SUPPORTING FINANCIAL INNOVATION AND STABILITY IN AFRICA'S AGRICULTURE

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Framing the Issue

When leaders of the G-20 countries meet in June, they will be focused on how to restore growth to the world economy. The election of a new French president and the Greek debt crisis have finally brought the discussion on the need for growth to the fore. However, memories of the causes of the worst financial crisis since the Great Depression will continue to loom large and the decisions made will need to include discussions on improving global understanding about vulnerabilities affecting financial systems and on initiatives to promote financial stability.

To date, there is a global consensus that emerging markets have managed the global financial crisis well and that bank deleveraging had a limited impact on the financial sector in Africa. Despite their positive growth since 2009, African countries are in search of ways to sustain their growth in a continuously volatile and uncertain environment. They are looking for ways to stimulate domestic and regional demand, to organize markets for primary commodities better, and to increase access to finance for the non-banked.

This is especially important because a focus on agriculture has led to substantial increases in production for a number of commodities on the continent. For example, between 2008 and 2010, the Ivory Coast and Cameroon increased the production of green coffee by 47 and 31 percent respectively. Ghana and Ethiopia increased production of maize by 27 and 17 percent respectively, while for rice paddy, Cameroon and Ghana increased production by 34 and 63 percent respectively. Tobacco production has increased by about 40 percent in the main producing countries in Africa, such as Nigeria, while production of groundnuts, beans and tea have all increased on average. Farmers are now faced with the issues of storage and marketing.

Policy Considerations

Similar to what happened in the United States between 1848 and 1920, improved production is creating a need for production differentiation and a need to improve quality, storage, marketing and transportation systems is creating new markets in Africa including organized spot markets, forward markets for warehouse receipts, and an increasing number of futures markets. This process of innovation has led to rapid financial innovation in Africa which if well managed could provide access to finance for millions of African farmers and businesses.

New financial instruments bring promise for the hundreds and millions of farmers, both commercial and subsistence, in sub-Saharan Africa. However, the unregulated use of some of these products is at the origin of the global financial crisis. The challenge for G-20 members will be to ensure that the much needed financial regulation designed to prevent another global crisis does not endanger access to finance for African agribusinesses and farmers.

Action Items for the G-20

G-20 policymakers will need to focus on four issues:

First, in addition to working on providing additional resources for increased production, the G-20 should also focus on developing a sustainable and inclusive agriculture trading market. Specifically, G-20 nations should help Africa put in place failsafe market infrastructure for agriculture commodity trading. Development partners should support a simple system of forward trading by working with countries to improve storage infrastructure and strengthening the legal environment for contracting. This combination would help to support the development of a warehouse receipt system across the continent, thereby providing farmers with better access to financing and an ability to smooth their incomes.

Second, as the agriculture market moves from a forward to a futures market, there will be a need to support the development of transparent, efficient and standardized trading via regulated clearing houses. If Africa's agriculture sector is going to leapfrog on financial innovation, African farmers must be protected from the errors of Wall Street. This means that the rules on over-the-counter derivatives must be enforced at entry on the continent to provide greater transparency. While this may constrain some trading by reducing the flexibility of farmers and other agents in the market, it will ensure that farmers and other traders have enough time to understand the instruments available to them in a secure and regulated environment. Standardized products will also allow for increased competition in the provision of such services, while also increasing the farmers' access to such products and services at competitive prices.

Third, the G-20 should support the development of credit agencies. The development of a warehouse receipt system and other related financial products will allow individual farmers or cooperatives to access banking sector credit using the warehouse receipts as legal tender. As a result, large parts of the previously unbanked segments of the population, especially women, would have the ability access financial institutions and build credit. To support this process, it will be important that countries develop credit bureaus that allow for the capture, storage and sharing of information across the sector. Assisting countries to improve their infrastructure for sharing credit information will allow for competition and open and equal access across the banking sector, thus enabling more farmers to have access to finance, including women.

Fourth, the G-20 should ensure that financial innovation related to the agriculture sector in Africa is monitored closely. There are a growing number of important regional banks which will manage the accounts of farmers as activity picks up. These banks could quickly become the systemically important financial institutions of Africa. With 70 percent of the rural population in Africa depending on agriculture for its livelihood, a crisis in the sector could quickly weaken financial institutions on the continent. Therefore, as the G-20 through the Financial Stability Board (FSB) works to develop tools to identify and anticipate shocks to the global financial system, it would be important to assist the banking sector in Africa in this particular field.

The 2010 decision to expand the work of the FSB to members beyond the G-20 was the right one. Now the FSB regional consultative group for sub-Saharan Africa must balance its activities to ensure that the quest for growth and financial inclusion in the region, especially in the agricultural sector, does not lead to a crisis down the road. The recent announcement by the G-8 of additional resources for agriculture with private sector support is welcome. The G-20 and G-8 should work with African countries to ensure that some of these resources go toward building and strengthening a framework for inclusive and competitive access to finance in the agriculture sector.

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