Foresight Africa 2014: It's Not Just Money That is Needed - Using a Bundled Approach to Increase Productivity in the AU's Year of Agriculture

Brookings Africa in Focus Blog

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The majority of people in Africa are engaged in the same profession: farming. Most of these individuals are small-holder farmers with fewer than 5 acres of land and little access to seed, fertilizer, financing, training or markets. Increasing the yields of these small holders has the potential to lift millions out of poverty in the coming decades.

More than any other sector, agriculture has the potential to spur inclusive economic growth in Africa. Growth in agriculture in the developing world has a multiplier effect on expenditures in poor households. Research shows that a 1 percent increase in GDP driven by agriculture leads to a massive 6 percent increase in expenditure growth[1] for the poorest 10 percent. The Chinese growth story corroborates this research. China's poverty reduction miracle was disproportionately achieved through growth in rural areas[2], with agriculture having a greater impact than any other sector.

African governments have already begun to prioritize agricultural growth. 2014 is the African Union's (AU) Year of Agriculture, but agriculture is not a new area of focus for AU countries. Just over 10 years ago, in the 2003 Maputo Declaration[3], AU countries pledged to devote 10 percent of national expenditure to agriculture. A handful of countries have consistently exceeded this target, but most have fallen short[4]. This year offers an opportunity to recommit to the 10 percent target and to draw attention to the importance of building an enabling environment for increased farm productivity.

Lack of finance is one of the largest barriers to increasing small-holder farmer productivity in sub-Saharan Africa, but many other factors compound the problem, such as weak property rights, lack of

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[1] Ligon, Ethan. Sadoulet, Elizabeth. "Estimating the Effects of Aggregate Agricultural Growth on the Distribution of Expenditures." *The World Bank Development Report.* 2008. Web. <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/11/08/000310607_20071108133513/Rendered/PDF/41368optmzd0Es1gate0growth01PUBLIC1.pdf>

[2] Ravallion, Martin & Shaohua Chen, 2004. "China's (uneven) progress against poverty," Policy Research Working Paper Series 3408, The World Bank.

[3] "AU 2003 Maputo Declaration on Agriculture and Food Security." *The New Partnership For Africa's Development*. The New Partnership For Africa's Development, 10 Nov. 2010. Web. 3 Jan. 2014. <http://www.nepad.org/nepad/knowledge/doc/1787/maputo-declaration>.

[4] "DATA Report: A Growing Opportunity: Measuring Investments in African Agriculture."*ONE*. 26 Mar. 2013. Web. <http://www.one.org/us/policy/a-growing-opportunity/>.

market access, insufficient technical knowledge, poor storage capacity, constrained water and energy supplies, and limited infrastructure. “Without access to credit, most small holders are confined to sub-optimal inputs and methods, and therefore to low productivity,” states the Dalberg report *Catalyzing Smallholder Agriculture Finance*[5]. In farming, maximizing yields at harvest time requires investments in inputs during planting such as hybrid seeds and fertilizer. But most farmers do not have enough cash on hand before planting to purchase these high-quality inputs. Without access to finance, farmers cannot increase their yields and their incomes. In addition to credit, farmers need support throughout the value chain to improve productivity. For example, farmers using new inputs require training to utilize them effectively and good infrastructure to bring the final product to market.

Given the demand for agricultural finance, it seems like banks should be jumping at the opportunity to offer credit to farmers. The Dalberg report estimates the global market demand for small-holder credit at $450 billion and the total supply at $9 billion—just 2 percent of the need. If the market opportunity is so great, what’s holding banks back? In short, risk and fear of lower profit margins. Banks evaluate agriculture as a high-risk sector and are concerned about default caused by weather- or pest-related crop failure[6]. Banks are also concerned about the high cost of operating in rural areas[7]. Most banks and microfinance institutions work in urban and peri-urban areas, and would have to invest in a costly expansion of operations to serve rural customers.

