Summary of Mexico’s agricultural development

With a population of almost 130 million, Mexico is the second largest economy in Latin America and the 11th largest economy in the world. In 1950, agriculture accounted for almost 20% of Mexico’s GDP—but in 2018 it represented only 3.4% of GDP. Though agriculture currently represents 13% of total employment, that share has shrunk from 33% since the market reforms of the 1990s. Today there are an estimated 6.8 million farmers in Mexico, primarily on farms of less than five hectares.

From colonial times up to the Mexican Revolution (1910-1920), agriculture was dominated by large private estates. Post-revolution agrarian reforms redistributed half of existing agricultural land to rural workers and smallholder farmers, under the ejido (communal land) system. These ejidos persisted in their original form until 1990, when new laws liberalized the land market and allowed parcels within the ejido to be sold, rented to outsiders, or pledged as collateral for a loan.

A brief view of the government- led era (1930s-1980s)

After the Mexican revolution (1910-1920), a long period of state-led economic development started, lasting until the end of the 1980s. In this period, Mexico transitioned from a highly rural and agricultural economy to a more industrialized and consumer-oriented economy. The dominant government party (PRI) consistently followed an inward-looking development strategy, focused...
on nationalizing oil and railways sectors, implementing an industrialization programme, and creating an active development bank system. In agriculture, the state stimulated domestic food production and the smallholder economy, while at the same time securing affordable food for the urban poor. Government complemented these strategies with policies focused on land reform, price support for food staples and oilseeds, heavy investments in irrigation and green revolution, and a stimulus to diversify production.

Agricultural finance helped the government achieve its policy goals. The state created agricultural development banks to provide direct and subsidized credit to agriculture and oriented this credit to specific priority sectors: the development of irrigation, increase of productivity, longer-term credits, and loans for the ejidos. During the 1940s, public development banks provided roughly half of the total agricultural credit. In the 1950s, public interventions encouraged private banks to increase their agricultural portfolios (i.e., through the state’s rediscounting facilities and guarantees), growing private market share to around 65% by 1960. However, the total share of financing allocated to agriculture still decreased as the sector became a smaller part of the overall economy.

What changed in the 1980s?

Expansionist economic and fiscal policies in the 1970s led to increasing public and international debt, which in turn became unsustainable during the global economic recession in the early 1980s. The broad economic crisis (public deficit, capital flight, devaluation pressure) primed Mexico for a new political and economic model. In 1982, the government nationalized private banks to prevent a collapse of the banking system. The resulting neoliberal regime under Carlos Salinas paved the way for fundamental reform of the economic and financial system. As Mexico committed to free trade agreements, agricultural products and land markets were liberalised. The financial sector was gradually opened to foreign shareholdership, and its regulations converged toward international standards. New financial policies included liberalization of interest rates, changes in the regulatory framework for financial institutions and the capital market (including re-privatizing banks that had been nationalized), and modernization of the development banks.

Structural adjustments in the agricultural finance sector (1988–present)

Macro level: The agricultural sector was fundamentally repositioned around the reforms of the Salinas government. Free trade agreements led to major food imports at much lower prices, creating a need for social transfers to buffer smallholder farmers from their inability to compete in the market. In 1993, the Mexican government launched a farm subsidy program (Procampo). By 2005, Procampo was reaching at least 1.6 million low-income producers with less than five hectares; yet it failed to reach many of the poorest farmers. In a later revision (2006), the program included a farm capitalization option that offered an alternative to interest-bearing credit. The capitalization option allowed smallholders to receive five years of payments in advance, based on a government-approved proposal for a productive project. Procampo was renamed to ProAgro Productivo in 2014.

Meso level: Policies, regulations, and institutions were reformed to mirror the macro liberalization agenda. Government support of
Agricultural finance became increasingly focused on more commercial agricultural producers, irrigated areas, and regions with internationally competitive agricultural potential. The primary agricultural development bank (BanRural) was replaced by a more narrowly defined public finance company (FND since 2003). FND has gradually shifted its portfolio from direct agricultural lending to a second-tier role, financing non-bank financial institutions (NBFIs) that operate in proximity to smallholder farmers. Although about half of FND’s current portfolio is NBFIs, only 8% of its financing goes to the most marginalized municipalities.

Since 2005, government policy toward smallholder farmers in marginalized areas has shifted away from provision of agricultural credit and toward a financial inclusion policy. This policy combines cash transfers; insurance against risks and catastrophe; inclusion in digital payments systems; a broader rural finance concept, including non-farm activities and microfinance; and the roll-out of financial education and consumer protection. In 2016, 25 million poor households and 1.5 million smallholder farmers received cash transfers through the Prospera program (formerly Oportunidades, and prior to that Progresa). Prospera was launched in 1997 and targeted women and school-age children, some of whom are part of smallholder households.

In 2015, the state monopoly on agricultural reinsurance was lifted, which allowed a few private companies to enter the market. More recently, the government is investing in digitalization in the financial sector. Leveraging increased connectivity and mobile phone penetration, government-to-person transfers are moving toward digital payments. A fintech law passed (2018) and branchless non banks are coming up, putting pressure on traditional banks to modernize their platforms. How this digitalization will influence agricultural finance is still to be seen.

