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Does Deposit Money Banks Credit to Agriculture Support Government Diversification Agenda in Nigeria? Issues for Legislative Consideration

Augustine C. Osigwe, PhD
Chukwuemeka Onyimadu

Executive Summary

The Federal Government has over the years adopted several frameworks to enhance credit supply to the agricultural sector. Given these efforts, this brief examines available related data with a view to know whether Deposit Money Banks Credits (DMBs) to Agriculture support Government diversification agenda. Theoretically plausible findings emerged. First, the correlation statistics of 0.896 indicates that higher DMBs loans and advances have the potential to speed-up diversification of the Nigerian economy. Second, with a correlation statistics of 0.892 we deduced that higher DMBs loans and advances to the agricultural sector boost agriculture value added as a percentage of GDP. A review of cross country experience towards promoting agricultural sector access to finance, presents credit models that Nigeria can tap into. Overall, we learned that the lower income countries have leveraged on the agricultural sector to diversify their economy. On the basis of our findings, a number of succinct recommendations that will aid the National Assembly to assist in deepening the existing successes towards promoting agricultural sector access to DMBs credit in Nigeria are presented.

I. Overview

1. As Nigeria exists a recession and transcends towards a positive growth trajectory, policy makers and all stake holders are even more concerned with ensuring domestic economic policies that will act as a safety net given Nigeria's obvious external vulnerability. This vulnerability is exacerbated by the existing structure of her economy; an economy dependent on crude oil, which has volatile price that is beyond the direct control of the government.

2. Due to the dependence on crude oil revenues and their consequent volatility, there has been an increased clamour for a more diversified economy. The increased outcry for diversification, especially as the economy begins its recovery from a recession, is hinged on the need for some form of policy and structural re-engineering of the productive and distributive

(allocative) base of the economy, with emphasis on increasing agricultural production and the non – oil sector in general. It has been argued that a more diversified economy, will engender a more inclusive growth and promote development outcomes. However, the evidence on Nigeria's diversification (2000 – 2016) indicates a severely less diversified economy (Figure 1).

3. To this end, the federal government through the Federal Ministry of Agriculture and Rural Development (FMARD) has had policies and legislation basically targeted at the transformation of the Agriculture sector. These policies and legislation cut across; Fiscal Policies, Domestic Content for Food (Enabling Legislations), Industrial Policies Financial Service Policies and Agricultural Policies. The fiscal policies are zero tariffs (custom, excise and value added) for import of agricultural equipment and agro-processing equipment, tax holidays for investors putting processing plants in staple crop processing zones, increase tariff on any commodity that Nigeria can produce (rice, starch, sugar, wheat etc.) to promote domestic production and local content, policy on import levy of 5% for brown rice and 30% for polished milled rice, and 5% on raw sugar and 10% on starches should be increased and revenue used to support domestic production and supportive incentives for investors for blending plants for ethanol.

4. Likewise, the Central Bank of Nigeria (CBN) has over the years adopted several frameworks to enhance credit supply to the agricultural sector of the economy. Among these are; Agricultural Credit Guarantee Scheme Fund (ACGSF), Agricultural Credit Support Scheme (ACSS), Commercial Agriculture Credit Scheme (CACS) and the Anchor Borrower's Programme (ABP). Given these efforts, this brief seeks to examine available related date with a view to understanding whether Deposit Money Banks Credit to Agriculture support Government diversification agenda.

II. Issues and Analysis of Relevant Data

5. There are serious concerns that the recent positive growth rates in the first and second quarters of 2017 were not a direct consequence of innovative long term policy framework, comprising fiscal – monetary – external sector policy initiatives but from an improvement in international crude oil prices. Despite the benefits of positive growth rates during a recession, the danger lies in the possibility of an unchanged structure of the economy, which may be less diversified. To promote diversification, part of the Government's policy drive in the Economic Recovery Growth Plan (ERGP) is increasing access to agriculture finance with a view to

increasing agriculture output and value added.

