning campaigns aimed at reducing rapid population growth.

A bank could even observe its CSR duty towards its own employees. This could be done by examining the employees' conditions of work and pay, their quality of life, and also the extent to which the company plays its part in maintaining the quality of their living conditions through vocational training programmes or, indeed, by anticipating redundancy plans and providing appropriate support. Improving the working conditions and social protections of employees is a key element in the contribution that businesses can make to development.<sup>23</sup> By using their CSR duties to help create a world with less poverty and more holistic economic development, it is submitted that banks would ultimately stand to gain in the long run.

The majority of the global poor live in rural areas and are poorly educated, mostly employed in the agricultural sector, and over half are under 18 years of age.<sup>24</sup> In Mozambique, for example, the vast majority of the population and almost all of the rural poor work in agriculture. Most of the population is disconnected from the growth process and low accessibility to and participation in markets has resulted in huge poverty rates between the lagging provinces and the rest of the country.<sup>25</sup> To bridge the unequal income distribution gap, banking regulatory laws could oblige banks to provide loans and financial assistance to rural farmers and micro-business owners who may not have collateral to put up as security. Banks might be incentivised to assist producers to increase their yield and move from subsistence farming to processing and marketing of their produce. This will help reduce absolute poverty in the farming sector.

This would not go against banks' profit-making objective: the loans would be at fair interest rates and research shows that giving small loans to rural people who want to start businesses but have no collateral or credit scores to put up can still generate a repayment rate of about 90 per cent.<sup>26</sup> The reason is simple: such people have a communal sense of belonging and a deep passion about making life better for their families. Give them a little springboard and they soar into success stories.

## Conclusion

Agenda 2030 remains an achievable dream. Humanity has already invented the tools to end poverty. The progressive practices in the education, health, energy, governance, food and agriculture sectors are all known. The problem is with the delivery of these tools to the global poor in order to eradicate poverty. A concerted effort is needed. Through a series of mandatory and incentivising reforms of banking regulatory laws, banks and financial institutions could be used to curb corruption, grow tax revenues, assist in data compilation on poverty and embark on societal campaigns geared towards attaining a world without poverty.

## Notes

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# How can banking regulatory law reduce poverty and support economic development?

**F**inance is a resource. It is a vital driver in the production of goods and services in an economy. Thus, it would be unwise to disregard its role in economic development and sustainability. With regard to the 'human development' perspective, finance is necessary for a decent standard of living for it covers the fair distribution of income and resources for all.<sup>1</sup> Access to finance creates 'an environment for people to individually and collectively develop their full potential by enabling them to exercise a reasonable choice in leading productive and creative lives that they value'.<sup>2</sup>

Banks play a critical role in fulfilling the aforesaid. From their core functions of taking deposits and effecting payment instructions, to their multi-functional roles in foreign exchange, securities and derivative markets,<sup>3</sup> banks are instrumental in the social issues of economic development and poverty reduction. Hence, this essay aims to discuss how banking regulatory law can reduce poverty and support economic development. Mobile banking has been deliberately selected as the specific area of discussion for it has been cited as the current forerunner in financial inclusion in developing regions, particularly in sub-Saharan Africa.<sup>4</sup>

## Mobile banking and economic development

Mobile banking complements economic development for it creates positive results in the intermediation between the saver and investment projects.<sup>5</sup> Mobile banks lend money to fund capital investment projects that form the core of economic development, namely industry, agriculture, mining and mineral processing, and technology. This is mainly attributed to the fact that the traditional 'brick and mortar' banks rarely reach remote areas.<sup>6</sup> Hence, mobile banking has resulted into the broadening of the deposit base by capturing low income households.<sup>7</sup> This deposit pool is readily utilised for mobile loans, monetary stability, government and external debt management and avoiding sector imbalances that may harm production in industry and agriculture. For example, Orange Money is a mobile application in Uganda that allows farmers to buy farming supplies and receive payments for their harvests.<sup>8</sup> Such loans notably bear a reduced value for the real-time settlement platform offered by mobile operators, as it does not require traditional risk assessment.<sup>9</sup> Mobile banking also aids finance mobilisation in areas concerned with 'green finance' such as pollution control, clean energy, clean transportation

and energy-efficient products. For example, M-Kopa Solar is a mobile financial service that allows savers to acquire a solar panel kit by making micropayments of below 50 cents following an initial deposit of US\$35.<sup>10</sup>

### Mobile banking and poverty reduction

Financial exclusion is undoubtedly a brutal fact and symptom of poverty. Financial exclusion entails ‘the inability to access necessary financial services in an appropriate form’.<sup>11</sup> In sub-Saharan Africa, access to savings, credit products and payment services has been tagged as a major constraint limiting the participation of low income households and micro-, small- and medium-sized enterprises, both in rural and urban areas.<sup>12</sup> Hence, large segments of the sub-Saharan population resort to unsustainable, informal, unregulated forms of financial services, such as pyramid schemes, which seem to be flexible in terms of the contractual conditions they offer, high interest rates and negotiable collateral.<sup>13</sup> Recent evidence has pointed to micro-, small- and medium-sized enterprise finance as an important channel of financial growth in developing regions.<sup>14</sup> Unfortunately, micro-, small- and medium-sized enterprises have been tagged as the ‘missing middle’: too big for micro-finance and too small for banks.<sup>15</sup> Commendably, mobile money fills the gap. Innovative, affordable and consistent mobile banking services have helped the ‘missing middle’ to exploit growth and investment opportunities.<sup>16</sup> This ideally reduces the informality of such enterprises and ensures their survival;<sup>17</sup> the ideal end being a decent standard of living for entrepreneurs and the community.

### A discussion of how regulatory law on mobile banking can reduce poverty and support economic development

In the case of *Commissioners of the State Savings Bank of Victoria v Permewan, Wright and Co Ltd*,<sup>18</sup> a bank was succinctly described as ‘a financial reservoir receiving streams of money in every direction and from which there issue outflowing streams where and as required to sustain and fructify or assist commercial, industrial or other enterprises or adventures’. Evidently, common law jurisprudence and common knowledge agrees to the fact that a bank, be it conventional or ‘branchless’,

is an element of society that complements economic development and promotes poverty reduction. Thus, such an entity is worth regulating. Nonetheless, a question lingers. How can regulatory laws on banking, and on mobile banking in particular, reduce poverty and support economic development?

#### a) *The regulation of technology in mobile banking*

Mobile banking is facilitated by technologies such as mobile phones, SIM cards, mobile networks and data encryption. In this regard, it is essential for regulatory law to be cognisant of the fluid and dynamic nature of such technologies, such as their ability to change or evolve over time. This is evident from the evolution of digital financial services across four distinct generations. The first generation involved the bare use of mobile phone technology for payments and settlements using pre-paid airtime.<sup>19</sup> Under the second generation, interest-bearing savings accounts were launched using mobile phone technology.<sup>20</sup> The third generation saw the use of transactions and savings data to generate credit scores for use in the evaluation and price of micro-credit.<sup>21</sup> The fourth generation covers international and cross-border remittances based on mobile phone technology.<sup>22</sup> The four-staged evolution of mobile banking technology has been hailed as the African banking revolution that has ‘captured the market and raised the financial inclusion profile’.<sup>23</sup> But, how can regulatory law on mobile banking support the continual development of mobile banking technology?

A ‘technology neutrality approach’ to regulatory law has been coined as a solution.<sup>24</sup> This means that the law should avoid being a technology-based text.<sup>25</sup> The text should be open and flexible enough to adapt and assimilate the innovations that the future promises.

#### b) *The regulation of mobile agents in mobile banking*

Under contemporary mobile banking, ‘branches’ have been replaced by mobile agents dotted together across the terrain. Hence, it is now normal for villagers and suburban dwellers to trek to a local kiosk or a neighbourhood booth to make a deposit to their mobile accounts. Although mobile agents have been identified as essential

intermediaries, their use also comes with a persistent liquidity risk due to cash out constraints, agent theft and their vulnerability to local robberies.<sup>26</sup> For example, employees of Telco MTN Uganda were reported to have stolen around \$3.5m from an account used to store cash.<sup>27</sup> One can only imagine how disheartening such news would have been to the hundreds of thousands of low-income Ugandans who had toiled to save each shilling. Developing regions and their low literacy levels may also create operational risk as a substantial number of mobile agents may have low levels of financial literacy.<sup>28</sup> How can regulatory law on mobile banking avoid the significant risks attached to use of mobile agents?

The law can begin by defining the roles, duties and qualifications of mobile agents.<sup>29</sup> A license issued from the central bank would be sufficient and conducive. Thus, the law could provide for a compulsory accreditation course under the auspices of the central bank. Regulatory law could equally codify the common law principle of agency by imposing liability on banks for all wrongdoings, negligent and intentional acts committed by their mobile agents.<sup>30</sup>

### *c) Protection of consumers in mobile banking*

Mobile banking has gained synonymy with rapid growth in customer base and banking products, particularly in the sub-Saharan region.<sup>31</sup> This has led to the increasing need for consumer protection. The increase in banking products and customer base has been described as a means of exposing consumers to invisible, unsustainable financial practices, such as Ponzi or pyramid schemes.<sup>32</sup> In the absence of consumer protections, such schemes may seem attractive to some groups, such as underprivileged women, migrant workers, ethnic minorities and indigenous peoples. How can regulatory law on mobile banking protect consumers?

One prudent step could be to outline the rights and duties of consumers, as well as the complementary rights and duties of other participants in the chain of mobile banking delivery.<sup>33</sup> Alternative dispute mechanisms should also be provided for by law as a means of redress for aggrieved consumers.<sup>34</sup> In view of developing regions, alternative dispute mechanisms are a favourable means of setting 'mobile banking disputes', for the amounts under contention may be meager compared

to the cost of going to court. In a bid to 'unbundle' mobile banking services, the law could provide for specific safeguards, such as deposit insurance to protect the monetary interest of depositors.<sup>35</sup>

### *d) Protection of consumer data in mobile banking*

Deposits, withdrawals, payments and the generation of credit scores in mobile banking revolve around consumer data.<sup>36</sup> Nonetheless, the use of consumer data in the utility of mobile banking bears some inherent risks, such as hacking and cybercrime. Apart from threatening the right to consumer privacy, unwarranted access to consumer data may deepen financial exclusion. For example, SIM card theft and hacking could result in electronically siphoning deposits from a mobile account; a mobile account likely owned by a widow, a sole breadwinner, a marketeer, subsistence farmer or fisherman. Poor data security could also be detrimental to economic development for it may stifle entry, growth and innovation, and breed an environment of distrust.<sup>37</sup> How can regulatory law on mobile banking protect consumer data?

First and foremost, data protection should be placed as a form of *ex ante* regulation. This means that data protection should be set by legislation as a condition for entry and participation in mobile banking. Using a risk-based approach, regulatory law should ensure that the costs of data protection law are proportionate to the benefits.<sup>38</sup> This is founded on the fact that stringent data protection law can be an impediment to the growth of mobile banking; data being the lifeline of the industry. For example, the end-to-end encryption of data required in India has been tagged as a contributor to the sluggish development of mobile banking.<sup>39</sup> Thus, the law should protect consumers through the least economically restrictive means possible.

### *e) Safeguards against money laundering threats and terrorist financing in mobile banking*

Mobile banking has gained prominence in developing regions of the world for it does not demand much information in the use of its services. For example, the huge customer base of M-Pesa in Kenya has been largely attributed to its 'non-bank based model'.<sup>40</sup> This characteristic of mobile banking carries

risks of money laundering and terrorist financing.<sup>41</sup> Money laundering has hampered economic development and poverty reduction in developing regions. Money that could have been used to fund a small- or medium-sized business, pay off government debt or build a hospital or school becomes a source to build palaces, charter flights around the world and purchase SUVs, all at the cost of the people who need it the most. The ripple effects of terrorism are similar. The damage to infrastructure necessary for development in the 1998 embassy bombings in Africa and the '9/11' attacks in the United States illustrate this. Oddly enough, the hubs for money laundering and terrorist financing and activity are often in developing regions. How can regulatory law on mobile banking prevent its potential abuse by money launderers and terrorism financiers?

First and foremost, consensus should firmly establish that mobile banks are not exempt from government rules and regulations which require a mobile banking provider to exercise due diligence in disclosing the identity of its users.<sup>42</sup> Should mobile banking be governed by the rigid 'Know Your Customer' regulation, such as the Global Anti Money Laundering Guidelines for Private Banks of 2000 or the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism? The response to such a question should be taken with care for the subjection of mobile banking to burdensome identity regulation could stifle economic development and hinder the growth of a new customer base.<sup>43</sup> In remote villages where customers lack access to passport photography facilities and photocopying or are illiterate, the regulatory law should be sensitive and provide for alternative means of identification. This includes a mobile agent being stocked with a cordless photocopier or granted the role of taking the passport photos of customers or entering details on their behalf. The law could equally offer a choice between manual or electronic submission of identification information and supporting document(s).

#### *f) Co-ordination of players in mobile banking*

The utility of mobile banking draws multiple participants, such as financial regulators (eg, central banks), commercial banks, telecommunication companies, mobile agents, consumers and other government

actors from the financial sector.<sup>44</sup> Players have divergent ambitions, ranging from the need of commercial entities to make profits to the interest of financial regulators to ensure overall monetary stability. In practice, such a vast array of actors and ambitions poses significant threats to economic development, financial inclusion, innovation and growth, such as co-ordination failure.<sup>45</sup> Co-ordination failure can lead to adverse systemic impacts on depositors, inter-banks and other financial institutions involved in the chain of mobile banking delivery. How can regulatory law on mobile banking avoid a co-ordination failure or collaboration risk?

Regulatory law on mobile banking needs to adopt an 'enabling approach'<sup>46</sup> and be framed in a manner that promotes co-ordination. The law should be participatory and place due emphasis on the notion of 'stakeholders'. For example, the interpretation section of an enabling statute could define actual and potential stakeholders. The enabling statute could also create a broadly represented body whose general aim would be promote rapport, consolidate and strengthen the interest rate for credit, and support co-ordination in mobile banking.<sup>47</sup> Regulatory law should clearly identify and define the roles of each stakeholder in the delivery of mobile banking, in line with their nature and capacity.<sup>48</sup>

#### **Conclusion**

This paper has endeavored to discuss how regulatory law on mobile banking can reduce poverty and support economic development. Regulatory law on mobile banking can reduce poverty and support economic development by regulating technology in an open and flexible manner in order to adapt and assimilate new innovations. Regulatory law could also define the roles, duties and qualifications of mobile agents and impose liability on banks for all wrongdoings, negligent and intentional acts committed by their mobile agents. In addition, regulatory law can protect consumers by outlining their rights and duties, providing alternative dispute mechanisms and deposit insurance provisions. Furthermore, regulatory law could protect consumer data by placing data protection as a form of *ex ante* regulation and protect consumer data through the least economically restrictive means possible. Regulatory law can provide safeguards

against the threat of money laundering and terrorist financing by placing due emphasis on the Know Your Customer principle, with permissible moderation. Furthermore, the law should set context-sensitive alternatives for identifying new users, such as the photocopying and filling in of documents by agents in remote areas. Lastly, regulatory law could promote proportionate co-ordination of all participants in mobile banking by being participatory in purpose, emphasising the notion of ‘stakeholders’ and defining the unique roles of each stakeholder.