**Micro level:** At the same time that the government was implementing broad, structural readjustment around more open agricultural markets, a structural readjustment was applied to the different financial institutions. Financial service provision was primarily left to the private sector (banks and NBFIs); public development banks (FIRA, FND) were repositioned to facilitate private financing; and NBFIs (in credit and insurance) were facilitated with renewed regulatory frameworks. The FIRA trust remains the largest public capital fund in Mexican agricultural finance, with assets under management that are larger than the combined agricultural finance portfolio of all private banks together (though there is some overlap). Since the liberal market reforms of the 1980s and 1990s, FIRA has concentrated its portfolio on private banks (80%) and regulated NBFIs (17%), with only a limited percentage going to public development banks (3%). This is a significant change from the policy, prior to the late 1980s, of equal public and private access to facilities.

In 1991, AgroAseMex shifted its portfolio from providing direct insurance to farmers toward reinsuring the commercial farmers’ mutualist insurance funds and the private insurance companies. The government started a large-scale premium subsidy program for individual agricultural insurance (SPSA, 1991). This was complemented with a collective agricultural catastrophe insurance (CADENA, 2003), contracted by the state with private insurance companies.

In 2014, President Enrique Peña Nieto launched a new agricultural finance program aimed at providing more credit to the Mexican countryside—with preferential interest rates, longer
credit periods, and fewer credit requirements. The new program provided a special product for small farmers at preferential interest rates of 7% annual (6.5% for women farmers). Under this scheme, farmers no longer needed collateral for credits; the government provided the necessary guarantees for loans granted by the private banking system, with loans linked directly to production.

What happened in the agricultural finance market?

In the period since the market-oriented reforms, there were two distinct phases. From 1991 to 2005, there was a massive contraction in farm credit, in terms of hectares financed (-/- 73%), farmers with access to formal finance (-/- 75%), and agricultural credit’s share in total bank portfolios (down from 8% to 2%). This was due to the economic recession and subsequent bank crisis, the opening of local markets to international competition, and the dismantling of subsidies to the development banks. This contraction also included a reorientation of credit from smaller producers to more commercial farmers, and to irrigated areas and regions with agricultural potential.

From 2005 to the present, the share of agricultural finance in bank portfolios stabilized at approximately 2% of total credit. While bank-based sources of finance have decreased, there have been new models of finance: for example, lead firms and processors within their value chains stepping in to provide forward contracts to enable financing through local banks and financial institutions. At the same time, the government has rolled out a more explicit financial inclusion policy—encompassing small farmers and rural households—and the development of more innovative agricultural insurance programs. For example, the coverage of catastrophe insurance is vast: In 2013, insurance covered ~12M out of the 22M hectares at national level, including in the poorer regions of Southern Mexico. The Global Findex also shows an increase in financial inclusion, measured by households having some type of account with a financial institution or elsewhere. Fintech is rising quickly in Mexico, challenging traditional banks to modernize and digitalize their offer to customers, which may pave the way for more non-traditional finance providers to provide services to smallholder farmers over time.

THE BANK-LED ERA TRANSITION

In relative terms, the level of finance provided by private banks in the 1960s (~65% of the agricultural finance market and 17% of bank lending portfolios) was substantially larger than it is today (where agricultural finance is less than 2% of private banks’ portfolios). While these relative figures have decreased, the dramatic shift in the structural orientation of the finance sector toward private banks in the 1990s, opening trade and land reforms, marked a clear transition from “government-led” finance to more free-market models. In this way, we mark the bank-led transition not by participation rates but by the positioning of banks within the broader economy.
The Mexico Agricultural Finance System Pre-1988

From colonial times up to the Mexican Revolution (1910-1920), agriculture was dominated by large private estates. Post-revolution, a long period of state-led economic development commenced that lasted until the late 1980’s. The government enacted policies to transition Mexico from a highly rural and agricultural economy to a more industrialized, consumer-oriented one. To achieve these policy goals, the state created agricultural development banks that provided direct and subsidized credit oriented toward specific priority sectors: the development of irrigation, increased productivity, longer-term credits, and loans for communal agricultural land (ejidos). In the 1940s, public development banks provided roughly half of total agricultural finance; in the 1950s, state interventions encouraged private banks to increase their agricultural portfolios to around 65% market share by 1960. However, total share of financing to agriculture decreased up until the more significant transition to more of a free market economy in the late 1980’s.

