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Policy Brief

Agricultural Financing in Ethiopia

A Historical Perspective

Before the Ethiopian “socialist” revolution, commercial farms were flourishing in many parts of the country. There was an Agricultural Development Bank (ADB) which was operating at full-swing financing commercial farms. Though few, there were also commercial banks that were encouraged by policy to finance investments in the agriculture sector.

The years immediately following the 1974 revolution witnessed bold measures impacting the socio-economic lives of Ethiopians and economic establishments. These measures include land reform and nationalization of commercial farms and financial institutions - banks and insurance companies.

The land reform measures provide peasant farmers with only “use rights” and put “10 hectares” as the maximum holding size per household. Unfortunately, the measures resulted in exacerbating the continuous reduction of farm size per household most of whom holding now 0.5 ha of land or less, which in general, is inadequate to produce enough food for their families. As a result, the proportion of farm households who are food insecure remained 20-25% of the country’s population. On the other hand, as part of the agrarian reform measures, producers and service cooperatives were promoted to serve as a vehicle for agricultural and rural development. The agrarian reform measures, in the words of Desalegn Rahmeto, rather aggravated poverty among the rural population .

The regime change in early 1990’s by the Ethiopian Peoples’ Revolutionary Democratic Front (EPRDF) made almost no alterations to contents of the 1975 Land Policy. The policy pursued since then has made no significant deviations from that of the previous regime except “Liberalization of Agricultural Marketing” . The liberalization, however, did not fix agricultural production bottlenecks including lack of access to financial resources which is basic to finance technologies to enhance farm productivity and production.

The land policy, which was tuned to the adoption of an “ethnic” federalism-based constitution, rather discouraged (though not formally) free mobility of labor and capital between regional administrations - compromising their efficient allocation and use. This has been costing the country by holding agriculture sector performance below expectation. Thus, the country remained incapable of producing enough to attain food self-sufficiency nationally, which made the system rather “Food Aid” dependent for decades.

The “Agriculture Development Led Industrialization (ADLI)” was also an ambitious strategy that aimed at not only developing the agriculture sector but also supporting the country’s economic/industrial development. The strategy failed to underline the vitality of finance towards developing the agriculture sector in general, and the peasant/smallholders’ sector in particular.

Consequently, to date, the farming systems remained backward and stagnant at subsistence production. The lack of emphasis on agricultural financing by the ADLI strategy was the major factor that made achieving the strategy’s objectives, including ‘food self-sufficiency at country level, unattainable.

A Closer Look: Agriculture Financing-a Sector Ignored by Creditors and Government

Ethiopia's economic growth over the last two-plus decades has been claimed as exemplary by many, including the WB and IMF. Nevertheless, development in terms of food self-sufficiency, reducing unemployment, and self-propelling industrial growth remained only as achievements deeply wished for. Despite the massive capital inflows (FDI, loans, and grants) over the last three decades, the above development challenges including lack of agriculture financing couldn't be addressed.

The country has witnessed adverse socio-economic and environmental effects due mainly to the 'lack of financial services to the agriculture sector' in general, and to the smallholder farmers/pastoralists, in particular. These negative effects are manifested by a significant population (about 25%) suffering from food insecurity and living below the poverty line; millions of unemployed youths; and widespread degradation of the farming environment. These all are indicators for much to be sought from agriculture in terms of boosting the sector's productivity and production, productive youth employment, and enhanced farming technologies. Consequences of the disregard by government policies and financial institutions to finance the agriculture sector are revealed in many ways, including

(i) low national budget allocation for agriculture; (ii) low agriculture orientation index (AOI) for credit; (iii) low agricultural loan disbursement; (iv) undiversified and non-corporatized agriculture, etc.

Low National Budget Allocation for Agriculture: despite its huge development impacts, the budget allocation for agriculture remained very low (less than 10% of the total). Over 85% of the 110 million people relying on agriculture and the wider geographical coverage with huge growth potential could have been the strong justification for the government to allocate more budget to the sector. In some years, the budget allocation is even less than what the African head of states uphold as principles for the Comprehensive African Agriculture Development Program (CAADP) which suggests the allocation of at least 10% of national bud- gets to the sector.