6. Agriculture financing can come as direct interventions from the government through Ministries and Agencies or by increased borrowings by Deposit Money Banks (DMBs). Despite the high positive correlations between finance and increased agricultural output, evidence shows that the amount of loans and advances by DMBs to the agricultural sector is relatively lower when compared to the manufacturing sector and oil and gas (Figure 2).

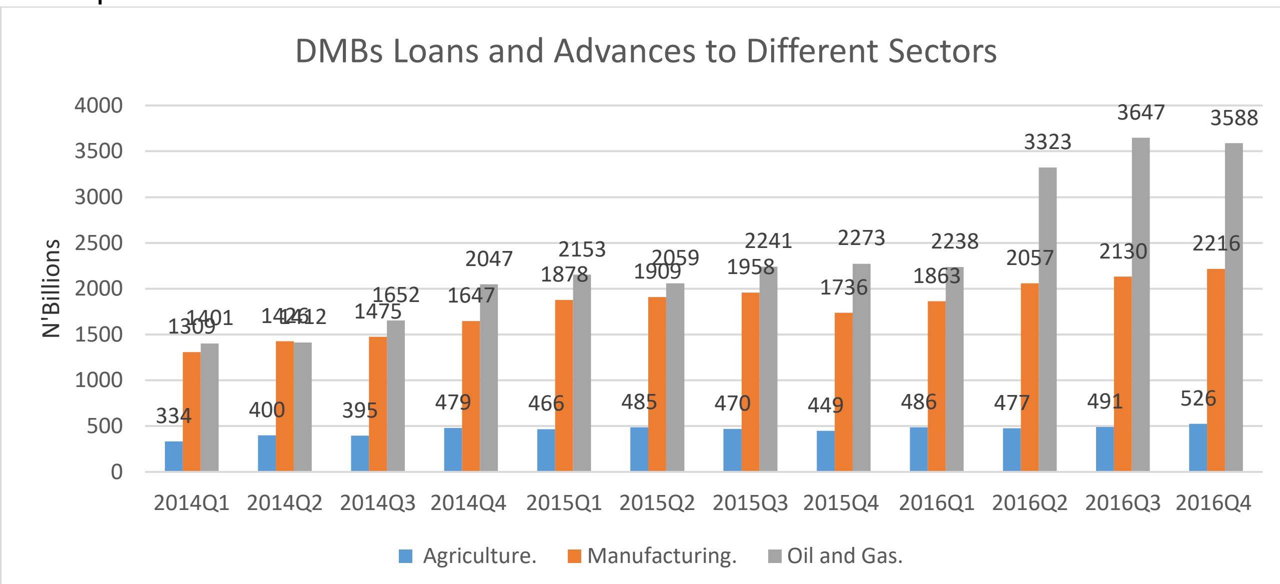

Figure 2: Loans and Advances by DMBs to Agriculture, Manufacturing and Oil and Gas.
Source: CBN Statistical Bulletin

7. Most institutions engaged in providing credit are often reluctant to provide such assistance to agriculture because of the more attractive returns from other sectors of the economy and (before the present administration) from borrowing to the government itself. Banks remain wary of small holder farmers due to the difficulty of assessing and managing the risks associated with credit. This has translated to very stringent screening measures and requirements when considering credit/loans for such farmers. This act does not only scare the young people away, but also reduces the capacity of the government to diversify the economy via agriculture.

8. The World Bank Enterprise Surveys in 2013 discovered that financial institutions often demand for immovable assets like land/buildings from small businesses as collaterals 73 percent of the time, whereas, 78 percent of the capital assets owned by these businesses (small

holder farmers inclusive) are vehicles, machinery, equipment and account receivables, which can also be used as movable collaterals.

9. Clearly, from Figure 2, DMBs give more loans and advances to manufacturing and oil and gas sectors relative to agricultural sector. Nonetheless, DMBs loans and advances remain an important access for increasing agriculture output and value added, which will ultimately lead to more diversification of the economy. To further buttress the important role of DMBs loans and advances to agriculture, we compared the trends in MBs loans and advances to the diversification index and agriculture value added as a percentage of GDP. In performing the comparative trend analysis, a simple liner correlation statistic (r) is used. If the correlation statistic is positive, it shows that increases (decreases) in one variable is associated with increases (decreases) in another variable and if negative, increases (decreases) in one variable is associated with decreases (increases) in another variable.

