BANK OF UGANDA

Remarks

By

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At the High-Level Meeting on Agricultural Financing in Uganda

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The Rt. Hon. Prime-Minister,

Hon. Ministers (present and past),

Ladies and Gentlemen,

Good morning!

In my remarks, I wish to highlight the numerous policy interventions and schemes undertaken by the Government of Uganda since the 1960s particularly those that had the banking industry actively involved; identify what I think is the most optimal strategy for agricultural modernization, and third, is to reiterate what I envisage as the appropriate role for the state in agricultural financing.

Interventions for agricultural development over the past fifty years can be broadly summarized into the establishment of institutions, the set-up of lending schemes and the application of tax incentives. Let me start by dealing with the experience of the public financial institutions. Government used public sector banks, the Uganda Commercial Bank and the Cooperative Bank to provide loans to farmers at subsidized interest rates – which were often highly negative in real terms. Some of these lending schemes were financed from the Central bank. About 20 percent of all commercial bank lending in the 1980s was allocated to farming entities such as the Coffee Marketing Board.

These policies did not work. Farmers and cooperatives were not able to use cheap credit to modernize their farming and were unable to repay their loans. By the early 1990s, both UCB and the Cooperative Bank had been rendered bankrupt by non-performing loans.

Uganda's experience was similar to that of many other countries in Africa. The continent is littered with many agricultural finance banks that became unprofitable and required continuous budgetary support, thus necessitating their restructuring in form of privatization, or complete closure like Lesotho's Agricultural Bank and Building Society.

Since the mid-1980s several targeted credit schemes have been implemented. The Government of Uganda through the Development Finance Department (DFD) of the Bank of Uganda managed several credit programs, (see table 1), that supported various investment projects in the different sectors of the economy, including agriculture, agro-industry, manufacturing and the services sub sectors like education, health, and tourism/hotels.

Table 1: Credit Schemes Managed by BOU/DFD between 1986-2006/07

Credit Program	**Source of Funding**
Rehabilitation of Productive Enterprises (RPE)	USAID (GOU)
Development Finance Fund (DFF)	BOU & Commercial banks
Apex I, II, III & IV	EIB (GOU)
Investment Term Credit Refinance Fund (ITCRF)	World Bank (GOU)
Export Refinance Scheme (ERS)	BOU
Cotton Sub-Sector Development Project (CSDP)	World Bank/IFAD
Crop Finance Fund (CFF)	Libyan Government

Export Promotion Fund (EPF)	GOU
Export Credit Guarantee Scheme (ECGS)	BOU /USAID (GOU)
Energy for Rural Transformation Refinance Fund (ERTRF)	World Bank (GOU)
Distressed Flower Project Fund (DFPF)	GOU

Source: Bank of Uganda

In the period prior to 2006/07, when the Development Finance Department and all its activities were transferred to the Uganda Development Bank limited (UDBL), DFD also coordinated a number of credit related programs. These included the Linkage Banking Program under the Africa Regional Agricultural Credit Association (AFRACA); the Capacity Building Program (CBP) for micro finance institutions under the Cotton Sub-sector Development Project; Research and advocacy on government programs, policies and processes from a gender perceptive under the Gender and Economic Reform for Africa (GERA) initiative of the North South Institute of Canada; Capacity Building for Rural Women Financial Intermediaries Program financed by a grant sourced from IFAD; and the DANIDA-funded Rural Financial Services Component (RFSC), which was aimed at widening financial services outreach to the rural areas.

Although these schemes yielded some individual successes, they have not transformed agriculture in this country. Agriculture valued added per worker measured at constant 2005 US dollars, has remained very low, despite Uganda's favorable resource endowments, increasing only marginally from an average of US$ 212 in the 1990s to an average of US$ 219 in the past five years, according to the World Bank's World Development Indicators.