Low Agriculture Orientation Index (AOI) for credit: this is an indicator showing the amounts of credits availed to the agriculture sector compared to its contributions to the national economy, i.e. GDP. An AOI less than unitary (1.0) is considered 'poor financing' of the sector. According to the FAO, Ethiopia's AOI went down from the 0.3 range in 2011/12 to 0.2 in 2017 which is extremely lower than the countries in the Sub-Saharan region.

Low Agricultural Loan Disbursement: agriculture's share of bank loans remains very low compared to that of other economic sectors – manufacturing and services. Based on DBE's annual report, the agriculture sector has been marginalized concerning loans disbursed over the past 40-50 years. The share of the agriculture sector in the disbursed loans averages only 30% compared to the 60-65% share of manufacturing industries. Moreover, the share of the agriculture sector is not consistent as it goes down, in some years, as low as to 5% (in 2018/19) – which considerably affects planned agricultural activities. This is mainly due to stringent loan criteria and limited initiatives in making the sector credit worthy.

Undiversified and Non-Corporatized Agriculture: Ethiopia's agriculture remains at a subsistence where non-agriculture GDP per capita and value-added per worker in the sector is very low. These show the low level of economic diversification and immaturity of the agricultural sector mainly due to lack of credit service to finance productivity-enhancing technologies, etc. Thus, urgent and coordinated efforts are required to develop a matured, diversified, and corporatized agriculture in Ethiopia. This can be done by facilitating farmers' access to adequate finance with business development support services.

The Way Forward: Recommendations

To ensure agricultural growth, structural transformation, and economic development in the country, "accelerated agricultural financing" is the recommended policy direction. The following support policies are the basis facilitating "accelerated agricultural financing".

Facilitating the demand for and supply of financial resources for agriculture: to realize transformative demand for an adequate supply of agricultural finance, the following initiatives are suggested. These include pursuing a policy and strategy to mobilize savings nationally; defining and specifying financial demands for the transformation and strategic growth of agriculture; reinstating agricultural bank with mandates to wholesale and retail banking and monitor institutions engaged in agricultural finance supply, and renovating financial market to promote access for credit regardless of sectors.

Promoting financial accessibility and agent expansion: to achieve this, the following interventions are recommended. Upgrading MFIs and credit and saving cooperatives to the level of rural banks; supporting private firms further to engage in agricultural financial markets through 'equity finance', 'angel investment' or 'agent banking; promoting digitization, employment of FinTechs, and inter-operability technologies among FIs.

Supporting ease of financing: to simplify agricultural financing, measures such as offering a special price on financial products for the agriculture sector and expanding the intangible collateral system by focusing more on ease of implementation, profitability, and effectiveness of agricultural projects are recommended.

On regulatory issues: introducing a comprehensive procedure (known by all) that ensures importation of genuine capital goods and machinery, etc.; developing system of registry and valuation of movable collateral assets; devising and implementing an appropriate system that ensures traceability of individual borrower; and providing appropriate system to facilitate transferability of the "use right" of farmland that is used as collateral are suggested.

Intensifying financing of smallholder farmers: to meet farmers' financial demands for productive purposes, capitalizing on important actions including focusing on financing micro and small-scale farming business; revising the budget allocation modalities for poverty reduction program (by the governments' PSNP and NGOs) toward credit-based and market-oriented allocation to enhance the productive capacity of able-bodied beneficiaries; promoting farms clustering and revising relevant policy for land consolidation toward enhancing mechanization are recommended.

Providing agricultural Business Development Support (BDS) and smart subsidy: making BDS mandatory among all financial service providers, integrating other complementary technologies with financial products, and designing and implementing project appraisal procedures ensuring selection of bankable projects that fulfil return on investment criterion are recommended towards utilization of financial services.

Promoting agricultural insurance: wider utilization of insurance services is critical to agriculture sector operators to utilize financial services. For this, establishing a separate public fund to subsidize insurance services for farmers' access towards sharing production and marketing related risks; reducing insurance premiums to promote the usage of the insurance services; expanding insurance products including smart subsidy particularly for the smallholder farming and pastoralists (integrated with other input services); stepping up public awareness in general, and farmers' literacy level in particular about insurance at educational institutions; re-establishing an independent and autonomous body that focuses on insurance expansion in the country; devising a regulatory framework for valuation of and traceability of agricultural and movable products are recommended.