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### Online resources

<http://hdr.undp.org/en/content/what-is-human-development>

### Notes

- 1 See <http://hdr.undp.org/en/content/what-is-human-development>.
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- 6 Mlachila, et al, *Financial Development in sub-Saharan Africa*, 31.
- 7 *Ibid*.
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- 12 Muganga, 'The Role of Regulation and Supervision of Micro Finance Institutions', 44.
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- 15 *Ibid* at 5.
- 16 *Ibid* at 78.
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- 27 *Ibid* at 442.
- 28 *Ibid* at 476.
- 29 See n 24 at 83.
- 30 See n 26 at 477.
- 31 See n 4 at 31.
- 32 See n 26 at 491.
- 33 See n 24 at 83.
- 34 *Ibid*.
- 35 See n 26 at 484.
- 36 See n 19 at 19.
- 37 *Ibid* at 34.
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- 39 Paul Makin, 'Regulatory Issues Around Mobile Banking' (Organization for Economic Co-operation and Development Report) 10.
- 40 See n 24 at 44-45.
- 41 *Ibid* at 46.
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- 45 *Ibid*.
- 46 'An enabling regulatory approach aims to permit market players to explore different outsourcing arrangements and products in order to provide an environment in which innovation and growth are encouraged.' David Porteous, 'The Enabling Environment For Mobile Banking In Africa', Department for International Development (2006) at [http://bankablefrontier.com/wp-content/uploads/documents/ee.mobil\\_.banking.report.v3.1.pdf](http://bankablefrontier.com/wp-content/uploads/documents/ee.mobil_.banking.report.v3.1.pdf) quoted in Bukley, Greenacre and Malady, 'The Regulation of Mobile Money In Malawi', 444
- 47 See n 26 at 460-461.
- 48 See n 24 at 83.

# How can banking regulatory law reduce poverty and support economic development?

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## Introduction

Banks are economic powerhouses for every economy. Among other things, they are centres for channelling financial resources from savers to borrowers for various investment purposes. To this effect, banks can be a tool for reducing poverty and supporting economic development. However, it is important to note that banks operate within a legal framework that regulates how they operate. As such, how banks are regulated has a greater bearing on how banks can perform, and this in turn may have an impact on how banks can relate

to economic issues of poverty and economic development.

This essay therefore seeks to relate how banking regulatory law can reduce poverty and support economic development. The first part defines the key concepts of poverty, economic development, banks and banking regulatory law. It then briefly discusses some the roles of banks in an economy. The third section provides a discourse on banking regulatory law, explaining how each type can help reduce poverty and support economic development. Finally, I presents a conclusion to the essay.

## Definitions

### *Poverty*

According to the World Bank,<sup>1</sup> poverty is the deprivation of wellbeing, and comprises many dimensions, which include but are not limited to<sup>2</sup> low incomes, the inability to acquire basic goods and services necessary for survival with dignity, and low levels of health and education. From the foregoing definition, the concept of poverty can be said to be a condition of lacking the basic necessities of life.

### *Economic development*

Economic development is the growth of the standard of living of a country's people from a *low-income* (poor) to a *high-income* (rich) economy.<sup>3</sup> Standard of living usually refers to the economic level of an individual, family or nation. People can measure it by the value of the goods and services produced or used by the individual, family or nation in a period of time.<sup>4</sup>

### *Banks*

A bank is a financial institution engaged in the accepting of deposits of money, the granting of credit (by loan, overdraft, etc) and other transactions such as discounting of bills, dealing in foreign exchange and related functions.<sup>5</sup>

### *Banking regulatory law*

At the heart of banking regulatory law lies the regulation and supervision of banks. Essentially, banking regulatory law can be defined as control over the creation, operation and liquidation of banks.<sup>6</sup>

It is important to note here that poverty and economic development are related. For instance, where there is poverty, there is no improvement in the standard of living of the people and vice versa. It is also important to note that economic development is a broader umbrella for economic growth.<sup>7</sup> This means that economic growth results in economic development. Research has shown that increases in economic growth are significantly related to reductions in poverty.<sup>8</sup> According to research, this is, among other things, achieved by raising the incomes of everyone, including the poor. This essay therefore treats the concepts as inter-connected; that is, by arguing that, where poverty is being reduced, economic development is supported and vice versa.

## The role of banks in an economy

Banks play an important role as an intermediary or go-between in the financial system of an economy.<sup>9</sup> Among other roles that banks play in an economy, the central ones include accepting deposits from savers, providing financial assistance to borrowers or investors in the form of loans on interest, and making profit from the deposits and the loans that they may in turn invest.<sup>10</sup> This is crucial to economic development as it connects those who have surplus to those who have little but are in need of it for business purposes. Inasmuch as the above roles seem promising insofar as poverty reduction and supporting economic development are concerned, the ability of the banks to come into business and to perform the above functions largely depends on the legal environment in which they may or are operating. The discussion therefore turns to the banking regulatory law and how the same can reduce poverty and support economic development.

### *Banking regulatory law and how can it help in reducing poverty and support economic development*

Banking regulatory law aims at creating an environment that ensures that only prudent and reliable banks operate and thereby reduce the risks often associated with banking business.<sup>11</sup> For the purposes of this essay, the following regulations or requirements form the benchmark of banking regulatory law: chartering and entry requirements, market discipline, bank insurance and supervision, specific limitations on banking activities and corporate governance. The discussion of each of these terms will be followed by a discussion on how can it reduce poverty and support economic development.

### *Chartering and entry requirements*

Chartering and entry requirements deal with the criteria that must be met to enter into the banking business.<sup>12</sup> These include the requirement for adequate capitalisation and management, and the convenience and needs of the community (the country), that is, does the economy need another bank? Can it compete? These measures ensure that only competent banks are formed for the benefit of the economy of a country.

When it comes to poverty reduction and

economic development, it should be noted that banks are business entities that operate as companies. The more banks that enter into an economy, the more businesses are created. This will in turn provide employment opportunities, the lack of which is one of the causes of poverty.<sup>13</sup> To this effect, the laws need to be flexible enough so as to ensure that it does not scare away potential investors. The flexibility should enable foreign banks to invest in a country without strict requirements. In South Africa for instance, which is one of the biggest economies in Africa, the Barclays Group holds a majority stake of about 55.5 per cent in the South African ABSA group.<sup>14</sup> This has contributed to the growth of the middle class, which is a sign of improvement in the living standards of people and indicates the reduction of poverty.

Flexibility brings innovation and expansion. One of the ways of encouraging flexibility is through keeping the capital requirement at a reasonable standard. Too much might be difficult to attain; therefore limiting the number of banks that begin or continue to operate. A good example is what happened in Nigeria in 2006: the Governor of the Central Bank of Nigeria (CBN) imposed a higher capital requirement (from 2bn naira to 25bn naira) on the banking organisations through a reform agenda aimed at improving their stability. This instead led to the consolidation of the banking industry, reducing the number of banks from 90 to 25. What followed was a huge number of people laid off, which is counter to economic development. There should be varying scales of capital requirement depending on the financial muscle of a proposed bank so that the law does not discriminate among investors. This will expand business in the economy.

### *Market discipline*

Market discipline essentially entails the ways in which market participants influence a financial institution's behaviour through monitoring its risk profile and financial position.<sup>15</sup> This regulation is based on the premise that anyone (depositors and professional investors) providing funds to a financial institution is an investor. As such, these players need access to and time for processing vital information concerning the banks they deal with. This will help them to assess the risk of depositing and investing with the banks.

The law that deals with disclosure of information by banks is critical when it comes to poverty reduction and supporting economic development. How this is achieved depends on the information available to both depositors and investors. Banking regulatory law must ensure that information concerning banks is easily accessible, easily understood and always available. This is important as it encourages more people to deposit with banks and in turn more funds are available for investment. In this way, savers increase their income from the interest they earn from their savings and the investments they facilitate improve the economy of a country through job creation, infrastructural development and other macroscopic activities.

In addition to the above, if information is readily available to and easily understood by potential savers and investors, it enables them to compare banks and then make well-informed decisions as to which bank is most suitable for their needs. This generates competition among banks. Competition is important in an economic setting. As one author has noted, moving to an advanced economy requires that vigorous local rivalry develop.<sup>16</sup> Rivalry brings about technological improvement, effective service delivery and innovation among the banks as they strive to attract customers. In Malawi, for instance, banks have extended their services to rural communities (in a programme known locally as *bank nkhonde*, meaning 'banks near to the veranda' or 'people') so as to enable local people to make deposits and access bank services such as obtaining loans, which they may use in various economic activities. This is a result of competition among the banks, which came about by how much information is now available to the people. This leads to the overall thriving in productivity of a nation's economy.

### *Bank insurance and supervision*

This requirement is premised on the idea that banks, being the main source of capital markets and the backbone of an economy, cannot operate without being subject to checks. They need to be subjected to strict and thorough examination and to remain connected to other financial institutions to act as rescuers in times of need. This must be done through both institutional and legislative frameworks. Banking crises are frequently attributed to

poor regulatory frameworks. For instance, the Great Economic Depression that took place in the United States from 1929–1933 is partly attributed to what is called the ‘free banking era’, when entry into the banking business was largely uncontrolled and banks were not connected to other financial institutions that could act as lenders of last resort.<sup>17</sup> This devastated both the US and the world’s economy as half of all banks failed. Unemployment rose to 25 per cent and homelessness increased. Housing prices plummeted by 30 per cent, global trade collapsed by 60 per cent and prices fell by ten per cent.<sup>18</sup>

Having seen how crucial banking regulatory law is to an economy insofar as issues of poverty and economic development are concerned, all controlling and supervisory bodies must ensure that banking regulatory laws are always properly enacted, regularly revised and strict enough to put the banks under scrutiny at all times. Proper enactment in this case means laws that reflect and respond to the current and ever-changing issues of the global financial market. The lack of or poor regulatory laws are a recipe for poverty and underdevelopment. Where banks are properly regulated, there is a healthy banking system that sees more jobs being created, living standards raised and the economy expanding. For instance, the Great Depression was ended by what is referred to as the ‘new deal’, which among other things saw the enactment of the Emergency Banking Act, which closed all banks and directed that reopening was based upon recommendations from examiners that a particular bank was financially secure.<sup>19</sup>

Banks are entrusted with people’s money and must make sure that the same is managed prudently. Prudential management and operation can only be achieved when the regulation framework is comprehensive and robust enough, that is, through the operations of regulatory bodies, to ensure a healthy system, which will in turn support the economy through investments and job creation. A healthy banking system will also enable the state to borrow money locally, thereby reducing the pressure and restrictions imposed by the World Bank and the International Monetary Fund as conditions for loans, such as reduction in government expenditure and the cutting of subsidies that negatively affect the poor. The laws should foster the establishment of various regulatory committees other than

the central or federal banks, which are in most cases centralised. The Basel Committee on Banking Supervision is a very good example. In 2001, it made a proposal based on three pillars:<sup>20</sup> improved minimum capital requirement, better supervising practices and market discipline. In the case of Malawi, for example, section 14 of the Banking Act puts all the banks under the supervision of the Reserve Bank of Malawi, which should ensure that banks adopt best practices in the interest of both depositors and lenders with regard to solvency, liquidity and profitability. All these are hoped to ensure prudential management and operation of banks by making sure that only banks that have satisfied these standards have access to the market. More benefits could be accrued if the laws place emphasis on the establishment and operation of more of these bodies.

#### *Specific limitations on banking activities*

This essentially requires that banks, as business entities, must operate within certain confinements beyond which they act *ultra vires*. Limitations include borrowing capacities, lending limits, and interest charges on deposits and loans, among others.

With regard to borrowing capacities, banking regulatory law must ensure that banks have clearly specified limits on how much money they can borrow from other institutions for their operations. Too much borrowing may be dangerous in the sense that, upon a failure to repay, the banks might be forced to wind up a debtor and this will harm depositors and creditors as they may not be able to recover their money. Too little borrowing is also dangerous as the banks may not be able to improve service delivery, which may in turn affect its operations. As such, banking regulatory laws must clearly specify the reasonable standard of borrowing, which must, among other things, be dependent upon the size of the bank, its capital and customer base. This will ensure that banks never become insolvent or underperform. This will ensure that loans continue to be provided by them and jobs are created.

The above also applies to lending limits. The law, depending on the financial muscle of respective banks, must state the limits of lending to avoid the situation of bank run. Banks, through the law, should never have the discretion of lending at the expense of their customers, depositors and investors.

On the issue of interest charges, it is important to note that banks are in a business, hence competition is inevitable. If the rate of interests offered by banks is not regulated, banks may harm one another through banking rates. Banking regulatory law must ensure that loan interests remain affordable and reasonable. Too high interest rates may scare away potential investors. This will reduce investments and employment rates. To avoid this, interest rates must be kept attractive and reasonable to keep both banks and investors in business. This will expand businesses in an economy, which will in the long run reduce poverty and support economic development through jobs and infrastructural improvements.

### Corporate governance

Lastly, banking regulatory law must embody the idea of corporate governance. This is a company law phenomenon that essentially embodies the idea that companies must be properly managed for greater profitability of both the company as an entity on the one hand and its shareholders on the other.

As alluded to earlier, banks operate as companies. As such, they must be subjected to the same requirements of corporate governance. The regulatory laws through various regulatory institutions must make it a strict requirement that banks be managed by people with certain minimum requirements and experiences in the field of finance and banking. Banks are entrusted with people's money and, through their managers, stand in a fiduciary position. One of the fiduciary principles is that the fiduciary must act with care and skill in managing the affairs of the beneficiaries.<sup>21</sup> The only way through which this may be attained is by making it a requirement that certain minimum qualifications must be met before assuming a position in banking business. This will ensure prudent management of the banks, hence reducing the risk of failure. As the beneficiaries of a bank extend to depositors and investors, regulation should not only be the concern of the banks' constitutions but also public law by way of legislation and policy.

Another very important aspect of corporate governance is that of corporate social responsibility. Banking regulatory law must make it a requirement that banks be concerned with the welfare of the communities in which they conduct their business. The law should contain specific requirements that banks be concerned with issues such as the environment, education

and health of the community. They must therefore dedicate funds aimed at these causes, for example, building schools, hospitals and bridges. This will improve people's lives thereby reducing poverty and supporting economic development.

### Conclusion

I conclude by stating that the economies of the world lean on banks as sources of capital. To this effect, any complacency in the regulatory framework will crumble the whole economy by raising poverty levels and dwindling development. To avoid this, banking regulatory laws through various state machinery must create an environment that ensures responsible and prudent banking so that more investments and jobs are created.

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# How can banking regulatory law reduce poverty and support economic development?

