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**A REVIEW OF THE LITERATURE ON FINANCIAL MARKETS AND
AGRIBUSINESS DEVELOPMENT IN SUB-SAHARAN AFRICA:
LESSONS LEARNED AND SUGGESTIONS FOR
AN ANALYTICAL AGENDA**

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ACRONYMS

AFRACA - African Regional Agricultural Credit Association

APC - A.I.D. Senegal Agricultural Production Support (APC) project

BNDA - Banque Nationale de Développement Agricole

CIDR - Centre International de Développement et de Recherche

CNCA - Caisse Nationale de Credit Agricole (France)

CNE - Caisse National D'Epargne

CUNA - Credit Union National Alliance

DFI - Development Finance Institution

FAO - Food and Agriculture Organization of the United Nations

FINCA - Foundation for International Community Assistance

FIRM - Financial Resources Management cooperative agreement

GTZ - Deutsche Gesellschaft fur Technische Zusammenarbeit (Germany)

IFAD - International Fund for Agricultural Development

INTERCOOPERATION - Organisation Suisse pour le Développement et la Coopération

MOU - Memorandum of Understanding

NGO - Non-Governmental Organization

PVO - Private Voluntary Organization

ROSCAs - Rotating Savings and Credit Associations

WAMU - West African Monetary Union

WID - Women in Development

WOCCU - World Council of Credit Unions

EXECUTIVE SUMMARY

INTRODUCTION

Agriculture is the dominant sector in Sub-Saharan African economies and is a potential catalyst for generating broad-based, sustainable economic growth. Improving the performance of the agricultural sector requires increasing productivity through the adoption of high-yielding technologies, improved management of natural resources, and more efficient marketing systems and agribusinesses. The efficient production, processing and marketing of agricultural commodities is often linked to access to efficient and reliable financial services. As farm and nonfarm businesses grow and become more sophisticated, they often need sophisticated financial services offered by formal financial institutions. Governments and donors have devoted a significant amount of resources in Sub-Saharan Africa to the task of providing loans and other financial services to agribusinesses. These efforts may have helped specific enterprises, but most countries today still do not have a strong, viable financial sector that can provide reliable financial services to farms and other agribusinesses.

This paper aims to improve our understanding of why this situation exists and identifies areas for additional research. It is based on an extensive literature review of financial markets and agribusiness development in the region, and by focused field work in Burkina Faso, Cameroon, Niger, and The Gambia. It was prepared for the Africa Bureau of A.I.D. as part of its effort to guide country missions in the design of successful agribusiness programs and projects.

FINANCIAL SYSTEMS

For the purposes of this paper, the financial sector was divided into three financial systems - formal, semi-formal, and informal - to emphasize the wide variety of financial arrangements found in Sub-Saharan African countries. The formal financial system in most countries has three components. One component includes the Ministries of Finance, the Central Banks, and the other national regulatory and prudential institutions. Normally, these entities do not make loans or accept deposits from clients other than the formal financial institutions. The second component consists of financial institutions that provide financial services directly to savers and borrowers, and these are the focus of this review. Commercial banks, savings banks, postal savings, development banks, cooperative banks, and unit rural banks are the most important formal financial institutions found in most countries. The third component represents the capital markets, including money, bond, and stock markets. Capital markets are in the early stages of development in most Sub-Saharan African countries. To date they have not been very important for agribusiness finance so they were excluded from this analysis.

Semi-formal financial arrangements generally fall outside the purview of the formal banking authorities. They usually involve groups of persons in some type of membership

organization and are often owned by their members. Some receive government and donor funds to subsidize their operations and for use in on-lending. The semi-formal financial arrangements most important for agribusinesses are agricultural cooperatives, credit unions, integrated development projects and parastatal organizations, village banks, self-help groups, and savings clubs. The least formal of these arrangements, especially village banks and self-help groups, are the fastest growing and are popular among NGOs and PVOs.

The informal financial system includes a heterogeneous set of individual and group financial arrangements. Some are autonomous and can be expected to thrive even when the formal system develops and expands, while others may represent a reaction to the repression of the formal system and may decline in importance as the formal system develops. Some experimentation is underway to use informal finance to channel funds to farmers and small scale enterprises. Examples of informal systems important to agribusinesses are communal clubs and mutual aid associations, rotating savings and credit associations, moneylenders, moneykeepers, private input suppliers, and friends, relatives and family.

APPROACHES TO FINANCIAL MARKET DEVELOPMENT

Three general observations should be made about the literature reviewed before discussing individual approaches to the development of financial systems. First, much of the literature is case study oriented with few cross-country studies or syntheses that systematically review the experiences of several countries. Therefore, it is necessary to view with caution the recommendations often found in studies which suggest that countries should introduce some reform or adopt some innovation because it appears to have worked in a small application in one country. Furthermore, the lack of systematic comparative analyses and thorough review of lessons learned is one reason that similar problems emerge across countries.

Second, the literature clearly shows that most governments and donors have pursued a supply-leading approach to finance which emphasized increasing the supply and reducing the cost of loans to specific sectors (i.e., agriculture, small farmers, etc.). Institutional strengthening has also been pursued to support this strategy. The supply-leading approach has been shown to have several fundamental weaknesses. It ignored savings mobilization and created a dependency syndrome in which the lenders become dependent on cheap government and donor funds. It created rent seeking opportunities in which nontargeted borrowers used political influence to gain access to the cheap funds. Financial institutions were undermined because they were often not allowed sufficient margins to cover their costs and risks. Finally, credit was treated as an input in production so its value as a fungible resource was ignored. The reforms that have been undertaken in many Sub-Saharan African countries in the past few years have reduced or eliminated many of these problems.

The third observation is that, until recently, most governments and donors have shied away from using the private sector to provide financial services to the agribusiness sector. At best, cooperatives are created and/or are used to channel loans to farmers and

agribusinesses. But few programs, for example, try to stimulate traders or trading networks to lend to priority clientele groups. This results in a heavy bias towards state involvement with its several problems of accountability and viability.

Several different forms of financial institutions have been promoted in Sub-Saharan Africa. For example, many countries have tried to expand commercial bank services to rural areas and reduce their urban bias. Targets and quotas have been established that specify the proportion of their loan portfolio that should be directed to rural loans. But in spite of these efforts, it has been difficult to get banks to make loans to borrowers and sectors that they perceive to be risky and uncreditworthy.

Most countries have Post Office Savings Banks and/or some other types of savings bank. They are often the only formal financial institution to supply deposit services in rural areas. Two problems have prevented them from playing a larger role in financial development. The first is that many pay low interest rates and offer poor services. The second is that their resources are often simply deposited with the Treasury rather than used for lending to their savers.

Development finance institutions (DFIs) have been set up to support agricultural development in many countries. Many have performed poorly because they were expected to perform both wholesale lending to parastatals and retail lending to farmers and cooperatives. They have also been used by donors as credit outlets for integrated development projects. Therefore, many DFIs do not mobilize savings and are dependent on government and donor funds. Since many have a large amount of nonperforming assets, they have been closed or recapitalized, and donors are rethinking their role in development.

Ghana is the only Sub-Saharan African country to develop a wide network of unit rural banks in an effort to provide financial services to households and businesses in rural towns and villages. In theory they have an advantage over branches of commercial and development banks in knowing their local clientele and can, therefore, screen local loan applicants and investment projects better. In practice, they have not performed very well.

Cooperative systems have been developed in many countries, especially to support agriculture. Donors have often used them to channel funds to specific clientele groups. Many of the cooperatives have become insolvent, however, and many have fallen victim to fraud and corruption when they have attempted to offer savings and credit services. They have experienced better loan recovery when they are able to deduct loan payments from the commodities delivered by members.

Credit unions have received a large amount of government, donor, NGO and PVO support. The credit unions have performed best when they focused on savings mobilization. When they have been encouraged to expand lending to productive business ventures, they have run into loan recovery problems. Credit unions are unique compared to other financial

systems because of their emphasis on savings mobilization and they generally do not target their lending for specific lending purposes.

Many bilateral aid programs, NGOs and PVOs actively promote the formation of local groups to engage in self-help activities and to pool savings. The funds mobilized are often deposited in a nearby financial institutions for use in making loans to individual members. Other groups are designed to create local village banks which mobilize savings and make loans. Since many of these groups are new and receive a great deal of assistance, the conditions required for their long term viability are not yet known.

There are relatively few programs reported in the literature in which governments or donors specifically channel funds to private input suppliers and storeowners/merchants for on-lending to their clients. Since input suppliers and product traders are expected to emerge through the privatization and liberalization programs underway in many countries, this type of financial arrangement is worthy of additional study.

Loan guarantee programs have been introduced in many countries to encourage greater lending and is a technique used by Women's World Banking in its operations. The literature is quite skeptical, however, about the extent to which these programs have actually contributed to additionality in loan programs.

Finally, there are regional programs that attempt to strengthen financial programs. The African Agricultural Credit Association (AFRACA) is one such attempt. It's membership includes agricultural credit institutions and Central Banks in the region. They are beginning to experiment with MicroBanker, a software program developed by FAO for use on microcomputers to manage small deposit and loan accounts.

LESSONS LEARNED

The literature review and the focussed field visits resulted in the identification of 14 key lessons learned concerning these attempts to develop financial markets in Sub-Saharan Africa.

1. ***MACROECONOMIC AND FINANCIAL POLICIES.*** *Financial markets cannot thrive unless the general macroeconomic and financial policies of the country are reasonably conducive. In recent years, the environment has been very negative for financial market development in many countries.*

Financial institutions are affected in several ways when macroeconomic policies and market trends are disadvantageous to agribusinesses. First, low profit enterprises appear too risky for lenders to finance; therefore they make few agricultural loans so their per unit operating costs are high. Second, they have few incentives to improve their capacity to service agribusinesses effectively, if they continue to concentrate on lending to urban

customers engaged primarily in import oriented commerce and trade. Third, they are discouraged from developing financial innovations to reduce costs and improve services for agribusiness customers. Fourth, the volume of voluntary deposits is low. Fifth, loan recovery levels are low.

The current trend towards greater market liberalization, deregulation and privatization in Africa is encouraging and should provide more propitious conditions for developing the financial system and the economy as a whole. Some frustration has been expressed, however, over the slow economic response that has followed reforms. A difficulty of the heavily indebted nations is that foreign debt service coupled with fiscal imbalances lead to high interest rates for government securities; therefore, it is financially rational for financial institutions to invest in high yielding public debt rather than make loans for private sector expansion.

2. *AGRICULTURAL PRODUCTIVITY, RISKS, AND INFRASTRUCTURE.*
Problems of low agricultural productivity, high production risks, and poor or nonexistent infrastructure reduce the potential for agribusiness development and retard the development of financial markets to serve agribusinesses.

There are three important agricultural issues that have a negative impact on agricultural producers, on the agribusinesses that supply their inputs and market their outputs, and on the financial markets that provide them with financial services. The first is that productivity levels are low for many types of crops and livestock, so producers are bad credit risks because many are poor and have few reserves to cover debt obligations when profits and income are especially low. Second, agroclimatic conditions are difficult, especially in the Sahelian countries. Producers are subject to considerable production risks and periodic crop failures wipe out their savings and accumulated capital. Third, infrastructure is weak and this affects input and output markets. Some of these problems can be ameliorated with improved access to financial services, but for most finance is not the solution.

A dynamic financial and agribusiness sector is needed to stimulate on-farm production, but its development is dependent on farm demand to grow. The structural problems of the agricultural sector are likely to take considerable time and investment to resolve. In the short term, economic reforms that require reductions in budget deficits may imply a cutback in government investments for agriculture. Therefore, another factor explaining the limited supply response of agriculture to recent reforms is that investments in irrigation, research and extension have been scaled down to reduce fiscal imbalances.

3. ***LOAN TARGETING AND SUBSIDIES.*** *The subsidization and targeting of credit that has characterized many credit programs has failed to resolve the real problems faced by the target groups. But they have had a negative impact on the institutional viability of financial institutions and may have even reduced, rather than increase, financial services to small, low-income producers.*

Many credit programs have been designed to fund special groups believed to have poor access to financial services. Credit packages are often narrowly specified to fund a particular crop or production package, or for use in acquiring inputs or draft animals and equipment. Loans that qualify carry low interest rates. There are at least five problems with this approach. First, because of the fungibility of finance, borrowers will shift loan funds to other purposes if they can earn a higher rate of return. Second, if the lender attempts to prevent the diversion of funds through close supervision, lender transaction costs are driven up, making it difficult to achieve long term self-sufficiency for the program. Third, the margins authorized for many targeted programs are often too low to cover lender costs and inflation, so the lender is decapitalized even if all loans are recovered. Fourth, if a project and/or institution is started with subsidies, it is difficult to transform it into a viable self-sustaining institution. Finally, the amount of subsidies is always limited, so a subsidized program always faces a limit to the number of participants it can accommodate and there are few incentives for the participants to graduate from a subsidized program.

The result of targeted, subsidized programs is often contrary to what has been expected. The viability of financial institutions is undermined. Borrowers who receive subsidized loans are not necessarily better off if the loan simply represents a one-shot increase in liquidity rather than a regular access to finance. Because of the excess demand for funds, lenders must engage in credit rationing which permits those with influence and political connections to crowd out the small, low-income firms and households for which the funds are targeted.

4. ***INTEREST RATES AND TRANSACTION COSTS.*** *When Central Banks and governments attempt to set interest rates at below-market rates, the low interest rates charged for loans contribute to high transaction costs for borrowers and poor loan recovery, while reducing the viability of financial institutions.*

Transaction costs are high for lenders in spite of so-called "cheap" government and donor funds, and they tend to be higher than the spreads lenders are permitted to charge for loans. Since this often leads to excess demand for subsidized funds, the lenders have to employ non-price rationing when faced with interest rate controls. When borrowers face high borrowing costs they often maintain good relations with informal lending sources where transaction costs are lower. They are likely to repay the informal lenders first to maintain their credit reputation, but allow formal loans to fall into arrears if they conclude that the institution is transient and will not be able to provide a new loan after the current one is repaid. Formal financial institutions, therefore, find it difficult to achieve viability, because of narrow interest margins and poor loan recovery for targeted loans.

5. **REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS.** *The regulatory and supervisory bodies for formal financial institutions have not developed sufficient capacity in many Sub-Saharan African countries to adequately ensure the prudential regulation of formal institutions, but they are now being called upon to expand their concerns into semi-formal financial systems. More attention is needed to designing institutions that encourage honest behavior and to monitoring and control procedures to support it.*

Policymakers have often attempted to build the financial system from the top down, and to use finance to stimulate economic growth. Rules and regulations have been established to direct lending to priority borrowers and sectors. Ministries of Finance and Central Banks have been preoccupied with monitoring how financial institutions have followed these regulations and ignored their traditional function of prudential regulation. Investments required to build strong regulatory and supervisory authorities have not been made so most Central Banks are poorly staffed and trained, have little research capability, and are not equipped to conduct regular, in-depth audits of the banking system.

6. **ACCESS TO FINANCIAL SERVICES, FINANCIAL DUALISM AND FINANCIAL LINKAGES.** *Financial dualism exists to a greater degree in Sub-Saharan Africa than in other regions, and a larger proportion of firms and households rely entirely on the informal financial system for all their financial services.*

The fragmentary data that exist in Sub-Saharan Africa suggest that no more than about 10 percent of rural households and enterprises receive formal loans in any one year. A greater percentage of large, urban based firms are expected to have access to formal finance, especially for export crops, than do small, rural farms. In most countries, a somewhat larger percentage of households and enterprises, especially in urban areas, have a deposit or savings account with some type of bank, cooperative or credit union. At the same time, a much higher percentage report transactions with the informal sector. The data also reflect poor linkages between financial markets, agribusinesses and small and medium enterprises, especially in rural areas. The degree of financial linkages is important to understand for two reasons. First, where formal-informal financial linkages are numerous and important, it can be expected that macroeconomic policies, such as controls of the money supply in the formal sector, will also be transmitted to and influence the performance of informal finance. Second, where the linkages are well established, it may be possible to make formal loans to large creditworthy enterprises with the expectation that they will on-lend to smaller enterprises with most difficult access, including agribusinesses in rural areas.

