Building a Regulatory Environment for Agricultural Finance

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Agricultural finance,[2] and access to finance more generally, can directly contribute to building more dynamic, diverse, and resilient agricultural sectors worldwide. In Uganda, the market for agricultural finance is evolving and receiving increasing attention from both the private and public sectors. Uganda's commitment to agricultural finance is evidenced by the Agriculture Finance Platform (AFP), which is hosted by the Uganda Agribusiness Alliance (UAA), and the Agriculture Finance Technical Working Committee (TWC) of the Ministry of Finance, Planning, and Economic Development (MoFPED), and Uganda stands to make a mark in the agricultural finance landscape. To support this possibility, in 2019, UAA, with support from the Alliance for a Green Revolution in Africa (AGRA), partnered with the New Markets Lab (NML), an international law and development center,[3] and FRIENDS' Consult Limited, a Uganda-based international consulting firm, to assess the legal and regulatory aspects of agricultural finance in the context of market and regulatory trends. The full results of this regulatory diagnostic will soon be published in collaboration with the aforementioned institutions, and this article summarizes the core findings, opportunities, and challenges facing agricultural finance in Uganda.

As the authors found, because of the nature of the agricultural sector, improving the regulatory environment for agricultural finance and addressing demand and supply constraints will require a systems approach that integrates regulatory considerations related to agriculture, trade, financial services, and the digital economy.[4] While this means that there is no silver bullet regulatory solution, it also signals that more creative, long-lasting solutions could be possible.

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[2] Agricultural finance is a broad term that encompasses financial services and products used by different stakeholders along the agricultural value chain. *See Making Finance Work for Africa, Policy Brief on Agricultural Finance in Africa*, African Union and GIZ GmbH on behalf of the German Federal Ministry of Economic Cooperation and Development. March 2012. Available at: http://www.ruralfinanceandinvestment.org/sites/default/files/Policy__Brief__mfw4a.pdf.

[3] New Markets Lab, "A Center for Law and Development," March 2019, Available at: https://www.newmarketslab.org/; *see also* "About New Markets Lab," 2019, available at: https://www.newmarketslab.org/about. The Regulatory Diagnostic was based on NML's systems approach to economic law and regulation, which assesses different components of the legal and regulatory system and their relation to each other, drawing upon good regulatory practices, comparative law, and experience with rules and regulations economy-wide.

[4] The Regulatory Diagnostic was based on NML's systems approach to economic law and regulation, which assesses different components of the legal and regulatory system and their relation to each other, drawing upon good regulatory practices, comparative law, and experience with rules and regulations economy-wide. New Markets Lab, "A Center for Law and Development," March 2019. Available at: https://www.newmarketslab.org/; *see also* "About New Markets Lab," 2019, https://www.newmarketslab.org/about.

Overall, because the agricultural sector is subject to high systemic risks and is composed of many small individual farmers (85 percent in Uganda's case),[5] traditional financial institutions, including banks, have often not been as capable or willing to finance agriculture's needs as would perhaps be the case in other sectors. Consequently, regulatory and financial services interventions need to be carefully tailored and understood with the dynamics of the broader agricultural sector, and the small farmer, in mind.[6] According to the World Bank, Uganda's current enabling environment[7] both supports and constrains agricultural finance and growth of the agricultural sector more broadly, yet it does not yet fully address the needs of agricultural small and medium-sized enterprises (SMEs).[8]

Overall, Uganda has taken a number of positive steps to put in place a comprehensive legal and regulatory framework for both the financial services and agricultural sectors, which has, in part, contributed to the significant increase in agricultural finance over the past twenty years. However, gaps do remain, and additional focus is warranted in several areas, including non-traditional financial services like digital financial services, alternative forms of collateral, and regulatory aspects of agricultural markets and trade, including standards.

Current Regulatory Framework for Financial Services and Agriculture

Since 2017, several important pieces of legislation have been passed in Uganda to improve regulation of the financial services sector and governance of financial services providers. Relevant regulations include those that govern the banking sector, insurance, capital markets and securities, and pensions and retirement benefits, as well as digital financial services, including mobile money, data privacy and protection, and digital consumer protection. Notably, Uganda has put in place new laws and regulations to cover new products that have emerged in the agricultural finance space such as agent banking, Islamic banking, moneylenders, non-deposit taking microfinance institutions, bancassurance, online foreign exchange trading, anti-money laundering, and the protection of electronic data and digital transactions. One of the most significant developments was the enactment of prudential and non-prudential regulation for informal financial service providers, including Savings and Credit Cooperatives (SACCOs), Village Savings and Loan Associations (VSLAs), moneylenders, and all other non-deposit taking financial institutions. These informal financial service providers were initially unregulated, yet they provided significant financial services to the agricultural sector.