10. First, the trend in DMBs loans and advances to agriculture and diversification index are compared. The correlation statistics of 0.896 indicates that higher DMBs loans and advances are associated with higher levels of diversification in the Nigerian economy (Figure 3). This is a clear indication that increased provision of Agricultural financing will encourage diversification by increasing agricultural output. Alternatively expressed, increased agricultural output diversifies the Nigeria's economy away from crude oil, all other things being equal.

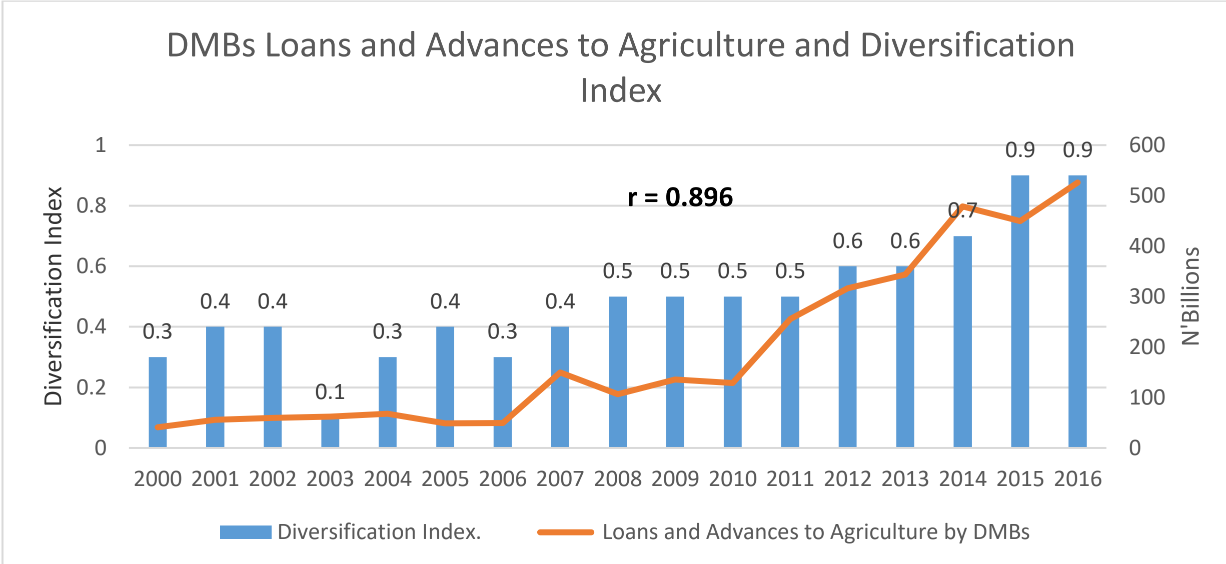

Figure 3: Trends in Diversification and DMBs loans and advances to Agriculture.
Source: CBN Statistical Bulletin and IIAG

11. Second, the trend in DMBs loans and advances to agriculture and agriculture value added[1] as a percentage of GDP was analysed. Expectedly, the correlation statistics of 0.892 indicates that higher DMBs loans and advances to the agricultural sector is associated with higher levels of agriculture value added as a percentage of GDP. This very high correlation indicates that access to finances is very important in inducing value added by the agricultural sector to the GDP. In this sense, the capacity of the agricultural sector to promote to economic growth is strongly tied to access to finance (Figure 4).

[1] Value added is the net output of the agricultural sector after adding up all outputs and subtracting intermediate inputs. It provides a measure of the value of goods and services in the agricultural sector, which suggests the capacity of the agricultural sector to contribute to growth.