Public support to the agriculture sector over the decade to 2015 has also included tax exemptions and subsidies, including the current Agriculture Credit Facility (ACF) that primarily targets value addition in agriculture and provides for a maximum interest rate of 12 percent using budgetary resources. The fiscal incentives have included: i) tax exemption on income earned by financial institutions lending to agriculture that was introduced in 2006/07; ii) income tax exemptions for new rural agro-processing investments; and iii) zero rating for VAT on most agricultural inputs and services. Various studies including those published in our very own Agriculture Finance Year Book have demonstrated that these tax incentives did not result in any significant gains to farmers in the form of either reduced input prices, or an increase in lending to the agriculture sector. Instead they benefited mostly the banks and importers while denying government revenues; and as a result, Government embarked on eliminating many of these tax incentives in the financial year 2014/15.

What lessons can we learn from these experiences? Agriculture in Uganda is dominated by small holder farmers, of whom two thirds are engaged in subsistence agriculture, according to the 2014 Uganda National Population and Housing Census. Therefore the agriculture development strategy must focus on the small holder farmer. Any risk-sharing model for financing must be based on a clear understanding of the profile and origins of the risk. In this case, we must resolve what continually constrains the modernization of agriculture and what makes small holder farming very risky for financing.

Smallholder farmers face a raft of constraints to modernising their farming, of which lack of financing is not necessarily the most important. Most smallholders produce very little surplus, beyond their own needs for consumption, which can be marketed. Furthermore, the vulnerability of agriculture to the weather, pests and other hazards means that surpluses cannot be produced with any degree of reliability. In these circumstances, agriculture assumes a very high risk premium, and borrowing money to purchase agricultural inputs is very risky for farmers, and they will unavoidably struggle to repay loans.

Modernising smallholder agriculture in Uganda requires a holistic set of interventions. The first priority should be to assist farmers to increase their output without exposing them to greater risks. There is evidence from agricultural projects that if smallholder farmers are given advice on the adoption of good agricultural practices, such as better seeds, optimal crop spacing, weeding, post-harvest handling etc, substantial increases in yields per acre can be achieved, even without the application of purchased inputs such as fertilisers. This would allow farmers to produce more marketable surplus and thereby generate cash incomes. The next step would then be to start applying modest amounts of purchased inputs such as fertilisers, to increase yields further.

Luckily, we are not short of demonstrable projects in the Uganda and elsewhere that have markedly improved yields per acre and income of the farmers by providing this sort of comprehensive support. The 2015 Agriculture Finance Year book for Uganda provided an assessment of one such pilot by the One Acre-Fund in Kamuli district. The main challenge facing agricultural policy is how to scale up the successes of individual projects to smallholders throughout the country. The key to delivering the interventions needed to modernize agriculture are effective, nationwide agricultural extension services. We also need to strengthen the rural infrastructure, especially the rural feeder roads, and provide the necessary support for private sector-led contract farming.

Once the above interventions are effected and farmers are able to earn cash incomes from selling their produce, the risk profile of agriculture will reduce and it will become possible to extend credit to them on a sustainable basis, although it is unlikely that commercial banks, given their cost structures, will be the most suitable financial institutions to do this. Instead financial institutions which specialize in small savings and loan facilities, and which have strong local roots, are better suited to delivering rural finance on a sustainable basis. Mobile banking and leveraging technology may also be able to contribute to solving market information deficiencies and delivering financial services in a more cost effective manner. A key question is whether rural finance can be provided on a purely commercial basis, or requires some degree of subsidy to offset the undoubtedly higher risks involved. We don’t yet have a definitive answer to this question.

I am of the view that, in implementing a holistic set of interventions highlighted above, Government resources should prioritize what it can do best and what the market cannot provide: the provision of public goods that benefit the majority of the small holder farmers such as policy, strengthening land rights, rural feeder road infrastructure, research and extension services, and supporting the strengthening of the ware house receipt system.

Tax incentives and subsidies as we have evidently seen are the least optimal way of utilizing public resources. I am aware that in a bid to lower the risk profile of agriculture and incentivize agricultural financing, government is introducing an agriculture insurance scheme. My advice is that any such publically funded insurance scheme should mainly cover systemic risk faced by the majority of farmers such as a general epidemic or extreme weather conditions.

Finally, the historical evidence with state-run agriculture financing mechanisms – risk sharing schemes or development banks on the African continent, is instructive that if any such financing institution or scheme is to efficiently support the development process, it must be managed on commercial principles.

I thank you for listening to me.