7. **THE CRUCIAL ROLES OF SAVINGS MOBILIZATION AND LOAN RECOVERY.** *Savings mobilization and effective loan recovery are two key factors that influence the long term viability of financial institutions. Both affect financial institutions and their clients in positive ways.*

Savings mobilization is a crucial factor in developing sound financial markets for two sets of reasons. First, the number of persons with deposit and savings accounts in a financial institution is generally much larger than the number with loans so many savers obtain great benefit from having secure places to hold their deposits and savings. Second, there are several ways that financial institutions benefit from mobilizing deposits. The total cost of funds may be cheaper, lenders can develop their own lending programs adapted to local needs, and information obtained from servicing a client's deposit and savings accounts can be useful in evaluating creditworthiness for loans. Default rates of 20 to 30 percent are common in many programs and are too high to be covered by raising interest rates to all borrowers. Default eventually destroys or severely retards financial institutions.

8. **COLLATERAL, CONTRACT ENFORCEMENT, AND PROPERTY RIGHTS.** *The absence of well-defined property rights and unreliable legal systems are often viewed as constraints to the functioning of formal credit markets. But since land may have little value due to local customs, improvements in land titling may have little impact on access to formal loans. The informal financial system, however, has found ways to deal with these problems.*

There is some evidence that security of title increases access to financial markets, but this fact does not necessarily justify great emphasis on improving land property rights and the legal system. Two other properties of acceptable collateral are necessary. First, items pledged as loan collateral must have value, which implies that a valuation method exists. Second, the eventual transfer of ownership or control over the asset pledged as collateral must be enforceable, which implies that a socially accepted mechanism of contract enforcement exists. In the absence of effective enforcement through the legal system, informal loan contracts use explicit or implicit enforceability clauses, such as the continuance of business relationships in linked transactions, third-party guarantees, or the witnessing of contracts by local authorities. Likewise, financial transactions with internal or built-in enforcement mechanisms, including supplier credit and other linked transactions, have attained a viability and stability that formal financial transactions rarely achieve. More attention is needed to identify how traditional contract enforcement mechanisms can be applied to formal finance.

9. ***THE IMPLICATIONS OF INFORMAL FINANCE.*** *Informal financial systems are pervasive in Sub-Saharan Africa, but there is no clear view about what this implies for formal financial systems or what policymakers should do, if anything, about informal finance.*

Most Sub-Saharan Africa countries have tried to reduce the role of informal finance by actively encouraging the semi-formal and formal financial systems. In some cases, they have tried to regulate them, such as when they try to impose interest rate restrictions. Two specific options have been largely untested until recent years. The first is to design specific informal-formal linkages, such as depositing self-help group funds as a loan guarantee with banks or developing wholesale-retail credit operations with traders, processors and other large enterprises that agree to make informal loans to small enterprises with funds borrowed from a formal institution. The second is to scale up or graduate an informal or semi-formal formal financial arrangement, such as a credit union or NGO lending program, into a formal financial intermediary. More experimentation is needed, however, before conclusions can be reached about the circumstances under which these alternatives can be successful.

10. ***SPECIAL PROBLEMS OF TERM FINANCE AND DEVELOPMENT FINANCE INSTITUTIONS.*** *Most Sub-Saharan African countries lack long term domestic savings for term lending. Attempts to create Development Finance Institutions have not adequately resolved the problem.*

Term finance is especially difficult to obtain in most Sub-Saharan African countries for four reasons. First, interest rates are often fixed and are rarely adjusted for changes in inflation. For long term contracts, this results in the erosion of purchasing power for a lender's portfolio, even with full loan recovery. Second, institutions face difficulties in effectively monitoring installment payments over a long time period. Third, there is greater risk of large price fluctuations or other external shocks for a project financed for a long period, so there is a greater probability that a loan will encounter repayment problems. Finally, lenders face the risk of a mismatch in term structure when long term assets are financed by short term liabilities. These reasons cause lenders to resist making term loans, and many DFIs created to resolve these problems have failed or are near collapse. Donor funding can temporarily resolve the domestic market failure by allowing DFIs to match long term loans with long term liabilities. The basic problem is the lack of long term domestic savings; until that problem is resolved, donor funding of DFIs is a poor substitute.

11. ***COOPERATIVES, SELF-HELP GROUPS AND OTHER SEMI-FORMAL SYSTEMS.*** *In spite of the many failures of cooperatives and credit unions, the fastest growth in financial services in many countries involves ROSCAs, savings clubs, village banks and other groups that operate on cooperative and self-help principles. The most successful group approaches are those that are built with strong member participation and control.*

The experience of many group arrangements, such as cooperatives and credit unions, is checkered in Sub-Saharan Africa. It is ironic, therefore, that the most rapid growth in financial services in many countries has occurred in semi-formal entities, such as ROSCAs, savings clubs, village banks and other groups that operate on cooperative and self-help principles. Much remains to be learned about the factors that contribute to the long term sustainability of cooperatives, credit unions and other group experiences, but some conclusions are emerging. First, governmental efforts to create cooperatives from the top down and use them as conduits for inputs and have usually fared poorly compared to those that begin with strong member participation and control. Second, credit unions do best when they emphasize savings mobilization and adopt conservative lending policies. Third, there appear to be limits to the size and composition of groups that can effectively work together at the local level. Fourth, small localized groups may never be a good source of long term finance, and there may be high covariance in member income which makes them vulnerable to crop failures and other economic shocks that simultaneously affect all members.

12. ***SPECIAL PROGRAMS FOR MICROENTERPRISES AND WOMEN.*** *Special programs for lending to microenterprises and women are emerging in many countries because of their lack of access to formal financial institutions. These programs frequently involve NGOs and PVOs, and occasionally are part of large financial reform projects.*

Studies show that small enterprises face greater difficulties in accessing formal financial services than larger firms, and women in Africa play a larger role in owning and operating businesses than in other regions, so their access to credit and other financial services is important. Many NGOs and PVOs have developed programs to support microenterprises but there is considerable skepticism about the capacity of many African institutions to implement large scale microenterprise projects. Furthermore, there are doubts that credit-only minimalist projects can resolve the problems faced by many enterprises, and that the small group loan approach with frequent loan repayments can be applied to farm and agribusiness lending. Access to formal finance is problematic for women even though it is often argued that women borrowers have a better loan repayment performance than men. The reasons are not clear. In some cases, legal and land tenure issues involved with borrowing from formal institutions may make borrowing particularly difficult for women. In other cases, financial institutions may perceive that the enterprises in which women engage are too small and risky for formal loans. A clearer understanding is needed about those issues which fall within the financial domain, such as ways to

streamline and simplify loan procedures, versus those that are related to larger society-wide constraints, such as the ability of women to own and mortgage property.

13. *THE EMERGING IMPORTANCE OF NGOS AND PVOS. NGOs and PVOS have rapidly expanded to fill the perceived need for credit, especially for microenterprises and women. Questions are being raised about their long term viability.*

With the decline in large donor-funded targeted credit programs, NGOs and PVOS have been created in large numbers to fill a perceived need for credit, especially for microenterprises and women. Several NGOs are implementing microenterprise projects oriented towards farm and nonfarm activities. There are also suggestions, however, that many of these programs are precarious, that they are poorly managed, that they are not business-like, and that they exist only because of large external grants and donations. Therefore, it is not clear that this wave of external assistance channeled through NGOs and PVOS will be any more successful in the long run in contributing to financial market development than previous donor sponsored approaches.

14. *LACK OF CONSENSUS AMONG DONORS. The lack of a common approach among donors to financial market and agribusiness development leads to fragmented financial markets, a lack of competition in the financial sector, and high reporting costs. Scarce local administrative talent must be used for donor coordination rather than building and operating strong financial institutions.*

A large number of bilateral and multilateral donors, NGOs and PVOS support and operate projects designed to strengthen financial market and agribusiness development in Sub-Saharan African countries. Although there seems to be a somewhat greater consensus today than previously about the appropriate role of finance in development, there is still a great divergence among the individual approaches. The lack of a common understanding and approach among donors creates problems. Each funds a specific model or activity and the result is an uncoordinated system that leads to fragmented financial markets, a lack of competition in the financial sector and high reporting costs for participating institutions. There is a great need for improved coordination in the donor community and a greater degree of consensus in the approach to be used for financial market and agribusiness development in the region.

RESEARCH AGENDA

A research agenda is presented for A.I.D. that responds to both the short and long term needs of financial markets in Sub-Saharan Africa. The first part aims to make a short term impact by working with and through informal and semi-formal finance. The second part emphasizes the research needs for strengthening formal finance.

A short term financial strategy that may improve the agricultural sector's response to economic reforms involves the expansion of wholesale-retail financial relations in which agribusinesses, linked to formal financial institutions, use their liquidity to make informal loans to retailers, farmers and microenterprises. The rationale for this strategy is that in countries where marketing is being privatized, the larger agribusinesses may have already established their creditworthiness with local or offshore financial institutions, or will be able to do so more quickly than smaller firms. Therefore, the financial sector can perform the relatively easier task of making wholesale loans to a small number of agribusinesses which, in turn, make retail loans to many smaller enterprises.

The research to analyze this possible strategy includes two types of studies. The first type is a set of selective case studies of emerging agribusinesses engaged in input and output marketing. The second focuses on the relationships between formal financial institutions and key agribusinesses. The studies would be designed to determine how agribusinesses finance themselves now, and how they would respond to greater opportunities for retailing loans to their clients.

The long term financial strategy in Africa requires an expansion of and improvement in formal finance. Research should seek to determine the reasons responsible for the wide range of problems and failures that have occurred, and to identify policy changes and/or innovations that will improve performance. Ten key research areas are identified.

1. Interest rate levels and related transaction costs.
2. Mechanisms to reduce risks for savers and lenders.
3. Strengthening prudential regulation and supervision with possible extension to semi-formal financial systems.
4. The dynamics of user owned financial institutions that influence their sustainability.
5. Applicability of the minimalist credit-only approach to agriculture.
6. Expansion of financial linkages.
7. Mechanisms for contract enforcement and collateral substitution.
8. Issues of gender and access to financial services.
9. Techniques for deposit-led restructuring programs for financial institutions.
10. Institutions and instruments for expanding term finance.

A REVIEW OF THE LITERATURE ON FINANCIAL MARKETS AND AGRIBUSINESS DEVELOPMENT IN SUB-SAHARAN AFRICA: LESSONS LEARNED AND SUGGESTIONS FOR AN ANALYTICAL AGENDA

A. BACKGROUND

Agriculture is the dominant sector in Sub-Saharan African economies and is a potential catalyst for generating broad-based, sustainable economic growth. Improving the performance of the agricultural sector requires increasing productivity through the adoption of high-yielding technologies, improved management of natural resources, and more efficient marketing systems and agribusinesses. The efficient production, processing and marketing of agricultural commodities is often linked to access to efficient and reliable financial services. Households and businesses use a variety of savings and lending services provided through formal and informal financial arrangements. Informal sources, often available at the local level, are adequate for many types of financial needs. However, as farm and nonfarm businesses grow and become more sophisticated, they often need more sophisticated financial services of the kind offered by formal financial institutions.

In recognition of the role of finance in the process of economic development, governments and donors have devoted a significant amount of resources in Sub-Saharan Africa, especially in the past couple of decades, to the task of providing loans and other financial services to agribusinesses. These efforts may have helped specific enterprises, but most countries today still do not have a strong, viable financial sector that can provide reliable financial services to farms and other agribusinesses. In fact, many firms and households still must rely on informal sources and arrangements for the safekeeping of their savings and for loans. This paper is aimed at improving our understanding of why this situation exists and identifies areas for additional research. It is based on an extensive literature review of financial markets and agribusiness development in the region, and by focused field work in four countries.

The Africa Bureau of A.I.D. has developed A Strategic Framework for Promoting Agricultural Marketing and Agribusiness Development in Sub-Saharan Africa. As part of its effort to guide country missions in the design of successful agribusiness programs and projects, the Bureau entered into a Memorandum of Understanding (MOU) with The Ohio State University through the Financial Resources Management (FIRM) cooperative agreement to conduct research on finance in Africa. The research activities are meant to build upon and extend current knowledge about the relationship between sound financial markets and services and the development of agricultural marketing activities and agribusiness ventures. The MOU identifies four tasks: 1) conduct a literature search on Sub-Saharan African financial markets; 2) prepare a brief draft report synthesizing the literature; 3) conduct brief research activities in four select countries; and 4) present a final report including the annotated bibliography and bibliographic essay.

This paper is the final report based on the literature review and focused field work in Burkina Faso, Cameroon, Niger and The Gambia. It has two objectives. One is to synthesize the lessons learned. The second is to identify priority research issues that need to be studied in order to design better projects and programs to improve the performance of agribusinesses in Sub-Saharan Africa. Although the results may be relevant to South Africa and Middle Eastern countries, the literature searched was limited to Sub-Saharan Africa. The paper is organized to address the several issues specified in the MOU. These include a synthesis of the current approaches being used to develop financial markets and to identify what seems to have worked and what seems to have failed; to identify the lessons learned from these experiences; to suggest aspects of financial market development and financial services for agribusiness and agricultural marketing that require additional investigation; and to develop for the Africa Bureau an analytical agenda for future research on finance to be conducted in the region.

Since a comprehensive annotated bibliography of over one thousand items generated the ideas included in this paper, the references included in this paper were limited to those items that are most comprehensive, are most accessible, and have been published most recently. Therefore, they capture most completely the lessons learned in Sub-Saharan Africa during the past couple of decades. The paper is organized into six sections. Section B provides a brief summary of the approach used to identify the literature reviewed. Section C defines the elements of the financial systems found in Sub-Saharan African countries. These systems could be arrayed along a continuum from most to least formal, but for purposes of discussion they are subdivided into three financial systems: formal, semi-formal, and informal. Section D reviews the major approaches used in these countries to develop financial markets. Section E summarizes several lessons learned from the different approaches, interventions, policies and programs used in the region to develop financial markets. The last section identifies several issues and a short term and long term research agenda for financial market development.

B. APPROACH USED IN THE LITERATURE REVIEW

A fundamental task for A.I.D. is to develop a strategy, policies and programs concerning financial markets as they relate to agriculture and rural development in general, and specifically for agricultural marketing and agribusiness development. Since the relationship between finance and economic enterprises is complex, for this bibliographic review it was necessary to adopt a broad view of the literature to be searched. This section briefly discusses the issues leading to the adoption of this broad approach which, of course, influences the nature of the analysis conducted and the conclusions presented.

The general approach to the literature involved: 1) defining the financial sector to be studied; 2) searching the literature in the U.S. and abroad for information on the types of participants and clients of financial systems in Sub-Saharan Africa; 3) reviewing the

agribusiness literature with special care; and 4) developing preliminary ideas about the nature of the lessons learned and the gaps that exist in existing knowledge.

