



ROLE OF GOVERNMENT IN RURAL AND AGRI-FINANCE:

BUILDING A MARKET-BASED SYSTEM TO SUPPORT SUSTAINABLE GROWTH



In order to unlock the full power of the agriculture sector in achieving development objectives, national governments should transition to an agri-finance system premised on three key principles:

- **Distinct:** The agri-finance sector has different requirements and potential for impact than the broader financial sector, necessitating dedicated policies and regulations. Lumping agri-finance policy into overarching economic and finance policy stifles the flow of private capital to agriculture given sector-specific risks and market dynamics.
- **Pluralistic:** The diverse funding needs of agricultural actors requires a corresponding variety of financial service providers (i.e., not only commercial banks) to provide financial products across crops, stages of production, types of financing, and ticket size.
- **Market based:** Transparent regulation and minimal political interference will drive competition, innovation, and the volume of capital required to scale a thriving agri-food system. This market-based approach still requires government involvement to ensure fair competition, protect consumer and environmental welfare, and finance public goods.

Each country is starting from a different point with important contextual factors that may affect the specific pathways and timeline for this transition. However, the evidence gathered globally from countries at varying stages of development indicates that these three principles can guide effective decision-making as countries navigate tradeoffs to build thriving and resilient agri-food systems. This summary and the accompanying briefing note outline an integrated framework for government action across macro, meso, and micro levels to facilitate this transition and maximize private sector impact while protecting public welfare and the environment.

Financing sustainable, growing national food systems

Food systems worldwide have evolved dramatically over the past two centuries to meet the needs of growing populations. Developed economies have created highly productive food systems that have increased the availability, and lowered the cost, of food. But their approaches have come with tradeoffs: smaller workforces, environmental externalities such as pollution and deforestation, less diversity in the varieties of food that are grown, and highly processed foods





contributing to unhealthy diets. Meanwhile, developing economies may employ as much as three-quarters of the national population in their food systems, but productivity remains low, rural poverty is high, and many countries are reliant on food imports. Across all stages of economic development, food systems are a vital engine for economic growth, food security, and social protection. They are critical to stronger nutrition and health outcomes and are a key part of the environmental sustainability equation. These multiple development agendas can only be achieved with a fit-for-purpose agri-finance sector.

In the early stages of agri-finance market development, country governments typically play a lead role in financing the agricultural sector through subsidy programs, state banks, and direct provision of retail credit. However, state-driven credit is often allocated based on political influence with predictable results: uneven distribution and low repayment rates. Even when done well, governments can only extend so much agri-finance before running into natural fiscal limits. As a result, as agricultural and financial markets mature, countries naturally transition to more market-based financing approaches.

This transition increases the supply of capital from private sources and can unlock significant growth in the agriculture sector. At the same time, market-based financing approaches can lead to excessive deregulation that creates social and environmental risks (e.g., worker rights, health safety, pollution, deforestation). It is important for each government to carefully design its agri-finance system, taking contextual factors into account to ensure that it accomplishes desired development goals while minimizing social and environmental risks.

Regardless of a country's starting point, the global evidence we have gathered from countries at varying stages of development points to three common principles for a strong agri-finance market fueling a thriving food system: distinct, pluralistic, and market-based. In this view of market development, three levels of action come together as outlined below:

Agri-finance maturity scorecard

| | | |
|--|---|--|
| MACRO LEVEL: Set strategic, market-based foundations for the development of agri-finance | | |
| INTEGRATED ACTION ACROSS LEVELS | Strategy | Agri-finance is established as an independent agenda within a market-based policy agenda |
| | Institutions | Agri-finance agenda has a distinct national “institutional home” with clear links to national plans across the government |
| | Resourcing | Agri-finance agenda is adequately resourced to deliver against objectives across the government |
| | MESO LEVEL: Establish key building blocks to enable market-based development of agri-finance | |
| Regulation & oversight | Supply-side | <i>FSP registration and licensing:</i> Regulations governing registration and licensing of agriculture-oriented FSPs <i>Agri-finance instruments:</i> Regulations enabling specific financial instruments <i>Prudential requirements:</i> Regulations affecting FSP leverage levels and safeguards |
| | Demand-side | <i>Collateral:</i> Regulations on use of collateral in agri-finance |
| | Enablers | <i>Consumer protection:</i> Data privacy and cyber protection laws <i>Reporting and data sharing:</i> Sharing of the risk of agriculture investments |
| Public good financial infrastructure | | <i>Registries:</i> Personal data enabling FSP risk assessment and decision making <i>Payments:</i> Digital payments infrastructure |
| Enabling digital infrastructure | | <i>ID:</i> National identification services <i>Data:</i> National agricultural data hubs <i>Markets:</i> Digital markets infrastructure to support agricultural trade |
| MICRO LEVEL: Implement specific tools to catalyse market lending and strategically active market segments | | |
| Directly mandating actions for the private sector | | Interest rate caps Bank lending mandates Loan forgiveness programmes |
| Institutions Establishing risk and cost-reduction mechanisms | | Partial credit guarantees Reinsurance pools Government-subsidized credit Government-subsidized insurance premiums Matching grants Funds and refinance facilities Dedicated facilities for catastrophes |
| Creating market incentives for agri-finance | | Differential taxation |
| Directly participating in agri-finance markets as a provider | | Finance through state banks State-owned insurance provision State-sponsored business development services & technical assistance |