## Introduction

After the 2008 financial crisis, which came about as a result of turmoil in the mortgage industry in the United States, the collapse of the financial accounting giant Enron corporation, and an increase in money laundering, financial institutions such as banks are today subjected to more regulations than before. In the US, bank regulators proposed what De Ghengi described as the most drastic overhaul of the financial sector since the 1930s.<sup>1</sup> And Llewellyn has argued that other components are downplayed and marginalised when the emphasis is focused too much on regulation.<sup>2</sup> On the other hand, Llewellyn acknowledges the importance of regulation in maintaining bank stability and in striving toward levels of consumer protection.<sup>3</sup> This essay argues that bank regulatory law should not only be seen in the narrower sense of maintaining bank stability and consumer protection but from a wider perspective of social and economic importance. The paper will show how banking regulatory law can be used to reduce poverty and support economic development. The paper will look at regulatory law concerning the licensing of banks, the governance of banks, the conduct of banks in giving out loans, regulations concerning bank transparency and in credit ratings.

## The concept of poverty

Poverty is difficult to define because the perception of poverty varies. A poor man in Kenya defined poverty by simply asking the interviewer to count the number of holes in his house.<sup>4</sup> In Brazil, at a forum discussing

poverty, one participant defined poverty as low salaries and a lack of jobs, and not having adequate food or clothes.<sup>5</sup> These are examples of how the perception of poverty differs. According to the World Bank, however, poverty can be categorised into two definitions. There is extreme poverty, where people live on less than \$1.90 per day; and there is more moderate poverty, where people live on less than \$3.10 per day.<sup>6</sup> The World Bank estimates that about 700 million people were living in extreme poverty in 2015.<sup>7</sup> What this means is that people are living below a minimum living standard, and do not have sufficient food or access to basic needs. This paper will proceed on this assumption.

## How banking regulatory law can reduce poverty

The issuing of banking licences is one crucial regulatory law that can play a big role in reducing poverty. In many countries, bank licences are issued by the central bank. The regulator will issue a licence upon being satisfied that conditions have been fulfilled by anyone who wants to venture into the banking business. Take India as an example: a licence is issued when, among other conditions, the applicant has shown that there is enough capital to serve the interests of the public. It is highly unlikely that a regulator will issue a licence to an applicant who has not satisfied these conditions. Furthermore, such conditions must be adhered to by the bank because there is constant supervision from the regulator to ensure that standards are maintained. This requiring banks to have

licences has two advantages, which this paper argues may help in the reduction of poverty.

Firstly, a bank that is adhering to its licence obligations serves the public better and to the satisfaction of its customers. Such a bank usually has the ability to attract more customers. More customers typically means more capital for the bank through deposits. The bank can then use this capital to make more investments. This will also mean creating more job opportunities; therefore, what follows is a reduction in poverty as more people have a source of income.

Secondly, when more people are motivated to keep their money in banks because of the good services of banks, the number of unbanked people in a country decreases. Two problems arise when the number of unbanked people in a country is high. First, people resort to keeping their money in their houses. This can create a shortage of money in circulation. As a result, a country may keep on printing more notes, wasting money that could have been used for other developments. Furthermore, where there is a high number of unbanked people, people may resort to depositing their money with unregulated banks. In Malawi, there is a high number of unbanked people; it is estimated for example that only 17 per cent of women have a bank account.<sup>8</sup> The result is that more women have resorted to depositing their money with unregulated banks, locally known as village banks. From this has arisen a high number of cases where such women have been swindled of their money. This has exacerbated poverty among rural women as these banks are illegal and once swindled, there is no compensation for the women.

Therefore, banking regulation that compels banks to have a licence and adhere to the conditions of the licence can reduce poverty in that more people are motivated to use banks allowing banks to gain more capital through deposits, which banks can invest and create more job opportunities. It also helps reduce the number of unbanked people in a country, giving them the opportunity to have access to regulated banks where their money is safe. This helps to reduce poverty in a country.

Money laundering has now become a serious crime, threatening peace and development worldwide. It is estimated that in 2009 criminal proceeds from money laundering amounted to 3.6 per cent of the global gross domestic product (GDP).<sup>9</sup> Seeing that money laundering has become a

serious problem in that it has become a way of sponsoring terrorist groups, the United Nations drew up the 1999 International Convention for the Suppression of Financing of Terrorism. Today, it is a requirement in most countries that banks must monitor all suspicious accounts and report them to security agents. In Malawi, banks report suspicious transactions as little as \$1,400 to the Financial Intelligence Authority.<sup>10</sup> In the US, the Bank Secrecy Act mandates banks to monitor suspicious transactions.<sup>11</sup> Regulation that compels banks to monitor suspicious transactions and block money-laundering activities can reduce poverty in the following ways.

First, terrorist activities disturb world peace and cause instability. Markets react negatively to instability. An example is on 11 September 2001, when markets fell sharply after an attack on the World Trade Centre in New York. Such instability can lead to investors being unwilling to invest their money. This means no new investments, no new jobs being created, etc. The result of all this is global unemployment rates going up. Unemployment not only increases poverty, but also leads to illegal migration, which destabilise families as family members (often men) leave their families in search of financial opportunities.

Furthermore, money that is involved in money laundering is sometimes stolen from government coffers or crime profits. One example comes from Malawi, where K256bn (\$365m) was stolen from government coffers in what is known as 'Cashgate'.<sup>12</sup> This public money would have been used to buy drugs in hospitals, build more schools, etc.

Therefore, regulation that compels banks to monitor suspicious accounts serves two good purposes. Firstly, preventing funding to terrorist groups thereby hampering their activities, creating a more peaceful and stable world that favours markets and may create more investments and job opportunities thus reducing global unemployment. Secondly, making sure that public money which governments may use to alleviate poverty through local projects is not stolen.

Good corporate governance is fundamental to the sustainability of corporate bodies. Cadbury defined corporate governance as a system in which companies are directed and controlled.<sup>13</sup> A bank, as an artificial entity with its own legal obligations, is required to have a set number of directors as prescribed by its Constitution. In India, it is a requirement

that the board of directors of a bank be composed of people with a range of skills and knowledge in topics including law, accounting or agriculture.<sup>14</sup> The directors must run the bank following good principles of corporate governance. It has been argued that the failures of companies like the Maxwell Business Empire, Polly Pack and BCCI in the United Kingdom, Masterboard and Crusader in South Africa, and the famous Enron in the US were all the result of poor governance.<sup>15</sup> This experience shows that poor governance can result in the company's downfall. Where big businesses fail, the losses can affect several entities. The government loses tax returns from such companies, which is revenue that the government would have used to finance projects to benefit local people. The suppliers to those liquidated companies lose business. Above all, people lose employment and this increases poverty. Therefore, banking regulatory laws that aim at promoting good governance can reduce poverty in that good governance will promote sustainability of companies and this will mean no loss of tax returns to governments, sustainability of jobs and business opportunities for suppliers.

Lastly, banks are required to obtain and maintain current credit ratings from the Credit Agency and must disclose it to investors and prospective investors. Banks with good credit ratings are a source of pride to any country. Such banks have the confidence of investors, creditors and consumers. Not only do they attract investors for the country, they also instil confidence in consumers. This encourages consumer spending, which reduces inflation. When inflation is reduced, the central bank may reduce the bank lending rate to commercial banks, and commercial banks can pass on that reduced lending rate to consumers. The result is more customers applying for loans, who are therefore able to obtain mortgages and property. In this way poverty is reduced.

### **How banking regulatory law can support economic development**

The major goal of economic development in its simplest form is to create wealth for a nation.<sup>16</sup> This is measured by the annual increase in GDP.

Reckless lending and a high rate of defaulting loans are a catalyst for ruining economic development in a country. The mortgage industry is an example. The mortgage industry is one entity that, if

ruined, can cause financial instability. In 2007, the fallout of the mortgage industry rocked financial markets in the US. The mortgage meltdown began in the summer of 2007. Bear Stearns had to spend \$3.2bn in June to bail out two of its hedge funds that suffered losses from the collapse of the sub-prime mortgage industry.<sup>17</sup> What followed was a series of crises that sent the mortgage industry into turmoil in the US. It took massive government intervention to bail out the industry. In July 2008, the Housing and Economic Recovery Act authorised the federal authorities to guarantee up to \$300bn over the next 30 years in fixed-rate mortgages for sub-prime borrowers.<sup>18</sup> But despite this government intervention, financial panic worsened to the point that in 2008, the Emergency Economic Stabilization Act was passed, granting the US Treasury to use up to \$700bn to stabilise the financial sector.<sup>19</sup> This experience prompted the Obama administration to promote what is known as the Volcker rule, which aimed at prohibiting banks and bank holding companies from investing in or sponsoring hedge funds and private equity funds.<sup>20</sup> All this shows that banking regulatory laws that deal with restrictions on loans and advances need prudent management. Reckless lending and unsecured loans can ruin the economy of a country and hamper economic growth; by contrast, if the loans and advances are managed properly, they can lead to economic growth, as the mortgage industry allows people to own property – one indicator of economic growth in a country. In India, the regulation does not allow granting of unsecured loans and advances.<sup>21</sup>

Transparency is important in banking. Banking is a business that deals with customers and companies' assets; therefore, consumers must know all the information about their banks. In the US, there is the Truth in Savings Act, where banks update customers about the terms of their deposit accounts.<sup>22</sup> There is also the Truth in Lending Act, which established standard disclosures for consumer creditors nationwide. Also in the US, bank regulators will demand information from banks on their financial health, consumer compliance and fair trading issues.<sup>23</sup> Such information may help consumers and investors to have confidence in their banks. This encourages people to invest in such banks and this may promote local investment, which means more taxes being paid to government and more

development in the country. This increase in the tax base will eventually promote economic development as a country has the resources to grow the economy.

In conclusion, banking regulatory laws are important from both a social and economic perspective. They are not only important in maintaining bank stability and consumer protection but also in reducing poverty and supporting economic growth.

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# How can banking regulatory law reduce poverty and support economic development?

**T**he term ‘bank’ refers to an institution that deals with money and other instruments and provides financial services. Banks accept deposits, make loans and aim to derive a profit from the difference in the interest rates paid and charged respectively. One class of banks is allowed to create money and these we call ‘lenders of last resort’ or central banks.

It is unquestionable that banks have a great role to play in a country’s economy. They are economically significant in that they accept deposits and on-lend it to persons who want it for investment. They serve as financial intermediaries providing sources of funding for investment, which is crucial in increasing production, exports, the creation of jobs and increasing the foreign exchange earnings of a country. Similarly, by lending to customers who need the money for basic consumption, the purchase of basic goods and services, the construction of houses, and education, banks increase demand for those goods and services, encouraging producers and service providers to expand their undertakings and increase production. An expansion in production involves employing additional workers, thereby creating new jobs; and encouraging producers and suppliers of raw materials to increase their own production and supply. Banks also play a positive role in encouraging saving by providing an incentive to save through the payment of interest on deposits and providing safety and security. Saving is also an important source of future investment and hence the improvement of living standards.

Banks operate within specific legal procedures and rules outlined by the government to which they are subject to, so as to function properly for the economic growth of the country. We call these procedures and rules the laws of banking. This essay will try to explain how banking regulatory law can be used to circulate money, fix interest rates, deal with monetary policy and regulate the foreign exchange value of currency in order

that poverty reduction and economic growth may be achieved.

## Circulation of money

Banks invite people to deposit money by promising that they will benefit from the interest paid on the money deposited in saving and other accounts. By providing incentives, they encourage people to deposit their money rather than holding on to it (making the money dysfunctional). The deposited money then becomes a source for lending to those who want funds to invest. This will result in an increase in the production of goods and services, and the creation of new jobs, resulting in increased employment and exports and reduced poverty. Banks are financial intermediaries for money circulation. A good banking system encourages people to deposit their money rather than holding on to it. A banking system and its procedures may either encourage or discourage depositors. It may make the money circulate well or it may block it from circulating. When the money is in circulation, transactions increase and the economy will operate. Money held in the home rather than deposited with the bank will cause the economy to slow down because the money that has to function is blocked and held.

### *Example: Eritrea*

The government of Country A formulated a policy that restricted depositors to withdrawing only \$5000 from their bank account, even if they wanted more. This discouraged them so they decided not to put their money in the bank but rather to hold on to it, saving it at home. The money that existed in circulation in the market was thus hidden somewhere. The banks began to face a shortage in the supply of money. The government printed more currency to meet the shortage. As more and more was printed, inflation became higher and higher and the

economy began to collapse. The price of goods rose until nothing could be bought with the currency. Later, the government made an assessment and formulated another policy that forced business firms to show their real income and deposit it. Hundreds of millions in cash were found buried in homes and the firms were closed until they deposited their money. Production halted for months, employees were out of work and the economy's progress worsened. This is the real case happening in Eritrea currently.

Banking law has to be formulated in such a way that permits money to circulate well.

### Fixing interest rates

The government can use banking law to increase or decrease interest rates when conditions occur that threaten the wellbeing of the economy. Banking law may be implemented to stimulate productivity by charging investors lower interest rates. Charging lower interest rates motivates investors to expand their undertakings and invite new investors. As investment increases, productivity will increase and the government will have a better source of revenue in terms of taxation on income and goods, charges and licence fees. The revenue collected this way will help the government to build social infrastructure and provide vital social services such as water, shelter, food and health centres. It will help those who are underprivileged to access at least the minimum requirements for life. It will help the government to initiate welfare programmes, healthcare systems, free primary education and the like. The increased investment and productivity will yield a higher GDP (an indicator of economic development). An increase in productivity will result in the need to hire new employees, thus creating new jobs, which will cast away the emotional anxiety of those who were previously unemployed. Unemployment is one of the greatest causes of poverty and victims of poverty often suffer from poor nutrition, inadequate medical care and emotional anxiety. In this case, lowering the interest rate results in reduced unemployment and higher productivity.

The government can fight poverty using three weapons: (1) lowering the interest rate to improve job opportunities, (2) educational programmes and (3) welfare programmes.

In cases of uncontrolled inflation, where prices are rising at high speed and the value of money is falling precipitously, banking

law can be utilised to raise interest rates so as to reduce (limit) the amount of money that banks have to lend investors. This, in turn, decreases the money supply in the economy so prices will be lowered.

### Monetary policy

The issue of monetary policy is closely related to inflation, where a surplus supply of money is available in the economy, and deflation, where by contrast there is a deficit in the supply of money. Monetary policy refers to actions taken by a central bank (eg, the Federal Reserve Bank in the United States) to control the money supply.<sup>1</sup> In cases of a deficit in the money supply, banks tend to increase the interest rates, which in turn demotivates new investments. In this case, the government should implement the laws of banking to make more money available to the banks, which will lower the interest rates. 'To increase the total number of jobs in the economy, the government makes more money available, lowers interest rates'.<sup>2</sup> This will invite new requests to the banks for money from those who want to invest. This will result in increased productivity and creation of new jobs. The government may also print currency in accordance with the laws of banking when the money supply is not enough to support an expanding economy resulting from increased investment and a lowered interest rate in the first place. Increased money supply will not only increase productivity, but will also raise the price, which in turn can cause inflation. Here, the government needs to take quick action, otherwise inflation will contribute to poverty by reducing the amount of goods that a given amount of money can buy.

