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POLICY BRIEF

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Creating an enabling policy environment for agricultural finance to support climate risk management in Uganda

Executive Summary

The impacts of climate hazards such as floods and droughts have significant consequences for the development of agricultural value chains. These impacts are critical in developing countries such as Uganda, which rely heavily on the agricultural sector to meet their economic and food security needs. Within agriculture, cereals such as rice are highly susceptible to climate hazards. Given that climate change projections for Uganda suggest that these hazards will become more frequent and intense, sustainable agricultural development will depend on how effectively various agricultural players manage climate risks. Consequently, climate risk management has a critical role to play in increasing agricultural production. Financial service providers can support value chain actors in adapting their activities in order to manage climate risks over time. Public policy must support private sector initiatives that strengthen climat risk management (CRM). Potential opportunities to enhance CRM exist, for example in ongoing public programs that promote agricultural finance – these can be improved by integrating investments in actions that facilitate climate adaptation by various actors along value chains. Resourcing, monitoring and evaluation of existing climate change adaptation-related programs is also necessary to identify opportunities to strengthen the role of financial service providers.

Introduction

In Uganda, climate change is among the main policy challenges to national development and economic transformation. Uganda's 2015-2020 National Development Plan (NDP) indicates that growth in the country's gross domestic product (GDP) during 2011-2015 was 1.7 percentage points below its target. The agricultural sector underperformed, with agricultural GDP growth averaging 2.1 percent per annum during 2010-2014. The impacts of climate change—including droughts, floods, storms, heat waves and landslides—are responsible for a portion of Uganda's poor agricultural performance.

The government's approach to managing the effects of climate change has been to roll out frameworks to guide interventions in climate-change adaptation and mitigation.[1] These frameworks include the Uganda National Adaptation Programme of Action (NAPA) launched in 2007 and the National Climate Change Policy (NCCP)[2] launched in 2014. Another effort has been made to integrate climate issues into the agricultural sector through the establishment of the Climate-Smart Agriculture (CSA) program for 2015-2025. Although these initiatives have supported public interventions related to mitigation and adaptation practices, they have not provided strong support for private sector investment to enhance adaptation to climate

change. This brief highlights how financial institutions can support CRM in Uganda through focused investments along the rice value chain. It also highlights the dynamics needed to create a friendly policy environment in the area of CRM by both value chain actors and financial service providers. This brief is based on the findings of case study research conducted through the initiative, "*Private sector investment in a changing climate: Resilient rice value chain development in Uganda (PSI-Climate) initiative*".