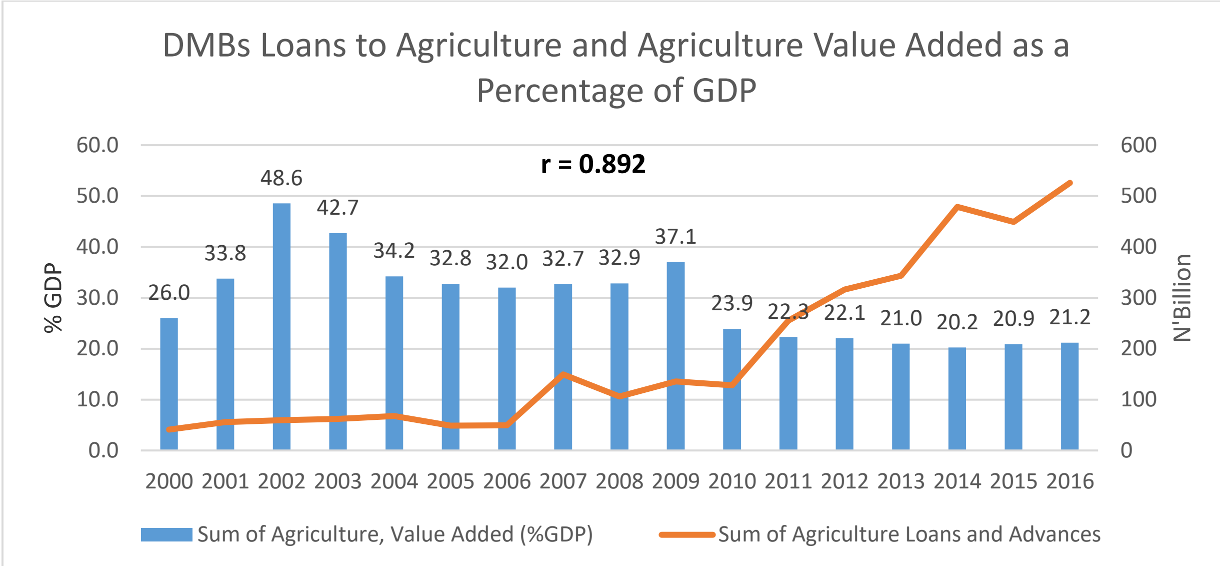

Figure 4: DMBs loans and advances to Agriculture and Agriculture value added as a percentage of GDP.
Source: CBN Statistical Bulletin.

III. Cross country Experience towards promoting bank credit to Agriculture

12. In this section, we try to show how different countries allocate financial resources to the agricultural sector. We classified the countries into: a) High Income Countries: Israel, United Arab Emirates and The United States of America; b) Upper Middle Income Countries: Albania, Argentina and Iran; c) Lower Middle Income Countries: Egypt, Bangladesh, India, Kenya; d) Low Income countries: Burkina Faso and Senegal.

13. The data for the selected group of countries show that, Agriculture value added as a fraction of GDP was relatively high for low income and lower middle income countries as compared to higher middle income and high income countries. Factually, agriculture value added as a fraction of GDP for high income countries was 1%, 1.3% and 0.7% for The United States of America, United Arab Emirates and Israel, respectively (Figure 5). On the other hand, agriculture value added as a fraction of GDP stood at 30% and 35% for Burkina Faso and Senegal, respectively (Figure 5). A plausible reason for such dispersion is based on high income countries being industrialized, with a high fraction of their GDP coming from services and technological innovations. Whereas, low income countries are less industrialised, with lower capacity to innovate and imitate technological advancements.