Generally, the government should make more money available to the banking system to lend at low interest rates when needed, and reduce funds available when money is in excess supply by buying or selling bonds.<sup>3</sup> It is important to note that monetary policy is one mechanism by which the government can achieve the objective of economic growth.<sup>4</sup>

### Foreign exchange

Banking regulatory law can be used to devalue the currency to make domestic products cheaper than imported goods. Devaluation is a measure that a government may take to reduce the value of its currency in terms of foreign currencies.<sup>5</sup> This is specifically useful for improving exports

by making exported goods less expensive to foreigners and thereby improving productivity domestically. Proportionally, it is used to make imported goods more expensive to domestic residents and thereby encourage them to buy domestic products. Countries use the devaluation mechanism to increase domestic productivity, create new jobs, tackle deficits in their balance of payments and in an insufficiency of their international reserves, and to eradicate poverty domestically. If an economy exports fewer goods than the goods it imports, it is generally in a downturn. Economists agree that economic downturns are a leading cause of poverty.

## Conclusion

To conclude, though poverty reduction and economic development are the results of the interplay between many factors, banking regulatory law has a big role in realising these objectives, particularly when used properly in managing money circulation, fixing interest rates, dealing with monetary policy and setting the foreign exchange value of the currency.

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# How can banking regulatory law reduce poverty and support economic development?

## Introduction

Internationally, banks and banking practices play a major role in the development of a nation. Banking transformed the world economy by introducing a safe means for keeping, lending and exchanging money in the marketplace by moneylenders and moneychangers. However, with the growth of banking and advancements in technology, there have been concerns over the ability of bank creditors to monitor the risks originating on the lending side and from micro and macroeconomic concerns over the stability of the banking system in the case of a bank crisis.<sup>1</sup> States have made efforts to secure, manage and monitor these risks by introducing measures like regulatory and institutional frameworks. For example, Tanzania has made reforms in its financial sector by dismantling the state-dominated banking sector and allowing foreign entries into the banking industry. This has resulted in the mobilisation of significant financial resources and increased competition in the financial services market. It has also enhanced the quality and efficiency of credit allocation.

By 2000, the reforms had led to an expanded branch network, scope of operations and an increased number of banking and financial institutions<sup>2</sup> (see the Framework on Financial Inclusion in Tanzania<sup>3</sup>).

This essay addresses the question of how banking regulatory laws can foster economic development and reduce poverty. The essay's focus is Tanzania.

## Conceptualisation

### Banks

According to *Business Dictionary*,<sup>4</sup> a bank is an establishment authorised by a government to accept deposits, pay interest, clear cheques, make loans, act as an intermediary in financial transactions and provide other financial services to its customers.

A bank is also defined under Section 3 of the Bank of Tanzania Act<sup>5</sup> to mean an entity that is engaged in the banking business. 'Banking business' is defined as the business of receiving funds from the general public through the acceptance of deposits payable upon demand, after a fixed period or after

notice, or any similar operation through the frequent sale or placement of bonds, certificates, notes or other securities, and to use such funds, in whole or in part, for loans or investments for the account of, and at the risk of, the person doing such business.

Therefore, a bank is a legally established entity that trades and invests in money. It accepts credits from depositors repayable upon demand and lends them to borrowers for interest for a specified period of time or through the placement of securities. In Tanzania, banks accept deposits from creditors and lend the same to customers. The security most used is the house mortgage.

### *Banking regulatory laws*

According to one source,<sup>6</sup> banking regulatory law is the form of government regulations that subject banks to requirements, restrictions and guidelines designed to create market transparency between banking institutions and the individuals and corporations with whom they conduct business, among other things. Hence, banking regulatory laws are general legal frameworks that govern or regulate the banking system of a particular country. Banking regulatory laws can be both a legal framework and an institutional framework. Given the interconnectedness of the banking industry and the reliance the economy has on banks, it is important for regulatory institutions to maintain control over the standardised practices of banking institutions. In Tanzania, for instance, the Bank of Tanzania (BOT) is the regulatory and licencing authority that oversees and supervises banks and other financial institutions. As for the legal framework, there exists the Bank of Tanzania Act GN. No 4 of 2006, the Banking and Financial Institutions Act of 2006 and the Companies Act Cap 212 of 2002, as well as the regulations and rules made thereunder as banking regulatory laws. Also, other banking regulatory laws are stated at page 774 of the review on Tanzania's banking regulations by Wilbert B Kapinga and others.<sup>7</sup>

### *Poverty*

According to the Overseas Development Institute in 2009,<sup>8</sup> poverty is a sense of helplessness, dependence and lack of opportunities, self-confidence and self-respect

on the part of the poor. Indeed, the poor see powerlessness and voicelessness as key aspects of poverty (Narayan et al, 2000). From this definition, an inference is that poverty is a severe situation whereby an individual, community or state becomes unable to sustain its basic needs. It is a concept that implies an inability to enjoy a decent living standard as people or nations fail to address challenges like food security, education, good sanitation, safe water, etc. For example, in Tanzania, based on the World Bank's 2012 estimates, more than one third of households live below the basic needs poverty line, earning less than \$1 a day, while 20 per cent of the total population live below the food poverty line. The rural communities of Mainland Tanzania and Zanzibar are mostly affected, making it impossible for many to sustain basic needs including, food, shelter, water, etc.

According to the World Bank's estimates of October 2017, Tanzania's poverty rate fell from 60 per cent in 2007 to an estimated 47 per cent in 2016, based on the \$1.90 per day global (extreme) poverty line. About 12 million Tanzanians still live in extreme poverty on earnings of less than \$0.60 per day. Many others live just above the poverty line and risk falling back into extreme poverty in the event of socio-economic shocks.

### *Development*

Development has been defined by the United Nations Development Programme (UNDP)<sup>9</sup> to mean a process of enlarging people's choices, allowing people to lead a long and healthy life, be educated, enjoy a decent standard of living 'as well as political freedom, other guaranteed human rights and various ingredients of self-respect'. Development is concerned with expanding the choices that people have, in order for them to lead lives that they value, and improving the human condition so that people have the chance to lead full lives.<sup>10</sup> Therefore, from my own perspective, development entails a person's or a nation's ability to sustain their own needs. Individuals can take charge of their own happiness and freedom, and make the most of it politically, socially, economically and scientifically, when they are not limited in terms of finance.

Development widens the distribution of goods and services that underprivileged people need. At the centre of development as a principle is the idea of investing in people with the most basic capacities, so that they can lead long and healthy lives, be knowledgeable, have

access to resources and social services needed for a decent standard of living, and be able to participate in the life of the community. Without these, many choices are simply not available, and many opportunities in life remain inaccessible.<sup>11</sup>

### **Aims and objectives of banking regulatory law**

Banking regulatory laws normally aim at prudentially and reasonably minimising the risks that both banks and customers are exposed to in the course of conducting the banking business, and avoiding misuses of banking like money laundering, conspiracy to corruption, abuse of power and fraudulent transactions.

Banking regulatory laws further aim at monitoring and enforcing compliance measures that facilitate legal banking operations. For example, in Tanzania, we have the Companies Act Cap 212, which requires companies to file their annual returns and declare before the Registrar of Companies any changes that happen to a concerned company, including bankruptcy and windings up. We also have business licensing laws that require banks to obtain licences and special permits from the respective authority before commencing business. And there is tax law, which requires banks and other financial sectors to obtain a Tax Payer's Identification number (TIN) and VAT certificate. From a prudential point of view, all these restrictions and requirements aim at monitoring and enforcing compliance with procedures by banks and other financial institutions.

Furthermore, banking laws aim at supervising and regulating financial institutions. This is provided for under Section 5 of the Banking and Financial Institutions Act of 2006, read together with the BOT Act. The supervision and regulation of banks and financial institutions helps to maintain the stability, safety and soundness of the greater financial system and to reduce the risk of losses to depositors. This also helps to improve public investment management to ensure efficient use of public resources and consequentially effects economic development.<sup>12</sup>

According to Wilbert B Kapinga,<sup>13</sup> banking regulatory laws aims at: (a) allowing only those institutions that are financially viable to operate in the market; (b) controlling excessive risk-taking through management of

banks; (c) allowing (in Tanzania) the Bank of Tanzania to establish appropriate controls and monitoring mechanisms over banks' affairs; (d) giving (in Tanzania) the Bank of Tanzania interventionist and enforcement powers over troubled banks; (e) protecting only small depositors in cases of bank failures; and (f) establishing appropriate rescue and exit means under the mandate of (in Tanzania) the Bank of Tanzania.

### **How can banking regulatory law reduce poverty and support economic development?**

As aforementioned, this essay aims to address how banking regulatory laws can help reduce poverty and support economic development. It is my view that the legal and financial sectors are vital to any society as they significantly contribute to the development of the economy through the facilitation of economic projects and other human undertakings. A well-regulated banking institution factors into the economy of a country. Below are the roles that banking laws play in poverty reduction and economic development.

#### *Banking laws provide a window for safe and advanced custody of money*

Banking regulatory laws provide a safe and reliable means of storing money as they establish banks and other financial institutions and regulate banking affairs. With well-regulated laws governing the financial sector, a person's money is stored in a safe and reliable place under specified terms between the banker and the customer. When the customer needs to have the money back, the requested amount is debited from their account. The customer can use this money to start a business, buy products for human consumption, build a house, make investments, enjoy vacations and access the education he or she wants. With the best means of storing money, a customer is also able to plan his or her financial affairs, hence can move out of poverty and develop economically.

In his article, titled 'The Roles of Banks in the Economy', Sanderson Abel<sup>14</sup> is of the view that:

'When you deposit your money in the bank, your money goes into a big pool along with everyone else's, and your account is credited with the amount of your deposit. The role of the bank is to provide a safe place to keep your money and sometimes the opportunity

to earn interest on your deposits.’ In line with Sanderson’s contention, it is my well-considered argument that through banking an individual’s finances are boosted, as storing cash through a well-regulated bank assists with saving and later enlarges an individual’s choices, without which many things would not be possible.

***Banking laws facilitate the fair distribution of financial assets***

Banking regulatory laws facilitate the fair distribution of financial assets. This is through the promotion of business opportunities to customers by providing them with fair access to bank loans at small, reasonable (sometimes zero) interest rates, particularly for small and medium-sized enterprises. This means that banks invest in the private sector, especially supporting entrepreneurship, hence standardising both their economy and that of the nation.

Addressing the role of the Tanzania Postal Bank (TPB) in Tanzania, Professor Lettice Rutashobya<sup>15</sup> contends that, with new bank branches, customers will be able to access bank loans, particularly for small and medium-sized enterprises (SME). It is an opportunity for customers to benefit from the TPB’s services to establish and expand their businesses, which could lead to improved living standards.

Furthermore, while describing the role of banks in the economy, Sanderson<sup>16</sup> states that: ‘Credit fuels economic activity by allowing businesses to invest beyond their cash on hand, households to purchase homes without saving the entire cost in advance, and governments to smooth out their spending by mitigating the cyclical pattern of tax revenues and to invest in infrastructure projects... The banks make available loans of different periods to agriculture, industry and trade. They make direct investments in industrial sectors. They provide industrial, agricultural and commercial consultancy hence facilitating the process of economic development.’

Standing in support of this contention, I believe that laws regulating banking activities play a major role in economic development and poverty reduction, as they facilitate and provide easy access to financial resources to be invested in human development and therefore assist in poverty reduction and support economic development.

***Banking regulatory laws help in the management of banking-associated risks***

It is the world’s reality that, with advanced technology and human evils, banks and financial institutions together with their customers are exposed to so many risks including those of money laundering, fraud, conspiracy to corruption and other banking offences. Also, banks are exposed to the risk of undergoing bankruptcy due to having undetected fraudulent borrowers and cyber-crimes, just to mention few. Now, with banking regulatory laws in place, these risks are managed to the highest standards. For example, in Tanzania we have the Cyber Crime Act, the Bank of Tanzania Act, the Economic and Organized Crime Controls Act and so many others that are there to assist in the management of banking transactions. In the case of any acts done in contravention of these laws, there is a means to capture the criminals and bring them to trial and sanctions. Also, we have the Land Laws and Mortgage Financing Act, which plays a significant role in the banking mortgage system hence reducing risks of financial crises at the individual and bank level. Sanderson<sup>17</sup> further states in his article that banks allow businesses and households to pool their risks from exposures to financial and commodity markets through derivatives instruments transactions. By derivatives instruments transactions, he is referring to the well-managed and regulated banking transactions that allows businesses and households to pool their financial risks hence promoting economic development.

***Banking laws form a foundation for community support***

Banking laws and regulations play another significant role in our communities by providing the centre point for community support. This is argued on the grounds that banking regulations require banks and other financial institutions to promote community wellbeing by directly providing support to communities, ranging from education, health, games and sports, entrepreneurships and other infrastructural supports. Through this, communities are able to access support that in turn becomes an opportunity in changing their living standard for the better and finally developing the economy. For example, CRDB Bank and NMB Bank are the two fastest-growing banks in Tanzania. In order to give back to the community, they now engage in

community work in the country. NMB Bank, being a bank that supports growth, is well positioned to utilise the market opportunities in agribusiness by focusing on value chains for different crops. They offer financial assistance to individual farmers and corporate bodies and make continuous investments in sector knowledge, products and partnerships with key stakeholders. NMB Bank's Agribusiness Department provides further loan facilities together with the Food and Agribusiness Research and Advisory Services (FAR).<sup>18</sup> All these bodies support poverty reduction in so many ways while assisting in developing national economy.

***Regulated banks provide for the easy transfer of money and the ability to make transactions with no need of cash***

Through regulated banks, cash can easily be transferred from one bank to another and from one place to another. The laws that regulate these banks transactions make sure that customers are receiving financial services without undue delays and via secure sources. For example, in Tanzania, banks like CRDB Bank and NMB Bank, in partnership with telecom companies like Tigo, Airtel and Vodacom, offer a mobile banking service used to transfer money from one source to another. This has been helpful to many Tanzanians, as now one can easily shop or pay for various services without necessarily having cash, hence reducing the risk of being robbed. This, in turn, has expanded the internal and external trade market, thus boosting the economy at the individual and national level.

***Banking regulatory laws facilitate the growth of microfinance institutions***

With the help of banks and banking law, a number of new financial institutions have emerged. These institutions have been able to protect the community, and in particular, households, against any unexpected need for cash. They are at the core of the financial market, offering to buy and sell securities and related products as needed, in large volumes, and with relatively modest transaction costs. In Tanzania, for example, currently there are fast-growing microfinance platforms including VICOPA, SACCOSS, VIBATI and many others, which are all regulated by the by-laws made in compliance with the banking and financial laws. Just recently, one refinance

company, Tanzania Mortgage Refinance Company Ltd (TMRC), financed surgery for four children at the Jakaya Kikwete Cardiac Institute.<sup>19</sup> 'Restoring good health to these children was of paramount importance and the same constitute restoration and maintenance of future generation for our country,' said Mr Osca Mgaya.<sup>20</sup>

***Banking regulatory laws promote transparency and good governance***

Undertaking major investments like banking business needs strong management to ensure projects are well planned, managed and executed. Banking regulatory laws not only ensure that people's money is in safe custody, but also encourage accountability, transparency and good governance in the financial sector, hence leading to poverty reduction and economic development.

