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The Role of Financial Sector in Agriculture Development and Industrialization

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ABSTRACT

In order to enhance the growth rate of the agricultural sector, which so far has been less than 4.5 percent per year, there will be need to solve, among other contraints, the availability of rural credit, improved property rights and infrastructure.

The financial sector is an essential player in agriculture development, playing a facilitating role of amassing the necessary capital for farm development, storage, processing and packaging, transport, insurance and marketing of agricultural produce. Unfortunately so far, only 6 percent of Tanzanians have access to financial loans from banks, with the agricultural sector accounting for only 1 percent of the loans. The banking sector attributes high risk in lending to farmers as the main bottleneck.

Introduction

In Tanzania, agriculture sector accommodates over 80 percent of the population and women account for more than 60 percent of its workforce (URT, 2009). The bad story is that the majority of the farm workforce is poor. Being core implementers, small farmers and especially women do not have skills and financial capital required to acquire and adopt new approached and technical innovations that could help them to get out of poverty.

There are various private and multi-national companies, as well as non-governmental organizations, contributing towards the goal of reducing poverty by equipping farmers with the required tools and inputs. However, the results have not been impressive; productivity in agricultural sector has not improved and the number of people living below poverty line has remained almost the same in the past decade.

Findings

Only 3 percent of agricultural households have access to credit the rest have no access to financial services that are prime important for supporting poverty eradication strategies. The local moneylenders or bank services have exorbitant interest rates that have become development barriers in rural areas. According to FinScope Survey of 2009, the proportion of adult population who use banks and other formal financial institutions in the country is 12.4 percent only; those who are totally excluded from formal and informal financial services account for 45 percent of adults in urban 60 percent of adults in rural areas. Moreover, bank penetration is lower than 10 percent in region of Africa.

Overview of agricultural sector in Tanzania

Like many other developing countries where 45 to 80 per cent of the population derives its livelihood, agriculture is the key determining sector in the economy of Tanzania.

The sector with an average growth rate of 3.3percent contributes around 24 percent of GDP, 20% of foreign earnings and 32% of country's export. While arable land is estimated at 44 million hectares, only about 10 million hectares or 23 percent are currently under cultivation; and only 326,492 out of the 2.3 million hectares are irrigated. The average size of land holding is between 0.9 and 3.0 hectares and keeps decreasing because of inheritance. Only 15 percent of farmers use improved seed.

Food production is mainly done in small scale and because of poor weather conditions, use of old technology and other problems, land and labour productivity is low. The average food crop productivity is 1.7 tons per hectare against 3.5 - 4 tons per hectare that can be achieved with proper technology and skills. Agribusiness in nontraditional export crops is still at very low stage. Higher food prices, driven by higher energy cost and rising demand in developing countries are good opportunities for Tanzania to develop its agro-industry to tap into regional markets and especially eight countries which it shares boarder with.

Agricultural sector is characterized by strong forward and backward linkages with other sectors and by high potential for a faster and sustainable growth and development. Its development is however constrained by insufficient infrastructure (transport, water, energy and communication), finance and limited access to finance, insecure property rights, poor farming systems which lead to depletion of natural capital and release of greenhouse gases and other pollutants.

In addition, there are marketing problems, crop losses due to pests and hazards, food waste in storage, distribution, in marketing and at the household level.

All these factors in turn stem from lack of funds and technical know how. Farmers being small are not in a position to remove all these constraints because of lack of funds.

Tough conditions and interest rates charged by financial institutions on agricultural credits discourage investors to make large agricultural investments. Since land in rural areas is not surveyed at household level farmers cannot use it as collateral to access bank credit.

Agriculture transformation initiatives

The measures include adoption of Agricultural Sector Development Strategy ASDS) and Program (SADP) in 2001 in order to transform from subsistence to commercial agriculture. The program is financed through ASDP Basket Fund, General Budget Support (GBS), stand alone projects, farmers and the private sector. There are five Development Partners in the Basket Fund; the World Bank, Government of Japan, Irish Aid, International Fund for Agricultural Development (IFAD) and African Development Bank (AfDB). At the national level, financing is done through the MTEF system as per budget guidelines.

In addition, the government is making improvements to the rural road network, irrigation infrastructure, identifying and surveying land for large-scale food crop farming, supporting research institutions to develop improved seeds, reduction of unsustainable forest harvesting and establishing and reviving agro-processing industries. In order to encourage trade in agricultural products and inputs the Government changed its VAT and custom duty policies.

