BLENDED FINANCE

A STEPPING STONE TO ACCELERATE INCLUSIVE AND SUSTAINABLE AGRICULTURAL TRANSFORMATION IN ETHIOPIA

Innovative funding sources can address key transitions needed for a more sustainable food and land use system such as stimulating more productive, regenerative and climate-smart agriculture, improving nutrition, closing gender gaps, reducing food loss and waste, and protecting and restoring nature, writes Sofi a Kassa (PhD), State Minister of Agriculture, Agriculture and Investment Division, Mandefro Nigussie (PhD), CEO, Agricultural Transformation Institute, Sofi a Ahmed, Country Manager of Food and Land Use Coalition Ethiopia.

Enhancing access to agricultural and rural financial services for smallholder farmers and pastoralists is an essential component in Ethiopia's transition from subsistence agriculture to more market-oriented and resilient agriculture and thereby rural transformation and sustainable growth.

The challenges to transform agriculture in Ethiopia are well known. More than 64 percent of farmers produce their crops on less than one hectare, accounting for an estimated 95 percent of total agricultural production. Lack of agricultural credit and rural financial services are a systemic constraint for rural transformation. Most smallholders do not have access to sufficient credit to invest in productivity-enhancing technologies such as improved seeds, agrochemicals, fertilizer, farm machineries, and irrigation technologies. For instance, agriculture receives less than 10 percent of bank lending, with the bulk reserved to agricultural export commodities. Most importantly, vulnerable groups including women farmers and pastoralists have limited credit options and there are limited alternative forms of affordable finance and insurance to serve smallholder farmers and pastoralists.

For this to happen, more specialization in agricultural finance and targeted solutions – especially for smallholders is required. Blended finance structures, which can change the risk profile of agricultural finance including by guaranteeing loans, providing longer payback periods, aggregating small projects and connecting to supply chain partners, supporting farmers, communities and other enterprises to invest in improve productivity, better soil and nutrient management, restoration of degraded farmlands and incentivizing more equitable practices.

Government actors have recognized the constraints of financial services and products for agriculture in Ethiopia. The National Bank of Ethiopia has issued a directive that obligates banks to allocate at least five percent of their credit disbursement of the year to individuals, cooperatives, and micro, small, and medium enterprises operating in the agriculture sector, based on their movable property collateral such as land, livestock or expected harvests from crops. In addition, the Ministry of Agriculture has proposed several policy reforms to address this agriculture and rural financing gap including creating more enabling environment to increase the credit extended by commercial banks to agriculture policy options to the establishment/restructure a policy bank for agriculture, as well as establishing cooperative banks in the draft revised Agriculture and Rural Development Policy, which is under review and by the Ethiopian Council of Ministers.

Blended finance arrangements, which typically combine grants and concessional capital (with interest rates below market rates or longer grace periods) and market rate capital from public and private providers, can play a key role in implementing the government's agricultural finance recommendations. In fact, blended finance could catalyze innovations that can unlock finance for smallholder farmers, make agricultural commercialization more sustainable, reduce investment risks and improve financial returns and increase economic, social, environmental, or other impacts.

Over the past decade, blended finance arrangements in Ethiopia have supported coffee cooperatives, microfinance institutions, and agribusinesses even within a financial services industry that excludes direct foreign investors. These arrangements have increased commercial lending, enhanced agricultural productivity, and targeted underserved areas and communities, including women in Ethiopia. Replicating structures that work to accelerate investment in agribusiness and unlock finance for smallholders will be key to scaling blended solutions while keeping transaction costs low. This approach can help Ethiopia become a global blueprint for investing in food security, nutrition, climate-smart agriculture, resilience and the circular economy.

Internationally, the Blended Finance Task Force, has identified operational examples that have mobilized capital for sustainable food and land use assets. These innovative funding sources can address key transitions needed for a more sustainable food and land use system such as stimulating more productive, regenerative and climate-smart agriculture, improving nutrition, closing gender gaps, reducing food loss and waste, and protecting and restoring nature. The Taskforce has highlighted over 60 new financial structures and solutions, and many of them are operational in other African countries and could be replicated in Ethiopia with the right partnerships across public, philanthropic and private investors.

Considering the strong evidence on the benefits and potential of blended finance, the Food and Land Use Coalition (FOLU) in collaboration with the Blended Finance Taskforce, launched the Innovative Finance Initiative in Ethiopia. Through this initiative, FOLU aims to promote a blended finance approach in Ethiopia to strengthen the agricultural sector and advance a sustainable food and land use system by mobilizing new capital that will increase the flow of funds for agriculture to protect people and planet and support economic resilience and growth. We believe this is an important step in identifying a set of strategic actions that can advance innovative blended finance instruments in Ethiopia.

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