***Banking regulatory laws facilitate the creation of employment opportunities***

With banking regulatory laws, more banks have been established. These banks create jobs and employment opportunities. In Tanzania, for example, there are more than 45 banks. They need manpower to conduct their business. Through employment, people boost their economy while contributing to the growth of their nation through their expertise and tax payments.

**Conclusion**

A regulated financial sector holds an outstanding role in the development of a nation's economy. Practical examples are seen in the world's economies, where investors can approach banks and other financial institutions with empty hands but bright business proposals, and leave with millions of dollars either in cash or credited in their banks. In countries poor or rich, it is unimaginable for the economy to grow without the role of banks. In the words of the Hon J M Kikwete, former President of Tanzania: 'A weak financial sector means a weak economy and an unstable financial sector means an ailing economy. It is for this reason that all governments in the world attach particular importance to the financial sector. We in Tanzania have been doing the same by making policy interventions and taking other measures in order to promote stability and growth of the financial sector.'<sup>21</sup>

Notes

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- 13 See n 2 above.
- 14 Sanderson Abel, 'Role of Banks in the Economy' (October 2013) [www.herald.co.zw/role-of-banks-in-the-economy](http://www.herald.co.zw/role-of-banks-in-the-economy). Sanderson Abel is an economist. He writes in his capacity as Senior Economist for the Bankers Association of Zimbabwe.
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- 16 See n 14 above.
- 17 *Ibid.*
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- 20 *Ibid.*
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# How can banking regulatory law reduce poverty and support economic development?

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## Introduction

This essay deals with the question of how banking regulatory law can reduce poverty and support economic development. The essay begins by providing an understanding of the key phrases of the question, which appertain to banking regulatory law, poverty reduction and economic development. Second, the essay will address the relationship between banking regulatory law, poverty and the economy, and the role of banking regulatory law in reducing poverty and supporting economic development. Finally, the findings of the essay will be addressed.

## Definitions

A bank is a financial institution licensed by its government and operated by accepting deposits and making loans. Banks borrow from individuals, business financial institutions and governments with surplus funds (saving).<sup>1</sup>

Banking regulation is a form of government regulation that subjects banks to certain requirements, restrictions and guidelines designed to create market transparency between banking institutions and the individuals and corporations with whom they conduct business, among other things.<sup>2</sup> Regulations vary widely between jurisdictions, and can include regulations on licensing and supervision, minimum capital and reserve requirements, market discipline, financial reporting, restrictions on large exposures, and activity and affiliation restrictions.

Poverty (the other axis of this essay) is a multi-dimensional and cross-sectoral phenomenon. To facilitate a comparative analysis of the different poverty profiles across the world, a standard definition of poverty has been adopted that is based on daily consumption. This definition means that to be considered as 'poor', an individual's daily consumption is less than \$1.<sup>3</sup>

On the other hand, poverty is categorised as absolute or relative poverty. Absolute

poverty reflects the state of having limited resources to fulfill even basic needs like food, shelter, clothing, health or education. A person who has limited resources to fulfill these needs is poor in absolute terms. Relative poverty identifies poor households as those whose income falls significantly below the average level of income in the economy. In developed countries, this approach is the best approach to identifying the poor.<sup>4</sup>

The corollary concept of economic development may be understood as an increase in self-esteem needs and freedom from oppression, as well as a greater choice. Poor economic development would therefore refer to a decrease in the standard of living in a given country.<sup>5</sup>

Likewise, some scholars define economic development as improvements in material welfare, especially for persons with the lowest incomes, and the eradication of mass poverty with its correlates of illiteracy, disease and early death.<sup>6</sup>

### Objectives of banking regulatory laws

Banking regulations in developed market countries have generally been used to pursue the following five objectives:<sup>7</sup>

- First, they have been used to achieve monetary policy objectives. The governments and central banks in these countries have often formulated monetary policy as one of their major economic policies and transmitted it through the instruments of financial regulation.
- Second, they have been used to ensure the health, stability and efficiency of financial markets. The banks, insurers and other financial institutions have been at the heart of the economic system because of their risk sharing, liquidity provision, information processing and payment facilitation services.
- Third, they have been used to promote competition.
- Fourth, they have been used to protect investors, consumers, the public and the economy from the dangers of market failure. Social and economic policy requires that investors, consumers, the public and the economy are protected from misunderstanding, fraud, information asymmetry, bounded rationality, transaction costs, monopoly, cartelisation and loss of savings due to failure of financial institutions.
- Lastly, they have been used to promote

miscellaneous economic and social policy objectives.<sup>8</sup>

### The relationships between banking regulatory law, economic development and poverty

Banking regulatory law, economic development and poverty are intertwined in many ways. Banking regulatory law has an important link with the economic development of a state. By contrast, poverty, by its nature, either directly or indirectly negatively affects economic development. Economic development is necessary for a sustained and widespread reduction in poverty.<sup>9</sup> Thus, banking regulatory law has a significant effect on economic development and poverty reduction, showcasing their interdependence.

There is a longstanding tradition in economics regarding the relationship between financial development and economic growth, that is, the connection between a country's financial superstructure and its real infrastructure. Economists argue that the former 'accelerates economic growth and improves economic performance to the extent that it facilitates the migration of funds to the best user i.e. to the place in the economic system where the funds will yield the highest social return'.<sup>10</sup>

Yet, economic growth and development have substantial differences. The notion of economic development is wider than economic growth. Economic development is unthinkable without economic growth, because growth is a pre-condition to economic development.

Furthermore, banks have a lot of significance in the economy in general. To understand the role of banks in the economy, imagine a world without banking institutions, and then ask a few questions. If there were no banks, where would you go to borrow money? What would you do with your savings? Would you be able to borrow (or save) as much as you need, when you need it, in a form that would be convenient for you? What risks might you face as a saver (or borrower)?<sup>11</sup> Thus, financial institutions in general and banks in particular have different functions and importance. Their functions can be categorised into five areas: saving mobilization, risk management, acquiring information about investment opportunities, monitoring borrowers and exerting corporate control, and facilitating the exchange of goods and services.<sup>12</sup> These are all major

classifications of financial institutions, particularly banks' functions. They have their own pros and cons in terms of the economy and poverty-reducing activities, which shows their intertwined nature.

### How can banking regulatory laws support economic development and reduce poverty?

Different studies conclude that the development of financial intermediaries (in our case, banks are categorised as a financial intermediaries) exerts a statistically significant and economically large impact on a country's economic development.<sup>13</sup> Additional evidence of the link between financial development and economic performance is found in the adverse impact that financial crises and systemic instability have on the real economy. For instance, the total cost of the 59 banking crises in developing countries from 1976 to 1996 – that is, before the East Asia financial crisis – was estimated to be \$250bn, an average of almost ten per cent of global GDP. For the East Asian crisis countries, estimates are in the range 20-55 per cent of GDP. The contraction of credit and general deterioration in financial services in turn have an adverse effect on investment and on economic growth in the long run.<sup>14</sup> For instance, banking regulatory law regulates the accessibility of loans. 'The assumption that improved access to credit will reduce poverty has seldom been tested, with the fact that small loans are being made is taken as proof that the poor are being reached and the fact that loans are being repaid as proof that incomes have increased'.<sup>15</sup>

A growing body of theoretical and empirical research has confirmed the view that the development of financial markets and institutions is a critical part of the economic development process. The financial system is the 'brain' of the economy, performing the function of allocating resources across space and time in an environment of uncertainty. These financial functions of mobilising savings, allocating resources and facilitating risk management contribute to economic development by supporting capital accumulation and technological innovation.<sup>16</sup>

Economic development is essential for poverty reduction. Nevertheless, policy intervention is needed if economic development is to deliver increased income and improved economic security to the poor. The link between financial sector development and economic development will

be affected by the efficiency of the financial sector's support to capital accumulation and technological innovation.<sup>17</sup>

Banking regulation has other objectives too: it also helps to protect the depositor by reducing the risks the customer is exposed to, to guide the activities of banks, reduce the risk of banks being used for criminal purposes, maintain their good relationship with customers, regulate bank confidentiality and so on.

### *Restrictions on pricing and interest rates*

In addition, banking regulatory law signifies restrictions on pricing (interest rate controls and controls on prices or fees). Interest rates and the customer's willingness to make deposits have a direct and positive interrelationship. When the interest rate paid by the bank is higher, the motivation of depositors to save their money in the bank increases. This also results in the bank's deposits increasing which enables investment by investors who borrow the bank's funds. This expansion of investment often results in the improvement of employment opportunities. Employment and economic growth also have a supportive relationship. On the other hand, a successful strategy of poverty reduction must at its core have measures to promote rapid and sustained economic growth.

Further, depositors also become beneficiaries through the interest rates paid by banks. When increases in interest rates are negatively affected, this discourages people from participating in domestic investment (particularly small investments introduced and operated by minimum amounts of capital); rather, people are interested and eager to deposit their money with banks and collect the interest paid.

In both lines of arguments, interest rate regulatory law affects the flow of cash, either deposited or invested, and this regulatory law can affect the economic development of the state and make its own contribution to poverty reduction. As we understand from their definitions, economic growth and development and poverty have an inverse relationship. Thus, when banking regulatory law affects economic development, it's clear that it will have either a positive or adverse effect on poverty. In other words, the increment of interest rates on the one hand results in people become eager to save money (ie, develop saving culture). In this

instance, investment ultimately expands by investors who borrow from banks. Hence, the expansion of investment results in economic growth and reduced poverty. Lowering interest rates charged encourages people to spend their money on investments rather than depositing it. Small investments by themselves introduce economic growth and reduce poverty. Therefore, in both lines of argument, banking regulatory law is an important means of reducing poverty and supporting economic growth.

#### *Reducing risk for the customer*

Banks make transactions possible that couldn't otherwise have been achieved, or that would only have been possible with huge risks. Although savers can generally withdraw their savings at any time, the total amount of money held by a bank doesn't fluctuate much because they have many customers. This scale helps banks to cover risks. Risks such as a borrower not being able to repay are reduced through diversification, meaning that banks can spread risks over various countries and industries.<sup>18</sup> Thus, banking regulatory law directly affects the banks' role in minimising risks for costumers. For instance, banking regulatory law may limit the extent to which banks can attach the properties of the borrower as a security on a loan. It also directly influences the banks' role related to minimizing risks.

#### *Restrictions on branches and new entry*

The poor in developing countries often do not have access to ongoing, formal financial services, and are forced to rely instead on a narrow range of sometimes risky and expensive informal services.<sup>19</sup> Those informal services can set economic development back and can deepen poverty as borrowers rely on their services. Banking regulatory law helps to restrict bank branches and new entries. The expansion of the banking sector typically results in wider access to financial services and provides the benefit of bank services such as transfer of risk from depositor to banker, available access to borrow, the benefits of interest earned, and a better option to the informal sector.

Likewise, it has additional restrictions on the portfolio of assets that banks can hold (such as requirements to hold certain types of securities or requirements not to

hold other types, including requirements regarding direct credit to favoured sectors or enterprises, and other rules affecting cooperation within the banking sector (eg, with respect to payment systems) etc).<sup>20</sup> The most important rationale for regulation in banking is to address concerns over the safety and stability of financial institutions, the financial sector as a whole, and the payments system in particular.

In earlier times, the economic literature has stated that financial sector development and economic growth had an indirect relationship. But this assumption has been replaced by a contrary view, which is that financial sector development has a direct link to economic growth and, further, poverty reduction.

#### *Liberalisation of banking*

Financial liberalisation in general and the liberalisation of banking in particular is another factor affected by banking regulatory law, which ultimately contributes to economic development and poverty reduction. Financial liberalisation, widely adopted by developing countries in the 1980s, was intended to expand the financial sector and improve access to credit for previously marginalised borrowers and savers.<sup>21</sup> There is another argument for bank liberalisation, in that it improves the accessibility of the banks, interest rates on saving, investment and growth. Growth also leads to economic development and poverty reduction. Bank liberalisation leads to economic growth and ultimately results in economic development and poverty reduction. Banking liberalisation is facilitated by banking regulatory law. The theoretical underpinning for banking liberalisation emphasises the influence of real interest rates on savings, investment and growth. And finally growth leads to development. However, there is a counterargument against the liberalisation of banks: financial liberalisation has led to an increase in financial fragility and systemic crises in developing countries' financial sectors.<sup>22</sup> Nonetheless, in my opinion the former argument is to be preferred. This is because bank liberalisation promotes positive competition and enhances the quality and quantity of banking services. Also, it generally signifies the introduction and development of investments, and finally, supports economic development and poverty reduction.

### Increased competition

Banking regulation is also understood to be a tool designed to control and prohibit anticompetitive practices and tendencies that might stifle competition. The competition mechanism has been useful to avoid the dominance of a few financial institutions over the economy, control the loss of impartiality in the allocation of resources, stimulate economic restructuring, increase resource mobility, flexibility, efficiency and innovation, cut costs, control destructive behaviours and governance problems, and increase consumer welfare.<sup>23</sup> Generally, the objective of competition laws is to maintain and enhance market competition by addressing 'restrictive business practices and regulat[ing] market structures that significantly lessen competition'.<sup>24</sup> When lawful competition develops, an upgrading of the state economy undoubtedly follows. Economic stimulation results in economic development.

### Conclusion

From the discussion above, it can be seen that banking regulatory law significantly contributes to supporting economic development and poverty reduction. Banking regulatory law determines the conduct of banks. As established earlier, banking regulatory law has an important link to the stable economic development of a state. This is achieved through risk management, promoting investment, determining pricing, interest rates, branches and new entries, liberalising the banking sectors, promoting competition and so on. Furthermore, economic development is necessary for a sustained and widespread reduction in poverty. As a result, banking regulatory law by different means supports development and reduces poverty.

### Notes

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- 12 Department for Financial Development, *The Importance of Financial Sector Development for Growth and Poverty Reduction*, (2004) Policy Division Working Paper, p 7.
- 13 See n 10 above at p 366.
- 14 *Ibid* at p 367.
- 15 *Ibid* at p 365.
- 16 *Ibid.*
- 17 *Ibid.*
- 18 See n 1 above.
- 19 International Competition Network Antitrust Enforcement in Regulated Sectors SUBGROUP 1 (2005), *An Increasing Role For Competition In The Regulation Of Banks*, p 2.
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- 24 CUTS Centre for Competition, Investment & Economic Regulation and DFID, *Pulling Up Our Socks: A Study of Competition Regimes of Seven Developing Countries of Africa and Asia under the 7-Up Project* (2003).

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# How can banking regulatory law reduce poverty and support economic development?