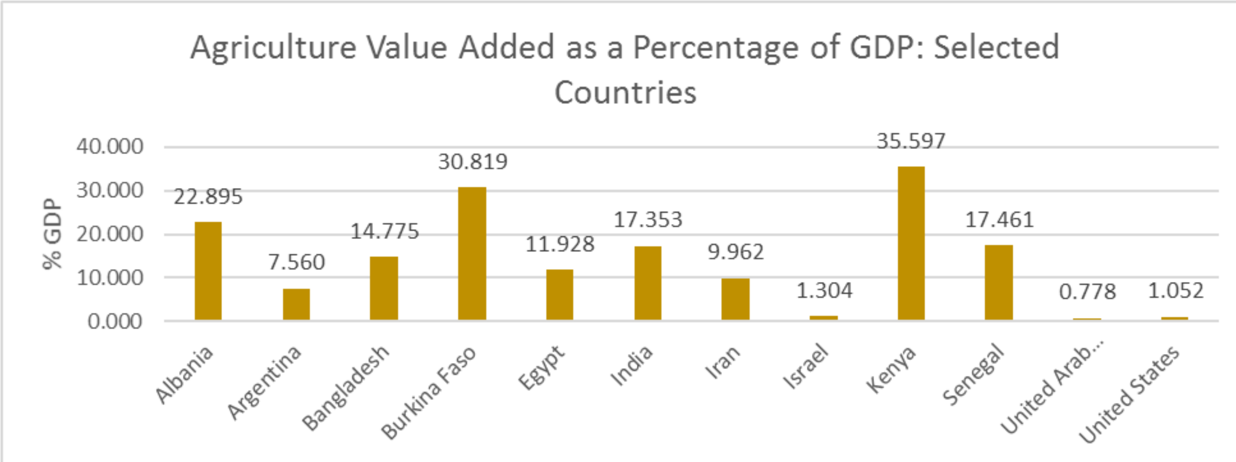

Figure 5: Agriculture Value Added as a percentage of GDP.
Source: World Bank Development Indicators (2017)

14. The data for the amount of credit allocated to the agricultural sector for the selected countries indicates that the fraction of credit to the agricultural sector relative to the total available credit is lower for high income countries and higher for lower income countries. Figure 6 gives the total allocation to agriculture for the selected countries, while Figure 7 indicates the proportions of agricultural credit to total credit. Clearly, the data shows that lower income countries and lower middle income countries allocate higher proportions of total credit to the agricultural sector than higher middle income and high income economies (Figure 7). Structural transformation (advance countries do more of manufacturing and services and less of agriculture) is one of the plausible reason for this.

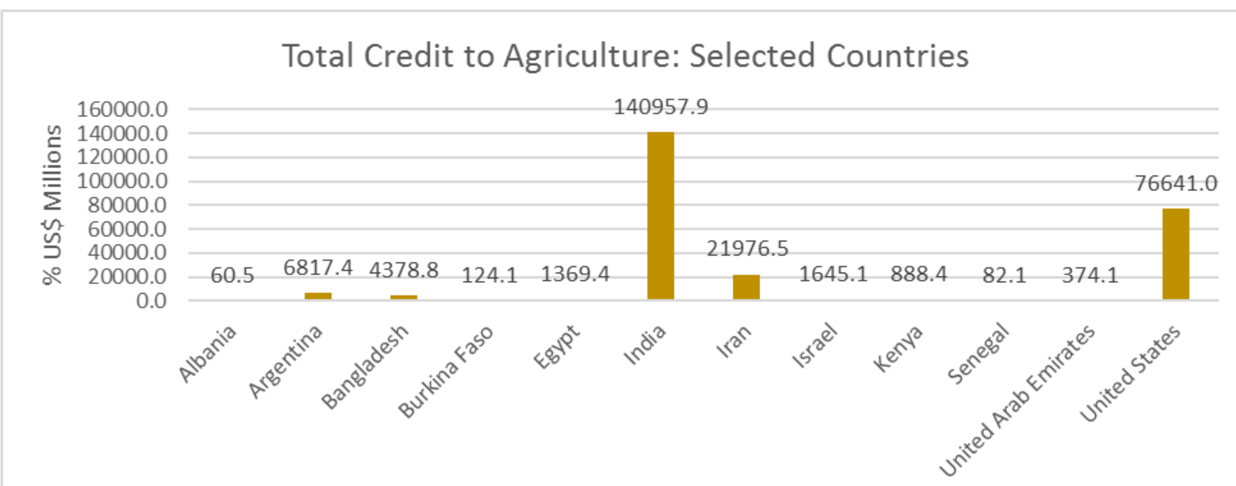

Figure 6: Total credit to Agriculture
Source: Food and Agriculture Organization (FAO) Dataset.

