ETHIOPIA: Use of Land Titles as Collateral to Obtain Credit in Rural Areas

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Ways out of poverty, vulnerability and food insecurity (AVE)

27B GOOD PRACTICE SERIES

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Use of land titles as collateral to obtain credit in rural areas

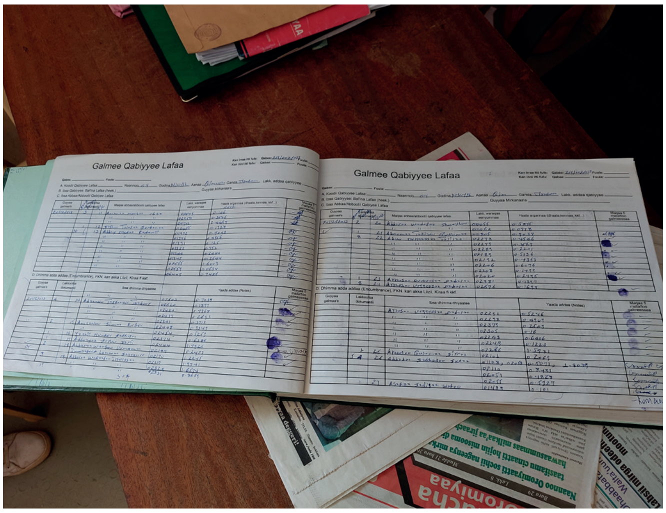
In Ethiopia, the land belongs by law to the state and its inhabitants. In the countryside, farmers thus have a lifelong right to use their land, can lease it out and give it away, but not sell it. This situation, among other reasons, has in the past led farmers to invest little in improving agricultural productivity through long-term measures such as irrigation, planting tree crops or terracing slopes. Another reason for a lack of willingness to invest is often the lack of capital. In the past, it was possible to take out group loans – mainly through the local cooperatives, but also through microfinance institutions – but individual loans were not granted. Also, the network of financial service providers in rural areas was and is not very dense.

The almost complete land title registration in the Ethiopian highlands has recently made it possible to use a land title as collateral for taking out a loan in rural areas as well. This measure, which was launched by DFID as a pilot programme, has been well received in rural regions by banks and other financial service providers as well as by smallholder families and is currently being continued by GIZ as part of the S2RAI project. The present study investigated the potentials and risks of mortgaging land titles using the example of the Kersa Malima Woreda (district) in the Oromia Region in Ethiopia. The farmers see the link between land title and loan as predominantly positive, among other things because if the loan is not repaid, the land title does not go to the bank, but the use of the mortgaged fields only has to be suspended for three years.

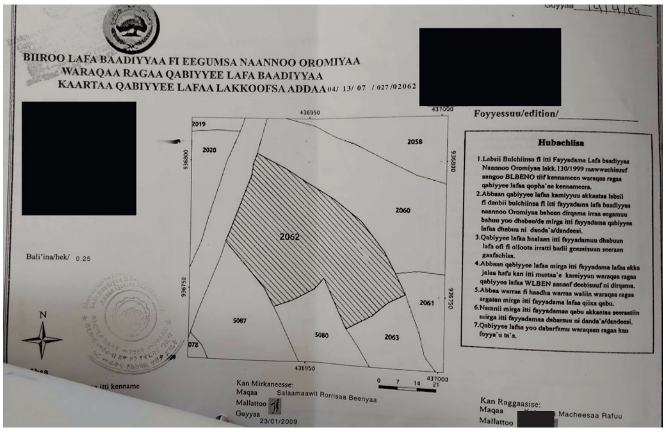
Land title registration, loans, rural finance, Oromia, Ethiopia

Country and project background

The vast majority of the Ethiopian population (more than 70%) lives from agriculture (cf. CIA 2022). On average, a farm cultivates 0.96 hectares (ha) of land. In Oromia Region the average is 1.15 ha, in Amhara 1.09 ha, in Tigray 0.91 ha and in the Southern Region (SNNP) 0.49 ha (Headey et al. 2014). The poverty rate in Ethiopia, as measured by the national index, fell from 29.6% in 2011 to 23.5% in 2016. However, it was primarily the urban population that benefited from this. In rural areas, the poverty rate went from 30.4% in 2011 to 25.6% in 2016 (World Bank 2020). Furthermore, Ethiopia is ranked 173 out of 189 countries in the Human Development Index (UNDP 2020) and is thus still one of the poorest and least developed countries in the world.