- **DEFINITION OF THE FINANCIAL SECTOR.** The financial sector of Sub-Saharan African countries is made up of several formal and informal arrangements and institutional forms. Both formal and informal arrangements may be important sources of financial services in any given country. Furthermore, understanding the factors that determine the success of informal finance may provide insights into ways to improve formal finance. For these two reasons, the literature search covered all types of financial arrangements and institutional forms, whether spontaneous or specifically designed and assisted. The financial sector will be defined in the next section as consisting of formal, semi-formal, and informal systems.
- **PARTICIPANTS IN THE FINANCIAL SYSTEM.** The participants or clients of any financial system include a wide variety of individuals, households, firms, businesses and organizations. Many studies do not specifically identify or describe the participants of the financial institution or arrangement being studied. It may be possible to learn, for example, that a credit union in Cameroon has many rural members, but there may be little information on the types of economic activity (enterprise or business) that may benefit from the financial services provided by the credit union. Therefore, the literature review included all materials that might have relevance, directly or indirectly, to rural and urban agribusinesses.
- **AGRIBUSINESS DEFINED.** The term agribusiness has been defined in several ways. We chose to adopt a broad definition in which agribusinesses engage in a wide variety of agriculturally related activities. Some involve on-farm production activities we typically think of as farming. Others involve a complex set of activities undertaken on or off the farm. This includes the typical backward linkages of input supply and distribution for rural and urban enterprises. They also include a variety of forward linkages that involve transporting, storing, transforming products produced on the farm and/or related to agricultural products. Agribusinesses range from small backyard processing activities to large scale multilateral companies. Some employ the most traditional technology, while others are tied into international markets and employ modern international technology. Although relatively little of the relevant literature actually uses the term agribusiness, in fact much of the economic activity found in Sub-Saharan Africa is directly or indirectly related to agribusiness. (See A Strategic Framework for Promoting Agricultural Marketing and Agribusiness Development in Sub-Saharan Africa, Office of Technical Resources, Bureau for Africa, Publication Series No. 90-1, USAID, 1991, for a more comprehensive discussion of this point.)
- **ECONOMIC ACTIVITY OF HOUSEHOLDS AND FIRMS, AND THE FUNGI-BILITY OF FINANCE.** Many individuals, households and firms in Africa engage in multiple economic activities. Some farmers, for example, produce commodities,

but also engage in processing, transportation and marketing activities which are often associated with agribusinesses. Likewise, a large urban firm may export both agricultural and mineral products. Because of this heterogeneity and the fungibility of finance, it is impossible, therefore, to identify studies and reports that analyze policies, projects, and institutions that benefit just one type of economic activity.

- **SAVINGS AND CREDIT.** African policymakers and donors share a concern for improving agribusiness access to formal finance, so they typically concentrate their interventions, policies and programs on lending and on public sector institutions because they can more effectively influence them. Many households and firms, however, find that deposit and savings services are even more important to them than loans, and the long term sustainability of formal financial institutions is crucially dependent on their ability to mobilize savings. For this reason, the literature review included materials that discuss both the lending and saving mobilization aspects of financial intermediation.
- **SOURCES OF LITERATURE.** The most relevant finance literature for this task is found in the U.S. Because many other bilateral donors and foreign researchers have been involved in finance, the literature search included not only the U.S., but also England, France, Germany, Italy and Portugal and donor archives such as the World Bank and FAO. Computer data bases were consulted, library collections were searched, and contacts were made with specific organizations that had access to relevant literature. The search included academic literature, consultant reports, NGO/PVO publications, and design and evaluation reports. Several publications identified in other annotated bibliographies were obtained and reviewed. A bibliography prepared by Mooney (1985) reviewed 220 A.I.D. agribusiness projects in Africa from 1970-1986. Several of these projects had credit components. The annotated bibliography by de Treville (1986) on contract farming in Africa also included some interesting publications dealing with finance. The WID bibliography by Townsend (1988) produced some relevant gender related material not found elsewhere. Since there have been many developments reported in the literature in the last decade that have changed earlier beliefs and recommendations, priority in coverage and analysis was given throughout the literature search to items produced in the 1980s and 1990s.
- **FIELD VISITS.** After the first draft of this paper was completed, brief field visits were made to Burkina Faso, Cameroon, Niger and The Gambia. These visits were structured to test some of the initial lessons learned and the ideas developed for the future research agenda. These visits involved discussions with key AID, banking and government officials, representatives of NGOs and the private sector. A list of contacts made is included in the appendix. Since funding constraints prevented more extensive field visits, a second phase of the research activity will be undertaken to explore the hypotheses and lessons learned in more detail and in more countries.

C. DEFINITION OF THE FINANCIAL SECTOR

An important first step in the analysis of the relationship between financial markets and agribusiness development is to identify the important elements of the financial sector that exist in a country. A wide variety of formal and informal arrangements, contracts and institutional forms are typically found in Sub-Saharan African countries. Together they provide financial services to both borrowers and savers. Governmental and donor policies influence how the financial sector evolves over time and how it functions to provide financial services.

Examples of the major types of financial arrangements and institutions found in Sub-Saharan Africa are presented in this section. These financial arrangements could be arranged along a continuum from most to least formal in terms of their organization and operation. But for purposes of analysis, it is useful to subdivide them into three groups or systems even if this involves some arbitrariness in grouping: formal, semi-formal and informal. In all three systems, some examples can be found that specialize largely or exclusively in lending, others in savings, and others that intermediate savers and borrowers. Table 1 lists the primary financial arrangements included in each. A brief explanation of the three systems follows. Only those examples which are most relevant for agribusiness purposes are listed.

1. FORMAL FINANCIAL SYSTEM

The formal financial system in most countries has three components. One component includes the Ministries of Finance, the Central Banks, and the other national regulatory and prudential institutions that establish the rules of the game for most formal institutions and sometimes for parts of the semi-formal and informal financial systems. Normally, these entities do not make loans or accept deposits from clients other than the formal financial institutions, but in most countries they play a large role in determining the terms and conditions under which other agents provide financial services. The Ministries of Finance directly affect financial institutions through their role in setting financial policies, influencing Central Banks, and through participation in donor financial project. Through their involvement in other policies, such as setting foreign exchange and tax rates, they influence the profitability and creditworthiness of businesses that are the clients of financial institutions.

The second component consists of a group of financial institutions that provide financial services directly to savers and borrowers, and these are the focus of this review. Several types of financial institutions found in some countries, such as insurance companies, and social security, pension and investment funds, are not included because to date they have not been important sources of financial services for agribusiness development.

Table 1
Important Components of the Financial Sector

Formal ^a	Semi-Formal ^b	Informal ^c
Regional and National Central Banks, Treasury, and Other Regulatory Bodies	Agricultural Cooperatives Credit Unions Banques Populaires	Communal Clubs Mutual Aid Associations ROSCAs
Financial Intermediaries:	Integrated Dev. Projects	Moneylenders
Commercial Banks	Village Banks	Moneykeepers/Mobile Bankers
Development Banks	Self-Help Groups	Input Suppliers
Savings Banks	Savings Clubs	Storeowners/Merchants
Postal Savings		Trader-lenders
Cooperative Banks		Farmer-lenders
Unit Rural Banks		Friends
Finance Corporations		Neighbors
		Relatives/Family

Capital Markets

- a The formal financial system includes 1) Ministries of Finance, Central Banks and national regulatory authorities; 2) formal financial institutions that provide financial services directly to savers and borrowers; and 3) capital markets including money, bond and stock markets.
- b The semi-formal financial system includes a variety of financial arrangements, often involving groups of persons as members in an organization. They usually fall outside the purview of the formal banking authorities, but are sometimes licensed and supervised by other governmental agencies.
- c The informal financial system includes a heterogeneous set of individual and group financial arrangements that generally fall outside the scope of government and donor assistance, but attempts are sometimes made to control and regulate them. Some are autonomous, while others represent a reaction to the repression of the formal system.

The third component represents the capital markets, including money, bond, and stock markets. Capital markets are in the early stages of development in Sub-Saharan African countries, such as Ghana, Kenya, Uganda and Zimbabwe. Nigeria is one of the few countries in the region in which the stock market is becoming fairly important. Although capital markets will emerge and will provide services to large scale agribusinesses, to date they have not been very important for agribusiness finance. This lack of developed capital markets may pose a constraint to the privatization of parastatals that are important in the agribusiness sector.

Formal financial intermediaries have been the focus of most government and donor intervention in Africa during the past two decades. These institutions have frequently been created, regulated, and financed with the objective of increasing their contribution to economic development. Most of the time, this objective of "supply-leading finance" has been more important than the objective of creating sustainable, prudent financial entities. The formal financial institutions most important for agribusiness development are briefly identified below and a discussion about their performance and problems is provided in the following sections.

- **COMMERCIAL BANKS.** Commercial banks are the oldest form of banking in most countries. Historically, they were often foreign owned and engaged mostly in serving an urban clientele and providing financial services for commerce and trade. A variety of measures have been employed to encourage them to expand their rural operations, but they are often accused of channeling rural savings into urban loans.
- **SAVINGS BANKS.** These institutions frequently have been organized and supported by European donors that recognized the need to stimulate the savings habit. In several countries, they have successfully mobilized rural and urban savings, but generally have not been an important source of loans except for housing.
- **POSTAL SAVINGS.** Many countries have a long history of promoting savings through the postal system. Although they mobilize savings from many households, they tend to invest in bank deposits, government bonds, and other safe financial investments rather than engage in making many loans to households or businesses.
- **DEVELOPMENT BANKS.** Governments and donors have been extremely active in creating, regulating and funding specialized development finance institutions (DFIs). DFIs are usually created to meet specific financial needs that other types of banks do not and/or can not provide. This often means that a state-owned Agricultural Development Bank or Caisse Nationale de Credit Agricole (CNCA) is created specifically to provide short, medium and long term loans to agriculture. Examples of these institutions can be found in a wide variety of countries including Burkina Faso, Kenya, Mozambique, Niger, Senegal, and The Gambia. Most of the funds lent by these banks are provided by governments and donors so these DFIs

generally do not mobilize much of their funds through deposits. This fact has made them heavily dependent on subsidies and vulnerable to failure.

- **COOPERATIVE BANKS.** A few countries have created cooperative banks as apex institutions serving agricultural cooperatives. Besides their regulatory functions for the cooperatives, they often try to capture government and other funds for on-lending by their member cooperatives that lend for production and marketing activities. These banks can be found in several countries, especially in East Africa, where there is a long tradition in cooperative development.
- **UNIT RURAL BANKS.** Ghana is the only Sub-Saharan African country with unit rural banks. These banks are owned by a large number of persons in the local community, and are chartered to provide financial services in that community. They provide both savings and lending services. One of the differences between unit banks and the so-called "village banks" being developed by NGOs is that they are formally regulated and supervised by banking authorities.
- **FINANCE CORPORATIONS.** Finance corporations are frequent in Latin American (financieras), but it is not clear if these nonbank financial institutions are important in Sub-Saharan Africa because they are not mentioned in most studies. Apparently they have met with some success in Kenya. Since African countries generally have less well developed financial systems than found in other regions, it is possible that finance corporations have not yet become important.

2. SEMI-FORMAL FINANCIAL SYSTEM

Semi-formal financial arrangements generally fall outside the purview of the formal banking authorities, but are sometimes licensed and supervised by other governmental agencies, such as a Cooperative Registrar, or are operated through a government office. They usually involve groups of persons in some type of membership organization and are often owned by the members. They may also have formal written statutes, constitutions, and by-laws. Some are created and supervised by NGOs and PVOs and receive government and donor funds to subsidize their operations and for use in on-lending to households and businesses. Many countries have used usury laws to set the maximum interest rates that the semi-formal financial system can charge on loans. Several examples of semi-formal financial arrangements that are important in the provision of financial services to agribusinesses are listed below.

- **AGRICULTURAL COOPERATIVES.** Multi-purpose agricultural cooperatives often provide loans and other financial services in addition to input and marketing services. They have been particularly popular in the East African countries of Kenya, Tanzania and Uganda. Some European donors have been active in recent years in supporting the development of agricultural cooperatives. Unlike credit unions, cooperatives usually do not emphasize savings mobilization from their members.

They are sometimes linked to apex cooperative institutions or federations from which they receive loans to finance their own operations and for on-lending. Agricultural cooperatives fund a wide range of agribusiness activities from on-farm production through off-farm processing, transport, storage and marketing.

- **CREDIT UNIONS.** Credit unions are single-purpose cooperatives that specialize in financial services. They have been actively promoted in Cameroon, Ghana, Lesotho, and Togo, and recently in Niger. A distinguishing feature of many credit unions is their strong orientation towards share ownership and savings mobilization. Whereas agricultural cooperatives often attempt to limit their loans to so-called productive purposes, credit unions typically lend for any purpose for which their members desire to borrow because obtaining a loan is a strong motive for saving by members. Hence, they finance a variety of productive and consumption purposes for households and their businesses. Credit unions have been frequently organized and assisted by churches or other NGOs and PVOs and they usually have formal operating rules. Banques populaires in Rwanda are a new type of unit financial institution that operates much like a credit union (Mugesera, 1987).
- **INTEGRATED DEVELOPMENT PROJECTS AND PARASTATAL ORGANIZATIONS.** Many Sub-Saharan African countries have included credit in integrated development projects and parastatal organizations to improve agricultural performance. For example, the A.L.D. Senegal Agricultural Production Support (APC) project provides technical assistance, training, equipment and credit to support improved cereal production (Mock, 1990). In Niger, the Centrale d'Approvisionnement receives credits from the CNCA and direct government subsidies to provide subsidized inputs to farmers through cooperatives (Graham, et al., 1987). An IFAD project in Mali channels its short and medium term credit operations through the Cotton Organization. Yet another example is the Sasagawa Global 2000 Projects in Ghana, Sudan, Tanzania and Zambia that provide credit in kind to farmers to support technological improvements in cereal production (Yudelman, 1991). Since these projects are implemented through government departments or special development agencies, the loans to farmers are sometimes made directly through a non-bank project office. In other cases, the loans are made through a cooperating financial institution or cooperative. Donor funds have supported many of these projects. The funds go to both on-farm and off-farm activities.
- **VILLAGE BANKS.** Several community based village banks have been created in recent years. For example, the Swiss organization INTERCOOPERATION, (Organisation Suisse pour le Développement et la Coopération), the French CIDR (Centre International de Développement et de Recherche), and the German GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit) are supporting the creation of village banks in Mali, Burkina Faso and The Gambia (INTERCOOPERATION, CIDR and Joint Working Group, 1989). These organizations are village organized and operated banks designed to mobilize savings and make loans in the village for production and

consumption. Unlike unit rural banks, they are not formally regulated and supervised by banking authorities. The U.S. Freedom from Hunger Foundation in its village-based credit-with-education food and nutrition programs in Ghana, Mali and Togo is stimulating village savings mobilization which is augmented by external funding sources (Aryeetey, 1992). The program in Ghana is linked to a unit rural bank. These programs are similar to the FINCA (Foundation for International Community Assistance) village banking model used in Latin America and Asia since the mid- 1980s (Holt, 1991).

- **SELF-HELP GROUPS.** The concept of self-help groups is frequently attributed to German development programs and seems to be more widely used in Asia than in Sub-Saharan Africa. Programs are being implemented to identify existing or create new village based groups and encourage them to mobilize their savings for the benefit of the village. An example is the IFAD Village Fund project in Mali. A distinguishing feature is the effort to link them with formal financial institutions by depositing group savings with a local lender. This group fund is intended as a guarantee against future individual or group loans made by the lender. The guarantee fund may be augmented by NGO funds to increase the amount of loans that can be guaranteed. The loans are typically intended to support on-farm or small off-farm processing and marketing activities.
- **SAVINGS CLUBS.** Savings clubs are like self-help groups except their primary objective, at least initially, is to simply encourage the savings habit among their members, without necessarily advocating that the savings are needed for village improvement or to establish the saver's future creditworthiness for a loan. In some cases, club members pool their labor and capital to engage in cooperative farming or other business ventures, such as with the kafos in The Gambia (Shipton, 1987). The well-known Zimbabwe Savings Clubs appear to be motivated in part by the opportunity for women to accumulate savings independent from, and sometimes without the knowledge of, other family members (Chimedza, 1989). Like the self-help groups, some savings clubs have government, donor or NGO support in their formation and operation.

