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Competitive behavior in Middle East and North Africa banking systems

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Abstract

This paper investigates the degree of market power in Middle East and North Africa (MENA) banking systems where research on competitive conditions is scant. The banking sectors of MENA countries are highly concentrated and they present unique characteristics in terms of ownership, structure and growth potential. The degree of competitiveness is assessed based on the revenue elasticity to input prices approach, and is related to a set of market and contestability indicators. The results show that, except for countries in North Africa where monopolistic conditions are found, the prevailing market structure in MENA banking is mostly monopolistically competitive. In line with the finding on other emerging and developed countries, assuring greater market contestability by allowing more foreign bank participation and reducing activity restrictions on banks is most important to guaranteeing competitiveness in the highly concentrated banking systems of the MENA region.
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1. Introduction

Recent advances in information technology, financial innovations, globalization and deregulation have reduced margins in traditional banking activities worldwide. This set off a wave of mergers between banks and other financial institutions causing drastic changes in the structure of the banking industry. In turn, greater consolidation raises concerns regarding issues of competition in the local retail markets. The policy implications of such concerns are particularly relevant

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Table 1
Three-bank total asset concentration average in MENA banking, 2000–2006

Country	Concentration
Algeria	85.92
Bahrain	80.47
Jordan	87.15
Kuwait	68.51
Lebanon	37.86
Morocco	49.50
Oman	79.14
Qatar	90.99
Saudi Arabia	56.11
Tunisia	45.09
Turkey	44.60
United Arab Emirates	49.62

Source: Author's calculations based on data retrieved from the BankScope database.

because regulators have traditionally used banking market structure as a policy variable to recommend measures aimed at fueling competition, promoting financial liberalization and removing barriers to entry.[1]

The Middle East and North Africa (MENA) region is strategically located between Asian economies and the Western world. Except for Turkey, MENA countries were colonized by the French or the British until mid of the past century. Major institutions including financial intermediaries were established following the Western style, but they present some interesting features that make them a challenging fieldwork. Financial sectors in MENA countries are generally still in the early phases of economic development. Capital markets are weak or almost non-existent, and financial markets are dominated by bank-financed credit mechanisms. In this framework, banks are the main suppliers of credit to private and public investment projects and they also finance government deficits. While this feature is common to many other emerging economies, banking sectors in the MENA region are unique in three aspects.

First, the recent oil price hike marks the beginning of a new era that was last witnessed a quarter of a century ago. Investment opportunities in the United States using petrodollars coming from the Middle East became more restricted after 11 September, so that oil surplus funds have to be channeled to productive uses elsewhere in the world. Monetary authorities in MENA countries generally require banks to adopt international accounting standards and to comply with international regulatory requirements, including Basel II and anti-money laundering recommendations. Still, a major concern is raised regarding the absorptive capacity of banks in the MENA region to recycle oil surplus funds, justifying the concerns of policymakers with appropriately designing policies for more efficient and stable banking systems.

Second, banking systems in the MENA region have traditionally been very highly concentrated markets. Table 1 shows the three-bank average concentration ratios over the period 2000–2006 based on total assets. While Lebanon, Morocco, Saudi Arabia, Tunisia, Turkey and UAE have a three-bank concentration ratio ranging between 37 and 57%, bank concentration in Algeria, Bahrain, Jordan, Oman and Qatar exceeds 80%. In spite of historical high concentration ratios,

[1] In the US, examples of regulatory changes include the relaxation of interstate branching in 1992, the Riegle-Neal Interstate Banking and Branching Efficiency Act in 1994, and the Financial Services Modernization Act allowing the operation of commercial banking, investment banking and insurance underwriting within the same holding company.

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