Some microfinance institutions have designed innovative products that mitigate risk and lower the cost of delivering financial services to rural areas. These farm microfinance products provide support to the farmer along the entire agricultural value chain to surmount the barriers to agricultural productivity. BASIX, a microfinance institution in India, offers agriculture extension and training services in combination with credit[8]. The business reached 500,000 clients by 2010 and was modestly profitable. Opportunity International offers farm microfinance to clients in several countries in sub-Saharan Africa, including Kenya, Malawi and Uganda[9]. Their lending model also links their clients to input suppliers, extension providers and crop buyers. Our organization, One Acre Fund, pairs finance with the distribution of seed and fertilizer, agriculture trainings and market facilitation[10]. All three institutions have developed farm microfinance products that “bundle” additional services that reduce the barriers to agricultural productivity that small-holder farmers face.

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[5] Dalberg Global Development Advisors. "Catalyzing Smallholder Agricultural Finance." Dalberg Global Development Advisors, 1 Sept. 2012. Web. 4 Jan. 2014. <http://dalberg.com/documents/Catalyzing_Smallholder_Ag_Finance.pdf>.

[6] "Improving Agricultural Microfinance: Barriers to the Supply of Agricultural Lending in the Philippines." Hanns Seidel Foundation. Innovations for Poverty Action, 1 Apr. 2009. 4 Jan. 2014. <http://www.hss.de/fileadmin/suedostasien/philippines/downloads/090401-Improving-Agricultural-Microfinance.pdf>.

[7] Röttger, Daniela. "Agricultural Finance for Smallholder Farmers: Rethinking Traditional Microfinance Risk and Cost Management Approaches." University Meets Microfinance. 13 Sept. 2013. Web. 4 Jan. 2014. http://www.universitymeetsmicrofinance.eu/uploads/2/5/8/2/25821214/agricultural_finance_for_small_farmers_umm_award_master_thesis_2013.pdf;.

[8] Mahajan, Vijay, and K. Vasumathi. "Combining Extension Services with Agricultural Credit: The Experience of BASIX India." The World Bank. Web. 15 Oct. 2014. http://siteresources.worldbank.org/INTARD/Resources/335807-1330620492317/8478371-1330712142266/Module3-IAP4.pdf

[9] "Agricultural Finance – the Opportunity Difference." Opportunity International, 1 Jan. 2012. Web. 4 Jan. 2014. http://opportunity.org/news/publications/knowledge-exchange/agricultural-finance-the-opportunity-difference.

[10] "Program Model." *One Acre Fund*, Web. 4 Jan. 2014. <http://www.oneacrefund.org/our-approach/program-model/>

As we move further into the AU's Year of Agriculture, what can be done by African governments, donor countries, nongovernmental organizations and the private sector to further increase access to farm microfinance and further reduce the barriers to agricultural productivity?

- Donors and African governments should work together to establish a multi-donor trust fund that provides seed funding for commercial banks and microfinance organizations to develop farm microfinance products. The Initiative for Smallholder Finance offers excellent guidance on the importance of donor funding that addresses supply-side constraints[11] in an October 2013 briefing paper.

- African Union countries should use the occasion of the Year of Agriculture to recommit themselves to allocating 10 percent of expenditure to agriculture, as set out in the 2003 Maputo Declaration. AU countries should recognize the importance of creating an enabling policy and infrastructure environment for farmers to improve yields and bring their products to market. The AU should not ignore the agricultural finance sector, and should pledge to make its development a budgetary priority.

- Commercial banks and microfinance organizations should use innovative design to develop new products that meet the vast demand from small-holder farmers. They should partner with other institutions that are versed in the challenges farmers face to offer services such as farm input delivery, technical training and market facilitation that will help their clients maximize their profit potential.

Combining increased access to farm microfinance with a value chain approach to farmer support has the potential to spur economic growth and reduce poverty in Africa. During the Year of Agriculture, AU countries, donor governments, nongovernmental organizations and the private sector all have the opportunity to take a bundled approach to make Africa's agriculture potential a reality.

[11] The Initiative For Smallholder Finance. "Local Bank Financing for Smallholder Farmers: A $9 Billion Drop in the Ocean." The Global Development Incubator. 24 Oct. 2013. Web. 4 Jan. 2014. <http://www.globaldevincubator.org/smallholderfinance/Initiative_for_Smallholder_Finance_Briefing_1.pdf>.