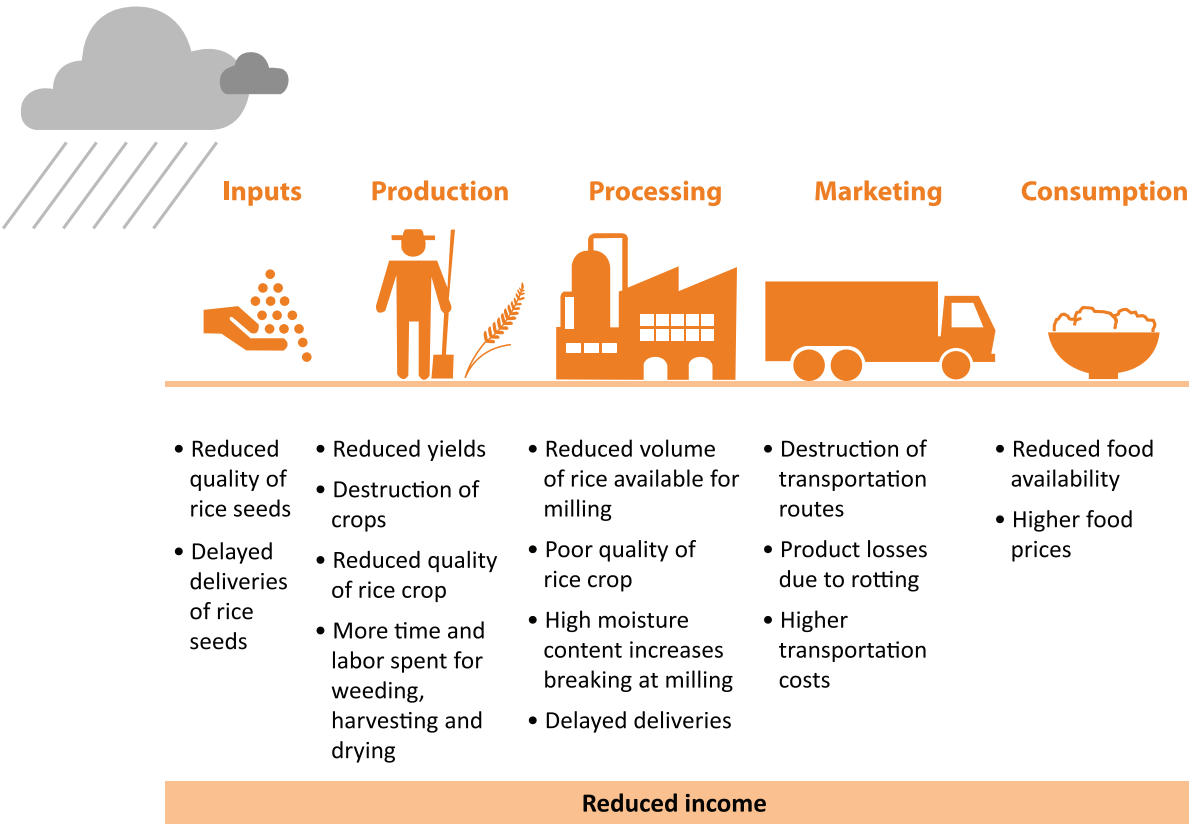
The Project

The PSI-Climate initiative explored how domestic private sector investment decisions can enable CRM by different actors along the rice value chain in Uganda. Led by the International Institute for Sustainable Development (IISD), the project was implemented in partnership with the Economic Policy Research Center (EPRC) and the Ministry of Finance, Planning and Economic Development (MoFPED) during the period 2014-2016. The research was conducted through two case studies, of which one focused on domestic private investments in quality rice seeds in Northern Uganda and the second on financial products in Eastern Uganda. The analysis presented in this brief is informed by the findings of the latter case study, which was conducted in collaboration with the Centenary Bank, a domestic commercial bank providing financial services to rice value chain actors in Butaleja, Budaka and Mbale districts. The research involved dialogues with farmers, millers, traders, transporters and service providers, as well as bank staff and experts in agricultural finance.

Impacts of climate hazards on agricultural value chains

The case study research in Eastern Uganda revealed that all of the value chain actors experience negative impacts of climate hazards on their rice-related activities. The climate hazards identified by the actors included droughts, floods, hailstorms and changes in rainfall patterns. These hazards affect activities all along the rice value chain, however the production stage is particularly vulnerable. Figure 1 presents the impacts of flood as an example. As shown in the diagram, the impacts at the inputs and production stages have spillover effects for the other stages. Loss of income affects all actors along the chain when supplies of rice are limited by extreme or variable weather

Figure 1 Impact Of Flood On Rice Value Chain



Vulnerability of value chain actors to climate risks is determined not only by their exposure, but also by their capacity to respond. The different actors along the value chain are employing a range of strategies to manage the risks they are currently facing. Diversification is an important strategy, with farmers planting different kinds of crops and pursuing off-farm income generating strategies, and other actors dealing with a range of different commodities. Some millers, traders and farmers keep reserves of rice that they can access during lean times. Consumers substitute other staple foods that are home grown or more cheaply available on the market. The research found, however, that some of the responses are not sustainable and may undermine longer-term resilience.