**T**he interconnectedness of the banking industry and a country's economic development accounts for every government's efforts to keep the country's financial system in close check. The level of national economic dependence on this industry at times justifies government bailouts in cases of financial crisis because the collapse of the banking industry not only has the potential to bring both national economic growth and development to a halt, but may also culminate in unprecedented increases in poverty levels.<sup>1</sup> Building on this premise, this essay seeks to explore the approaches through which banking regulatory laws can reduce poverty and support economic development. The discussion in this essay commences by attempting to define key terms: banking regulatory laws, economic development and poverty. The essay then provides a detailed analysis of the role of the banking industry in economic development and poverty reduction. Particular emphasis will be placed on the impact of banking regulatory laws on both economic development and poverty reduction. Finally, a conclusion will be provided.

A fundamental goal of most governments is to ensure that its efforts in all the sectors of the economy translate into improved wellbeing of the country's citizens. Most governments achieve this by implementing effective fiscal and economic policies and by regulating financial institutions, trade and tax policies with the intent of providing an impetus for economic growth and accelerating economic development. Though closely linked, economists understand economic growth and economic development as different concepts. While economic growth is more concerned with the expansion of the country's total production and wealth, which translates as increased aggregate output value, economic development is understood as the increase in citizens' quality of life, usually measured using a human development index<sup>2</sup> such as life expectancy, literacy rates and the reduction of poverty levels.

To achieve meaningful economic growth, which in most cases results in economic development, governments make efforts to industrialise their economies, for example by embracing new farming technology, to improve the flow of money, for example by developing more efficient financial systems, and to ensure that their market systems are efficient for effective trade both at micro and macro-economic levels. For all this to be achieved, there must be a well-developed financial sector that supports the economy. The banking industry is the main component of the country's financial superstructure and it plays a decisive role in the development of industry and trade in a country.<sup>3</sup> Most economists contend that the banking industry is the main catalyst of economic growth and that its role in reducing poverty can by no means be underestimated. They premise their argument on the fact that the banking industry removes the deficiency of capital, which is a main barrier to investment, and facilitates the migration of funds to that of the best user in the economic system where the funds will yield the highest social returns.<sup>4</sup> The capital the bank forms through the mobilisation of its deposits is channelled to productive investments through the disbursement of loans. With these loans, industrialists acquire new technology, farming is mechanised and traders expand their business. This results in increased productivity, which is good for economic development as the country's aggregate income thereby increases.

In most developing countries, however, economic growth or increased GDP fails to result in an increased quality of life if the country's economic system neglects the rural masses who form a huge percentage of the total population. The banking industry, by contrast, through its network of branch banking, is able to transform rural merchants engaged in small-scale business into significant players in the economic system of a country.

The proponents of a pro-poor financial development approach contend that the widening of access to credit is an appropriate step towards poverty reduction. It is, however, difficult to come up with a crosscutting definition of poverty due to the economic variations globally. According to the United Nations, one is said to be in absolute (or extreme) poverty if he or she survives on less than \$1 per day.<sup>5</sup> Economic growth and financial development can help bring most people out of the poverty cycle. Banks help companies to expand and create more jobs for the people. The loans that traders obtain help to strengthen their financial muscle and buying power.

An industry of economic significance cannot run without supervision. As mentioned above, most economists are in agreement about the impact of the banking industry on economic development and poverty reduction. They substantially agree that a country with well-developed financial systems is more likely to experience positive changes in its economy. However, if the banking industry indeed provides a stimulus for economic development and poverty reduction, as argued by most economists, why is poverty still on the high side in most developing countries and transition economies? Why do economies struggle when both commercial and development banks have been in existence for decades? Perhaps the response lies in the management of the national financial systems as discussed below.

### **The role of banking regulatory laws in poverty reduction and economic development**

The significant economic functions banks perform and the implications for a country's financial stability result in the banking industry being heavily regulated. Banking regulatory laws are requirements, restrictions and guidelines which regulatory agencies subject banks to in order to maintain control over the standardised practices of the financial institutions.<sup>6</sup> The idea of regulating the banking industry is premised on the 'too big to fail' notion. The failure of a bank may in a short span of time cripple an entire economy. Poverty levels may increase since a number of industries and investors could go out of business. There are two main justifications for subjecting the banking industry to a set of regulations: first, the government seeks to protect the economy

by endeavouring to remove the risk of bank failures and second, the government seeks to protect depositors from both bank failures and from misuses and abuses of the banking industry.<sup>7</sup> Banking regulatory laws should be designed to propel financial development and attempt to avoid financial crises if they are to reduce poverty and support economic development.

Banking regulatory laws must be designed to keep interest rates at an optimum percentage as a way of promoting investment and encouraging a saving culture. Charging high interest rates appears to have negative impacts on the economy. Firms and individuals are less likely to want to borrow money due to the increased cost of borrowing. At this point, the bank runs the risk of making losses as only bad credit risks are usually willing to borrow under such circumstances. This situation makes lenders less willing to make loans, thereby leading to a decline in investment<sup>8</sup> and in aggregate economic activities.

In most developing countries, charging high interest rates hammer a blow on the market systems as the small investors who dominate the nation's economic system go out of business if they cannot afford the increased cost of borrowing. A disruption in the flow of money in the economic system can paralyse a country's economy and may result in increased poverty levels. With interest rates at an optimum level, the flow of money in the mainstream should be normalised and inflation rates reduced. Firms are willing to borrow and in turn increase their productivity, which is good for economic growth and poverty alleviation. In such a situation, a society will be on its way towards improving its economic development and increasing its financial depth and resilience, which will result in a substantial reduction in poverty as people's economic and financial muscle is strengthened.

Regulatory agencies should consider taking into account the nature of the country's economy when implementing and/or enforcing regulations in respect of interest rates. As mentioned above, in most developing countries, economic systems are dominated by small businesses that cannot afford high interest rate charges. Usually, an economy that ignores these businesses will fail to see meaningful growth.<sup>9</sup> Transformation of these small businesses into substantial firms requires support from financial institutions such as banks. Regulatory laws

should not therefore set equal interest rates for both large and small investments. Lending situations should charge interest rates depending on the investment category the borrower's business falls into. This may transform most small businesses into fully fledged ones, which can profoundly assist in maximising the aggregate output value.

Banking regulatory laws on asset restrictions and capital requirements should be framed in such a way that they help to win and maintain the depositors' confidence in the banks to overcome their reluctance to put funds into the banking system. Capital requirements oblige banks to maintain a certain level of equity capital to guard against bank insolvency. Restrictions on asset holdings forbid banks from holding risky assets that may result in bank failure if they do not pay off. Bank insolvencies can result in small depositors suffering significant losses. Depositors want to be sure of the safety of their funds before they put them into the banking system. In most cases, they rush to the bank to make withdrawals at the slightest sign of a financial crisis. This often happens because depositors lack information regarding their bank's capital levels and the kind of risks the bank is taking; or the protections in place (if any) for those depositors' funds. Most economists argue that a lack of information in the banking sector can trigger panic, which can then paralyse the entire industry.<sup>10</sup>

Where there is uncertainty in financial markets, most firms and individuals avoid the banking system and hold on to their funds. This situation leaves the banks without funds to make loans to fund productive investments in the country's economic system. The failure of banks to support the industry and trade will result in a decline in the country's total output and most industries even start to lay people off. To avoid this situation, regulatory agencies must firstly ensure that the banks' capital levels never fall below a minimum to avoid bank insolvency, which has adverse effects on the economy. Second, every bank should periodically issue a report disclosing its capital levels and the kinds of risks it is taking. It should be mandatory that these reports be publicised for depositors to know the status of their banks. This approach will see the banks avoiding undertaking unnecessary risks. It will again incentivise depositors to put their money in the banking system and the banks to resume channelling the funds into the most

productive sectors of the economy through the disbursement of loans.

Most developing countries are trying to industrialise their economies to increase their country's aggregate output. Such programmes can only be successful if there is an increase in financial depth in order to have a population with a sufficiently strong buying power to support the growth of industries. In an industrialised country, the government collects enough revenue for service delivery, which in turn improves the living standards of the people. Economic growth and the improved wellbeing of citizens is what governments anticipate when implementing banking regulatory laws.

For meaningful and sustainable economic growth, regulatory laws should not just focus on capital requirements and asset holding restrictions. Regulatory agencies must put in place regulations that allow banking industries to carry out a supervisory role over their borrowers' investment. It is argued by some scholars that part of the reason that not much of the envisaged improvement in economic growth has been experienced is that most people who borrow money misrepresent the nature of their business at the time the loan is being made and they alter their business thereafter.<sup>11</sup> It becomes a double jeopardy when an investor makes losses in a risky undertaking and fails to repay the loan and the bank too makes losses due to that failure. In such a case, the money that was meant to add value to the country's economy will have been misused. Supervision will bring two advantages: first, the bank will keep a substantial margin between the value of the loan advanced and the value of the borrower's assets. Second, since both the bank and the borrower intend to minimise the administrative cost of lending, the borrower will likely venture into a more productive investment, which will enable them to repay the loan and contribute towards economic development.

Banking regulatory laws should provide protection to both depositors and the national economy by making it mandatory for every bank to embrace the deposit insurance programme, which effectively controls the effects of bank failure. The banking industry in general is regarded as too big to collapse in light of the subsequent economic consequences and implications on financial stability. Usually, the tendency is for the government to bailout a large bank that is on the verge

of collapse by pumping in more money to boost the bank's capital base. Banks should be obliged to buy insurance to secure the safety of the depositors' funds in case of bank failure. Under such a system, creditors and depositors have full confidence in the bank and no longer need to rush to the bank when the rumor about a financial crisis hit the streets.<sup>12</sup> The deposit insurance law serves three main purposes: first, it is contended by some economists that this system would see the government saving a lot of money as there may be no need for the government to bail out the bank since all the depositors are covered and the failure of the bank may have minimal consequences.<sup>13</sup> Second, the bank minimises the risks that it takes knowing perfectly well that it stands to lose a lot should it collapse, as such bank insolvency is prevented at all costs.<sup>14</sup> Third, the depositors build confidence in the banking system as failure of the bank does not necessarily mean they will lose their funds.

Above all else, the deposit insurance programme helps to keep the entire financial system in good shape and the flow of money in the country's economic system is not disrupted. This system may see the economy surviving a complete crash in case of a bank failure, since the depositors will get their money back. Therefore industries will continue their operations until the economy revitalises. Keeping the financial system in good shape is an effective way of achieving economic growth. Bank regulatory laws must therefore be designed to achieve that end.

In conclusion, discussion in this essay has centered mainly on the approaches through which banking regulatory laws can help to reduce poverty and support economic development. The detailed analysis on the role of the banking industry on poverty reduction and economic development has been provided. Precisely, the banking industry serves as the brain of the country's economic system: it helps to coordinate the most productive sectors in the economy and the country's financial system. Banking regulatory laws play the crucial role of creating an enabling environment for investment and economic development. To achieve this, regulatory laws need to support financial development and improve the performance of banks for the smooth flow of money in the economic system of a country.

#### Notes

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# How can banking regulatory law reduce poverty and support economic development?

**A** bank is an entity that is engaged in the banking business. Section 3 of the Bank of Tanzania Act<sup>1</sup> establishes the Central Bank of the United Republic of Tanzania, which provides for the formation and implementation of monetary policy, the issuing of currency, and regulating and overseeing all banks and other financial institutions in the country.<sup>2</sup> Banking regulatory laws include the Banking and Financial Institution Act No 5 of 2006, which carries the authority to license, regulate and supervise all banks and financial institutions in Tanzania as provided under its section 4(1).<sup>3</sup> Furthermore, this Act supervises all banks and provides for the comprehensive regulation of banks and financial institutions. Another law included under the banking regulatory laws is the Mortgage Financial (Special Provisions) Act, which allows people to apply for loans using their land as security.

Regarding the question of how banking regulatory laws can reduce poverty and support economic development, the following points stand:

*By allowing groups of youth graduates to take out loans and start small businesses, with their leaving certificates and business proposals as security for the loans*

Many graduates cannot obtain loans because most banks have heavy conditions attached such as owning real estate, vehicles or business equipment (to mention a few categories of assets). It is very difficult for graduates to qualify because they lack these valuables as fresh graduates. Bank regulatory laws should consider this in order to reduce poverty, as by doing so the economy of an individual would be improved.

*Banking regulatory law should provide loans for education, as this is a strong way to reduce poverty*

When you educate a person, he or she will often use that knowledge to fight poverty and ignorance; section 5(1)(b)(i) of the National Microfinance Bank Limited Incorporation Act<sup>4</sup> provides for this. Bank regulation laws should consider this in a broader way since the world now is as one village, and educating the younger generation is much more considered, as it plays a key role in the market competition of scholars. To a great extent, it is education that gives people the knowledge and skills to fight poverty. Moreover, one extra year of schooling helps to increase an individual's earnings by up to ten per cent. Every additional year at school increases average annual gross domestic product (GDP) by up to 0.37 per cent.<sup>5</sup> Education will furnish technology to the extent of improving the living standards of the people as a way of supporting economic development.

*By way of allowing people to use their land as mortgage to obtain a loan as provided under section 112(1) of the Land Act<sup>6</sup>*

A majority of people hold some land under a granted right of occupancy and customary right of occupancy, so that by allowing them to use land, this can help them to get a loan and use that loan to improve their living standards. Section 8<sup>7</sup> amends section 114 of the Land Act as it gives rights to spouses to use their land to ask for a loan. Read together with section 45,<sup>8</sup> which deals with multiple mortgage accommodations, this can be seen as a stepping stone to reducing poverty at the family level and hence supporting economic development.

*As a way of financing agriculture, which is seen as the backbone of Tanzania's economy and is a leading sector in the country<sup>9</sup>*

Agriculture also acts as a boost to the national and individual economy since a large number of people (in Tanzania) are farmers. It is an undisputed fact that agriculture contributes much to GDP – more than any other sector – at up to 29 per cent.<sup>10</sup> One vision and mission of the Tanzania Agricultural Development Bank (TADB) is to promote agricultural transformation from subsistence to commercialised modern farming and agri-business to promote economic growth and reduce poverty.<sup>11</sup> The core aim of TADB is to work with farmers by providing loans at an interest rate that is affordable and to encourage many of them to borrow, since a large number of farmers are poor. By doing so, the farmers will be able to expand their holdings, improve their earnings and as such the rate of poverty will be reduced and the economy will be improved.

#### *By reducing bank interest rates*

Bank regulatory laws should set an interest rate that is friendly and affordable for people. Currently, borrowing is a nightmare because of high interest rates charged which are unaffordable by a large number of borrowers who are small business owners such as street food vendors. Other banks should take an example from the TADB, which charges interest rates of between seven to 12 per cent,<sup>12</sup> so many people who are engaged in small businesses can borrow money. The overall lending of commercial banks in Tanzania is around 16 per cent for short-term loans,<sup>13</sup> which shows how difficult it is for many to afford them. This high interest rate makes people afraid of borrowing from the bank and they continue to be poor. If the bank interest rates were to be reduced to the extent that even a small businessperson could borrow, this would lead to the reduction of poverty and the support of economic development.