3. INFORMAL FINANCIAL SYSTEM

The informal financial system includes a heterogeneous set of individual and group financial arrangements. They generally fall outside the scope of government and donor assistance, but attempts are sometimes made to control and regulate them. Some are autonomous, such as communal clubs and mutual aid associations, and can be expected to thrive even when the formal system develops and expands. Some types of trade finance, however, may represent a reaction to the repression of the formal system, and may decline in importance as the formal system develops. Since the informal system seems to thrive in spite of the problems that plague the formal system, some experimentation is underway to use the informal system to channel funds from governments and donors to farmers and small

scale enterprises. Linkages naturally exist between the formal and informal systems when traders, processors, and exporters borrow from formal institutions and on-lend to farmers and marketing agents who produce and purchase commodities. Some examples of informal financial arrangements that are important to agribusinesses are discussed below.

- **COMMUNAL CLUBS AND MUTUAL AID ASSOCIATIONS.** Although there is little systemic information, there are indications that some rural villages in Sub-Saharan Africa have developed local communal or mutual aid associations or funds to meet local needs. They seem to serve more of an insurance or community development role rather than being a source of finance for businesses. These organizations have a strong saving and self-help orientation. Some focus on mobilizing labor and funds for village projects. Others mobilize funds as part of their social activities. In some countries, the villages maintain strong links with former sons and daughters of the village who have migrated to urban and foreign jobs. These migrants often send money back to their home villages to help finance local projects. Although generally oriented towards projects that benefit the entire village, these organizations may make loans to village members in cases of emergency. Normally loans are not made to finance individual businesses.
- **ROTATING SAVINGS AND CREDIT ASSOCIATIONS (ROSCAs).** ROSCAs are a very popular form of organization for mobilizing and allocating savings in Africa. They are known under a variety of names such as tontine, osusu, susu, idir, djanggi, and tontine (Cameroon, Senegal), osusu (The Gambia), asusu (Niger, Sierra Leone), ekub (Ethiopia), djanaggi (Cameroon), and chilemba (Uganda, Zambia, Zimbabwe) (Chandavarkar, 1989). In the typical ROSCA, a group of individuals assemble around an organizer, and each member makes a fixed contribution of money at regular intervals (daily, weekly, monthly). The savings "pot" is then allocated to one member through prior agreement, through lottery, or through auction. The process continues until each member receives a pot. The cycle may then be repeated, or the group may dissolve and be reconstructed later with different members. ROSCAs are a credit mechanism for those whose turn comes up early in the cycle; for those whose turn comes up late, it is a savings mechanism. The funds are often used for consumption or to finance a lumpy investment. But since the timing of receipt of the pot cannot be predicted, ROSCAs cannot be counted upon as a source of credit for a project involving a specific calendar, such as farming (Von Pischke, 1992).
- **MONEYLENDERS.** Moneylenders are private individuals who specialize in making loans or make loans as a sideline business. They may augment their private source of capital with formal loans obtained for one of their business enterprises. They generally make short term loans, often use for consumption and emergency purposes, but also engage in lending for production purposes. Moneylending is often viewed negatively in many countries, so many firms and households hesitate to admit in surveys that they borrow from moneylenders. They have been studied in the Malawi (Bolnick, 1990), Nigeria (Eboh, Ugama and Kereke, 1991) and Sudan

(Ahmed, 1975), but generally professional moneylenders appear to be less important in Sub-Saharan Africa than in many Asian countries.

- **MONEYKEEPERS/MOBILE BANKERS.** Some financial arrangements exist that provide savings facilities through an individual agent. Village moneykeepers in Niger, for example, accept deposits from individuals and village clubs and associations for safekeeping. Sometimes these funds are used to purchase goods for the saver in the capital city or in other countries (Graham, et al., 1987). In Nigeria and Ghana, "susu collectors" visit market women daily to collect savings (Seibel, 1989). These savings agents usually pay no interest on the deposits collected, and may even charge a fee for the service provided, so factors other than the rate of return on savings motivate the savers. One motive is the possibility of a future loan because some agents are also moneylenders and use their own capital or the savings mobilized to make loans. Another motive is to physically remove the savings from the household and from the possible claims of other family members. Because of some cases of fraud, Ghana now requires that susu collectors be licensed with the Central Bank. Women's World Banking received the first license to collect savings from women market traders in Accra in a savings program which may eventually evolve into a lending operation as well.
- **PRIVATE INPUT SUPPLIERS, STOREOWNERS, TRADER-LENDERS, AND FARMER-LENDERS.** Private marketing agents have always existed for some crops and are beginning to play a larger role in countries that have privatized their parastatal marketing boards. Furthermore, the traditional local retail shops found in towns and villages have always been an important source of credit for consumption goods and for the products they sell that are used as production inputs for local businesses. These firms and individuals provide credit as a means to expand their businesses. Input suppliers and storeowners are interested in selling their production and consumption goods, so to increase sales they agree to accept deferred payments from purchasers who lack liquidity to immediately pay cash. Therefore, they provide credit-in-kind and usually receive payments in cash. Repayment may be required in a few weeks for consumption goods, or at the end of the production season or cycle for production goods. Trader-lenders, millers and processors and other agribusinesses need farm products for their trading and processing activities. They provide loans, in cash or in kind, to operators of farms and other businesses in order to assure access to the products they produce (Miller, 1977). Usually, therefore, loan repayment is made in products at the end of the crop year or production cycle. Farmer-lenders may make loans to farm workers to insure that they get labor needed for crucial periods of farm work. Loan repayment then is made in labor services during the crop season. Farm and nonfarm businesses also make loans when they consign their products to middlemen and merchants for sale.
- **FRIENDS, NEIGHBORS, RELATIVES AND FAMILY.** Informal loans are made by a variety of persons who are closely related to or are in close proximity, socially

and physically, to borrowers. These persons often provide loans for emergency purposes, but are also reported by entrepreneurs to be the most important source of funds for working capital and fixed assets used to start agribusinesses (Liedholm and Mead, 1987; Liedholm and McPherson, 1991). In many cases, these loans carry no specific term, and are repaid only when the borrower has the capacity to do so. They also tend to be interest free but may involve reciprocity when the lender needs a loan or labor services.

D. APPROACHES TO FINANCIAL MARKET DEVELOPMENT

The purpose of this section is to summarize the major approaches used by governments and donors to develop financial markets in Sub-Saharan Africa during the past couple of decades. This review is limited to those approaches for which the agribusiness sector is one of the sectors expected to benefit from the approach. The presentation focuses on the institutional forms that have been the target of the approach, or through which financial services are channelled to businesses and enterprises.

Three general observations should be made about the literature reviewed before discussing the individual approaches. **First**, much of the literature is case study oriented with few cross-country studies or syntheses that attempt to systematically review the experiences of several countries. Therefore, it is necessary to view with caution the recommendations often found in studies which suggest that countries should introduce some specific reform or adopt some innovation because it appears to have worked in some small application in one country. Furthermore, the lack of systematic comparative analyses and thorough review of lessons learned is one of the reasons that similar problems emerge across countries and programs, and why policies and programs are introduced in a country when they have been shown to be flawed in other countries.

Second, the literature clearly shows that most governments and donors have pursued a supply-leading approach to finance which has emphasized increasing the supply and reducing the cost of loans to specific sectors (i.e., agriculture, small farmers, etc.). Institutional strengthening has also been pursued but usually to support the supply-leading strategy rather than to build strong financial intermediaries. To reach their objectives, governments have established targeted credit lines for specific clientele groups, have set quotas for commercial bank loans to these groups, have limited and subsidized interest rates, have channelled funds through banks, cooperatives and credit unions that agree to lend to the desired clientele, and have created specialized agricultural development banks and other institutions to specialize in lending to these groups.

The supply-leading approach has been shown to have several fundamental weaknesses. It ignored savings mobilization and created a dependency syndrome in which the lenders become dependent on cheap government and donor funds. It created rent

seeking opportunities in which nontargeted borrowers used political influence to gain access to the cheap funds. Financial institutions were undermined because they were often not allowed sufficient margins to cover their costs and risks. Finally, credit was treated as an input in production so its value as a fungible resource was ignored.

The reforms that have been undertaken in many Sub-Saharan African countries in the past few years have reduced or eliminated many of the problems associated with targets, quotas and interest rate restrictions. Many institutions are now placing more emphasis on savings mobilization, recovering loans and covering operational costs. However, it is disturbing to note that many of the recent NGO and microenterprise projects reported in the literature appear to be repeating some of these same mistakes today (Adams and Von Pischke, 1992).

The third observation is that, until recently, most governments and donors have shied away from using the private sector to provide financial services to the agribusiness sector. At best, cooperatives are created and/or are used to channel loans to farmers and agribusinesses. But few programs, for example, try to stimulate traders or trading networks to lend to priority clientele groups. This results in a heavy bias towards state involvement with its several problems of accountability and viability. This problem will be discussed in detail later.

- **COMMERCIAL BANKS.** The objective in many countries has been to expand commercial bank services to rural areas because of the perception that households and businesses in rural Africa suffer from a credit constraint greater than their urban counterparts. Efforts have been made to reduce the urban bias of banking by expanding the banking network into rural areas, and by reducing the interest rate and increasing the amount of loans made to rural customers. Nigeria has been particularly active in this approach by setting targets or quotas for the commercial banks that specify a proportion of their loan portfolio that should be allocated to rural loans (Okorie, 1988). Banks that did not meet their quota were required to deposit the deficit interest free in the Central Bank for lending to the Nigeria Agriculture and Cooperative Bank. The Central Bank of Kenya followed a similar policy beginning in 1975 when it required the commercial banks to lend 17 percent of their deposit liability to agriculture (Masini, 1987). Donors have often channeled project funds through central banks for commercial bank on-lending to targeted customers. Many of these programs and policies have been developed on the expectation that commercial banks would overcome their traditional reluctance to lend to rural clients if their cost of funds would be reduced, and if they gained experience in rural lending through participation in an integrated project which removed or reduced some of the production and market problems normally confronted by their borrowers. The Nigerian experience reflects the difficulty of getting banks to make loans to borrowers and sectors they perceive to be risky and uncreditworthy (Central Bank of Nigeria, 1986). The experience of many countries that recently reformed their financial systems is that commercial banks have tended

to withdraw from agricultural lending. This has been the case in Ghana, The Gambia and Uganda. This trend is likely to continue as long as banks continue to hold a negative view about agriculture and agribusinesses, and as long as high interest, low risk alternative investments exist in government securities.

- **SAVINGS BANKS AND POSTAL SAVINGS SYSTEMS.** Most African countries have a Post Office Savings Bank and/or some other types of savings bank. They are often important for small savers. For example, Niger has a Caisse National D'Epargne (CNE) which mobilizes savings through the post office branch network. It is the only formal financial institution to supply deposit services in rural areas. A survey of farm households revealed that although little formal savings was reported, the CNE was the single most important institution where deposits were kept (Graham, et al., 1987). The rural nonfarm population, however, represented a much larger share of CNE accounts and represent the greatest potential for rural savings. Surely many of these accounts represent local agribusinesses that use the CNE to hold their temporary surpluses. Another example is the Caisse Générale d'Epargne in Zaire which specializes in the collection of savings from individuals through the widest network of branches of any bank in the country. Until 1978, these savings were used mainly to make medium to long term mortgage loans and invest in public debt instruments. After 1978, it began to make small, short term consumer loans and short term commercial credit to small and medium private traders. The institution was in jeopardy as of 1987, however, because of bad debts on mortgage loans and accumulated operating losses (Masini, 1987).

Two problems have prevented savings institutions from playing a larger role in the financial development of African countries. The first is that many pay low interest rates on savings and offer poor service so they have not realized their potential to mobilize savings. The second is that their resources are often deposited with the Treasury or a local bank to minimize the risk of managing assets. Considering the limited capacity of these institutions, this is a prudent policy. But some might play a more dynamic role by lending, especially in rural areas where they are the only formal institution. One example of this possibility is the fact that the AID Mission in Madagascar is considering ways to energize the National Savings Bank (Caisse D'Epargne) and assist it to begin lending operations.

- **DEVELOPMENT FINANCE INSTITUTIONS.** DFIs have been set up to support agricultural development in many African countries. In West Africa, these often take the form of CNCAs. With the exception of the Burkina Faso CNCA, many DFIs have performed poorly. Many DFIs have been expected to perform both wholesale lending to governmental parastatals engaged in input supply and commodity marketing, and retail lending to farmers and cooperatives. Donors often use DFI branches as retail outlets for the credit components of their integrated development projects. The limited branch network of most DFIs restricts their ability to mobilize deposits and make retail loans. Since they do not mobilize many savings and are

government agencies, most of the lending of DFIs is targeted, either to specific parastatals and cooperatives in their wholesale function, or to specific types of borrowers for targeted end uses in their retail function. A large amount of the assets of many DFIs represent nonperforming loans made to parastatal organizations. As a result of their poor performance and as part of the financial reforms ongoing in Africa, some DFIs are being closed, others are being recapitalized, and donors have been encouraged to rethink the role of these institutions in development (McKeon, 1990). Specific examples include the closing of the CNCA in Niger, and the closing of the Agricultural Development Bank and the privatization of the Gambian Commercial and Development Bank in The Gambia.

- **UNIT RURAL BANKS.** Ghana is the only Sub-Saharan African country to develop a wide network of unit rural banks of the type found in the U.S. and the Philippines. They were designed to provide financial services to households and businesses in rural towns and villages (Addeah, 1989). Their stockholders are residents of the local area, so in theory they have an advantage over branches of commercial and development banks in knowing their local clientele and can, therefore, screen local loan applicants and investment projects better. They have been supported by government equity investments, and by special credit lines from the Central Bank. They also benefit from special training and assistance programs, and are used by the government and donors to finance cocoa production and other agribusinesses. Therefore, these banks participate in targeted programs, but have the flexibility of mobilizing savings, and determining their own lending activities within the general constraints set by Central Bank regulations.
- **COOPERATIVE SYSTEMS.** Many African governments have actively supported the development of agricultural cooperatives, and some have stimulated the formation of national federations and apex cooperative financial institutions. For example, the Cooperative Bank of Kenya was set up in 1965 to serve at the central bank for the cooperative movement. It was designed to both mobilize savings and make loans. Then in 1969, the Agricultural Finance Corporation was set up as a specialized lending institution to lend to farmers, cooperatives, and private companies (Masini, 1987). Likewise, the Agricultural Finance Corporation of Zimbabwe was created in 1981. Almost ten years later, it became active in small farmer lending through a World Bank project. Prior to that, small farmers were largely served by agricultural cooperatives linked together in the Central Association of Cooperative Unions (Masini, 1989). Some government and donor programs aim to directly support the cooperatives so they eventually become stronger sources of services, including finance, to their members. Other programs, such as the A.I.D. Agricultural Sector Loan I project in Kenya, have used a cooperative bank as an institution to extend loans to farmers. Many cooperatives have encountered problems of insolvency, and many have fallen victim to fraud and corruption, such as occurred in The Gambia (Clark, 1987). Rarely have cooperatives been able to manage successfully the offering of savings and credit services. The Danish-funded

Cooperative Development Fund in Kenya seems to have had a somewhat better experience. The funds went through the Cooperative Bank of Kenya to the cooperative societies that on-lent to its members. It has experienced fairly good recovery because it can deduct loan payments through coffee and milk deliveries to cooperatives (Danida, 1989).