The Bank-led Transition: Major Events

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**Macro**

A. Salinas government elected with a neoliberal market reform agenda (1988)
B. WTO/GATT commitment and signing of North America Free Trade agreement (NAFTA) (1992)

**Meso**

F. Public development bank closed down and replaced by public finance company (FND), leaving the rural deposit market to the private banks (2003)
G. Government changes policy away from the provision of agricultural credit towards a financial inclusion policy (2005)
J. State monopoly on agricultural reinsurance lifted (2015)
J. Fintech law passed facilitating digitalization in the financial sector (2010)

**Micro**

B. Agricultural insurance reform with premium subsidies introduced (1991)
G. Introduction of agricultural catastrophe insurance (CADENA) contracted by the state through private insurance companies (2003)
G. Agri-finance is increasingly focused towards more commercial agricultural producers, irrigated areas and regions with agricultural potential (2005)
H. President Enrique Peña launches new agricultural finance program, ProAgro Productivo, with preferential interest rates and requirements (2014)

**The Finance and Payments System**

**The Rural Infrastructure & Agricultural Sector**

G. Agricultural development policy oriented towards commercial agricultural producers, promoting irrigation and niche export markets (2005)

**Providers: Supply**

F. Farm subsidy program Procampo launched to offset the effects of NAFTA on smallholder farmers (1993)

**Clients: Demand**

Conditional cash transfer program, Oportunidades (originally Progress) launched for poor households and for smallholder farmers (1997)

Overview of Government Actions

Under the neoliberal regime of Carlos Salinas, in 1988 Mexico commenced fundamental reform of its economic and financial system, marking a macro-level shift in the orientation of the economy. At a macro-level, free trade agreements (including NAFTA, signed in 1994) led to liberalization of agricultural product and land markets. Subsequent Government policy toward smallholder farmers in marginalized areas shifted away from provision of agricultural credit toward a broader financial inclusion strategy (cash transfers, insurance, digital payments, education, etc.).

At the meso-level, new financial policies were enacted, including liberalization of interest rates: changes in the regulatory framework for financial institutions (including re-privatizing banks that had been nationalized); and, modernization of the state development banks. The state monopoly on agricultural insurance was also lifted, allowing private companies to compete and a fintech law passed to support digital payments and banking.

At the micro-level, subsidy and social transfer programs were created to support farmers unable to compete in this new market, while Government supported credit and insurance support was provided through new institutional arrangements.

Results

From 1991 to 2005, there was a massive contraction in farm credit due to economic recession and the adjustment to the rollout of Mexico’s participation in NAFTA. Financing was reoriented away from smallholder farmers to more commercial operations and to irrigated areas and regions with agricultural potential.

From 2005 to the present, agricultural finance has stabilized at 2% of total bank portfolios. New sources of financing, such as vertically integrated value chain approaches, have replaced bank-based sources of finance. Global Findex shows an increase in financial inclusion of Mexican households and fintech is rising quickly, paving the way for non-traditional finance providers.

For more details on the Mexico experience please refer to Annex 1.
Summary of Turkey’s agricultural development

With a population of 82 million and GDP of USD 770 billion, Turkey is the 19th largest economy in the world. Agriculture’s share of GDP has continuously decreased in Turkey (from 55% in 1960 to 5.8% in 2018), although agricultural production has been rising. The contribution of agriculture to the economy in 2018 was USD 45 billion, while the annual export of agricultural products increased from USD 4 billion in 2002 to more than USD 22 billion in 2018. Over the same time period, employment in the agricultural sector in Turkey dropped from 37% to 19%.

Turkish agriculture is characterized by fragmented smallholder parcels, with ownership generally divided due to inheritance. As of 2014, there were three million registered agricultural holdings in the country. The average farm size has remained steady at around seven hectares over the past 60 years. Despite the recent emergence of more commercial farms, 52% of farming enterprises are small-sized holdings or family farms less than five hectares, fragmented to 5.9 parcels on average.

Soon after the establishment of the Turkish Republic in 1923, the government implemented policies to support agricultural production through administered agricultural prices and tariff protections, subsidized credits, and infrastructure projects. Agricultural lands were separated into smaller pieces through an inheritance law passed in 1926; yet, with the support of the government, smallholdings were able to survive and improve production. However, the policies drastically changed toward a market-based economy in the 1980s. In that period, the government reduced subsidies and market controls in all sectors, including agriculture. After financial crises in 1999 and 2001, this transition from state-led development to market-oriented policies began to influence changes in the agricultural finance market.

A brief view of the government-led era (1930s-2000)

With the end of the Ottoman era and the establishment of the Turkish Republic in 1923, Turkey’s agricultural and financial policies significantly evolved, following a state-led development policy. The country passed legislation transferring land ownership from the state to existing farmers and removing high agricultural production taxes in 1926. Next, it reorganized agricultural institutions to support rural development. Between 1925 and 1937, the government established the Agricultural Combines and Agricultural Affairs of State; modernized the structure of Agricultural Credit Cooperative (ACC); and transformed Ziraat Bank—which had been established in 1883 as a
farmers’ cooperative—into a state organization and the principal financial agency for farmers. From the 1930s until the 2000s, the government supported farmers by purchasing an expanding list of crops at administered prices and providing subsidized credits for inputs and machinery.