Since the reform of the Marxist government in 1975, land in Ethiopia generally belongs to the state and its people. This means that farmers only have a lifelong right to use their land, but not a right of ownership. This allows them to lease and bequeath their land, but not to sell it (Deininger et al. 2007). In an almost nationwide process covering the entire rural highlands of Ethiopia, since 1998 (test phase) and 2003 (implementation phase), the land used for agriculture has been registered and land titles have been issued to the users (ibid.). The issuing of the titles takes place in two steps. It starts with the First Level Land Certificate (FLLC), which has already led to increased land security among users. Among other things, this leads to an increase in investments on the land, for example for soil and water conservation measures or the planting of trees. According to the Ministry of Agriculture, 98% of the land in Oromia Region had been attributed an FLLC in 2022. Amhara, Tigray and the Southern Nations, Nationalities, and Peoples' Region (SNNPR) can boast similarly high numbers.



The second step of registration is the issuance of the Second Level Land Certificate (SLLC). This is issued in the names of both spouses in the case of married couples or all spouses in the case of polygamous households, contains a drawing with the correct measurements, unlike the FLLC and is registered with the Land Administration and Use Office. Each individual parcel is given an individual number, the Unique Parcel Identification Number (UPIN). Of the more than 50 million plots in the Ethiopian highlands, 25 million have already been registered and surveyed by 2022, and SLLCs have already been issued and handed out to landowners for 18 million plots.

The SLLC is used by holders to assert their claim in conflicts over land such as boundary disputes, in the division of land in the case of divorce or in inheritance disputes. In addition, farmers can use the SLLC to take out a loan, which was previously not possible in rural areas. In rural areas, applying for a loan was previously only possible in a group. Even then, there was a limit of 20,000 Birr (= 365 euros in June 2022) per person.

The supply with financial service providers such as banks and microfinance institutions (MFIs) in rural Ethiopia is very inadequate, although their density has definitely increased in recent years. In 2014, only 22% of adults in Ethiopia had an account with any financial institution compared to 29% in sub-Saharan Africa and 62% globally. Only 7% of Ethiopians had taken out a loan from a formal financial institution in 2014. Agricultural financing is offered by banks almost exclusively for larger farms. High transaction costs for small loans make business with small agricultural loans unattractive for banks, which is also due to the generally scattered settlement structure in rural areas, few opportunities to check creditworthiness and a lack of collateral among smallholder farms. On the other hand, the existing offer is not accepted by the smallholders, so that the question arises whether the offer of the financial service providers is tailored to the existing demand for small loans in the agricultural sector. The dependence on rain-fed agriculture and climatic uncertainties that can hinder repayment make smallholder farmers in particular reluctant to take out loans (Berhane / Abay 2019).

One exception is financial cooperatives, which offer their members the opportunity to save and take out loans. These have grown strongly in number in recent years. According to Benti (2019), MFIs and financial cooperatives in rural areas have contributed significantly to poverty reduction. They have been supported with financial services by the International Fund for Agricultural Development (IFAD) since 2003.