- **CREDIT UNIONS.** Donors, NGOs and PVOs have actively supported the African Credit Union movement. A.I.D. has channeled much of its support for country projects through the World Council of Credit Unions (WOCCU) and the Credit Union National Alliance (CUNA). A.I.D. funded credit union projects have been particularly active in Cameroon, Lesotho and Malawi, and more recently in Niger. The Canadians and Germans have also been active supporters of the movement in several countries. As with cooperatives, sometimes the assistance has aimed to strengthen the movement directly through the provision of equity capital, technical assistance and training to credit unions and their national leagues and federations. In other cases, the credit unions were assisted indirectly with funds provided by governments or donors for on-lending to their members. The technical assistance and training programs were intended to help credit unions improve their performance, recruit more members and savings, make better quality loans, and increase loan recovery. One of the objectives of this assistance has been to encourage credit unions to more aggressively make loans to productive business ventures rather than deposit their surplus funds in banks. But when the Cameroon credit unions began to move in this direction, they ran into increased loan recovery problems (WOCCU, 1985). It was concluded that one of the problems that seriously weakened the credit unions in Lesotho was their involvement in projects designed to expand productive lending when they were not adequately prepared to undertake it (WOCCU, 1992).

Two important characteristics of the credit union movement distinguish it from many other approaches to financial sector development. First, savings are emphasized and are a necessary condition for participation in the credit union. Second, unless they get involved in government or donor lending schemes, credit unions normally do not target their own funds for specified lending purposes. In fact, credit unions often do not keep detailed records on purposes of individual loans. It is expected that they play an important role in financing on-farm and off-farm agribusinesses. Magill (1991) estimated that 3 to 4 percent of the loans made by credit unions in Malawi went to small enterprises primarily involved in trading or home-based businesses. In Togo, almost one-quarter of the credit union loans made in 1989 were for small-scale production and commercial activities. About 80 percent of loans went to vendors, traders and small shopkeepers. Data from a sample of loans revealed that they largely financed sales of foodstuffs (cereals, corn, fish) and textiles (clothing, cloth, woven materials).

- **SAVINGS CLUBS, SELF-HELP GROUPS AND VILLAGE BANKS.** French, German, Swedish and Swiss bilateral programs, many NGOs and PVOs and multi-

lateral agencies have active projects to stimulate individuals to form groups for self-help activities, and to pool their individual savings. The savings club approach in Zimbabwe emphasizes the savings habit as a way to accumulate money for future production and consumption uses. Women often find this to be an important motivation for participation. Saving to establish creditworthiness for a future loan seems to be a secondary consideration for most savings clubs. The funds mobilized are deposited in the nearest financial institution. For example, the IFAD Financial Village Fund project in Mali began working with village associations (villages) in 1985 to promote socio-economic development of villages. A specific objective is to collect savings for deposit in a village account in the Banque Nationale de Développement Agricole (BNDA). Loans have been made for oxen, farm equipment, and seasonal inputs of seed and fertilizer (Bédard, Volume 2, 1987). The village bank approach in Burkina Faso, Mali and The Gambia is designed to actually develop small scale village banks in which savings are mobilized, deposited and used within the village (Chao-Beroff, 1990).

Although there is considerable interest in these participatory groups, particularly within the NGO and PVO community, the large international donors are just beginning to use them for on-lending for development projects. The uses made from loans provided by these groups, therefore, cover a wide range of consumption and production purposes, at both the individual and group or village levels. A characteristic that differentiates these groups from other types of financial arrangements is the relative homogeneity of the participants and the small size of the groups. To choose to participate, to accept the financial and social obligations of membership, and to accept group liability for loans requires that the members know each other. This knowledge can be most easily obtained by restricting group membership to one village, to persons in the same occupation, and to persons with the same social and ethnic background (Schrieder and Cuevas, 1992; Slover and Cuevas, 1991).

- **PRIVATE INPUT SUPPLIERS AND STOREOWNERS/MERCHANTS.** Although suppliers of production inputs and consumer goods frequently provide informal credit, there are relatively few programs recorded in the African literature in which the government or donors specifically channeled funds to these sources in an effort to increase their ability to offer credit. One exception is the A.I.D. Senegal Agricultural Production Support project, approved in 1987 and evaluated in 1990 (Mock, et al., 1990). It was designed to increase cereal production by improving seed production, input distribution, and crop storage, marketing, and processing. Credit was to be provided through the banking system to firms engaged in these activities, and the input suppliers were expected to on-lend to the cereal producers. At the time of the evaluation, the financial component had never really been tested. The commercial banks were not willing to lend to the small and medium enterprises targeted for the project because of their perceived risk. The banks were willing to lend to the largest input distribution firms, but most of them had already borrowed up to the limit acceptable to the banks. There is little information available on

which to judge whether or not increasing formal loans to these types of firms results in greater informal on-lending to farmers or agribusinesses. Furthermore, many local government officials have a hostile and suspicious attitude towards private traders, sometimes because of ethnic differences, so it is difficult to get them accepted as legitimate participants in targeted programs.

- **LOAN GUARANTEE PROGRAMS.** Nigeria is one African country that aggressively promoted the use of a loan guarantee program in an effort to reduce lender risk and, thereby, encourage greater lending. Some NGOs and PVOs use second tier guarantee programs to expand the loans available to self-help groups. The Women's World Banking in Ghana and The Gambia deposits funds as guarantees in banks that agree to expand lending for women. The literature generally has been skeptical about the extent to which guarantee programs in developing countries actually contribute additionally to loan programs (Levitsky and Prasad, 1987). The argument usually made is that if a lender thinks that a loan will be good, it will be made; if it is expected to be a marginal or bad loan, it will not be made even if there is a guarantee, since only part of the loan will be covered.

There is little information available to comprehensively evaluate the impact of guarantees on volume of lending or the type of loans made. The Nigerian experience is indicative of some of the problems encountered with guarantees. The Agricultural Credit Guarantee Scheme Fund in Nigeria was designed to support lending for establishing and managing plantations, cultivating a wide variety of crops, and poultry, livestock and fish farming. It became operational in 1978. The liability of the Fund ranged from 75 to 100 percent of the loans made. Although the volume of guaranteed loans has grown, the basic problems that banks face in lending to agriculture and agribusinesses, such as high administrative costs, uncompetitive rates of interest, and lack of rural infrastructure, were not resolved. Therefore, as early as 1984, it was predicted that the bad debt problem faced by banks would simply be transferred to the fund (Ghatpande, 1984). An evaluation in 1986 concluded it had largely benefitted large farmers, had not significantly contributed to commercial bank lending to agriculture, but suffered a large default rate which impaired its ability to recycle the fund. The weaknesses were diagnosed as: 1) a belief by borrowers that they did not have to repay banks because the loans were guaranteed, 2) diversion of funds due to low interest rates, 3) high default rates, 4) low coverage of small farmers and cooperatives, and 5) cumbersome procedures and delays in repaying claims (Central Bank of Nigeria, 1986).

Subsidized credit guarantee funds have been set up in several WAMU (West African Monetary Union) countries to guarantee loans made to assist small, medium and cottage industries. Generally, these funds have not benefitted many businesses, yet have experienced large losses and have required frequent replenishment of their funds (Balkenhol, 1990).

- **AFRICAN REGIONAL AGRICULTURAL CREDIT ASSOCIATION (AFRACA).** In addition to the different approaches to financial market development that have been attempted in individual countries, one regional approach should be mentioned. AFRACA, headquartered in Nairobi, Kenya, is part of the FAO system of regional agricultural credit associations. They were started with FAO sponsorship and support in the mid 1970s, but have now largely outgrown FAO financial support and receive support from donors directly. Major agricultural credit institutions and Central Banks are members and pay annual dues. AFRACA's programs include periodic technical meetings to report on issues important to the member countries, specialized training programs, distribution of publications, and the funding of small scale research projects. AFRACA is currently experimenting with Microbanker, a software program developed by FAO for use on microcomputers to manage small deposit and loan accounts. The first installations in Asia were evaluated as being successful in reducing bank operating costs and releasing staff for other activities, such as improved loan collection programs.

E. LESSONS LEARNED

This section presents our analysis of the major lessons learned about the policies and programs used to stimulate the development of financial markets and agribusinesses in Sub-Saharan Africa. Our analysis is based on the literature review, the visits made to the four countries, and the previous professional experiences that OSU faculty have had in the past several years studying African financial markets. These have included major studies in Niger, Mozambique, The Gambia, and Zaire, and short term assignments in Cameroon, Ghana, Kenya, Guinea, and Togo. The topics covered in this section begin with general macroeconomic concerns and end with specific financial ones. Most of the lessons cut across the various institutional forms discussed in the previous sections, and the exceptions are specifically noted. Most apply to all countries, but because of differences in history, development strategy, and policy environment, some are more significant in some countries than in others.

1. MACROECONOMIC AND FINANCIAL POLICIES

Financial markets cannot thrive unless the general macroeconomic and financial policies of the country are reasonably conducive. In recent years, the environment has been very negative for financial market development in many countries.

The general economic and political environment in which financial systems operate makes a significant impact on their performance. Unfortunately, several Sub-Saharan African countries have experienced serious political disruptions, wars and civil conflicts. Ethiopia, Liberia, Mozambique and Somalia are a few of the countries with these problems.

Obviously, in these circumstances, the disruption of economic activities and uncertainties about the future affect decisions and abilities to save, invest and respect previous contracts. Where these conflicts are widespread, there is little opportunity to build strong financial markets, and donors can do little except provide emergency humanitarian assistance. An important concern in the major strife-ridden countries is the length of time that may be required for the economy to recover and for economic institutions, including banks, cooperatives, and credit unions to be rebuilt.

Many financial sector programs and projects designed to strengthen financial markets directly or indirectly have involved targeted assistance to specific institutions and/or clientele groups. The general macroeconomic environment has been largely ignored. Increasingly, the Africa literature has noted the important role of the macroeconomic environment in influencing economic performance generally, and the financial sector specifically (World Bank, 1989; Callier, 1991).

It is now well documented that the general development strategy and accompanying macroeconomic policies pursued in several countries are major disincentives for agricultural growth. A study by Krueger, Schiff and Valdés (1988) found that the impact of government policies on agriculture from 1975 to 1984 was large and negative for Côte d'Ivoire and Zambia, but positive for Ghana. In several countries, import substitution industrialization policies and the heavy taxation of agriculture through parastatal marketing boards have tipped the terms of trade away from agriculture. Interest rate and other subsidies have been rationalized as a way to partially compensate for this discrimination. The problem is that the disincentives affect all producers with marketable surpluses, while usually only a few benefit from the subsidies. In addition, there are particular market circumstances and price movements that affect specific countries. The termination of the coffee agreement and the resulting price decline affects the major coffee producers; low cost foreign commodities, such as those available from the Republic of South Africa, discourage production and marketing of specific crops in Lesotho and other neighboring states (Simmons and Herlehy, 1990).

The relative impact of exogenous shocks versus policy failures varies widely across countries. For example, the Sudan did not suffer any deterioration in international terms of trade from 1973-75 to 1981-83, but its policy framework became highly distorted. On the other hand, Malawi lost five percent of its gross domestic income to movements in terms of trade, but its policy distortions remained relatively low. The terms of trade loss in Zambia was 18 percent of GDP and policy distortions reached a high level (Gulhati, 1988).

Financial institutions are affected in several ways when macroeconomic policies and market trends operate to the disadvantage of agribusinesses. First, low profit enterprises appear too risky for lenders to finance; therefore they make few agricultural loans so their per unit operating costs are high. Second, they have few incentives to improve their capacity to service agribusinesses effectively, if they continue to concentrate on lending to urban customers engaged primarily in import oriented commerce and trade. Third, they are

discouraged from developing financial innovations that will reduce costs and improve services for agribusiness customers. Fourth, the volume of voluntary deposits is low. Fifth, loan recovery levels are low.

Unsound financial policies have also had a negative impact on the financial sector in many Sub-Saharan countries (Jaeger, 1991). Interest rate controls have prevented lenders from establishing margins sufficiently high to cover costs and risks of lending to a dispersed agribusiness clientele. For example, Simmons and Herlehy (1990) noted that the maintenance of negative interest rates in Malawi jeopardized the financial viability of the institutional credit system designed to serve rural clients. Low interest rates and the availability of donor funds are believed to discourage rural savings mobilization in many countries. Barriers to entry and exit and detailed regulation of banks prevent the creation of new banks and discourage the development of financial innovations. The mandatory quotas used in Nigeria and Kenya to force lenders to make low interest loans to agriculture and other priority sectors force interest rates up in the non-priority sectors as lenders are forced to cross subsidize their operations. This may slow growth in the nonagricultural sector with negative spillover effects on agriculture.

The political economy of economic policymaking and political interference into financial decisions about whom to lend to and from whom to collect appear to be significant issues, although the literature on them is sketchy. What seems clear is that the pervasive efforts to control economic and financial activity in Africa creates excellent opportunities for rent seeking behavior so that some financial decisions are made on noneconomic and nonfinancial criteria.

The current trend towards greater market liberalization, deregulation and privatization in Africa is encouraging and should provide more propitious conditions for developing the financial system and the economy as a whole. Some frustration has been expressed over the slow economic response that has followed reforms in Ghana, Malawi and The Gambia. The lack of entrepreneurial skill, on the one hand, and the remaining economic and political uncertainty, on the other, have been identified as possible explanations. High interest rates are also identified as a problem. The difficulty of the heavily indebted nations is that foreign debt service coupled with fiscal imbalances lead to high interest rates for government securities. Therefore, it is financially rational for financial institutions in Ghana, The Gambia and Uganda, for example, to invest in high yielding public debt rather than make loans required for private sector expansion. This crowding out problem disappoints those who thought that the recent economic and financial reforms would result in a greater flow of funds to agribusinesses. Even though the reforms improved opportunities for private sector development, several problems still prevent the financial systems from being more responsive in supplying financial services to agribusinesses.

The accumulation of foreign debt in many countries, coupled with macroeconomic and political uncertainty, and the uncertainty about the CFA franc zone, have dampened the development of linkages with international financial markets in two ways (Sirleaf and

Nyirjesy, 1991). **First**, many international banks began to withdraw their branches from Sub-Saharan Africa in 1985. The countries affected include Cameroon, Congo, Côte d'Ivoire, Gabon, Kenya, Liberia, Mauritius, Niger, Nigeria, Senegal, Sierra Leone, and Sudan. These departures were only partially offset by the expansion of Ecobank, Meridien and Equator in the region. **Second**, bank lending in the region in recent years has been concentrated in a few countries, especially Côte d'Ivoire, Kenya, Mauritius, Mozambique, Niger and Zimbabwe. Offshore financing for specific agribusinesses is not well documented, but it is expected to be concentrated among the largest, most creditworthy customers and used to facilitate the importation of raw materials and equipment (i.e., to expand export sales from developed countries) and the exportation of major African agricultural commodities. This type of lending is likely to be secured with offshore deposits or some form of irrevocable repayment.

2. AGRICULTURAL PRODUCTIVITY, RISKS, AND INFRASTRUCTURE

Problems of low agricultural productivity, high production risks, and poor or nonexistent infrastructure reduce the potential for agribusiness development and retard the development of financial markets to serve agribusinesses.

This review did not probe deeply into the large literature that exists about the production problems of agriculture. That would require an in-depth separate study, and there are great differences in interpretation about the African experience. Proponents of one school of thought argue that the problem is economic, that is, inadequate incentives for producers. Another school of thought argues that the problem of agriculture is technology, that is, appropriate production technology has not yet been developed for African conditions.

There are three important agricultural issues in many Sub-Saharan African countries, that are more acute than in many Latin American and Asian countries, and that have a negative impact on agricultural producers, the agribusinesses that supply their inputs and market their outputs, and the financial markets that provide them with financial services. The first is that productivity levels are low for many types of crops and livestock, so even if production costs are low, profit margins are thin. Producers, therefore, are bad credit risks because many are poor and have few reserves to cover debt obligations when profits and income are especially low. Second, agroclimatic conditions are difficult, especially in the Sahelian countries. Producers are subject to considerable production risks in spite of the multiple cropping and intercropping strategies they employ. Periodic crop failures wipe out their savings and make it difficult for them to accumulate capital. Third, infrastructure is weak and this affects input and output markets. Some of these problems can be ameliorated with improved access to financial services, but for most finance is not the solution. Seed and fertilizer supplies are often irregular, pesticides and agricultural chemicals unavailable, marketing channels inefficient, and roads, bridges, ports and information systems underdeveloped and easily disrupted.