In this period, Ziraat Bank and ACC were the sole financial service providers to Turkish farmers. Ziraat Bank provided government payments and subsidies, and supported ACC to allocate credit to farmers. As of 2000, Ziraat Bank was extending 58% and ACC was extending 42% of agricultural loans to Turkish farmers. As they employ below-market interest rates, both institutions experienced operational losses that would eventually contribute to financial crises and resulting market reforms in the 2000s.

The oil crises in 1973 and 1979 put significant pressure on the Turkish economy. The inflation rate increased from 8% in 1970 to 64% in 1979, and the economy contracted by 0.5% in 1979 and 2.8% in 1980. At the same time, international interest rates were high, limiting Turkey’s access to global credit markets. These economic problems, combined with political turmoil that ended with a military coup in 1980, triggered market liberalization reforms that involved a substantial reduction in support and protection in all sectors, including agriculture. The changes also included a decrease in import tariffs, transition to an export-oriented strategy, and liberalization of financial markets that allowed free movement of capital internationally and banks to determine their own interest rates. Those reforms improved the market capitalization of the financial system, increased the role of private banks in the macroeconomy, and partially opened the market to imports of agricultural products. However, Ziraat Bank and ACC kept their monopoly positions in the agricultural finance market by supplying subsidized credits to farmers until the second wave of macroeconomic and agricultural reforms in the 2000s.

**What changed in the 2000s?**

**Macro level:** Two macro factors started to move Turkey from government-based to more bank-based agricultural finance in the 2000s. First, an IMF-supported economic program in 2001 transformed the banking sector in Turkey. The country experienced the most profound economic crisis in its history in 2001; after which, with support from the IMF, the government implemented its Strong Economy Program, which cut budget deficits and restructured the Turkish banking sector. Second, Turkey’s accession to the European Union started in 2005. The government began to align agricultural policies with those of the EU. For example, agro-environmental issues attained more prominence, as EU law and regulations emphasize the integration of environmental concerns and good practices in land management and rural development. It also facilitated Turkey’s gradual alignment with the EU’s Common Agricultural Policy (CAP) that involved direct income support to farmers, rural development support through the EU’s Instrument for Pre-Accession Assistance on Rural Development (IPARD), establishment of a farmer registry system, and other directed production subsidies.

**Meso level:** In 1999, Turkey established the Banking Regulation and Supervision Agency; and in 2001, it passed a new banking law that regulated the financial sector and restructured financial institutions. As a result, Ziraat Bank had to increase credit interest rates to market levels in order to lower the banks’ operational losses, keeping them there until 2004. This enabled the competitive environment necessary for private
banks to enter the market. In the same period, the government privatized a small bank owned by the credit cooperatives of fig, grape, cotton, and olive farmers (Tarisbank)—this became the first significant commercial bank in the agricultural finance sector. Additionally, Turkish banks started to follow BASEL-II rules, further improving the financial stability of the system. The credit registry bureau of Turkey—which was established by banks in 1995—was enhanced in 2011 with a new regulation to cover all governmental and non-governmental financial service providers.

In 2005, the Turkish government launched new regulations and institutions to support the transition toward market-based agriculture, and to align Turkish agricultural institutions with the institutions of the EU. Among these new regulations, the establishment of an agricultural registry system was one of the most important for the country’s financial system. The government collected information on true capital and land structure of farmers through the system, which enabled the implementation of other micro policies (e.g., establishment of insurance pools). In 2013, the agricultural trade credit evaluation system (TARDES) became effective under the credit registry bureau of Turkey. This system combines information from the agricultural registry system and the existing credit registry bureau to estimate the annual cash and credits of farmers and evaluate their credit applications. The system includes ± 200,000 farmers (±7% of the registered agricultural holdings) as of 2017.

The government also passed a new law on licensed warehousing in 2005. This enabled banks to use receipts from the warehouse as collateral in farmer credit applications (i.e., a warehouse receipt system). In 2014, the government passed a new land law to prevent the further fragmentation of agricultural land and aggregate small landholdings, when possible. The law states that agricultural lands cannot be divided into multiple parcels that are smaller than the limits in the legislation. Moreover, when a farmer plans to sell land, owners of neighboring lands have some priority as buyers. As land sizes increase, farmers can improve their collateral, and thus their access to financing.

**Micro level:** The Strong Economy Program abolished administered output prices and decreased, stopped, or reformed agricultural subsidies (including subsidized credits by Ziraat Bank and ACC). Administered prices were replaced by direct income support; however, this proved unsuccessful in increasing agricultural production, and in 2010 was replaced by a regional support scheme (in Turkish: Havza Bazlı Destek Sistemi). Those support policies were also empowered with organic agriculture and livestock support programs involving subsidized credits since 2018.

The new agricultural insurance law established the Turkish Agricultural Insurance Pool (TAR-SIM) to improve farmer access to affordable insurance by providing a government subsidy. From 2005 to 2018, the take-up rate for agricultural insurance increased from 0.5% to 16%. This system also helped banks extend loans with lower interest rates to insured farmers.