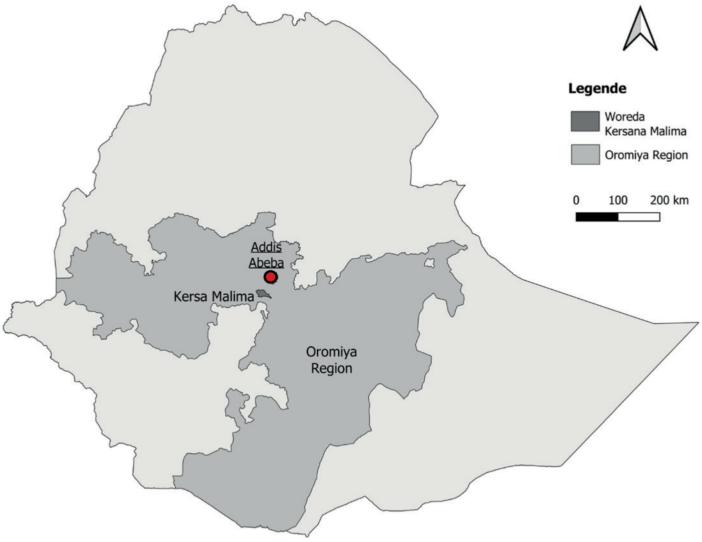
Traditional savings and credit groups, so-called equb, are widespread in Ethiopia and are mainly used by women.

Goals and activities at a glance

The Land Investment for Transformation Programme (LIFT) pilot project has been implemented by DFID together with the Ethiopian government since 2014. This programme has developed and tested ways to improve access to financial services for smallholder farmers. In the process, packages were developed for and with MFIs that enable smallholder households to use their land titles as collateral to obtain loans. In 2021, this project component was transferred to the S2RAI project implemented by GIZ together with the Ethiopian Ministry of Agriculture and continued there.

LIFT was based on the assumption that farmers would be willing to invest more in the productive and sustainable use of their land if land security improved. Land titles were issued in the four regions of Amhara, Oromia, Tigray and SNNPR in slightly different ways depending on the regional legal situation, but always with the participation of the affected population.

A team from the Institute for Development and Peace (INEF) at the University of Duisburg-Essen conducted research in the project in four kebeles (communities) of the Kersa Malima Woreda in the Oromia Region in March 2022. In addition to focus group discussions (FGDs) and intensive interviews with farmers, numerous interviews were conducted with key persons related to the project. The research focused exclusively on the land title and borrowing nexus; the other project components were not the subject of the study.



In the Oromia Region, the MFI WALCO, which operates there, was transformed into Sinqe Bank in order to be able to meet the demand for individual loans with land titles as collateral. According to Sinqe Bank and the Land Administration and Use Office in Kersa Malima Woreda, the procedure for borrowing is based on the model developed by LIFT and in practice runs as follows: First, a (male or female) farmer submits a loan application to Sinqe Bank. The bank checks the person's so-called track record, i.e. whether the person has a savings account with the bank and what the savings behaviour is, as well as whether the person has taken out loans before and what the repayment behaviour was. Secondly, the borrower must submit a business plan stating what he or she intends to use the loan for. The bank requires an SLLC as collateral. In addition, the bank checks with the kebele administration whether the person actually resides at the location. Someone who is not resident in the locality can open a savings account at the bank, but cannot get a loan.

In addition, the bank checks by letter with the Land Administration and Use Office whether the parcel(s) of land for which the SLLC is presented is/are actually owned by the person applying for the loan and whether the parcel(s) is/are not currently leased or otherwise used by someone else. The Land Office checks the registration of the plots and sends a response letter to the bank. If the parcel is free of other bonds, the bank now enters into a loan agreement with the person naming the amount, purpose and repayment mode and reports this back to the Land Office, which blocks the UPIN of the parcel(s) for other transactions until the loan is repaid. In order to publicise this possibility of borrowing, the Land Office organised information events for farmers at woreda and kebele level. The maximum limit for a loan with an SLLC at Sinqe Bank is currently Birr 75,000, with 2 ha of land mortgaged for this amount.

If a person cannot repay the loan in the agreed time, this is first reported to the local administration as well as the Land Office. The local administration puts the use of the mortgaged plot(s) out to public tender and the use is leased for a period of three years to a person who can settle the outstanding debt directly with the bank. After that, the use returns to the original owner. Thus, the land title itself is never affected, but the use of the mortgaged parcel(s) is merely temporarily transferred to another person.

