# BANK OF UGANDA

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**AT THE FINANCING AGRICULTURE FORUM**

**ORGANISED BY THE WORLD BANK**

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I would like to welcome everyone to this Forum on agricultural financing. The Forum offers us the opportunity to explore solutions to what is a very long standing challenge in development policy; how to provide finance in an affordable, efficient and sustainable manner to agriculture; a sector which is dominated in Uganda as elsewhere in Africa by smallholder farmers. These solutions will include new and innovative financial services for farmers, which is one of the main themes of this Forum.

I would like to thank the Agricultural Finance Support Facility for organising this Forum and also thank Centenary Bank for hosting it. Centenary Bank has been at the forefront of efforts to extend finance into the rural areas of Uganda for the best part of two decades. Agriculture plays a much more prominent role in the business strategy of Centenary Bank than it does for most other banks in the country. Centenary Bank allocates almost 20 percent of its loan book to the agricultural sector, compared to just 7 percent for the commercial banking system as a whole in Uganda.

Agricultural policy in Uganda has not been a great success. Real growth in the agricultural sector has been anaemic for a long time. Over the last 12 years, since the turn of the millennium, real growth in the sector has averaged only 2.7 percent per annum, barely a third of the growth rate for the economy as a whole. The growth of food crop production was even lower, averaging only 2.1 percent per annum, 1.4 percentage points less than the rate of the country's population growth. If these trends continue, Uganda will no longer be able to grow sufficient food to feed its own population, let alone produce a surplus for export. Uganda

cannot afford to allow the stagnation of its agricultural sector to continue if poverty eradication and structural transformation is to be a realisable objective. Eradicating mass poverty in Uganda will not be possible unless there are large increases in agricultural productivity to boost farm incomes.

A recent report into inclusive growth in Uganda by the World Bank offers important insights into why the agricultural sector has performed poorly and also proposes a strategy for stimulating the transformation of the sector. At the heart of the poor performance of agriculture in Uganda is the failure to promote commercialisation among smallholder farmers, and especially among the smallholder farmers who produce staple food crops.

The commercialisation of smallholder farming is essential if agricultural productivity is to be raised. Hence, a policy priority for the agricultural sector should be to encourage smallholder farmers to shift from subsistence farming to a more commercially oriented approach to farming; using more inputs and selling more of their output on the market. Smallholder farms dominate the agricultural sector in Uganda and hence the transformation of agriculture cannot be achieved unless we can tackle successfully the obstacles facing smallholders. It is not sufficient to focus our efforts only on the large farmers.

The commercialisation of smallholder farming will increase the demands for appropriate forms of finance to enable farmers to fund their inputs and to store crops after harvesting in order to obtain better prices. Consequently, a radical strengthening of agricultural finance has a key role to play in any strategy for promoting the commercialisation of smallholder agriculture, although we should be realistic and acknowledge that more finance alone will not transform

agriculture in Uganda. Many other reforms are also needed to strengthen rural infrastructure, research and extension services, input supplies and land tenure rights.

The financing of smallholder agriculture poses difficult challenges for a multitude of reasons; the high transactions costs involved; the lack of suitable loan security; the inherent risks entailed in farming; and the heterogeneity of the sector. Market failures prevail in many segments of the economy and a major obstacle to financing smallholders. To remedy market failures, the Government in Uganda, in common with those in many other developing countries, implemented programs to channel subsidised credit to framers, and to force banks to open branches in rural areas, in the 1970s and 1980s. These efforts were for the most part a costly failure. However, the market friendly financial sector policies that Government has implemented for the past two decades have not been conspicuously any more successful at improving the access of farmers to finance. As I noted at the start of this address, the agricultural sector, which accounts for over 20 percent of GDP, receives only 7 percent of the credit extended by commercial banks.

Solving the problem of meeting the agricultural sector's need for finance will require the development of innovative solutions. Such solutions should not be exclusively focussed on extending credit to farmers, but should entail a package of financial services encompassing savings instruments, payments services and insurance, in addition to credit. Key questions which must be answered if successful solutions are to be found include: What is the appropriate mix between market forces and government intervention? Are public subsidies needed to support finance for smallholders? And if so, what exactly should public subsidies be used for? How can the risks involved in lending to farmers best be mitigated?

What sort of reforms to land tenure systems are needed to enable land to be used as collateral for lending? What type of financial products is needed the most by smallholders to enable them to adopt commercial farming practises? What type of financial institution is best suited to delivering financial services to smallholder farmers; commercial banks, deposit taking microfinance institutions, savings and credit cooperatives, or some other type of institution?

I do not have answers to all of these questions, but I would like to offer a few thoughts on the general direction in which I think public policy towards agricultural finance should evolve. I do not think that the transformation of smallholder agriculture can be achieved without a prominent role for Government and without elements of public subsidy, given the pervasive market failures which afflict the sector. However, the design and use of public subsidies for agriculture needs to be very carefully thought out.

The lessons of past government ownership of banks, both in Uganda and in other developing countries, should lead us to be very wary about calls to set up a state owned agricultural bank. Public ownership of a bank does not, per se, eliminate the market failures which impede efficient agricultural finance. Often a state owned bank offers the worst of both worlds, combining Government failure with market failure.

Subsidising the interest rate charged on agricultural loans from the Government budget does not seem to be a sustainable solution, not least because the more successful are such subsidies in promoting the expansion of agricultural credit, the less affordable they become. It would be more efficient to focus scarce public resources on subsidising activities which clearly have the characteristics of public

goods, such as disseminating information, improving land titling systems and training farmers in financial literacy. Public subsidy might also be warranted to support the start up costs of institutions which provide services to smallholders and which could become economically viable without subsidy once they have become established and achieved some minimum economies of scale.

Finally I also think that we must take a realistic view of what can be achieved by public regulation in respect to our goals for agricultural finance. Regulation can be reasonably effective in achieving a limited set of public policy goals; notably ensuring that formal sector financial institutions such as commercial banks are managed in a prudent manner. It is not an effective tool for achieving more developmental goals, such as the allocation of credit to priority sectors; because such regulation is often at odds with the commercial imperatives of financial institutions. Public regulation is also ill suited to achieve almost any public policy goals when it is applied to a large number of small, informal financial institutions, such as savings and credit cooperatives, because the unit costs of regulation are prohibitive and render it ineffective.

On this note I would like to end and wish you the best for your deliberations at this forum. If you can help to craft sustainable solutions for agriculture finance you will make an indispensible contribution to the future welfare of this country.

Thank you for listening.

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