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[5] Uganda Bureau of Statistics, Statistical Abstract 2018,available., available. Available at: https://www.ubos.org/wp-content/uploads/publications/01_2019STATISTICAL_ABSTRACT_2019.pdf.

[6] Regulatory Guide for the Financial Services Sector, New Markets Lab and the International Centre for Trade and Sustainable Development, 2016; The Role of Law and Regulation in International Trade Finance: The Case of Correspondent Banking, Katrin Kuhlmann, World Economic Forum, White Paper 2017, available, available at. Available at https://docs.wixstatic.com/ugd/095963_6a55cec9c5f441b087e4cca01dba5b24.pdf.

[7] Throughout this article, the term "enabling environment" will be used to refer to the system of rules and legal instruments (policies, laws, regulations, and other measures) that govern economic and market activity and the institutions that implement these instruments.

[8] World Bank, *Closing the Potential-Performance Divide in Ugandan Agriculture*, World Bank Group 2018, available., available. Available at: http://documents.worldbank.org/curated/en/996921529090717586/Closing-the-potential-performance-divide-in-Ugandan-agriculture.

In addition to financial services themselves, regulation of the agricultural sector overall must also be understood and considered, as it impacts both demand for, and supply of agricultural finance directly and indirectly. Relevant regulatory issues include rules and regulations related to access to agricultural inputs, farmer producer organizations and cooperatives, availability of agricultural infrastructure (including storage, logistics, and irrigation), services regulation, and product standards (including SPS measures), some of which arise at different stages in the value chain (for example, standards).[9] If not well integrated, the regulatory framework governing the agricultural sector lead to gaps in regulatory design, implementation, and enforcement.[10] Again, Uganda has taken important steps to improve the regulatory system governing the agricultural sector through laws and regulations on agricultural inputs and cooperatives, for example. However, gaps do remain in these and other areas that can affect agricultural productivity, product marketability, farmers' livelihoods, and business profitability.

In addition to these aspects of the enabling environment, other systemic regulatory issues impact access to agricultural finance. These include rules around taxation, contracting, and permitted forms of collateral. Because these elements of the regulatory system touch on both agriculture and financial services, reforms here could have greater impact overall.

Gaps and Challenges

Despite positive advancements in Uganda's enabling environment for financial services and agriculture, a common set of challenges face the enabling environment for agricultural finance.[11] The challenges can generally be classified into three groups: market specific challenges, regulatory design challenges, and regulatory gap challenges, which include, for example:

Market-Specific Challenges:

- Limited capacity to provide agricultural loans and other financial services specific to the agricultural sector;
- Limited agricultural finance product innovation and design associated with inadequate skills;
- Internal organizational culture and policies that may not favour financing agriculture;
- Inadequate current and accurate data to inform financial institutions of the financial supply and demand gaps in the agricultural sector; and

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[9] Katrin Kuhlmann, "The Human Face of Trade and Food Security: Lessons on the Enabling Environment from Kenya and India," Center for Strategic and International Studies, December 2017, available at: https://docs.wixstatic.com/ugd/095963_d0db766f66984c13a883db2f66cff84a.pdf.

[10] *See, e.g.,* Katrin Kuhlmann, "Reframing Trade and Development: Building Markets Through Legal and Regulatory Reform," World Economic Forum and International Centre for Trade and Sustainable Development, November 2015, available at http://e15initiative.org/wp-content/uploads/2015/09/E15-Finance-and-Development-Kuhlmann-Final.pdf.

[11] Based on stakeholder consultations held in Uganda in May 2019, prior analysis by UAA (*see* Uganda Agribusiness Alliance, "Diagnosing Agriculture Finance in Uganda." Synthesis Report. November 2017.), and analysis by FRIENDS' Consult Limited (financial and market) and New Markets Lab (legal and regulatory).

- Shortage of suitable, long-term funding liabilities to put into agricultural lending.

Regulatory Design Challenges

- Challenges in contract law and enforcement stemming from limited understanding of contractual terms and payment schedules that do not affect agricultural market realities;
- Regulatory limitations associated with the limits on credit concentration, liquidity management, and the credit classification and loan provisioning requirements;
- Issues associated with land tenure and administration, which impact productivity and increase the cost of production, affecting marginalized groups like the youth, the disabled, and women the most; and
- Gaps in the regulation of cooperatives (changes to the Cooperative Law are underway).