Project impacts achieved so far

The documentation of the project impacts achieved is based on the available evaluation reports of the project, especially the quantitative study by Nathan Associates London Ltd (2019), which surveyed 926 borrowers and 456 comparison households. Secondly, this good practice booklet is based on our own qualitative field research in Kersa Malima Woreda, which primarily addressed issues that were not investigated or only slightly explored in the mostly quantitative evaluations.

According to Nathan Associates (2019), the average loan amount per borrower taken out with an SLLC as collateral is Birr 31,000 (median Birr 30,000), with sums ranging from Birr 5,000 to Birr 50,000. LIFT works with six MFIs on a pilot basis, among which ACSI in the Amhara Region is the most developed and established one. Interest is charged for a loan of between 15 and 19%, and the loan term is between one and three years, with an average duration of 26 months. ACSI, for example, offers longer-term loans at slightly higher interest rates.

The evaluation by Nathan Associates (2019) reiterates the high demand for credit that also exists in Kersa Malima Woreda. During the evaluation, 1% of the borrowers stated that they had previously taken out informal loans from neighbours and moneylenders, and 12% mentioned loans from MFIs or Saving and Credit Cooperatives (SACCOs), which are always granted as group loans. The average amount borrowed was Birr 11,800, much less than loans with land titles as collateral.

Respondents in Kersa Malima Woreda said that although they had taken out group loans in the past, they saw many disadvantages in this procedure. There are always defaulters for whom the group has to take responsibility in the end. These are the rules of the MFIs and SACCOs. Thus, the other group members first had to repay the outstanding amount to the financial service provider and then, in lengthy and possibly costly court proceedings, claim the money from the people who could not repay in time. Of course, this also leads to conflicts within the group. The possibility of getting an individual loan was consistently welcomed in the FGDs and individual interviews. In addition, it was very much welcomed that the individual loans with land titles as collateral could be much higher than the group loans, which it is still quite possible to take out. Sinqe Bank in Kersa Malima Woreda had granted 50 individual loans with SLLCs as collateral at the time of the investigation, in addition to a total of 2000 group loans.

Nathan Associates (2019) indicate that 88% of borrowers invested in productive income-generating activities, of which 63% invested in agriculture, 29% in livestock and 5.5% in non-farm activities. With the help of these investments, they achieved an added value of 33.6% per ha in agricultural activities alone compared to the same activity before taking out the loan. In our own survey in Kersa Malima Woreda, the main uses of the loans mentioned were the purchase of artificial fertiliser, the leasing of additional arable land and the purchase of animals for fattening and breeding. To a lesser extent, the loan is used to renovate the house or build additional rooms, rent a tractor to cultivate the fields, acquire improved seeds and pesticides, or purchase a scale to establish a grain trade. One borrower also mentioned the purchase of a small threshing machine for teff (a cereal variety), and another the replacement of traditional beehives with modern, more efficient ones.

Another effect of the measure is the empowerment of women. The Nathan Associates surveys found that women are more involved in decision-making than before due to their increased economic role, and that credit decisions are often made jointly by spouses.

Challenges and conditions for success

▶ The demand for loans by farmers is very high. In the Woreda studied, Sinqe Bank, which is responsible for individual agricultural loans with SLLCs, is far from being able to meet the demand – despite the Ministry of Agriculture’s statement that Kersa Malima is one of the Woredas where the model of lending with land titles as collateral works well and where LIFT has worked for a long time. In order to be able to sound out and assess the numerous loan requests, Sinqe Bank first serves those people who have already taken out one or more group loans with Sinqe (or previously WALCO) and repaid these without any problems. Furthermore, they check the agricultural situation of the borrowers on site. For this purpose, Sinqe Bank has 20 employees in the Woreda and motorbikes as means of transport. This equipment and staff, in addition to the lack of financial resources to serve the continuously increasing demand for credit, is far from being sufficient.