1. Macro Level: Strategic Foundation

The foundational step in creating the desired agri-finance system is establishing agri-finance as a distinct agenda requiring dedicated attention. This oftentimes requires establishing a governmental body dedicated to the specific needs of the agri-finance sector, which is relatively rare across countries. Establishing this agenda ensures coordination across the multiple agencies converging on rural development and allows for alignment of objectives, policies, strategies, and resources.

The challenge for governments: *How to create a strategic foundation for agri-finance that fits within the institutional landscape of the country to coordinate multiple Ministries around an integrated policy agenda*

2. Meso Level: Building Blocks

Actions at the meso level are enablers of the agri-finance market, determining the diversity of product availability and making lending less risky and costly. These are often regulatory changes or investments in public goods which stimulate innovation and enable lending efficiency.

Meso-level initiatives should be prioritized before micro-level interventions are considered. Key meso-level actions include:

- Adapting financial system regulations to the unique requirements of agricultural finance
- Developing digital infrastructure, such as a national ID system, to facilitate monitoring and payment
- Creating mechanisms to enhance market transparency and reduce information asymmetries

The challenge for governments: *How to invest in the right agri-finance building blocks that unlock agri-finance and investment through minimizing risk, lowering costs, and creating the right incentives*

3. Micro-level: Interventions for Specific Market Segments

After a distinct agenda has been set and meso-level enablers have been enacted, there will likely still be gaps in the agri-finance market. Many agriculture segments in emerging markets require some form of intervention to activate lending. Particularly when the returns to agricultural lending are significantly lower than in other sectors, or simply compared to Government bonds. Governments have several options for influencing these segments, though selecting the appropriate approach involves complex considerations including where to intervene and how to best structure interventions. This is why it is important to have a strong macro foundation, which facilitates prioritization and sequencing across stakeholders.

Policymakers also need strong evidence for which of these micro-level interventions are best equipped to their context and how it should be implemented. The accompanying policy brief reviews the evidence base of the micro-level interventions across Africa, Asia, and Latin America to provide insights on effective approaches to agri-finance development, including:

- Approaches that have been used most extensively to activate agri-finance and how these approaches have been evaluated;
- The common range of potential impacts for individual interventions, including examples of where different impacts have been realized; and

- Principles of best practice design and implementation for individual interventions.

The challenge for governments: *Where and how to support agri-finance providers or market segments in the short term to enable market development (a catalytic role) or more structurally (a social protection role)*

These insights can guide governments in developing more targeted and effective approaches to agricultural finance market development.

Practical actions that governments can take to build market-based agri-finance systems

Given the complexity of developing agricultural finance markets and the limited evidence base, three fundamental shifts in government approach are recommended:

1. Establish the foundations of agri-finance as a i) distinct; ii) pluralistic; and iii) market-based agenda, regardless of the starting point.
2. Develop a more strategic approach to market building centered on an integrated view of macro-, meso- and micro-level action.
3. Segment the market clearly and draw on evidence of best practices globally and data-driven insights locally when attempting to achieve outcomes in agricultural markets at the micro level.

Conclusion

Countries with development objectives tied to agricultural systems should transition toward distinct, pluralistic, market-based agri-finance systems. Even as governments shift away from direct provision of agri-finance, they retain essential roles in creating enabling environments, addressing market failures, and ensuring that agricultural finance systems serve national development priorities. By adopting the framework and recommendations outlined in this summary and accompanying policy brief, governments can play a more effective role in developing a competitive agri-finance market that supports a robust food system and thriving agricultural economy.