Monitoring and evaluation of agricultural financing: monitoring and evaluation system through establishing agriculture specific "M&E desk" mandated with ensuring the sector's efficient and effective utilization of financial resources needs to be established at the MOA or NBE with an establishment of an overarching desk at the Office of the Prime Minister that undertakes periodically an impact evaluation of agricultural projects and programs run by public and private organizations.

The Aspiration: Impacts of Adequate Agricultural Financing

If the agriculture sector in general and the smallholder farming system and pastoralists in particular, are helped with access to adequate financial services (credit, saving, insurance, and payment services) positive and transformative results would be a reality.

The positive outcomes would include improved adoption of farm technologies, increased production and productivity, extensive and diversified farming, rehabilitated and developed natural resources, mechanization and use of water for irrigation, value additions, development of markets and marketing, etc. The impacts of such initiatives on socio-economic, technological, and environmental aspects of the farming sector and the country's economy at large are enormous.

Impacts of adequate financing would include (i) poverty reduction; (ii) food self-sufficiency; (iii) improved farmers' livelihood; (iv) reduced unemployment and social stability; (v) expansion of agro-industry and structural transformation (in the backward and forward linkages); (vi) commercialization of agriculture; (vii) wiser utilization of natural resources – land; water; etc.; and (viii) environmental conservation and development.

Poverty reduced: when smallholder farmers and pastoralists employ productivity and production enhancing inputs, provided that finance is made available, productivity and production can significantly grow at a higher rate. These result in an increased and sustainable income and livelihood to support the population. Higher-income and sustainable livelihoods are the bases for poverty reduction with positive social and economic effects.

Food self-sufficiency/security attained: farmers and pastoralists could achieve surplus agricultural production by applying modern inputs and technologies through employment of labor, land resources, and modern technologies. Such increase in food production and productive capacity can make farmers & pastoralists and the society at large food self-sufficient and ensure attainment of consumption requirements from own production or through the market using the increased income.

Farmers' lifestyle improved: increased farmers' and national income would help facilitate and improve access to social, economic, and technological facilities including education and health. With education, financial awareness would be increased and exposures to bank services and digital technologies make farmers' life easier.

Unemployment reduced and social instability avoided: through improved access to adequate finance, development of commercial agriculture with smallholder farmers and pastoralists as well as medium and large-scale commercial farms would be expedited. These ventures would productively engage the unemployed youth labor and vast expanse of land.

Bringing unutilized productive resources to production could have enormous national economic significance and social benefits. With credits availed, utilization of more than half of idle cultivable land (55%) and water resources (90%) for agricultural production would be accelerated. Increased production from such ventures could positively affect macroeconomic variables including the GDP, unemployment, and inflation.

It is evident that youth unemployment in the country tends to develop negative psychological consequences including loss of self-esteem, increased stress from family/social pressures, and uncertainty with the future labor market. If the youth unemployment problem is not addressed, poverty, higher crime rate, and social and political ills could force social unrest and instability.

Agro-industry expanded, and national economy structurally transformed: agricultural productivity and surplus production would be enhanced from increased investments in the sector. These motivate the marketing of agricultural commodities and boost the establishment and expansion of agro-processing industries (foreword linkages).

The process also encourages backward linkages to meet growing demands for varieties of agricultural inputs. Growing agro-industries require improvements in quality and volume of agricultural production which demands the same from inputs suppliers. These processes ensure structural transformation of the economy towards the industry's (manufacture and service) development in the backward and forward linkages.

Environment conserved and developed: natural resources development projects would be encouraged along with the availability of adequate financial services and favorable investment policies. Projects could include the development of forests which, in addition to its economic significance, would have positive impacts on natural resources protection and conservation as well on the environment and climate change. Availability of agricultural finance would encourage climate change adaptation and related technology utilization with measures for sharing risks of climate damages (flood, drought, disease, etc.) using insurance services.

Note:

This document is an extraction and summary of key findings from a formal study conducted by Precise Consult International. Both primary and secondary data were used. While the former were collected via key informant interviews and focus group discussions, the latter were collected from different organizations as well as from internet resources. In addition, the study employed descriptive data analysis techniques and benchmarking of best-practice lessons for Ethiopia.

All data that were used in this brief are referred in detail in the full research document which can be found by visiting www.preciseethiopia.com or by email request to info@preciseethiopia.com.

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