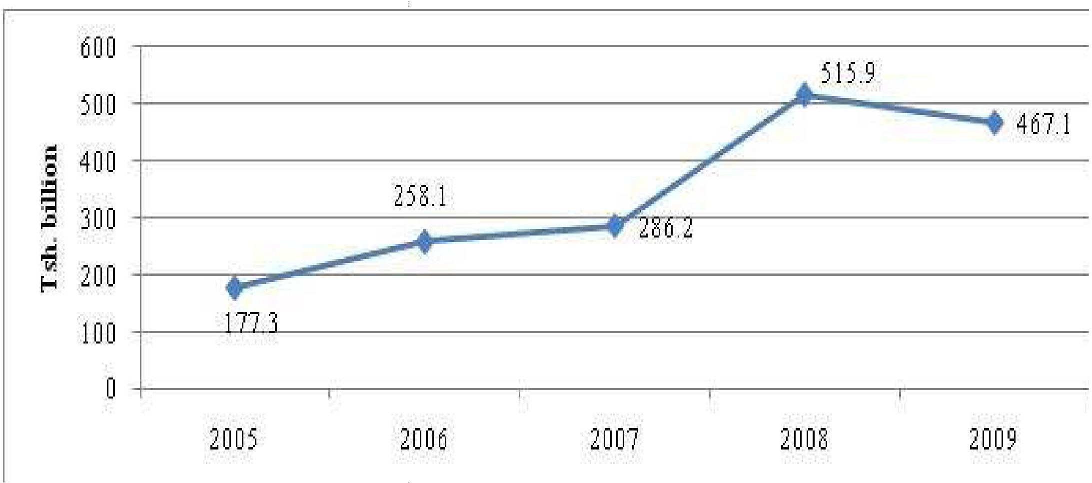
Agricultural financing

Financing of agriculture has been through a variety of sources, government being the main. Government budget to agriculture has been increasing over time following the implementation of ASDP and CAADP.

The share of government expenditure on agriculture increased from 6.2 percent in 2007/08 to 7.2 percent in 2008/09 and then to 7.9% in 2010/11. This amount is less that 10 percent share required for rural development. Tanzania Investment Bank (TIB) a government-owned development bank is the first development finance institution established by the Government of Tanzania. It was re-capitalized and its strategic development plans were re-vamped and its management re-structured. As of December 2010[update], TIB had a total asset base in excess of US$62 million (TZS: 93 billion).

The government intends to raise that figure to US$265 million (TZS: 400billion), in the next few years. The bank has a significant portion of its portfolio in the Tanzanian agricultural sector upgraded.

Bank of Tanzania report of 2010 shows that flow of lending to the agriculture sector by domestic commercial banks in 2009 decreased to Tsh.467.1 billion from Tsh. 515.9 billion in 2008 (by 9.5 percent) despite the fact that the flow trend had been rising from 2005 to 2008 (Fig.1).



Source: BOT 2010

Together with above sources of finance, NGOs and small farmer through participatory initiatives also contribute significantly to agricultural financing. Contribution by private sector is well recognized in medium and large scale farming and currently through ***kilimo kwanza initiatives.***

Conclusion and Recommendations

It is clear that the sector of agriculture is crucial in the economy of Tanzania and it has high potential for a faster and sustainable growth and development. However, its development is constrained by many varying factors, the main being lack of finance capital, insufficient infrastructure and property rights.

Accessing credit services provided by financial institutions has been a major concerned of stakeholders in the agriculture sector, and mainly by smallholder farmers who have no property to use as collateral. Financial institutions have rejected alternatives to traditionally known properties to use as collateral. Consequently they cannot make medium and large investments.

Formal financial institutions hastate to extend credit to agricultural productive activities because they claim that these activities are risk ventures. From above analysis it is clear that both conventional and traditional agriculture generate substantial pressure on the environment, albeit in different ways.

In other words, risk associated with agricultural activities are mostly man made and can be reduced substantially by promoting more environmentally sustainable agriculture. Lack of land use plan has also some risk attached to it because banks fear to extend credit to agricultural activities which later-on can be affected by change in use of the land occupied. It is therefore recommended that:

1. Farmers be given title deeds which they can use as collateral
2. The land use plan of should be prepared in such a manner to avoid conflicts
3. Promotion of group farming societies is also suggested as a further means of facilitating the supply and supervision of credit in agriculture. Provision of credit to construct storage facilities and agro-processing industries.
4. To adopt green agriculture practices whereby financial institutions and other agricultural funders should extend credit or support to agricultural activities with farming practices and technologies that promote green agriculture.

Implementation of the suggested recommendations will depend on commitment by government towards green agriculture in terms of applying pro green growth measures which include training of farmers, policy measures, encouraging farmers to invest in green agriculture, eliminating barriers to trade in technologies and services needed for a transition to green agriculture.

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