The government established a credit guarantee fund in 2005 to support small- and medium-sized enterprises (SMEs) to access loans for new or expanding businesses, input purchases, investments in new technologies, moving to a new workplace, working capital finance, trade finance, and leasing. The fund guarantees help banks offer lower credit loans up to USD 150,000, including to farming enterprises. The government is currently
working on a larger guarantee scheme specifically for farming enterprises.

**What happened in the agricultural finance market?**

Turkey had a relatively favorable environment to expand private banking in the 2000s. Most consumers (including farmers) already had a bank account with a debit card. There were widespread branches of private banks, and ATM and telecommunication facilities all over the country. The banking sector was using a credit scoring system, and there was a national ID registry system. After the meso- and micro-level reforms combined with this favorable environment, private banks entered the agricultural finance market, introduced new products (e.g., farmer credit cards to purchase inputs, farmers loans through SMS messages), and increased their market share substantially. As of 2018, private banks supply 31% of credit to the agricultural sector while the state banks and ACC provide about 69%.

There are, however, two important challenges to improving Turkish farmers’ access to finance and the role of private banks in that finance. First, smallholder farmers cannot benefit from the existing credit guarantee fund targeting SMEs. Second, private banks cannot distribute subsidized or zero interest government credits, a role that is reserved for Ziraat Bank.

**Note on both Turkey and Mexico:** In both countries, the structure of agricultural production has changed substantially after the year 2000. Aggregators and processors, and foreign direct investment, have influenced the way in which production and processing are structured, and financed. Also in the two countries, their proximity and trade agreements with the EU (Turkey) and NAFTA (Mexico) have boosted the emergence of modern value chains, with higher levels of vertical integration (i.e., financing from the top) and/or partnerships with domestic and foreign private banks and investors. High-value export crops such as dried fruits and vegetables in Turkey (e.g., Berk, 2013), or avocados and other high-value horticulture in Mexico, have become examples of globally integrated value chains. This paper does not look in depth at these structural changes in the agricultural market but does acknowledge that these changes have a substantial “demand-side” impact on how primary producers and agri-SMEs seek and access credit and insurance.
The Turkey Agricultural Finance System Pre-2000

Soon after the establishment of the Turkish Republic in 1923, the government undertook a state-led development policy, through which it administered agricultural prices and tariff protections, subsidized credits, and infrastructure projects. On the financial side, the government modernized the structure of the Agricultural Credit Cooperative (ACC) and transformed Ziraat Bank into the principal, state-led financial agency for farmers. In 1980, triggered by economic problems and a military coup, the government implemented market liberalization reforms that significantly reduced social protections in all sectors, including agriculture. These reforms improved market capitalization and increased the role of private banks in the macroeconomy. However, Ziraat Bank and ACC maintained a monopoly in the agricultural finance market by supplying subsidized credits to farmers until the 2000s when the economy was opened further and Turkey joined the European Union.

The Bank-led Transition: Major Events

2000

A Strong Economy Program (IMF program) initiated to cut government budget deficits and restructure Turkish banking sector (2001) in response to 2000 recession

MACRO

D European Union Accession process (2005) with the Government beginning to align with EU Common Agriculture Policy (CAP) with support through Pre-Accession Assistance on Rural Development (IPARD)

THE FINANCE AND PAYMENTS SYSTEM

New banking law passed to regulate the financial sector and restructure state owned banks including the main public agriculture bank (Ziraat Bank) and agricultural credit cooperatives (2002)

B Turkish Agricultural Insurance Pool (TARSIM) established that makes agricultural much more available (2003)

THE RURAL INFRASTRUCTURE & AGRICULTURAL SECTOR

Licensed warehouse law passed regulating the market for warehouses and enabling the banks to accept warehouse receipts as collateral in the credit application of the farmers (2005)

C Farmer registry system established (2005)

Land law passed to prevent the fragmentation of agricultural land and aggregate small holding (2014)

CLIENTS: DEMAND

Change in agricultural support framework: Abolition of the administered output price and introduction of direct income support for farmers (2002)

B Direct income support abolished and regional agri-production support introduced (2010)

H New Government support program for livestock and organic agriculture development introduced with subsidized loans (2018)

Subsidies and tax deduction for licensed warehouse use introduced (2019)

MICRO

State run, Ziraat Bank reduces the level of subsidy for agricultural loans, opening space for private banks to enter the agricultural sector (2002)

C Credit guarantee fund established to help SMEs (including agricultural enterprises) access credit with lower interest rates; Agricultural insurance pooling system established with subsidized insurance premiums (2005)

D Agricultural credit evaluation system established (2013)

Overview of Government Actions

Turkey moved from government-based to more bank-based agricultural finance in the 2000s through several key actions. At the macro-level Turkey committed to a program of reform and support from the IMF and subsequently joined the European Union, which required alignment on relevant agricultural, environmental, and financial policies.

At the meso level new laws regulating the financial sector and restructing financial institutions were created enabling a more competitive market for private banks. An agricultural registry system was also introduced to collect information on true capital and the land structure of farmers. A new law on licensed warehousing was also introduced, which enabled banks to use receipts from the warehouse as collateral in farmer credit applications.