▶ A creditworthiness check is carried out. One criterion is the person’s credit history. On the other hand, savings behaviour and savings assets are reviewed. The preparation of a business plan on the part of the borrower is particularly important. The benefit of the loan as presented in the business plan must exceed the loan amount by at least 2% according to the applicable regulation. This margin is considered far too small, as it is very quickly cancelled out by inflation. The risk is also very high for many planned activities for which the credit is to be used. Rain-fed agriculture is extremely climate-dependent and crop failures can occur. Animals bought from credit can also die. In addition, many farmers complain that the prices for agricultural products remain the same, while artificial fertilisers, seeds and agricultural equipment are becoming steadily more expensive.

▶ The responsibilities and procedures between the bank, the Kebele administration and the Land Administration and Use Office are clearly regulated, well-coordinated and are mostly carried out without charging fees. The established procedures enable smooth cooperation. However, delays can sometimes occur, for example, due to scarce human resources and the lack of transport options.

▶ One challenge is the fact that SLLCs are usually issued to the parents’ generation, but they often no longer want to invest in their land, while one or more of the landowners’ children would like to do so. This should be considered and responsibilities should be discussed when advising borrowers on the preparation of a business plan as well as in the loan agreement.

Conclusions for development cooperation in general

▶ This study was conducted to explore possibilities for individual rural loans where a land title can be used as collateral but is not lost to the borrowers in case of non-repayment of the loan. The model presented, in which defaulters lose the right to use the mortgaged plots for a period of three years, but then get it back, fulfils this condition. It makes it necessary to issue titles for each plot.

▶ The issuance of land titles creates security for farmers in the long-term management of their land and thus also has a decisive influence on their investments in the land.

If, as in the case of Ethiopia, spouses are listed jointly on the certificates, women can enforce their rights to the land on the farm under modern land law in the event of divorce or the death of the husband. This practice seems to be gaining ground and is also accepted by men. On the other hand, women can take out loans themselves. As all spouses are recorded on the land titles, the consent of each one is necessary.

▶ A clear regulation of responsibilities, processes and, if necessary, fees among the authorities and financial service providers involved is a basic prerequisite for the functionality of the system presented here. An acceleration of the processing time or streamlining of the processes could possibly be achieved through increased digitalisation of the processes.

▶ The borrowers as well as the Land Office have repeatedly suggested that the business plan or the loan agreement should contain milestones for measuring success, the achievement of which would be monitored by the bank (or an authority still to be determined). It also makes sense to involve sectoral authorities (e.g. for agriculture, animal production, or water) in the preparation of the business plan.

▶ Strengthening resilience at the household level succeeds in the documented case, as well as generally, primarily through economically effective measures. By taking out a loan, smallholder households have the opportunity to use the money productively and invest the profit in further productive activities, children's schooling, health expenses and improving their own housing situation and nutrition.

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Images

Cover photo: Loans are often taken out to have the farmland ploughed with a tractor, 1. Land Title Register, 2. Second Level Land Certificate (SLLC), 3. Map of Kersa Malima Woreda in the Oromia region of Ethiopia, 4. Land Administration and Use Office at Woreda level, 5. Focus group discussion with a group of men, 6. Satellite dish acquired by group loan 7. Threshing machine for which credit is sometimes taken out for servicing 8. Homestead with grain harvest in Kersa Malima Woreda.

Fig. 3 (map) was created by Fabio Pruß
all photos by Karin Gaesing

Project characteristics*

B4 – Intensity of research team involvement:
G1 – Gender index:
P2 – Participation
A7 – Target group index

* For an explanation see Good Practice handout or https://www.uni-due.de/inef/inef_projektreihen.php

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The research project aims to develop recommendations for state development cooperation. The aim is to identify measures that can better reach poor, vulnerable and food insecure population groups and efficiently support them in improving their living situation in a sustainable way.

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The project is funded by the German Federal Ministry for Economic Cooperation and Development (BMZ) under the special initiative "One World – No Hunger".

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ISSN: 2512-4552