The impact of climate hazards also affects financial institutions that invest in the agricultural value chains. More specifically, the impacts of droughts and floods directly affect Centenary Bank by increasing threats to profitability. The bank experiences increased default rates for loans and reduced savings deposits. CRM by value chain actors will therefore yield benefits for both the actors themselves and the bank. The process of CRM along agricultural value chains involves assessment of climate risks, adaptive management of value chain activities and responding to shocks when they occur.[3] These inter-related functions must occur on an ongoing basis to develop value chains that are climate-resilient, allowing actors to achieve their business objectives in spite of climate variability and change.

How can agricultural finance support climate risk management along value chains?

There are a variety of ways for financial service providers to support CRM by value chain actors. Loans can provide capital for investing in livelihood/income diversification, in which farmers plant more than one crop, and for investing in livelihood/income diversification, in which farmers plant more than one crop, and investing in multiple non-rice businesses. Loans can also be used to smooth fluctuations in income, allowing households to meet basic needs such as food, education and healthcare. Savings can also help manage risks and uncertainty, providing a buffer when incomes are affected by climate extremes and changes. Although not yet widely available, micro-insurance can provide compensation for losses.

For institutions offering microfinance, there are numerous ways in to achieve this. First, existing products and services can be adjusted to reflect the realities of climate change. This will likely include increased flexibility in credit and savings products, as well as the creation of incentives for clients to invest in CRM. Second, as noted above, new products (most notably insurance) may be required to meet client needs in a changing climate. Third, financial service providers can play a role in supporting better decision-making by their clients, for example through the dissemination of climate and weather forecasts. To support all of these options, financial service providers must invest in a rigorous and ongoing analysis of risks (including climate risks), and engage in adaptive management of their operations, products and services to minimize the negative effects of climate change on both their clients and the bottom line.

Implications for policy

Government efforts can leverage on the important role that finance plays in CRM to enhance value chain performance. Policies and strategies that integrate finance and climate risk management can have far reaching impacts on investments and adaptation for agriculture value-chain development. Some progress on this has already been achieved. For example, the aforementioned CSA program presents opportunities to innovate in the delivery of microfinance services to farmers and to encourage the adoption of weather index insurance. It also recognizes the need to invest in agro-meteorological infrastructure and strengthen climate information services, both of which are critical to supporting improved decision-making for CRM. Challenges in taking this forward include the definition of roles and responsibilities for different actors, including the private sector, as well as the barriers to realizing effective and accessible climate information systems.

In addition, the recently created Agricultural Finance Platform (AFP) under the MoFPED provides opportunities to deliberate on issues concerning CRM and finance in agriculture. The AFP is responsible for bringing together various stakeholders to advocate and create a dialogue about policy issues concerning agricultural finance in Uganda. One major barrier to creating an environment that is conducive to encouraging agricultural finance to support CRM is the lack of an agricultural finance policy and strategy. This makes it difficult to identify how investments in CRM should proceed and the appropriate roles

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of the public and private sectors. Although efforts to implement an agricultural finance policy have been initiated through the agricultural finance platform, it is important for CRM issues to be explicitly identified and included in that policy.

Moving forward, it is also important that the CSA program and the planned National Adaptation Plan (NAP) for the agricultural sector to be well resourced, monitored and evaluated so that they can generate lessons and practices that enhance investments. The challenge is that financial service providers are unaware of existing opportunities to address climate risks and consequently expand their agricultural loan portfolios. Furthermore, there is need for in-depth research to identify strategic areas in which financial service providers can invest.

Endnotes

1 Government of Uganda (GoU). 2015. National Development Plan
2 Government of Uganda (GoU). 2014. National Climate Change Policy
3 IISD (2016). Enabling climate risk management along agricultural value chains: Insights from the rice value chain in Uganda. IISD Climate-resilient value chains and food systems briefing note written by Angie Dazé and Julie Dekens.

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