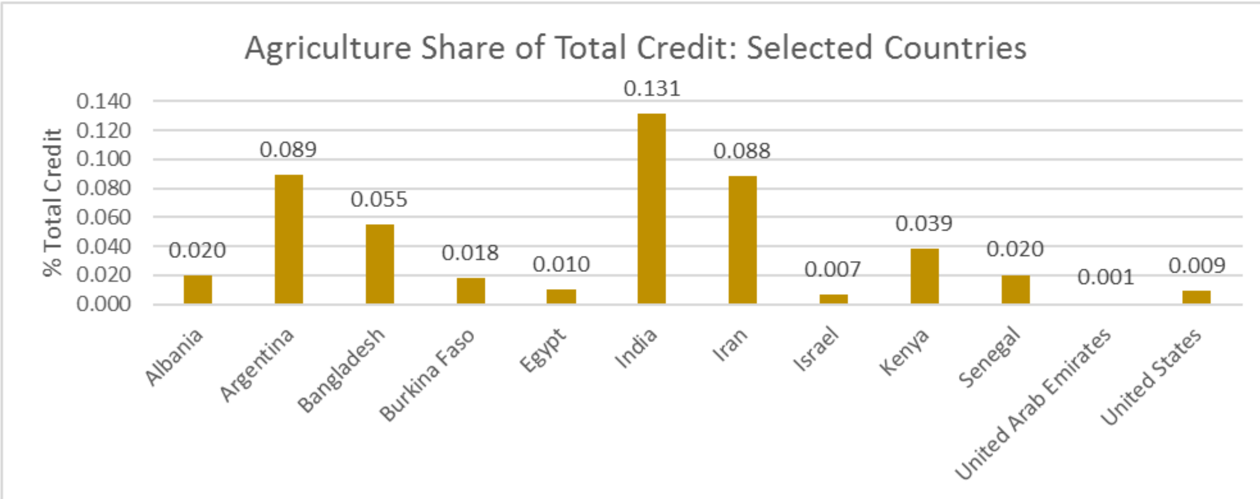

Figure 7: Share of Agriculture to Total Credit
Source: Food and Agriculture Organization (FAO) Dataset.

IV. Lessons for Nigeria

Nigeria has to learn from the lower income countries to increase the fraction of its credit to the agricultural sector relative to the total available credit by so doing it will boost its agriculture value added as a fraction of GDP and diversify the economy away from crude oil.

From the High Income Countries we learn that after a certain growth threshold, agriculture's contribution to the GDP begins to decline. By then the economy slides from agriculture to manufacturing and services – a concept economists describe as the natural growth ladder or transformation.

V. What the legislatures should do

Banks remain wary of small holder farmers due to the difficulty of assessing and managing the risks associated with credit. To address this, the National Assembly should encourage the Ministry of Finance to adopt credit ratings for Smallholder farmers. The credit rating would enable financial institutions to readily assess the financial capacity of farmers and by extension boost their confidence for them.

The usual practice of financial institutions demanding for immovable assets like land/buildings from smallholder farmers as collaterals should be outlawed by NASS. Vehicles, machinery, equipment and account receivables, which can also be used as movable collaterals could be recommended.

The relevant NASS committees should cause the CBN to come up with legislation that encourages banks to direct an increasing share of funds to the agric sector and increase the number of training extended to existing and intending farmers. Failure to meet specified target would imply that the banks will have to allocate funds in providing relevant training for farmers. Technical assistance to increase capacity through training, research and provision of information should be granted to farmers. We there add that the training should incorporate business plan writing since it forms one of the essential requirements in obtaining loans from most banks – BOI inclusive.

To channel much finance to the agricultural sector and by extension diversify the economy, we recommend a single digit interest rate for the sector or a subsidised interest rate credit program.

To establish transparency, accountability, equity and fair play, the relevant National Assembly Committees should as well demand that the CBN furnish them with information relating to all federal government loans targeted at promoting the agric sector in Nigeria, at least in the last five years.

The views expressed in this Research Issue Brief are those of the author(s) and do not necessarily represent the views of the Institute and its Management.

Contact
National Institute for Legislative and Democratic Studies (National Assembly)
14/18 Danube Street, Off IBB Way, Maitama
Abuja, Nigeria.
Email: info@nils.gov.ng
Website: http://nils.gov.ng/
Tweeter: @nilsnigeria