Farmers respond to incentives. When they expect to receive good commodity prices, they expand output by purchasing more inputs and adopting new technology. As their income and food security grow, they are more inclined to consider new methods to reduce environmental risks and preserve fragile natural resources. This leads to increased demand for good quality inputs, for transportation and marketing services, and for information about technology, prices and markets. Therefore, a dynamic financial and agribusiness sector is needed to stimulate on-farm production, but its development is dependent on farm demand to grow and become a dynamic contributor to development.

Often, the analysis conducted to justify targeted credit projects has underestimated the negative consequences of agricultural productivity, risk and infrastructure problems on the demand for loans. Credit can give farmers some additional liquidity to stimulate production. But it cannot resolve these more fundamental problems, which in the long run determine the success of the agricultural sector and the financial system that serves it. The attempt to raise agricultural production in Lesotho, for example, through increased lending by credit unions did not succeed because credit was not the key constraint to improved production (Simmons and Herlehy, 1990). Farmers who participate in targeted credit programs may even be worse off when the programs fail due to these underlying problems, but they are saddled with bad debts that prevent them from getting future loans. A clear example of this bad debt problem recently occurred in Ghana when the loan recovery rate in the Sasagawa Global 2000 project plummeted as it rapidly expanded from hundreds to thousands of participants (Yudelman, et al., 1991).

These structural problems of the agricultural sector are likely to take considerable time and investment to resolve. In the short term, economic reforms in structural adjustment programs that require reductions in budget deficits may require a cutback in government investments for agriculture. Therefore, another factor explaining the limited supply response of agriculture to the reforms is that the investments in irrigation, research and extension which may have contributed to past growth and productivity have been scaled down to reduce fiscal imbalances.

The structural problems of African agriculture also translates into reduced demand for commercial credit by agricultural producers and agribusinesses. Farmers and agribusinesses that face weak profits and high risks cannot pay the high interest rates currently charged for commercial loans. Nor can they risk losing their current assets by pledging them for loans. This explains the fact that much of the demand for small, high interest informal loans is for trading and commercial activities. This negative situation will change as the positive efforts of reform are felt. Although there are demand constraints in international markets, especially for traditional export crops (Koester, et al., 1990), there are opportunities for expansion into new market niches, such as horticultural exports (Islam, 1990). The successful expansion of horticultural exports in Kenya and the emergence of these exports in The Gambia demonstrate this potential (McFarland, et al., 1989). As the demand for these products grow, so will the demand for credit and for inputs and marketing services provided by agribusinesses.

3. LOAN TARGETING AND SUBSIDIES

The subsidization and targeting of credit that has characterized many credit programs has failed to resolve the real problems faced by the target groups. But they have had a negative impact on the institutional viability of financial institutions and may have even reduced, rather than increase, financial services to small, low-income producers.

Many credit programs have been designed to fund special groups believed to have poor access to financial services, such as cotton growers, cereal producers, or nonfarm enterprises. To stimulate the adoption of specific cropping patterns and production practices, credit packages are often narrowly specified to fund a particular crop or production package, or for use in acquiring inputs or draft animals and equipment. Loans that qualify carry low interest rates. There are at least five problems with this approach. First, because of the fungibility of finance, borrowers will shift loan funds to other purposes if they can earn a higher rate of return. Second, if the lender attempts to prevent the diversion of funds through close supervision, lender transaction costs are driven up, making it difficult to achieve long term self-sufficiency for the program. Third, the margins authorized for many targeted programs are often too low to cover lender costs and inflation, so the lender is decapitalized even if all loans are recovered. Fourth, if a project and/or institution is started with subsidies, it is difficult to transform it into a viable self-sustaining institution. Finally, the amount of funds for subsidies is always limited, so that a subsidized program always faces a limit to the number of participants it can accommodate, and there is no possibility of expanding it to all those enterprises that merit subsidies. There are also few incentives for the participants to graduate from a subsidized program into a commercial unsubsidized lender.

Firms and households develop a complex pattern of production and financial arrangements to meet their needs. Often times they engage in several income earning enterprises simultaneously to utilize idle resources and distribute their income risks. Targeted programs, that encourage them to specialize in certain enterprises without providing strong support in the event of failure, expose them to increased risks. Lenders that offer loans for a variety of untargeted production and consumption activities are more likely to provide useful services and, therefore, will likely be valued by their customers.

The result of these targeted, subsidized programs is contrary to what has been expected. The viability of financial institutions is undermined. Borrowers who receive subsidized loans are not necessarily better off if the loan simply represents a one-shot increase in liquidity rather than a regular access to finance. Because of the excess demand for funds that exists, lenders must engage in credit rationing which permits those with influence and political connections to crowd out the small, low-income firms and households for which the funds are targeted.

4. INTEREST RATES AND TRANSACTION COSTS

When Central Banks and governments attempt to set interest rates at below-market rates, the low interest rates charged for loans contribute to high transaction costs for borrowers and poor loan recovery, while reducing the viability of financial institutions.

Only two studies were found that carefully calculated the transaction costs of financial intermediation. These two studies, in Niger and the Sudan, suggest that the cost pattern found in other regions also exists in Sub-Saharan Africa (Ahmed and Adams, 1991; Graham et al., 1987). Transaction costs are high for lenders in spite of so-called "cheap" government and donor funds, in part because of the heavy reporting costs associated with them. The costs tend to be higher than the spreads they are permitted to charge for loans. Since this often leads to excess demand for subsidized funds, the lenders have to employ non-price rationing when faced with interest rate controls. This means that borrowers face high borrowing costs because of the bureaucratic procedures involved, the number of trips and the expense required in travelling to the lender to monitor the application process, the occasional bribe that must be paid, etc. Even if they are lucky enough to get a loan, the borrowers often maintain good relations with informal lending sources because the transaction costs are lower, even if the interest rates are higher, and they are usually a reliable source of consumption and emergency loans. Furthermore, borrowers are likely to repay the informal lenders first in order to maintain their credit reputation, but allow formal loans to fall into arrears if they conclude that the institution is transient and will not be able to provide a new loan after the current one is repaid. Formal financial institutions, therefore, find it difficult to achieve viability, because of narrow interest margins and poor loan recovery for targeted loans.

5. REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

The regulatory and supervisory bodies for formal financial institutions have not developed sufficient capacity in many Sub-Saharan African countries to adequately ensure the prudential regulation of formal institutions, but they are now being called upon to expand their concerns into semi-formal financial systems. More attention is needed to designing institutions that encourage honest behavior and to monitoring and control procedures to support it.

Policymakers have often attempted to build the financial system from the top down, and to use finance to stimulate economic growth. Many attempts have been made to mobilize domestic and international resources, and channel them through various institutional means to targeted enterprises and individuals. Rules and regulations have been established to direct lending to priority borrowers and sectors. Ministries of Finance and Central Banks have been preoccupied with monitoring how financial institutions have followed these regulations. As a result, they have ignored their traditional function, that is, prudential regulation with the aim of developing strong financial institutions. Investments

required to build strong regulatory and supervisory authorities have not been made. Therefore, most Central Banks are poorly staffed and trained, have little research capability, and are not equipped to conduct regular, in-depth audits of the banking system. Rules either do not exist or are not enforced to prevent excessive lending to insiders or to one client. There is little attention to assuring that institutions properly and uniformly report on loan recovery, or make reasonable allowances for bad debt. Training programs for the banking sector are weak or nonexistent (Ogunleye, 1991).

At the semi-formal and informal level, problems can also be serious. Credit union and cooperative officials have embezzled money and have made excessive loans to managers, employees, and to elite members who have sufficient power to avoid repayment. These problems contributed to a weakening of the credit unions in Ghana and Lesotho.

There are suggestions that problems of petty corruption and thievery are endemic in Africa and are bound to damage financial institutions. These problems are known but not widely documented. For example, it is clear that corruption was a major factor in the demise of many DFIs, such as the Agricultural Development Bank in The Gambia. Although these problems may explain part of the phenomena, it is more likely that insufficient attention has been paid to designing institutions that encourage and reward honest behavior and to institutionalizing monitoring and control procedures to support it. This problem must be resolved if formal financial institutions are to function properly, and if savers are to have enough confidence to entrust their savings to them. It is particularly important now that liberalization measures are deregulating interest rates, targets, quotas, etc. The negative experience of the Southern Cone countries in South America following financial reforms shows the danger that exists for financial systems when prudential regulation is neglected.

6. ACCESS TO FINANCIAL SERVICES, FINANCIAL DUALISM AND FINANCIAL LINKAGES

Financial dualism exists to a greater degree in Sub-Saharan Africa than in other regions, and a larger proportion of firms and households rely entirely on the informal financial system for all their financial services.

Relatively few comprehensive financial surveys exist in Africa, so it is extremely difficult to quantify accurately the issue of access to formal financial systems, especially for agribusinesses in rural areas. The fragmentary data that exist suggest that no more than about 10 percent of rural households and enterprises receive formal loans in any one year. For example, a sample of rural households in Niger reported that about half received at least one formal loan over a five year period, but only four percent reported regular access to formal credit and few saved with formal institutions (Graham, et al., 1987). In Zaire, less than five percent of the households surveyed had ever received a formal loan in the fairly heavily banked Shaba region and it was estimated that in an average year only fifteen out of every thousand rural households obtained a formal loan. Formal loans were defined to

include credit unions and development projects so access to banks was even less. Only three percent of the households interviewed in the more remote Bandundu region reported ever receiving a loan and only two out of a thousand households obtain formal loans in an average year (Cuevas, et al., 1991).

A greater percentage of large, urban based firms are expected to have access to formal finance, especially for export crops than do small, rural farms. An enterprise survey in Ghana revealed that over 80 percent of the medium and large scale enterprises had received a bank loan, but only 18 percent of the microenterprises (less than four workers) reported ever having received one (Steel and Webster, 1991). It is expected that in most countries, a somewhat larger percentage of households and enterprises, especially in urban areas, have a deposit or savings account with some type of bank, cooperative or credit union. At the same time, a much higher percentage report transactions with the informal sector. These data reflect the poor linkages that exist between financial markets, agribusinesses and small and medium enterprises, especially in rural areas.

There appears to be a greater degree of financial dualism in Sub-Saharan Africa than in other geographic regions, with a larger percentage of the population that is completely outside the formal and even the semi-formal system, and relies solely on informal sources for its financial services. Financial linkages may also be less well developed. Savings accumulated in credit unions and self-help groups are often deposited in banking institutions, such as is the common practice in Cameroon and Senegal. In some cases, these groups also borrow from the same banks. But there is less evidence than exists in other regions of linkages in which borrowers in the formal system operate as lenders in the informal system. This is frequently the case in Asia for traders and merchants, and is viewed as an efficient way to provide loans to poor, small farmers and microenterprises. It is possible that these linkages are in fact less widespread in Africa because of the important role historically played by parastatal marketing systems. Conversely, it could simply reflect the fact that researchers have not systematically analyzed the issue. Traders in food commodities in The Gambia, for example, acknowledged that they obtain letters of credit from their offshore banks for importing basic commodities. In turn, they provided suppliers credit to their customers (Graham, et al., 1992). Private cereal traders in Senegal also reported receiving loans from a variety of sources and on-lending to their customers (Goetz, et al., 1987).

The degree of financial linkages is important to understand for two reasons. First, where formal-informal financial linkages are numerous and important, it can be expected that macroeconomic policies, such as controls of the money supply in the formal sector, will also be transmitted to and influence the performance of informal finance. Second, where the linkages are well established, it may be possible to make formal loans to large creditworthy enterprises with the expectation that they will on-lend to smaller enterprises with most difficult access, including those agribusinesses in rural areas most distant from urban centers. This possibility will likely be constrained by the magnitude of marketable

surpluses produced by these smaller enterprises which in turn depends on resolution of the agricultural production problems discussed above.

7. THE CRUCIAL ROLES OF SAVINGS MOBILIZATION AND LOAN RECOVERY

Savings mobilization and effective loan recovery are two key factors that influence the long term viability of financial institutions. Both affect financial institutions and their clients in positive ways.

Savings mobilization emerges from the literature review as a crucial factor in developing sound financial markets for two sets of reasons (Bédard, et al., 1987; Fischer, 1989). First, the number of persons with deposit and savings accounts in a financial institution is generally much larger than the number with loans. Therefore, many savers obtain great benefit from having secure places to hold their deposits and savings. While some bank clients perceive good investment opportunities in their businesses, and therefore borrow, others perceive that their best opportunity is to hold part of their investment portfolio in financial assets. Second, there are several ways that financial institutions benefit from mobilizing deposits. The total cost of mobilizing deposits for lending may actually be cheaper than for external funds. By mobilizing their funds, lenders can develop their own lending programs adapted to local needs rather than simply making targeted loans designed by the government or donors. Information obtained from servicing a client's deposit and savings accounts can be useful in evaluating creditworthiness for loans.

Loan recovery emerges as the most important factor determining the long term viability of many financial institutions. Default rates of 20 to 30 percent that are common in many programs are too high to be covered by raising interest rates to all borrowers. Default eventually destroys or severely retards financial institutions such as occurred in many DFIs, including the Agricultural Development Bank in The Gambia, the CNCA in Niger, and the credit union movement in Ghana. Unless governments or donors agree to recapitalize institutions with large defaults, they will eventually wither away. Many institutions have been lax in accounting for delinquent loans, in systematically collecting overdue loans, and in establishing realistic reserves for bad debts. One explanation is that management has not needed to be very concerned about these problems when using external funds. When lending out of mobilized funds, however, lenders must be more careful about the quality of loans made, they are forced to keep better loan records, and they have to be serious about loan recovery, otherwise they will not have the liquidity to meet demands for withdrawals. Borrowers may also take their loan repayment responsibilities more seriously when they know that the loan funds come from local savings rather than external sources.

Savings mobilization, of course, raises some complex management issues that financial institutions have to anticipate. One is that better management skills are required for a balanced institution compared to a single purpose one, and accounting systems must be improved to handle a large number of deposit and savings accounts. The high covariance

of income in a small geographic region may imply that most households and businesses want to borrow at the same time, and most have surpluses at the same time, so there are difficulties in intermediating funds. Apex financial institutions, such as the Credit Union League in the Cameroon, that can transfer funds across regions may help this problem. Finally, there are risks to savers in countries that do not have deposit insurance. There are several reports in The Gambia, for example, about savers losing their savings when banks and credit cooperatives failed.

8. COLLATERAL, CONTRACT ENFORCEMENT, AND PROPERTY RIGHTS

The absence of well-defined property rights and unreliable legal systems are often viewed as constraints to the functioning of formal credit markets. But since land may have little value due to local customs, improvements in land titling may have little impact on access to formal loans. The informal financial system, however, has found ways to deal with these problems.

The traditional view is that lenders require collateral for loans so that in the absence of clear land titles, or other forms of collateral or collateral substitutes, there will be a contraction of credit on the supply side (Binswanger and McIntire, 1987). Therefore, the absence of well-defined property rights, and unreliable legal systems are often cited as constraints for the functioning of formal credit markets in Sub-Saharan Africa. The rationale for this argument relies upon two factors: (i), the requirement that collateral be "appropriable", i.e., that ownership of the item pledged as collateral is potentially transferable from borrower to lender in case of default, and (ii), the widespread dominance of customary (traditional) property rights, as opposed to legal (contractual) rights in land markets and other asset markets. The implications are that untitled land is invalid as collateral in credit transactions, and extensive titling programs are needed to improve access to credit, especially for the rural population.