#### *By way of encouraging people to save their money*

There is a need to mobilise local savings and promote a savings habit in the population, especially among low income earners, small scale farmers and small scale businesses as provided under section 5(1) (a).<sup>14</sup> This will

help people not to misuse but save their money for future use, should they be faced with a financial difficulty. To a low income earner, a savings habit would be of much help in reducing poverty since their basic salary is normally not enough to cover all their needs. Through saving, a person can plan how to use the little he or she has in savings to overcome poverty and other hardships. Also, to a small-scale farmer or small-scale business, this saving habit would help them to continue with the business since normally their capital is not very big and they do not produce surplus goods. This means they often depend on the small amount of products they produce. Hence, encouraging this group of people to maintain a savings habit will lead to the reduction of poverty and support of economic development. Furthermore, if people are confident with the way the banks operate, this avoids eye-borrowing, which helps people to implement their investment plans based on what they have been saving.<sup>15</sup> However, saving gives the customer the autonomy to access their money at any time when they need it most and, on top of that, they will benefit from affordably monthly fees.<sup>16</sup>

#### *By way of finance*

Village cooperative banks are community banks that are rural in origin. To a large extent, members of these groups are basically the shareholders. Their goal is to help individuals toward the eradication of poverty at the grassroots level. The National Microfinance Bank (NMB) has struck a partnership deal with Vikoba Groups Union of Tanzania (Viguta). Under this partnership, NMB will provide financial solutions to these groups across the country, including loaning to people who are members of this cooperative bank. Also, Akiba Commercial Bank provides loans for entrepreneurial groups, usually with five or six members who are known to each other.<sup>17</sup> By doing this, poverty will be reduced since members of this community are assured with financial support to put towards their activities.<sup>18</sup>

#### *Through financial investment in infrastructure*

Many developing countries have room for improvement in their infrastructure.<sup>19</sup> To finance their projects, a number of contraction companies will seek funds from

the bank and, by doing so, a number of people will secure jobs in those construction companies. Thus, investing in infrastructure will provide jobs to the jobless and improve standards of living. For example, constructing roads requires a number of people for the roads to be completed. Investing in construction will lead to the reduction of poverty and, at the same time, the road will facilitate the easy transportation of products and increase labour productivity in areas such as agriculture. Most of all, investing in infrastructure will facilitate market access and reduce transportation costs, which in the end help in reducing poverty as people will be employed, the cost of living will be reduced and the economy will be developed.

*By providing credit facilities for the implementation of business ideas that will improve financial and social conditions<sup>20</sup>*

However, credit facilities should give an opportunity to the poor to access savings accounts, which, to a large extent, will elevate their living standards and them help to lift themselves out of poverty and to finance their economic activities.<sup>21</sup>

*By providing entrepreneurship skills and knowledge*

Bankers can help people with various banking activities. They also give advice on the particular business that a person is engaged with, which enables them to manage their business with a reliable partner who gives start-up advice and assistance. They also provide the best banking products to suit each person.<sup>22</sup> Collectively, this assistance helps people to obtain sufficient business skills to improve their service delivery. It will also help to reduce poverty since the business owner will produce products that meet the market demand and therefore improve economic development.

*By the way of financing social services like health, water and education as a way to reduce poverty*

Education is one key to eradicating poverty. But, without good health, a person cannot think of any kind of development. That is why CRDB Bank donated 60 desks to Nyanza primary schools in Nyamagana District.<sup>23</sup> The Bank Manager, Ms Mwamfupe, said ‘the bank is committed to [giving] one percent

of its profits annually to fulfill its social obligations in supporting the government to improve the health and education sector[s]’. The same bank donated 375m Tanzanian shillings for school desks for councils and municipalities across the country,<sup>24</sup> as this strategy of financing the education sector in the long run helps the wellbeing of individuals and nations, and is also a way to reduce poverty and promote economic development. Also, in health sector, the banks continue to provide hospital equipment. For example, Exim Bank Tanzania, to celebrate 20 years of serving Tanzania, donated 40 beds and mattresses worth 20m Tanzanian shillings. Exim Bank Tanzania invested 200m Tanzanian shillings in Tanzanian healthcare by donating 500 mattresses and beds to public hospitals in 13 regions across the country.<sup>25</sup> In the end, this donation will help to reduce poverty and support economic development.

*By empowering women*

Banking regulatory laws should consider women, many of which live in rural areas and below the poverty line.<sup>26</sup> In Tanzania, the poverty line is measured as earning less than \$2 per day.<sup>27</sup> Women are often left behind in development and are faced with higher rates of poverty due to a lack of education and the financial skills to fight poverty. In spite of that, in Tanzania, there are two financial institutions focused on women’s issues. These are the Tanzania Women’s Bank (TWB) and the Covenant Bank for Women, which specifically target customers with low incomes with small and medium enterprises, and have a specific focus and emphasis on women entrepreneurs.<sup>28</sup> Through these banks women can attend seminars that may help them by explaining how they can borrow money and engage in small business so as to make them part of economic development. It should be noted that most women are responsible for buying food and household goods, so an increase in the income earned by women would lead to higher household expenditure and education,<sup>29</sup> and hence reduce poverty and support economic development.

In conclusion, banking regulatory laws can reduce poverty by: providing groups of youths with loans to start small businesses; providing education loans, which will give equal opportunities to every person to acquire an education and the life skills to fight poverty;

allowing people to use their land to obtain loans; financing the agricultural sector, since the majority of people depend on farms and it's the backbone of the national economy; reducing bank interest rates so as to give a chance to as many people as possible to obtain a loan, which will facilitate money circulation and stimulate small businesses in the country. Also, by promoting a savings habit to help prevent the misuse of money and encouraging people to save for future plans; and financing village cooperative banks, which help people from rural and urban areas who subscribe to this community bank. Moreover, through financial investment in infrastructure, which implies the provision of jobs to the jobless and uplifts their standard of living; by providing credit facilities for the implementation of business ideas, to the extent of providing entrepreneurship skills and knowledge so as, when they borrow money, people grow their businesses; also, by way of financing social services to the community such as education and health. A final way to eradicate poverty is by empowering women to uplift them from the poverty line and assist them with entrepreneurship skills that will improve their living standards and hence support economic development.

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# How can banking regulatory law reduce poverty and support economic development?

**F**or many years, developing countries have adopted or come up with generally similar regulatory laws to check the activities of financial institutions, with the main aim of protecting the public from exploitation by profit-minded financial institutions. The similarity is attributed to the existence of the same sources of aid to such countries.

In Uganda, the laws regulating financial institutions are codified in statutes such as the Financial Institutions Act 2004, the Financial Institutions (Amendment) Act 2016, The Bank of Ugandans Act and The Money Laundering Act, among others, as well as regulations and guidelines such as the Bank of Uganda Mobile Money Guidelines 2013. In principle, all persons are equal before and under the law in all spheres of the economy and society and in every other respect, and shall enjoy equal protection of the law.<sup>1</sup> Banking regulations help regulate banking institutions which in turn can reduce poverty levels and promote economic development as discussed below.

A bank is any company licensed to carry out the financial business of banking.<sup>2</sup> Banking is the business activity of accepting and safeguarding money owned by other individuals and entities and then lending this money with the aim of making profits.

Banking regulatory laws are laws set by the regulating financial institution to regulate and check on the activities of financial institutions, especially commercial banks, with the major aim of protecting depositor's interests and attracting commercial activities thereafter. There are forms of government laws and regulations that subject banks and financial institutions to certain requirements, restrictions and guidelines, and are designed to create market transparency between banking institutions, corporations and individuals with whom they conduct business, among other things.

Economic development is the process by which a nation realises improvements in the

economic, political and social wellbeing of its people. Economic development is proven through indicators including measures of poverty, economic structures, gross domestic product (GDP) per capita,<sup>3</sup> literacy rates, demographic indicators, disease indicators, life expectancy, unemployment levels, income inequality, inflation levels and the political environment, among others.

Poverty, on the other hand, is a condition or situation where people are not able to meet their basic needs, for example food, clothing and shelter. Poverty is a condition that is to an extent caused by surrounding social, political, economic and environmental conditions. This range of causes is the greatest issue that makes poverty a peculiar problem faced by the world. It can be classified into two categories: absolute poverty<sup>4</sup> is fixed regardless of the community and relative poverty<sup>5</sup> varies from community to community.

*As a regulatory procedure, the central bank can facilitate licensing and the supervision of all financial institutions*

This can be done by prohibiting financial institutions from making transactions without a licence.<sup>6</sup> The power to grant licences and the application for the same lies with the central bank.<sup>7</sup> The central bank also has the power to revoke a licence if the financial institution fails to comply with the law.<sup>8</sup> The licensing regulatory procedure can be employed by the government to identify financial businesses yet to be established and ensure that companies (corporate bodies) and financial institutions are accountable for their actions.

This can regulate and mitigate the potential exploitation levels of the public/depositors by banks and can increase the number of people conducting business with such institutions, as their deposits are secure. Regulation can make the company/institution legally liable

for any misconduct that could result in losses for the clients. As a result, the client's usual financial position can be restored in the result of bank misconduct and they can carry on their investments. Employees can retain their jobs, thus earning a better living. Therefore, poverty reduction and economic development can be imminent.

Using a banking licence as a regulatory procedure, the central bank can also keep track of the financial institution's business finances for tax purposes. This can enable the government to carry out effective taxation, which can increase the government's revenue, facilitate the country's budget, reduce government borrowing and its related disadvantages, and increase the government's internal investments as a result. This can, in the long run, create local employment opportunities and increase the incomes of the natives, hence poverty can be reduced and economic development can be realised.

*A minimum reserve requirement<sup>9</sup> is one of the principles that can be employed by the central bank*

The government can isolate the financial institutions that may join the industry with less capital, which could therefore go bankrupt and fail to refund the depositor. A person proposing to conduct financial business in the capacity of a bank in Uganda must have a minimum paid-up cash capital of not less than 200,000 currency points invested initially in such liquid assets in Uganda as the Central Bank may approve of.<sup>10</sup>

This requirement can aid in ensuring that financial institutions do not take on excess leverage and become insolvent. The basic intent of the government through minimum requirements can be premised on the banks keeping a certain amount of deposits at hand to cover possible withdrawals. The banks can also issue loans to customers based on a fraction of the cash they actually have at hand. The government makes one requirement of them in exchange for this ability.

With such a law, the public can be assured that their deposits with such financial institutions have maximum protection because institutions are prevented from taking excess leverages. This can increase public trust in financial institutions, thus attracting individual and corporate bodies to deal with such institutions, which can increase savings and borrowing, foster investments and employment opportunities, and improved

standards of living. Economic development can be seen in the long run.

The minimum reserve requirement can further check the ability of the bank to issue loans as it is required that the loans must be advanced to customers based on a fraction of the cash they actually have on hand. This can reduce poverty and promote economic development in that the institutions given a licence to carry on financial business must raise the reserve requirement as provided by section (26) (supra). Through the process, such institutions can be in a position to advance loans to their clients. This can in turn facilitate massive investments at domestic levels, employment opportunities, increased incomes, improved standards of living and hence lead to reduced poverty and economic development.

*Adopting 'corporate governance'<sup>11</sup> as a regulatory requirement by the central banks to regulate the activities of financial institutions, especially commercial banks*

Among other things, corporate governance calls for the bank to be a body corporate, to be incorporated locally, have a minimum number of directors and an approved constitution of articles of association.<sup>12</sup> The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance the understanding of key supervisory issues and improve the quality of banking supervision worldwide. On the African continent, the King Code<sup>13</sup> has gained popularity due to its nature of being non-legislative and for the practical nature it exhibits.

Under Part (iv) of the King Code,<sup>14</sup> among others, provides for the appointment of a board of directors, disqualification of the director, conflict of interest assessments, responsibilities of the board, duties of directors, removal and suspension of directors, board meetings, an audit committee of the board, and an Asset and Liability Management Committee. Furthermore, a public company shall at the time of registration of its articles, adopt and incorporate into its articles the provisions of the code of corporate governance contained in table F.<sup>15</sup> But it should be noted that the corporate requirement is optional to private companies.<sup>16</sup> These requirements can encourage the banks to be well managed.

This call for transparency and personal responsibilities is directed at the management board of the financial institution. It can also expand the guidance on the role of the board of directors in overseeing the implementation of effective risk-management systems. It can emphasise the importance of the board's collective competence as well as the obligation of individual board members to dedicate sufficient time to their mandates and to keep abreast of developments in banking as well as underline the importance of a sound risk culture to drive risk management within a bank.

*Financial reporting and disclosure can be used to regulate the activities of financial institutions*

This can be through mandatory orders to financial institutions, directing them to submit all audited annual financial statements to the central bank.<sup>17</sup> The major aims of financial statements are to provide information about the financial position, performance and changes in the financial position of any particular financial institution. In return, this can enable investors, potential creditors, traders and depositors to make informed economic decisions before dealing with such institutions.<sup>18</sup> This can, in the long run, minimise the losses therein.

These requirements can enable the government to determine the correctness of the declared tax owed in tax returns, and to keep track of economic progress through analysis of the financial statements of businesses from different sectors of the economy. It can also facilitate the provision of information on economic resources of institutions, information to investors, promoters, debt providers and creditors, and to various stakeholders regarding performance and management of a financial institution, for example, how diligently and ethically they are discharging their fiduciary duties and responsibilities.

To that end, the public is able to make prudential decisions, based on the institution's banking character, regarding the bank accounts they will open and in which bank. This helps to minimise losses, thus protecting an individual's funds, which could be invested in other profitable businesses and in return increase people's incomes and reduce poverty. Hence, economic development can be achieved.

*Credit rating regulations can be employed in the regulation of financial institutions*

Under this requirement, financial institutions, especially banks, can be required to maintain a current rating from an approved credit rating agency and to disclose it to depositors and prospective investors. These ratings can be designed to provide information for prospective clients and investors regarding the relative risk that one assumes when engaging in business with a bank. Ratings agencies assign borrowers a credit rating that makes a significant impact on the lending terms offered to them.

The credit rating system can reflect the borrower's ability to fulfil his obligations fully and punctually. It can further reflect the tendencies of the bank to take on high-risk endeavours in addition to the likelihood of the bank succeeding in such deals or initiatives. Government credit ratings can be assigned based on various criteria such as foreign-currency liquidity, monetary policy, political risk, composition of the economy, revenues and many other criteria.

Credit ratings can therefore enable the government to protect the population against any profit-minded businesspersons who are willing to make the highest profits at the expense of others. By fixing the rate at which loans are advanced, people can be motivated to secure loans. In return, investments in key sectors of the economy are realised. This can lead to increased outputs and exports, and can as a result increase the incomes of the people. Thus, it can reduce poverty and enhance economic development thereafter.

*The central bank, hand in hand with the organs of the government, can adopt regulatory polices under which collapsing financial institutions are given support*

This has been explained by economists as the 'too big to fail theory'.<sup>19</sup> Proponents of this theory believe that some institutions are so important that they should receive beneficial financial and economic policies from governments or central banks since they are worth preserving. Though some scholars have observed that banks are not too big to fail,<sup>20</sup> the government has carried on with preserving banks that are almost failing. In doing so, the deposits in such financial institutions are protected and the public is much more assured that a commercial company is to exist at all costs, as the government finances it in times of financial hardship.