At the micro level the IMF sponsored Strong Economy Program, replaced administered prices with direct income support; and later with a regional support scheme. Increased take-up of agricultural insurance was enabled by government subsidy and credit guarantees were used to stimulate lending to small- and medium-sized enterprises.

Results

After decades of a state monopoly on agricultural lending, private banks entered the agricultural finance market, increasing their market share to 31% (state banks and ACC provide 69%) by 2018. These private banks introduced new products, such as credit for inputs and lending via SMS.

Agricultural insurance take-up increased from 0.5% in 2005 to 16% in 2018, which allowed banks to extend lower interest rates to insured farmers.

200,000 farmers are also now registered with the credit registry as Turkey continues to improve its institutions and governance in line with EU Common Agricultural Policy.

For more details on the Turkey experience please refer to Annex 1.
Summary of Uganda’s agricultural development

With a population of 44 million and a population growth rate of 3.3% per year, Uganda is one of the fastest-growing countries in East Africa. Currently, agriculture accounts for 24.2% of GDP, 50% of all exports, and 65% of employment, overwhelmingly on small farms under 2 hectares.

In Uganda, agricultural growth was robust in the years immediately after independence in 1962. The late 1960s until the mid-1980s were, however, characterized by disruption and conflict—particularly during the 1970s, when agricultural output fell at an average rate of 2.5% per year. Today agriculture is confronted with multiple structural challenges, such as the predominance of smallholdings, practicing rain-fed low-yielding agriculture, tenure insecurity, and poor infrastructure. In 2014, only 16% of farmers purchased inputs. Uganda is among the most vulnerable and simultaneously least adapted countries to climate change, and increasingly frequent climatic shocks take a heavy toll on rural livelihoods and the economy.

The average size of Ugandan farms is shrinking. From 2006 to 2016, the share of all household farms that were less than two hectares in size rose from 75% to 83%. These challenges hamper agribusiness development and commercialization in Uganda; one of many reasons why private sector investment in Ugandan agriculture has been modest compared to Kenya, Tanzania, or Ethiopia.

A brief view of the government-led era (1962-1987)

Following independence in 1962, the Ugandan government followed inward-looking economic policies based on import substitution, central planning, and licensing for mining and other industries. When Idi Amin came to power in 1971, he expelled many Ugandan-Asian business families while dramatically expanding the public sector. There were only 10 parastatals in 1972. By the mid-1970s the number of parastatals increased to 23 and were responsible for up to 250 different business enterprises.

A significant public expense in this period was the use of subsidized agricultural credit. The government established specific institutions—such as the now defunct Uganda Commercial Bank (UCB) and the Cooperative Bank—to make relatively cheap credit widely available to farmers and facilitate the modernization of agriculture. Under this scheme, loans were provided at subsidized interest rates (highly negative interest rates in real terms). In reality, these interventions became an instrument for outreach and influence, with
little attention paid to the financial health of the lending institutions. Politically motivated loan forgiveness, major natural calamities or price slumps, and inefficient loan deployment weakened the repayment culture in rural Uganda. Hence, periodic capital injections were required to keep the lending institutions alive. Both banks were eventually rendered insolvent in 1998/99.

With the fall of Idi Amin in 1979, a new government under President Milton Obote sought support from the IMF and World Bank to prevent the economic collapse of the country. To encourage foreign investment, the new government adopted market-based policies including removing price controls, floating the exchange rate, and tightening government spending. Owners of expropriated firms and properties were encouraged to return. The collapse of the IMF’s stand-by arrangements in mid-1984 and the disintegration of the military government in early 1986 after five years of civil war marked substantial deterioration in economic performance in Uganda. In January 1986, Yoweri Museveni became president, a role he has held to the present day.

What changed in the late 1980s?

From 1987 onward, the government of Yoweri Museveni launched the second wave of reforms aimed at stabilizing the economy, resuming economic growth, and maintaining a sustainable balance of payments. Changes touched the public sector, markets, and prices, as well as exchange rates and trade. Since 1992, Uganda has managed to combine high levels of economic growth with low levels of inflation. However, while the first bout of growth was partly ascribed to the recovery of production capacities—as peace returned to the country and policies became more predictable—subsequent growth demanded investment from both domestic and foreign sources. International aid has provided a crucial cushion since the reforms started: first, for the repair of essential infrastructure, and second, to enable the country to undertake reform measures. Of particular note was the debt relief provided by the Paris Club of multilateral lenders. Under the Highly Indebted Poor Countries (HIPC) initiative, Uganda was forgiven its debt in different cycles in 1998 and 2000. This enabled the country to, among other things, save funds and used this to fund the growth of its economy.

Structural adjustments in the agricultural finance sector

Macro level: The National Resistance Movement launched the Economic Recovery Program (ERP) in May 1987, with support from the World Bank and IMF. The goals of the program remained more or less intact in the following decade: to stabilize the economy, bring about a resumption of growth, and enable maintenance of a sustainable balance of payments position. Macroeconomic stability has ensured containment of inflation to single-digit levels, positive GDP growth rates (above 4.5% per year), and a reasonable level of international reserves. This stabilization of the macro-economic environment created new space for agricultural finance to slowly re-emerge over the following years.