Indeed, there is some evidence that security of title increases access to the financial markets. Even officially granted occupation certificates in Nigeria have been treated by major financial institutions as necessary collateral for various types of loans (Feder and Noronha, 1987). This fact does not necessarily justify, however, great emphasis on improving land property rights and the legal system. Two other properties of acceptable collateral complement the appropriability feature. First, items pledged as collateral must have value, which implies that a valuation method exists. Second, the eventual transfer of ownership or control over the asset pledged as collateral must be enforceable, which implies that a socially accepted mechanism of contract enforcement exists.

Collateral valuation requires the existence of markets or some other suitable method of determining the use value of the asset. The value of land as collateral, even under perfectly defined legal ownership, relies upon the use value of the resource, and is a function of its relative scarcity. When land markets exist, land prices will reflect the use

value of the resource. But in many regions, land markets don't exist and in many regions of Sub-Saharan Africa, water use rights convey significantly more value than land use rights. Moreover, other assets likely to be pledged as loan guarantees, such as livestock, consumer durables, or use rights on plantations, are likely to meet the appropriability, value, and enforceability conditions for acceptable collateral, without the shortcomings associated with land use rights.

Contract enforcement mechanisms do not necessarily require a legal, Western-style, system of rules and regulations. Indeed, a legal system may not even be a sufficient condition for the existence of an effective contract enforcement mechanism, if law enforcement, such as foreclosure on collateral, is not a credible threat to the potential defaulter. In some areas, social custom or political imperative may make it impossible for banks to foreclose on land that secures a defaulted loan (Atwood, 1990). In some areas of Kenya, land has little collateral value because land transfers to outsiders through sale or foreclosure are not always accepted as legitimate (Migot-Adholla, et al., 1991).

In the absence of effective enforcement through the legal system, informal loan contracts use explicit or implicit enforceability clauses, such as the continuance of business relationships in linked transactions, third-party guarantees, or the witnessing of contracts by local authorities. The same authority, administrative or customary, that recognizes an individual's use right of a resource serves as a guarantor of the enforceability clause involving that resource. Some formal lending programs are succeeding in replicating or adopting the contract enforcement mechanisms prevalent in informal transactions. Likewise, financial transactions with internal or built-in enforcement mechanisms, including supplier credit and other linked transactions, have attained a viability and stability that formal financial transactions rarely achieve. More attention is needed to identify how traditional contract enforcement mechanisms can be applied to formal finance rather than wait for expensive land titling programs to resolve the land-as-collateral issue.

9. THE IMPLICATIONS OF INFORMAL FINANCE

Informal financial systems are pervasive in Sub-Saharan Africa, but there is no clear view about what this implies for formal financial systems or what policymakers should do, if anything, about informal finance.

Informal financial arrangements and transactions are pervasive in Sub-Saharan Africa. They have managed to survive in many situations where formal finance has failed. It is clear that the informal and semi-formal financial systems must have some advantages over the formal system. There is no clear understanding about what to do with or about informal finance. The options include: 1) ignore it, 2) regulate it, 3) convert informal into formal finance, 4) borrow informal finance techniques and apply them to formal finance, and 5) strengthen linkages between informal and formal finance (Adams and Ghate, 1992).

Most Sub-Saharan Africa countries have tried to reduce the role of informal finance by actively encouraging the semi-formal and formal financial systems. In some cases, they have tried to regulate informal finance, such as when they try to impose interest rate restrictions. The Central Bank of Ghana, for example, recently required that susu savings collectors have to be licensed. In other cases, they have ignored informal finance, perhaps because they have recognized the futility of trying to regulate it. Two specific options have been largely untested until recent years. The first is to design specific informal-formal linkages, such as depositing self-help group funds as a loan guarantee with banks or developing wholesale-retail credit operations with traders, processors and other large enterprises that agree to make informal loans to small enterprises with funds borrowed from a formal institution. The second is to scale up or graduate an informal or semi-formal formal financial arrangement, such as a credit union or NGO lending program, into a formal financial intermediary. This occurred recently when a tontine in Cameroon was converted into a bank. These options require much more study and experimentation, however, before conclusions can be reached about the circumstances under which they can be successful.

10. SPECIAL PROBLEMS OF TERM FINANCE AND DEVELOPMENT FINANCE INSTITUTIONS

Most Sub-Saharan African countries lack long term domestic savings for term lending. Attempts to create Development Finance Institutions have not adequately resolved the problem.

Term finance is especially difficult to obtain in most Sub-Saharan African countries for four reasons. First, interest rates are often fixed and are rarely adjusted for changes in inflation. For long term contracts, this results in the erosion of purchasing power for a lender's portfolio. Therefore, even with full loan recovery, the real value of the portfolio declines. Second, institutions face difficulties in effectively monitoring installment payments over a long time period. Account management is notoriously the weakest feature of bank administration in developing countries, especially in Africa where management skills and practices are less developed. Third, there is greater risk of large price fluctuations or other external shocks for a project financed for a long period, so there is a greater probability that a loan will encounter repayment problems. Finally, lenders face the risk of a mismatch in term structure when long term assets are financed by short term liabilities. This causes commercial banks, that make loans out of deposits, to resist making term loans.

The lack of term finance has prompted many governments and donors to create and fund DFIs. But many have failed or are near collapse for several reasons (McKean, 1990). First, as noted earlier, large transfers of donor funds into DFIs have created attractive opportunities for rent-seeking by powerful groups in the society. Thus, political intrusion has influenced the allocation of loans toward the rich and powerful and created serious loan recovery problems as borrowers perceived their loans as government entitlements for services rendered in other political arenas. This has exacerbated inequalities in the

distribution of wealth and income. This point is documented most clearly in The Gambia (Graham, et al., 1992).

Second, as noted above, the absence of well-defined property rights and underdeveloped judicial and legal systems have compounded and reinforced the entitlement psychology. Courts frequently make judgements favorable to borrowers or delay proceedings indefinitely on cases associated with large loans. Enforcement of collateral is rare and costly, thereby compromising this important guarantee for term finance. DFIs and commercial banks have not been very successful in finding alternative solutions to traditional collateral. On the other hand, some informal and semi-formal financial systems have been able to effectively use collateral substitutes, such as group lending, group guarantee funds and linked contracts, to resolve this problem.

Third, the administrators and managers of DFIs are usually civil servants so incentives for good performance are largely absent in these institutions. There is little to no accountability; hence there are few internal sanctions for creating or administering a poorly performing loan portfolio. The normal poor delegation of authority means decisions are delayed and reviews are carried out at several administrative levels so that all responsibility is socialized and no one is accountable for poor institutional performance.

Fourth, the reliance on donor resources creates large overhead costs in the form of repeated screening, documentation and reporting about loans made. Ironically, the additional personnel and time required to service targeted, subsidized loan schemes usually does nothing to strengthen the loan portfolio or improve recovery. The margin of 3 to 4 percent which donors typically allow for DFIs to administer their programs falls short of the 8 to 10 percent costs they typically must spend to administer the donor's target portfolio. On the other hand, DFIs commonly have poor accounting systems with inadequate and misleading documentation of loan delinquencies and arrears, especially for term loans.

Fifth, DFIs tend to have few branches thereby limiting access to the rural population and raising costs to those who try to obtain loans. This fact limits their ability to reduce dependency on external funds by offering deposit and savings services. By not offering savings services, they miss an important source of information about their customers that can be used when making lending decisions.

In summary, the African experience of institutions largely offering term finance has been mostly negative. The short and medium term domestic deposits they have managed to mobilize do not match the longer term loans made. Inflexible interest rates erode the bank's capital base in the face of inflation and high administrative costs. Most important is the entitlement psychology that invariably accompanies the recourse to donor funds. Donor funding can temporarily resolve the domestic market failure by allowing the DFI to match long term loans with long term liabilities, but it also creates the potential for political intrusion and rent-seeking. The basic problem is the lack of long term domestic savings; until that problem is resolved, donor funding of DFIs is a poor substitute.

11. COOPERATIVES, SELF-HELP GROUPS AND OTHER SEMI-FORMAL SYSTEMS

In spite of the many failures of cooperatives and credit unions, the fastest growth in financial services in many countries involves ROSCAs, savings clubs, village banks and other groups that operate on cooperative and self-help principles. The most successful group approaches are those that are built with strong member participation and control.

A wide range of financial arrangements exist that share the characteristic of being owned and operated by their users. These range from large cooperatives to small self-help groups. The experience of these group arrangements in Africa is checkered.

Multi-purpose agricultural cooperatives have generally been a failure because they are often used as agents for government control rather than for promoting group interests. In West Africa particularly, governments have used cooperatives as a means to link parastatal marketing agencies to farmers for purposes of supplying inputs and purchasing farm products. Cooperatives on-lend in kind or in cash, and rarely offer deposit or savings services. These cooperatives are not business oriented, are under-capitalized, are controlled by the government, are mistrusted by farmers and many have built up large bad debts. A somewhat more positive cooperative experience occurred in East Africa where cooperatives began with more of a grassroots approach. The early successes in Kenya, Tanzania, and Uganda have run into difficulties in recent years, however, and they have been propped up with donor funds. For example, the Cooperative Savings Scheme for small coffee farmers in Kenya was reasonably successful. Total savings mobilized often surpassed small and medium loans outstanding. Loans were made out of funds mobilized and recovery was high. A Danida-funded project with the Cooperative Bank of Kenya provided support to less well developed cooperatives for training and on-lending. The rate of disbursement was less than projected but loan recovery was good, with an arrears rate of less than five percent after almost four years of operations (Danida, 1989). Other cooperative programs in the country have not fared as well, however. World Bank and A.I.D. programs that used cooperatives for on-lending have been criticized for contributing to high farmer and cooperative loan arrears by making access to credit too easy.

Credit union performance varies widely. They are performing fairly well in the Cameroon, Malawi and Togo, less well in Lesotho and poorly in Ghana. One of the factors that explains the relative success of credit unions compared to other types of cooperatives is their strong commitment to savings mobilization. To borrow, a member must first save. Unless they participate in special projects, credit unions usually lend only the funds they mobilize. This forces the leadership and the membership to take the lending process seriously. Therefore, they tend to follow conservative lending procedures. But this practice has also resulted in pressure to engage in more aggressive lending for productive purposes. The experience of Cameroon and Lesotho is that when they expand lending, they encountered higher delinquency rates (WOCCU, 1985; WOCCU, 1992).

Credit unions provide valued savings services for members and make loans important for enterprise development and household consumption, but they also have limitations. Some have not been aggressive enough about savings mobilization and have not been competitive because their interest rate structure has not kept pace with inflation. They are generally more successful in low inflation countries than in high inflation ones because they find it difficult to adjust their interest rates quickly. Given a loan to savings multiple of 2 or 3 to 1, they have been dominated by borrowers who cannot get sufficient loans to meet demand. Management skills have been weak, and they have had losses due to poor loans and embezzlement. Some have difficulty in serving the poorest groups in society and women.

Given the negative image that cooperatives have in much of Sub-Saharan Africa, it is ironic that the most rapid growth in the development of financial services in many countries has come from semi-formal entities, such as ROSCAs, savings clubs, village banks and other groups that operate on cooperative and self-help principles. Many of these groups are spontaneous and autonomous. Tontines in the Cameroon, for example, are pervasive and some are reported to involve thousands of dollars in urban areas. A new bank recently licensed in the Cameroon is reported to be based on a long-standing tontine. The strength of such traditional group activities is often due to the fact that they are created out of self-interest by the participants who are committed to their success, and who carefully screen the membership and monitor performance to assure success (Henry, 1991). Because of these positive features, many organizations now promote the formation of groups, and governments and donors are using them to channel outside funds into rural and urban agribusinesses. The challenge suggested by the credit union experience is how to keep these groups saver-dominated, so that saver interests are protected when outside resources become so large that they represent most of the loanable funds. Borrower dominated interests can take over in these circumstances, leading to low interest rates and poor loan recovery.

Much remains to be learned about the factors that contribute to the long term sustainability of cooperatives, credit unions and other group experiences, but some conclusions have emerged. First, governmental efforts to create cooperatives from the top down and use them as conduits for inputs and to act as government agencies have usually fared poorly compared to those that begin with strong member participation and control. Second, credit unions do best when they emphasize savings mobilization and adopt conservative lending policies. Third, there appear to be important limits to the size and composition of groups that can effectively work together at the local level. They must achieve a high degree of sophistication if they are to successfully operate federations and apex institutions that intermediate funds across regions and heterogeneous memberships, and handle a large amount of resources as in the Cameroon. Fourth, small localized groups may never be a good source of long term finance, and there may be high covariance in member income which makes them vulnerable to crop failures and other economic shocks that simultaneously affect all members.

12. SPECIAL PROGRAMS FOR MICROENTERPRISES AND WOMEN

Special programs for lending to microenterprises and women are emerging in many countries because of their lack of access to formal financial institutions. These programs frequently involve NGOs and PVOs, and occasionally are part of large financial reform projects.

Interest in the special problems of financial services for microenterprises and for women has expanded rapidly in Sub-Saharan Africa as it has in other regions in recent years. Studies show that small enterprises face greater difficulties in accessing formal financial services than larger firms. Furthermore, enterprise studies frequently reveal that women in Africa play a larger role in owning and operating businesses than in other regions (Fong and Perrett, 1991). As many as 25 percent of rural households are female-headed with women having sole responsibility for managing production and financial decisions. Women provide much of the labor for operating farms and other agribusinesses (Due and Gladwin, 1991). For these reasons, the issue of women's access to credit and other financial services is even more important in Sub-Saharan Africa than in the rest of the world.

The growth of microenterprises has been attributed to their advantages in the efficient use of capital and labor (Liedholm and Mead, 1987), but they have also been a source of employment for employees released in recent economic reforms. They are particularly important for women because of low barriers to entry (Carr, 1990). Therefore, many NGOs and PVOs have developed programs to support microenterprises. Some large donor funded projects, such as the World Bank financial reform projects in Ghana and The Gambia, have included special training and lending activities for women. The minimalist approach is frequently advocated because of the fairly successful examples found in other regions of which the Grameen Bank in Bangladesh is most well known. There is considerable skepticism, however, about the capacity of many African institutions to implement large scale microenterprise projects. Furthermore, there are doubts that credit-only minimalist projects can resolve the problems faced by many enterprises, and that the small group loan approach with frequent loan repayments can be applied to farm and agribusiness lending with its greater seasonality in production and cash flow.

Gender issues have figured more prominently in credit studies in recent years in Sub-Saharan Africa. Studies have shown that many ROSCAs, self-help groups, savings clubs, and other semi-formal and formal financial arrangements are organized by women and have mostly or only female members and participants. Since market vendors are often women, market based groups are often exclusively composed of women. These informal financial arrangements have evolved because of the special needs and opportunities of women. Formal finance, however, is more problematic for women than informal finance even though it is often argued that women borrowers have a better loan repayment performance than men. The reasons for difficult access are not clear. In some cases, legal and land tenure issues involved with borrowing from formal institutions may make borrowing particularly difficult for women. In other cases, financial institutions may perceive that the enterprises

in which women engage are too small and risky for formal loans. Yet in other cases, women may not even try to get formal loans because they anticipate they will be denied.

Greater attention is needed on gender issues in financial markets. A clearer understanding is needed about those issues that need attention which fall within the financial domain, such as ways to streamline and simplify loan procedures that affect women, versus those that are related to larger society-wide constraints, such as the ability of women to own and mortgage property.

13. THE EMERGING IMPORTANCE OF NGOS AND PVOs

NGOs and PVOs have rapidly expanded to fill the perceived need for credit, especially for microenterprises and women. Questions are being raised about their long term viability.