This can prevent losses to individuals and can keep their financial status at a gradual increase. It can also protect or secure the jobs of the employees of that financial institution, which would otherwise be under threat. They can protect their income abilities and standards of living and hence reduce poverty and support economic development.

*The government can invent and incorporate mobile banking into financial institutions to ease banking activities*

This can be done through the introduction of numerous laws and regulations with the major aim of protecting the public from being exploited by telecommunication companies.<sup>21</sup> In Uganda, such laws include regulating mobile depositing and withdrawal rates. Mobile banking comes under the supervision of the Bank of Uganda.<sup>22</sup> Under this system, high consumer protection is observed,<sup>23</sup> and this can therefore enable the public to carry out banking since mobile banking is accessible. The deposit rates are lower in mobile banking compared to ‘office’ banking, which at times involves filling out documents and travelling distances to carry out saving and borrowing activities. Mobile banking can also ease individual access to their account standings. Mobile banking can attract a large portion of the public to carry out savings, which in the short term can enable investments in different sectors of the economy, thereby creating employment. This can result in increased incomes and thus reduce poverty, hence result in economic development.

*Legislators can pass acts, such as the Financial Institutions (Amendment) Act 2016, which introduces three new products*

The three products introduced by the Financial Institutions (Amendment) Act 2016 into Uganda’s banking sector are Islamic banking<sup>24</sup> and Bancassurance,<sup>25</sup> which mean using a financial institution and its branches, sales network and customer relationships to sell insurance products,<sup>26</sup> and Agent Banking.<sup>27</sup>

Islamic banking is based on justice and fairness; it created the principle of ‘profit sharing’,<sup>28</sup> whereby the bank and the customer share the risk. This system of financial intermediation can contribute to a

more equitable distribution of income and wealth. Further, through the profit and loss-sharing principle, the Islamic banking system can mobilise resources and is less likely to face any sudden run on deposits. As such, Islamic banks have a minimum need for maintaining high liquidity. Islamic banking also prohibits speculative transactions, which are dominant in the usual banking system. This destabilises speculation and can be in the best interests of depositors.

Bancassurance is a system in which a bank has a corporate agency with one insurance company to sell its products. By selling insurance policies, a bank can earn a revenue stream apart from their banking business (fee-based income). This income can be risk-free for the bank since the bank simply plays the role of an intermediary for sourcing business to the insurance company. This can increase the public’s engagement in borrowing due to the partnership that exists between the bank and the insurance company

Agent banking can reduce customers’ spending in the process of accessing teller services by easing access to banking services. It also increase incomes through commission and increases customer traffic, hence generating more business to the retail outlet, which can in the long run increase lending ability. This can in turn encourage investment, creating employment opportunities. Thus, agent banking can increase the general incomes of individuals and the entire GDP,<sup>29</sup> hence fostering economic development.

In conclusion, taking a view of poverty and economic development in ‘developing countries’, more political and social initiatives are needed. The situation is very complicated because each ‘developing country’ has a unique history and today faces relatively similar challenges with regard to financial issues. Development efforts require many different parts of society to work together towards the same goals. In reality, this can hard to achieve. Reducing poverty and fostering economic development remains fragile, as illustrated by the vulnerability of the entire economic status, restricted to access financial institutions and the laws set to regulate such institutions in ‘developing countries’. Another issue remains as to the political situation of any given country.

## Notes

- 1 Constitution of the Republic of Uganda 1995, Article 21(1).
- 2 The Financial Institutions Act 2004 Laws of Uganda, Section 2.
- 3 The measure of the average income earned per person in a given area in a specified year. It is calculated by dividing the area's total income by its total population.
- 4 Poverty is synonymous with destitution and occurs when people cannot obtain adequate resources to support a minimum level of physical health.
- 5 Occurs when people do not enjoy a certain minimum level of living standards as determined by a government (and enjoyed by the bulk of the population), that varies from country to country, or sometimes within the same country.
- 6 Financial Institution Act 2004 Laws of Uganda, Section 4.
- 7 Financial Institutions Act 2004 Laws of Uganda, Section 10.
- 8 Financial Institutions Act 2004 Laws of Uganda, Section 17.
- 9 Reserve requirements are requirements regarding the amount of cash a bank must hold in reserve against deposits made by customers.
- 10 Financial Institutions Act 2004 Laws of Uganda, Section 26.
- 11 The process and structure used to direct and manage the business and affairs of the financial institution with the objective of ensuring its safety and soundness and enhancing shareholder value cover for the overall environment in which the institution operates, comprising a system of checks and balances that promote a healthy balancing of risk and return. See Section 3 Financial Institution (Corporate Governance) Regulations 2005, Laws of Uganda.
- 12 Basal Committee on Banking Supervision.
- 13 King Report on Corporate governance by Mervyn E King, retired South African Supreme Court Judge. With the different codes, ie, King 1 (1994), King 2 (2002), King 3 (2009), and the recent (2016) King 4.
- 14 Financial Institutions Act 2004 Laws Of Uganda
- 15 Companies Act 2012 Laws of Uganda, Section 14(1).
- 16 Companies Act 2012 Laws of Uganda, Section 14(2).
- 17 Financial Institutions Act 2004 Laws of Uganda, Part VI.
- 18 International Accounting Standard Board (IASB).
- 19 The theory asserts that certain corporations, particularly financial institutions, are so large and so interconnected that their failure would be disastrous to the greater economic system, and that they therefore must be supported by governments when they face potential failure.
- 20 Chen Zhou, 'Are Banks Too Big to Fail? Measuring Systemic Importance of Financial Institutions' available at SSRN [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1546384](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1546384).
- 21 These are the companies that operate mobile networks. They include MTN and AIRTEL, among others.
- 22 Bank of Uganda Mobile Money Guidelines, 2013, para 13 Laws of Uganda.
- 23 Bank of Uganda Mobile Money Guidelines, 2013, para 12 Laws of Uganda.
- 24 Islamic banking refers to a system of banking or banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Islamic economics.
- 25 The partnership or relationship between a bank and an insurance company, or a single integrated organisation, whereby the insurance company uses the bank's sales channels in order to sell insurance products; an arrangement by which a bank and an insurance company form a partnership so that the insurance company can sell its products to the bank's client base.
- 26 Section 40 of the Financial (Amendment) Act 2016 Laws of Uganda. / 115B (4).
- 27 Agent banking means providing limited scale banking and financial services to the population through engaged agents under a valid agency agreement, rather than a teller/cashier [www.bb.org.bd/aboutus/regulationguideline/psd/agentbanking\\_banks\\_v13.pdf](http://www.bb.org.bd/aboutus/regulationguideline/psd/agentbanking_banks_v13.pdf).
- 28 Various incentive plans introduced by businesses that provide direct or indirect payments to depositors.
- 29 Growth Domestic Product.

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## How can banking regulatory law reduce poverty and support economic development?

**T**his essay deals with the purpose of banking regulatory law in its quest to reduce poverty and in turn support economic development. The essay will address poverty and economic development in developing nations. Finally, the essay will try to see the role of law, in particular banking regulatory law, in improving lives through supporting economic development. The purpose of this essay is to look at banking regulatory law as a quest to end poverty and support economic development, particularly in underdeveloped countries.

There are key critical sectors to the development of the economy of any given country. A strong pillar of such economic development that greatly aids poverty reduction is the banking industry. Measures, laws and regulations should be put in place to regulate the banking sector in order for it to contribute effectively to the reduction of poverty and advance economic development in the growing economies of underdeveloped countries.

Behind almost all human activity in the modern world lie banks and financial intermediaries, greasing the wheels of

our social, personal and working lives. It is of utmost importance to elaborate on how banking regulatory laws can reduce poverty and consequently support economic development. It must be noted that strong economic growth goes hand in hand with a reduction in poverty. In light of this, financial services enable the poor in society to increase and diversify their incomes, build human and social assets, and improve their lives in ways that reflect the multi-dimensional aspects of poverty. The banking sector is a critical player in the economic growth nexus of a well-functioning or growing economy.

It is an unassailable fact that banks have historically behaved undesirably by society's standards. This is due to bank collapses, high interest rates for loans offered to the public and poor corporate governance mechanisms. It is under such auspices and judgement by society that banks were catapulted into reforming and stricter banking regulatory laws were introduced, aimed at advancing economic development and fighting for the eradication of poverty in less-developed communities. IMF head Christine Lagarde points out that 'Regulation is necessary particularly in a sector like the banking sector, which exposes countries and people to a risk.'<sup>1</sup> Hence, banking regulatory law has brought about 'banktivism', which is a change to the traditional paradigm of banking operations to a new, modern shift that looks to banks to use their power in financial markets to address social imbalances, promote economic development, end poverty and pollution, address climate change and support overall community development.

Poverty both directly and indirectly affects economic development. Poor economic development mainly results from a high unemployment rate, which generates low income and productivity rates. It is therefore important that a viable, strong and dependable banking sector is created, which in turn results in the creation of financial regulations that enhance the functioning of the banking sector for the promotion of economic prosperity.<sup>2</sup> Economic development may be understood as an increase in the standard of living, improvement in self-esteem and freedom from oppression, as well as greater choice.<sup>3</sup> Thus, the creation of a banking regulatory system where compliance is a priority, with monitoring and oversight mechanisms by management providing professional and sustainable access

to financial services for all economic activities in developing countries, is key to economic development and warding off poverty.

Poverty is rife in most developing nations wherein political processes have failed to ameliorate and eradicate such poverty. The larger part of the population in developing countries live in rural areas in which agriculture is the main economic activity. Formal financial institutions have often avoided financing rural areas due to the perceived higher costs and risks. Furthermore, commercial banks usually refuse to serve poor households and micro-enterprises because of the high cost of small transactions. It is against this backdrop that banking regulatory law should come in and address such lacunae through adequate banking regulatory legislation, which would allow the poor in rural areas access to financial and banking services. Financing agriculture for poor households through farming input loan schemes enables poor farmers to produce more agricultural produce for sale and in turn service their loans with banks. Thus, it is essential for banks and society to work closer with each other in coming up with diversified ways to eradicate poverty and increase economic growth in underdeveloped nations. Hence, banking regulatory law plays a fundamental role as increasing access to banking and financial services can have a positive impact on economic growth and poverty alleviation.

Developing countries and economies are usually home to most small and medium-sized enterprises. Such small and medium-sized enterprises have often been shunned by capital banks for funding. If funding has been offered, the interest rates have not been favourable for such business start-ups. This has further caused a stagnation in the economies of scale and the means of production within most developing nations. Banking regulatory law ought to take into consideration and address such interest rates for start-ups in developing nations. The law ought to fix interest rates that are commensurate with such small and medium-sized enterprises earmarked for economic empowerment.

It is important to note that the Millennium Declaration was adopted by world leaders committing their nations to stronger global efforts to reduce poverty, improve health and education, and promote peace, human rights and environmental sustainability.<sup>4</sup> The public and private sectors, in particular the

banking sector, must affirm through strong regulatory laws their collective responsibility to help in achieving such goals. Access to financial services for the poor will contribute to poverty reduction. Hence, banking and financial services enable the poor to increase and diversify their incomes, build human and social assets, and improve their lives in tremendous ways that reflect the multi-dimensional aspects of poverty.

It is important to note that banking regulatory laws are not just about preventing crises but also about cultivating financial systems that provide growth-promoting services and empowerment to financially marginalised groups such as women. For instance, in Zimbabwe, banking operations and legislation make it difficult for women in business to acquire capital loans from commercial banks. Yet, in fact, more women than men are involved in the means of production and economic activities that ward off poverty at the household level. It sometimes happens that the goal of social and economic change to bring about equality and empowerment of women is reached more quickly through legal development.<sup>5</sup> Hence, banking regulatory law must also provide for financial inclusivity of women so as to incentivise and allocate credit to women with the best entrepreneurial ideas and abilities, and not simply to those with the most wealth and political connections. Hence, it can be noted that, through banking regulatory laws, economic empowerment is achievable as well as gender balance. Thus, this strong correlation between banking regulatory law and poverty eradication is critical for the economic status of each developing society or nation to improve.

It is of utmost importance to note that any developing country or society that does not support its youth in their entrepreneurial activities will succumb to poverty. The reduction of poverty lies in the banking sector's provision of loans and funds to youth to boost their production activities and economic development to sustain their livelihoods. Statistics show that the majority of the total population in developing countries is constituted by youths. Hence, there is great need that any regulatory laws with regards to banking also cater for the provision of funds to finance young people's economic activities. It is essential to note that broader access to the financial system and the inclusivity of young people in such a system can boost

job creation and investments in education, thus subsequently emancipate youths from unemployment and eradicate poverty. The Zimbabwean government at some point in time introduced a youth fund known as the Kurera/Ukondla Youth Fund, which was disbursed to youths through the Central African Building Society (CABS Bank) and was meant to support youths in business and production areas.<sup>6</sup> Although this was a step in the right direction, the due administration of the youth fund was put into jeopardy due to serious mismanagement. Hence, countries have to restructure their financial sector effectively and efficiently to facilitate economic development and progression, especially among the youth. Banking regulatory laws in developing countries must ensure that governments reduce their ownership role in banking and consider creative ways to use the banking sector to eradicate poverty. Hence, banking regulatory law must ensure that the government's primary role is to ensure macro-economic stability and a conducive environment, and implement laws concerning financial institutions, governance issues and policy instruments that stimulate economic prosperity.

In light of the view that development of the financial sector accelerates economic growth, it is important to note that the banking industry is one of the key financial intermediaries through which economic growth, progression and effective eradication of poverty can be achieved. It is therefore agreed that banking regulatory laws must promote ethical banking to restore public confidence in the banking sector in its quest to end poverty and facilitate economic progression and development. Banking regulations must make becoming compliant with laws meant to support economic development a priority. With a strong banking regulatory framework in place, growing economies will ensure adherence to strong and effective corporate governance mechanisms, which in turn will ensure that the banking sector is treated more as a friend and not a foe of economic development and poverty reduction in growing economies.

## Conclusion

In conclusion, it must be noted that banking regulatory law has the power and force to support economic development and eradicate poverty. However, there is need

for law reform within developing economies to make sure that banks join the quest for economic development through substantial contributions to society, by affording bank loans with low interest rates and supporting mechanisms for women, youths and poor agricultural farmers. Hence, it is important to note that the banking sector has a role to play in society in supporting economic development and ultimately in the reduction of poverty.

### Notes

- 1 Lagarde, C, 'Ethics & Finance - Aligning financial incentives with societal objectives', International Monetary Fund (2015) [www.imf.org/News](http://www.imf.org/News).
- 2 James Barth et al, 'Bank Regulation & Supervision in 180 countries from 1999 to 2011', National Bureau of Economic Research Working Paper 18733 (issued January 2013).
- 3 Michael Todaro, *Economic Development* (11th ed, Pearson 2011).
- 4 United Nations Millennium Declaration, [www.un.org](http://www.un.org).
- 5 See n 1 above.
- 6 Statement on Kurera/Ukondla Youth Fund progress, [www.oldmutual.co.zw/newsdetails/oldmutual](http://www.oldmutual.co.zw/newsdetails/oldmutual).