In 2007, Uganda Vision 2040 was approved to provide development paths and strategies to operationalize Uganda’s vision statement, which is “A Transformed Ugandan Society from a Peasant to a Modern and Prosperous Country within 30 years.” Successive National Development Plans sought to operationalize this vision and included a reform framework for the agricultural sector. While there has never been a specific national ag-
ricultural finance policy, in 2019 the government, through the Ministry of Finance Planning and Economic Development developed one which is currently going through the final approval process.

Prior to 2005, policy efforts to improve access to financial services in Uganda focused on enabling microfinance institutions to transform into deposit taking institutions, supported by the Microfinance Deposit Taking Institutions Act 2003.

**Meso level:** In the late 1990s and early 2000s, the Ugandan banking industry underwent significant restructuring. Several indigenous commercial banks were declared insolvent, taken over by the central bank, and eventually sold or liquidated. This restructuring was followed by the passing of the Financial Institutions Act in 2004 and the Financial Institutions Regulations in 2005, which created a new framework for the banking sector that included tighter supervision from the Bank of Uganda, more stringent requirements, and higher capital provisions. During 2008 and 2009, several of the existing banks accelerated branch expansion through mergers and acquisitions or new branch openings.

The restructuring led to significant growth in both formal (banks, credit institutions, and microfinance deposit-taking institutions) and semi-formal (SACCOs and VSLAs) financial service providers. The number of commercial banks (Tier-1) grew from 14 in 2007 to 24 in 2018. Currently, most banks in the country are foreign-owned, including major international institutions such as Stanbic, Citibank, Barclays, and Standard Chartered. However, several locally owned banks have been established, including DFCU Bank, Postbank, Housing Finance Bank and Centenary Rural Development Bank.

In 2006, the Warehouse Receipt System Act established the Uganda Warehouse System Authority, an independent regulatory body that started to operate in 2015. With this measure, the government is attempting to promote alternative forms of collateral that could enhance agricultural lending.

In 2016, the government amended the Financial Institutions Act (FIA) that allowed for the provision of agent banking, Islamic finance, and bancassurance (selling insurance through bank channels). A four-tier system of financial institutions was also set up to serve different market segments and needs. One of the most significant recent developments, in 2017, was the enactment of prudential and non-prudential regulations for Tier-4, previously unregulated financial institutions. These regulations apply to about 1,749 operational SACCOs; 81 licensed Non-Deposit-Taking Institutions; at least seven microfinance wholesale lenders, 446 licensed money lenders; and thousands of informal Village Savings and Loan Associations (VSLAs).

Another significant development is the enactment of the Movable Property Security Interest Act no. 8 of 2019 and the attendant regulations, which makes it possible to use moveable property as security and establishes security interests in other assets such as livestock, furniture, and produce.

**Micro level:** Since the mid-1980s, the government of Uganda has implemented several targeted agricultural financing schemes. For example, the Government of Uganda through the then Development Finance Department (DFD) of Bank of Uganda managed several credit programs that supported various investment projects in the different sectors of the economy, including agriculture, agro-industry, manufacturing and others. DFD also coordinated a number of
credit related programs including; the Linkage Banking Program under the Africa Regional Agricultural Credit Association (AFRACA); the Capacity Building Program (CBP) for microfinance institutions under the Cotton Sub-sector Development Project; Research and advocacy on Government programs, policies and processes from a gender perspective 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 the above schemes yielded some individual successes, they did not necessarily lead to the sector-wide transformation as they did not resolve what continually constrains the modernisation of agriculture and what makes smallholder farming and agri-MSMEs very risky for financing.

In 2001, the agricultural state bank UCB was privatized into the hands of the South African Standard Bank group. By that time, UCB represented two-thirds of the branch network in the country and held around 50% of the bank deposits in the country. In 2005, the government developed a rural financial services plan to create a new framework for providing rural access to finance through new channels. The plan had six objectives, including to ensure access to loanable funds at affordable interest rates and the promotion of savings accounts. Moreover, the fiscal incentives included tax exemption on income earned by financial institutions lending to agriculture (introduced in 2006/07), income tax exemptions for new rural agriprocessing investments, and no value added taxes (VAT) on most agricultural inputs and services. This policy promoted SACCOs as the primary delivery channel; because they are member-owned and -controlled, SACCOs were ideal channels for the government’s aspirations.

Since the mid-2000s credit guarantees have been used to partially cover default risk, ensuring secure repayment of all or part of formal sector agribusiness loans. Several facilities supporting the agricultural industry have been established, including USAID’s DCA Guarantee Scheme, the Agricultural Business Initiative (aBi Trust, a multi-donor trust) and the Agricultural Credit Facility (ACF), which was set up by the government of Uganda in partnership with Participating Financial Institutions (PFIs).