Regulatory Gap Challenges

- Lack of a policy framework for agricultural finance (although, notably, this development is currently underway) to coordinate public and private activities to improve agricultural finance;
- Need for financial sector regulation for alternative sources of funding for agriculture (including remittances, pensions and retirement benefits);
- Absence of binding legislation on payment systems, which inhibits consumer protection, especially regarding electronic payments and transactions;
- Inadequate regulation of contract farming, which creates imbalances in transactions between farmers and buyers, affecting compliance and parties' ability to benefit from such agreements;
- Gaps in the legal and regulatory frameworks for the financial services and agricultural sectors, which impact the availability of and access to agricultural finance, despite notable developments. These include:
    - Need for National Payment Act and Regulations based on international good practices and rules on factoring and invoice discounting based on international good practices;
    - Consistently implemented tax rules for financial services (e.g. insurance);
    - Gaps in the legal framework for cooperatives (amendments to the Cooperatives Societies Act are also pending);
    - Regulatory gaps and limited capacity for implementation related to agricultural inputs (such as seed, fertilizer, and pesticides); and
    - Regulatory gaps and limited compliance capacity with respect to standards and quality control measures that arise throughout the value chain (including production, processing, packaging, storage, transportation, and trade) which the marketability of agricultural products, especially across borders.
- Limited alternative forms of collateral provided for under law and regulation (other than moveable assets), which could present important alternatives to using land as collateral, such as lease financing and warehouse receipts systems (WRS).

Key Recommendations

Most of the recommendations that would address these gaps could be adopted in the short term and would represent immediate wins for improving the enabling environment for agricultural finance. These include, for example, finalizing and adopting the draft policy on agricultural finance that is already under development. Enactment of the National Payment System Act and Regulations would also fill a gap in the financial services sector that will be critical to improving the enabling environment for agricultural finance by providing consumers with protection from risks such as fraud when engaging in electronic payment transactions. Other countries, such as Kenya, have taken a similar approach. Finally, in the near term, Uganda could move forward with changes to the pensions and retirement benefits regulatory framework, so as to further integrate the informal sector and widen the savings base in order to provide alternative forms of funding for the agricultural sector.

With regard to regulation of the agricultural sector, some recommendations would take more time to adopt and implement and fall more within the medium- and long-term. One priority for the Ugandan government would be to develop a stronger legal basis for increasing smallholder farmers' participation in cooperatives, which would improve access to agricultural financing, inputs, and other extension services. In parallel, developing a regulatory structure for contract farming in compliance with international standards (including, for example, an annotated standard model contract) with a well-designed dispute settlement mechanism could improve farmers' rights and reduce instances of breach of contract. Further, the enabling environment could be strengthened through better implementation of existing rules and new measures, such as an enhanced regulatory framework for agricultural inputs (this could include putting in place regulations on plant breeders' rights to make the existing law operational and authorizing private seed inspectors to strengthen quality controls and build capacity in seed production). Strengthening the implementation of standards and developing innovative ways to ensure compliance with standards through improvements to national standards systems and private sector self-regulation could also be key to unleashing Uganda's agricultural potential. Finally, continuing to improve the framework and implementation of regionally harmonized rules, including at the East African Community (EAC) level (this could include, for example, harmonized standards for financial services) would be essential to access wider market opportunities for the agricultural sector.

Additional regulatory issues deserve focus which cut across both financial services and agriculture. While many of these recommendations span the medium- to long-term, some, such as finalizing bills already under development, can be done in the short-term as well. One priority recommendation is to develop and strengthen the enabling environment for alternative forms of collateral in order to shift away from using land as the primary form of collateral (although when land is used as collateral, upholding stakeholders' rights and streamlining procedures for land governance will be important, particularly when approached through a gender lens). Interventions could include finalizing and enacting the draft Law on Lease Financing; finalizing and enacting the Moveable Property Security Interest Bill; and establishing an electronic collateral securities registry, all based on international good practices. Finally, it will be important to address factoring and invoice discounting, which could partially bridge gaps in contract law and enforcement and strengthen implementation of Uganda's WRS Act and Regulations. As just one example of the interconnectivity between recommendations, enhancing engagement with farmers' cooperatives would help strengthen the link between WRS, commodities exchanges, and online markets in order to address the needs of both farmers and warehouse operators, as well as improve the implementation of quality control procedures and measures for contract breach.

Overall, the private sector will need to play a key role as well through development of specifically tailored financial products; data collection; and investment in appropriate infrastructure (such as laboratories, storage facilities, and digital trading platforms). Guidelines and standards on provision of agricultural business development services and strengthened capacity of agricultural advisory service providers would also be beneficial. In particular, the authors also recommend harnessing opportunities presented by digital finance, electronic traceability, and even blockchain to address interconnected challenges with financial services availability, collateral, traceability, and even market standards. Uganda has already done a great deal of work to improve the enabling environment for agricultural finance. By prioritizing a tailored set of additional interventions, Uganda could well become a global good practice itself.