With the decline in large donor-funded targeted credit programs, NGOs and PVOs have been created in large numbers, some with international affiliates, to fill a perceived need for credit, especially for microenterprises and women. In the small country of The Gambia, there are over 100 registered NGOs, of which about a dozen provide financial services to poor households and enterprises (Graham, et al., 1992). An equally large number were found to be operating in Ghana. In Niger, these semi-formal organizations are practically the only source of rural financial services today other than those offered by the informal financial system. Several NGOs are implementing microenterprise projects oriented towards farm and nonfarm activities. Claims are made that these projects reach a large number of clients on a sustainable basis, in contrast to the largely negative experience of DFIs and multipurpose cooperatives. There are also suggestions, however, that many of these programs are precarious, that they are poorly managed, that they are not business-like, and that they exist only because of large external grants and donations. They may assist a few select participants, but they are not capable of growing very large. Therefore, it is not clear that this wave of external assistance channeled through NGOs and PVOs will be any more successful in the long run in contributing to financial market development than previous donor sponsored approaches (Adams and Von Pischke, 1992).

14. LACK OF CONSENSUS AMONG DONORS

The lack of a common approach among donors to financial market and agribusiness development leads to fragmented financial markets, a lack of competition in the financial sector, and high reporting costs. Scarce local administrative talent must be used for donor coordination rather than building and operating strong financial institutions.

A large number of bilateral and multilateral donors, NGOs and PVOs support and operate projects designed to strengthen financial market and agribusiness development in Sub-Saharan African countries. Some of these projects have broad scope, while others

involve only a few villages or enterprises. Although there seems to be a somewhat greater consensus today about the appropriate role of finance in economic growth and development, there is still a great divergence among the individual approaches. A.I.D. was among the leaders to recognize the limits of subsidized farm credit projects and was followed by the World Bank in working to correct the distortions created by specific targets and subsidies. But other donors, such as IFAD and some private organizations, still target specific groups for projects that provide credit at interest rates that fail to cover costs. Some of the major problems identified with small farmer credit projects are now reappearing in microenterprise projects.

The lack of a common understanding and approach among donors creates problems (Morss, 1984). It complicates coordination and dialogue with governments about policy reforms. One donor trying to strengthen savings mobilization is frustrated when another channels subsidized funds into the same institution. Each donor and organization has a specific model or funds a particular activity and requires a special monitoring and reporting procedure. The result is an uncoordinated system that leads to fragmented financial markets, a lack of competition in the financial sector as each project operates in isolation employing its own model, and high reporting costs for participating institutions. It also creates confusion in the minds of local decision makers about the appropriate strategy for growth and development. The problem has become so serious in The Gambia that the Central Bank is being forced to provide some guidelines for NGO/PVO financial operations (Graham, et al., 1992). But the Central Bank has hardly enough capacity to regulate and supervise the formal banking system and this additional task forces it to use scarce administrative talent to focus on donor relations rather than building and operating strong financial institutions. There is a great need for improved coordination in the donor community and a greater degree of consensus in the approach to be used for financial market and agribusiness development in Sub-Saharan Africa.

F. RESEARCH AGENDA

The Sub-Saharan African governments and the donor agencies are faced with a difficult challenge. On the one hand, they need to implement reforms and make investments for long term economic growth and development. On the other hand, they need to respond in the short term to slow economic and agricultural growth in many countries. This section presents a research agenda for A.I.D. that responds to both the short and long term needs of financial markets. The first part presents research suggestions aimed at making a short term impact, while the second part identifies research issues associated with long term financial development. In the short term, reliance is placed on working with and through informal and semi-formal finance. In the long term, the objective is to strengthen formal finance.

1. SHORT TERM

Many African countries have made progress in implementing reforms needed for long term growth and development. Markets and institutions are being liberalized, deregulated and privatized. New private agribusinesses are expected to emerge and replace parastatal enterprises for input distribution and output marketing. Many of these agribusinesses may need financial services if they are to grow and become competitive. Input dealers may need working capital loans to finance their inventory and accounts receivable as they supply their retailers, who will make credit sales to farmers. Private traders, retailers and processors may have to make cash and kind loans to farmers to stimulate production of the commodities needed for their agribusinesses.

While the recent economic reforms have stimulated loan demand from farmers and agribusinesses, the old targeted loan programs are being dismantled in many countries. Financial institutions are discontinuing the fairly simple task of implementing targeted programs and funding large firms and parastatals. They now need to begin developing their own loan programs and making many smaller loans to clients with whom they have had little previous experience. They cannot be expected to immediately make this transformation, but their failure to respond quickly may jeopardize the economic reform programs.

A short term financial strategy that may be worthy of consideration in this situation is one which involves the expansion of wholesale-retail financial relations in which agribusinesses, linked to formal financial institutions, use their liquidity to make informal loans to retailers, farmers, and microenterprises. This strategy would essentially involve mimicking the historical pattern of finance that existed in which import and export firms provided goods on credit or provided loans to producers and assemblers in advance of production. Brief sketches of how these trade and financial arrangements worked historically can be found in the books by Bauer (1954), Hopkins (1973) and Meillassoux (1971). Furthermore, these kinds of financial arrangements exist today for some commodities in some countries. For example, importers of rice and flour in The Gambia can often get 60-90 day credit from their European and Asian suppliers so they, in turn, provide short term credit to their wholesale and retail customers. Likewise, private peanut traders used to provide short term loans to producers to ensure their supplies before parastatal agencies took over peanut marketing.

The rationale for considering this strategy in countries where marketing is being privatized is that the larger agribusinesses may have already established their creditworthiness with local or offshore financial institutions, or will be able to do so more quickly than smaller firms with no financial track record or written accounts on which formal lenders can base credit decisions. Therefore, in the short term the financial sector can perform the relatively easier task of making large wholesale loans to a small number of agribusinesses which, through their retailers and agents, perform the more difficult task of making retail loans to hundreds and thousands of smaller enterprises. These agribusinesses, in the short term, should have a comparative advantage relative to formal financial

institutions in accumulating information necessary for screening customers for loans. This will occur naturally as the agribusinesses interact with their customers through selling them inputs and purchasing their products. Furthermore, the agribusinesses may be able to achieve good loan collection performance through linked contracts in which borrowers have incentives to repay loans in order to gain access to inputs and markets.

The research agenda to analyze this possible strategy includes two types of studies. The first type is a set of selective case studies of emerging agribusinesses engaged in input and output marketing. These studies should involve rapid subsector analyses of particular commodities or commodity groups to identify the principal agents involved, to determine how commodities flow backward and forward through the subsector, and to assess how equity and borrowed funds provide the liquidity to finance these flows. The specific issues to be investigated include: 1) types of financial services obtained from formal, semi-formal and informal financial systems, 2) terms and conditions of existing financial contracts, 3) types of backward and forward linkages that these agribusinesses have, and 4) special innovations, if any, that are facilitating access to finance. These studies should also determine the reaction of large agribusinesses to the possibility of making more cash advances and loans to their customers.

The second set of studies should focus on relationships between formal finance and key agribusinesses. These studies should evaluate the primary constraints that impede the flow of funds into commodity subsectors. The constraints might be venture capital for start-up costs, or additional working capital for enterprises that already have a minimum amount of fixed assets and working capital. Specific measures, such as expanded loan guarantees, equity funds, and bonded warehouses, should be evaluated for their possible contribution to expanding the funds supplied to agribusinesses.

2. LONG TERM

The long term financial strategy in Africa requires an expansion of and improvement in formal finance. Only formal finance can be expected to provide the volume of funds on the terms required for long term economic growth and development. The supply-leading approach to financial market development that has characterized much of the last two decades cannot stimulate economic growth, as argued by its proponents. In fact, the growth of the financial sector will depend significantly on the growth and performance of the economy, rather than vice versa. Some of the important agricultural productivity, risk and infrastructure problems mentioned above must be resolved if rural financial markets are to perform well.

The literature reviewed reveals that there is no such thing as a unique institutional form that will succeed in providing financial services to African agribusinesses. All the forms tried to date have strengths and weaknesses. The research agenda for financial markets should attempt to determine the reasons responsible for the wide range of problems and failures that have been encountered, and to identify policy changes and/or innovations

that will improve performance. Listed below are ten general research topics that, if undertaken, will provide answers to some strategic questions.

a. **INTEREST RATES AND TRANSACTION COSTS.** Issues about interest rates have been the subject of great debate, but relatively little systematic analysis has been conducted on the subject in Sub-Saharan Africa. The savings literature is inconclusive about the role of interest rates in stimulating financial savings relative to other factors such as easy access and security of the savings. This could imply that savers in fact view the return on savings as less important than expected, or that interest rates on savings have never been increased enough to generate a significant response. The important issue clearly demonstrated is that low income savers have a substantially greater potential for financial savings than normally recognized.

Most of the concern about interest rates on loans has focused on the need for low interest rates to stimulate borrowing which is expected to increase production, productivity and investments. Research has shown, however, that borrowers are more concerned about timely access than cheap interest rates. The significant issue concerns the impact of interest rates on lenders. Careful analysis is needed on the level of interest rates required for full-cost recovery for loans including empirical estimation of lender transaction costs and losses. It is likely that such estimation will reveal that most lenders must charge much higher interest rates than at present to cover their costs, especially for small rural loans, but that the high rates charged by some microenterprise programs may reflect a significant amount of inefficiency. This observation implies the need to track transaction costs over time to determine if financial institutions are improving efficiency. This will focus attention on the need for innovations to reduce transaction costs so the returns to savers can be raised and the costs to borrower can be lowered.

b. **RISK REDUCING MECHANISMS.** Savers and lenders share a general lack of confidence in the future of the economies of many African countries. Savers doubt that financial savings can provide the same level of return and security that are obtained from investments in real assets. Lenders doubt that many borrowers will repay their loans. More research is required on risk reducing mechanisms that improve confidence, such as deposit insurance, group lending, and loan guarantees, to determine how they can be used more effectively in Africa to reduce risks, and increase both savings and loans.

c. **PRUDENTIAL REGULATION AND SUPERVISION.** Another issue closely related to confidence in the financial system is that of prudential regulation and supervision. Regulatory authorities in Africa have not been successful in preventing formal financial institutions from engaging in unsound practices. The regulatory burden will get even more difficult as countries attempt to bring some informal and semi-formal financial arrangements within some type of regulatory framework. Research now underway in other regions needs to be extended to Africa to determine the appropriate ways to strengthen regulatory processes for those financial arrangements that grow beyond the scope of self-regulation, yet are too small and numerous to be treated as formal financial institutions.

d. **DYNAMICS OF USER OWNED INSTITUTIONS.** Small self-help groups appear to be functioning fairly well in Africa while cooperatives and credit unions have a checkered experience. There is little comprehensive analysis to explain this apparent paradox. It may be a matter of scale, or institutional design, or nature and magnitude of government involvement. Alternatively, the problems that will be faced by self-help groups may have not yet emerged. These are important questions because of the large number of self-help groups, village banks and other groups being sponsored by NGOs and PVOs. Some countries may be tempted to massively expand these operations without clearly understanding their strengths and weaknesses. On the other hand, these groups may use techniques that could be successfully employed by cooperatives and credit unions. Another concern is that many self-help groups appear to be vulnerable because their activities are concentrated in small geographic areas with a limited range of economic activities. Some mechanisms are needed to diversify their portfolios. A great deal of experimentation is taking place and many different models and approaches are being used. A systematic comparative analysis is needed in order to clarify what is working, what is not, and what innovations can be introduced to strengthen them.

e. **THE MINIMALIST APPROACH APPLIED TO AGRICULTURE.** The credit-only approach being used in minimalist programs appears to have been fairly effective in providing financial services to microenterprises in other regions. The limitations of this approach, however, are not well understood. First, the successful applications are found in regions more densely populated than most of Africa. This factor may limit the productivity of bank officers and increase operating costs in Africa. Second, most experience has been gained from programs that lend mostly to nonfarm or noncrop enterprises. Many African enterprises are linked to agriculture, which may require more lumpy investments and may produce more variations in cash flow than the microenterprises financed elsewhere. More research is needed on the applicability of the minimalist model to African conditions.

f. **FINANCIAL LINKAGES.** Informal and semi-formal financial systems will continue to provide a major amount of the financial services received by many households and enterprises in the foreseeable future. Although they have displayed great versatility in the face of difficult economic environments, they have limitations such as small scale and concentrated portfolios that expose them to risks. Increased linkages between formal, semi-formal and informal finance could help each utilize its comparative advantages and reduce the weaknesses of the other. In this way, the users of the financial services would gain from the advantages of each. Existing linkages need to be studied to see how they can be expanded and utilized more broadly.

Another question concerns financial linkages of African countries with international financial markets and especially new innovations to stimulate these linkages. This area of study is important because these linkages may represent a crucial source of foreign capital investment for emerging agribusinesses, especially in the short term while local capital markets are developing. Some linkages already exist between African producers and exporters and European importers and banks. There may be ways to strengthen and expand

these linkages. A second important aspect of these linkages is that they may help local financial institutions to understand and develop the standards required in international finance.

g. CONTRACT ENFORCEMENT AND COLLATERAL SUBSTITUTION. Most formal financial systems in Sub-Saharan Africa have relied upon the traditional approach of using physical capital as collateral to secure loans. The absence of clear property rights and an active land market have created problems for banks in attempting to use land as collateral in the way it has been done for years in other countries. At the same time, it has been difficult for the formal systems to use the collateral substitutes that seem to work well for semi-formal and informal finance. Improved property rights and legal methods of contract enforcement will eventually reduce these impediments. But in the meantime, there is a need to learn if there are ways for formal finance to adopt some of the traditional contract enforcement mechanisms.

h. GENDER AND ACCESS TO FINANCIAL SERVICES. The crucial role that women play in Sub-Saharan households and businesses, especially in trading and in rural areas, requires that the issues concerning their access to financial services must be better understood in order for appropriate policies to be implemented. Detailed studies are required to sort out which of the potential issues are really important. In some cases, the problem may simply be one of training more female agricultural extension workers to work with women. In some cases, the problem may require legal changes regarding the rights of women to own and mortgage land. Other cases may require expanding some of the new innovations, such as forming and linking women's self-help groups with the banking system. Finally, some cases may require fundamental changes in the attitudes and opportunities that cause women to engage in economic activities which are too small and risky to qualify for commercial lending. The crucial question that must be asked everywhere is whether or not the problems can be addressed within the financial system itself or whether they require substantive changes that go beyond finance.

i. DEPOSIT-LED RESTRUCTURING PROGRAMS. The most common way being used to restructure and rehabilitate failing banking institutions in most Sub-Saharan Africa countries is through increased government or private equity capital. However, a deposit-led approach is being used by A.I.D. in the Dominican Republic and Honduras to rehabilitate credit unions, and to strengthen the Agricultural Development Bank in the Dominican Republic. The two rural credit programs of the Bank Rakyat Indonesia and Badan Kredit Kecamatan in Indonesia have emerged as independent viable entities based on strong deposit performance and adequate pricing of services. More attempts need to be made in Africa to strengthen financial institutions through deposit mobilization, and to accompany these efforts with action research to guide the programs and report the results.

j. EXPANDING TERM FINANCE. Term lending is not likely to emerge very soon in most African countries. But as the benefits of economic reform are realized and as countries begin to achieve greater economic and political stability, the conditions for term

finance will improve. Investors will begin to consider long-gestation projects, savers will begin to view long term savings contracts more positively, and lenders will become more optimistic about long term lending. Research is needed to design appropriate institutions and instruments that will be conducive to long term savings and loan contracts once these changes occur.

Africa is desperately short of human capital in most fields, and this is also true in the finance field. Instability and low salaries make it difficult for most countries to retain trained staff in universities and research institutions. Most central banks and financial institutions have not made a strong effort to train and retain quality staff and to develop the capacity to conduct the research needed to build strong financial markets. More attention is needed to strengthen local research capacity, and to create and support regional research networks, such as AFRACA and the African Economic Research Consortium. These networks can be used to nurture domestic programs through training and the implementation of regional research projects.

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APPENDIX

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