In 2016, the government established the Uganda Agriculture Insurance Scheme (UAIS) as a multi-peril and weather-indexed insurance pilot whose objective is to cushion farmers from losses arising from natural disasters and to attract financing to agriculture. As part of this program, the government provides premium subsidies. The program has achieved significant uptake with more than 67,000 policies sold in its first 18 months.

What happened in the agricultural finance market?

The transition from directed credit through UCB in the early 2000s to a more pluralistic, private sector-oriented financial system was a process that has played out over the past 20 years. Structurally, Uganda has developed a more expansive landscape of financial institutions and a more robust policy framework that has facilitated the entry of a number of new products, including mobile money, value chain finance, and micro-insurance. The share of agricultural credit as a percentage of total credit has gradually recovered from less than 5% in 2009 to over 12% in 2018 after a decade of decline. In 2013, 95% of all agricultural finance was provided by commercial banks, demonstrating the dramatic shift in the structure of the sector since the late 1990s. However, this increase in agricultural lending
has been highly concentrated in credit provision to mid- and large-sized companies operating in a small number of primarily export-oriented value chains.

Over the past two decades, smallholder farming households and micro agricultural SMEs have become primarily the customers of SACCOs, mobile money providers, donor-funded development programs, and government insurance. These offerings have increased the level of formal financial inclusion in Uganda, with 58% of rural adults having an account at a financial institution or a mobile money account in 2017, up from 20% in 2011 (World Bank, 2017). However, at the same time from 2006 to 2016, the share of all household farms that were less than two hectares in size rose from 75 percent to 83 percent, greatly increasing the fragmentation of smallholder production in the country.

Today, a gradually maturing and pluralistic financial system continues to develop within the governments’ 2040 vision, national development plans and the draft National Agricultural Finance Policy. Donor and government subsidies continue to support affordable credit, insurance, and extension of financial inclusion through savings accounts. However, progress remains slow for the vast majority of smallholder households and micro-SMEs.
The Uganda Agricultural Finance System Pre Mid-1980s

In the years immediately following independence in 1962, Uganda experienced robust agricultural growth. However, from the late 1960s until the mid-1980s, regular conflict and political disruption caused agricultural output to fall an average of 2.5% per year. In the 1970s, the government under Idi Amin made significant use of subsidized agricultural credit; however, in practice, loan deployment was inefficient and often politically motivated. With the fall of Idi Amin in 1979, a new government under Milton Obote sought international support and investment to prevent the economic collapse of the country. Obote’s government adopted market-based policies, including removing price controls, floating the exchange rate, and tightening government spending. Civil war in the early 1980s led not only to the collapse of agreements with the IMF, but to the disintegration of the military government. In 1986, Yoweri Museveni became president and launched a second wave of economic reforms that have shaped the economy to the present day.

The Bank-led Transition: Major Events

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tr>
<td>2000</td>
<td>Agricultural Finance strategy commissioned (2019)</td>
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<tr>
<td>2010</td>
<td>Warehouse Receipt System Act (2006) passed to establish the Uganda Warehouse System Authority</td>
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<tr>
<td>2020</td>
<td>National Agricultural Advisory Services (2001) launched to provide new farmer-led extension system</td>
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Overview of Government Actions

Under Yoweri Museveni, the Ugandan government launched reforms aimed at stabilizing the economy, resuming economic growth, and maintaining a sustainable balance of payments. At a macro level, the government launched an Economic Recovery Program with support from the World Bank and IMF. Twenty years later, in 2007, Uganda adopted its Vision 2020 framework to operationalize national development strategies, including for the agricultural sector. A specific national strategy related to agricultural finance is currently being drafted.

At the meso level, the Ugandan banking industry was significantly restructured in the late 1990s and early 2000s. This was followed in the mid-2000s by regulatory legislation that established tighter supervision from the Bank of Uganda, more stringent requirements, and higher capital provisions. Later legislation, in 2016, set up a four-tier system of financial institutions to serve different market segments and needs. The government also established a Warehouse System Authority, which helps promote alternative forms of collateral.

At the micro level, the government developed a rural financial services plan to ensure access to affordable credit and to promote savings accounts. Incentives for rural finance were created through tax exemption on income earned by financial institutions lending in agriculture and credit guarantees to partially cover default risk. The government also established a subsidized agricultural insurance scheme in 2016.

Results

Uganda has developed a more expansive landscape of financial institutions, including internationally- and locally-owned formal banks, microfinance, SACCOs, and Islamic finance institutions. The number of commercial banks grew from 14 in 2007 to 24 in 2018. The share of agricultural credit as a percentage of total credit has gradually recovered from less than 5% in 2009 to more than 12% in 2018 after a decade of decline. In 2013, 35% of agricultural finance was provided by commercial banks, representing a dramatic shift from state-led finance. However, the vast majority of this finance is provided to larger agri-SMEs and commercial farmers.

Uptake of government-backed agricultural insurance has been significant, with more than 67,000 policies sold in the first 18 months.

For more details on the Uganda experience please refer to Annex 1.