ROLE OF GOVERNMENT IN RURAL AND AGRI-FINANCE:

Transitioning to private sector involvement

BRIEFING NOTE 17 | JUNE 2020

EXECUTIVE SUMMARY

The long-term growth and development of agricultural markets depends on access to a range and volume of capital which, over time, naturally eclipses governments' ability to provide that capital directly. As private capital markets and financial service providers become involved in the agricultural finance market, the challenge for governments becomes how to appropriately create, incentivize and regulate space for the private sector. As countries move to higher levels of agricultural productivity, more mature agricultural markets, more sophisticated banking systems, and larger farm sizes, the commercial business case for financial service provision emerges. However, this process can take decades and often remains incomplete with some market segments requiring on-going subsidy to attract financial services. Questions remain: How to accelerate the participation of private sector financial service providers while markets are still developing? How to do so in ways that are aligned with national development goals, including transitioning subsistence farmers to viable livelihoods and ensuring domestic food security?

This Briefing Note builds on previous analysis of the natural stages of agricultural finance and interrogates more deeply the transition that countries make from government-led to more bank-led agricultural finance. By adding the historical experiences of Mexico, Turkey, and Uganda (as well as other specific initiatives in other countries around the world) to past research by ISF Advisors into the United States, Germany, and South Korea, we gain a greater understanding into the unique approaches that different countries have taken to make this transition. While these approaches are heavily influenced by each country's macro-level approach to managing the economy, analysis shows the importance of meso-level enablers and more direct micro-level interventions. As we unpack government actions into these different levels and acknowledge the dynamic interplay between the agricultural and finance sides of the market we create a more systemic view of these historical experiences.

What becomes clear from this work is that transitioning from government-led agricultural finance to the involvement of private sector financial service providers is difficult. This transition typically happens over decades as macro, meso, and micro enablers are put in place and refined. However, experiences from across the world reveal lessons learned about what actions governments can take, how those actions should be coordinated across levels, which institutions should be tasked with implementing government initiatives, and the role that strong commercial incentives play in activating private sector financial service providers. In stimulating a new conversation about the role of government we propose that:

1. Donors have an important role to play in promoting private sector involvement, but government engagement and integration with the policy environment is critical to sustainable participation

2. Governments need more, and more reliable, evidence to guide integrated policy making and implementation

3. Governments need new ways of managing the agricultural finance agenda across the macro, meso and micro levels, as well as ministries to enable sustained private sector participation

INTRODUCTION

For the majority of the 20th century, governments around the world played a central role in providing the capital and directing the retail distribution of agricultural finance. However, as economies have grown, and global trade has increased, there have been very real limits to the fiscal capacity of governments to directly provide finance. For example, in the United States (one of the largest agricultural economies in the world) the agricultural sector was valued at USD 1.05 trillion in 2017. With farm debt alone worth around USD 450 billion, the US government relies on the private sector to deploy the majority of this capital.

This economic progression from government directed to more private sector oriented happens in different ways in different countries. But looking at key indicators of the maturity of the agricultural sector in the context of broader economic growth, a trend emerges that can illuminate the different operating contexts for the private sector. As can be seen in **Figure 1**, developing countries skew toward earlier stage sector maturity. The conditions inherent in earlier stage market development have a direct impact on the strength of the business case for private sector financial service providers to enter the market.

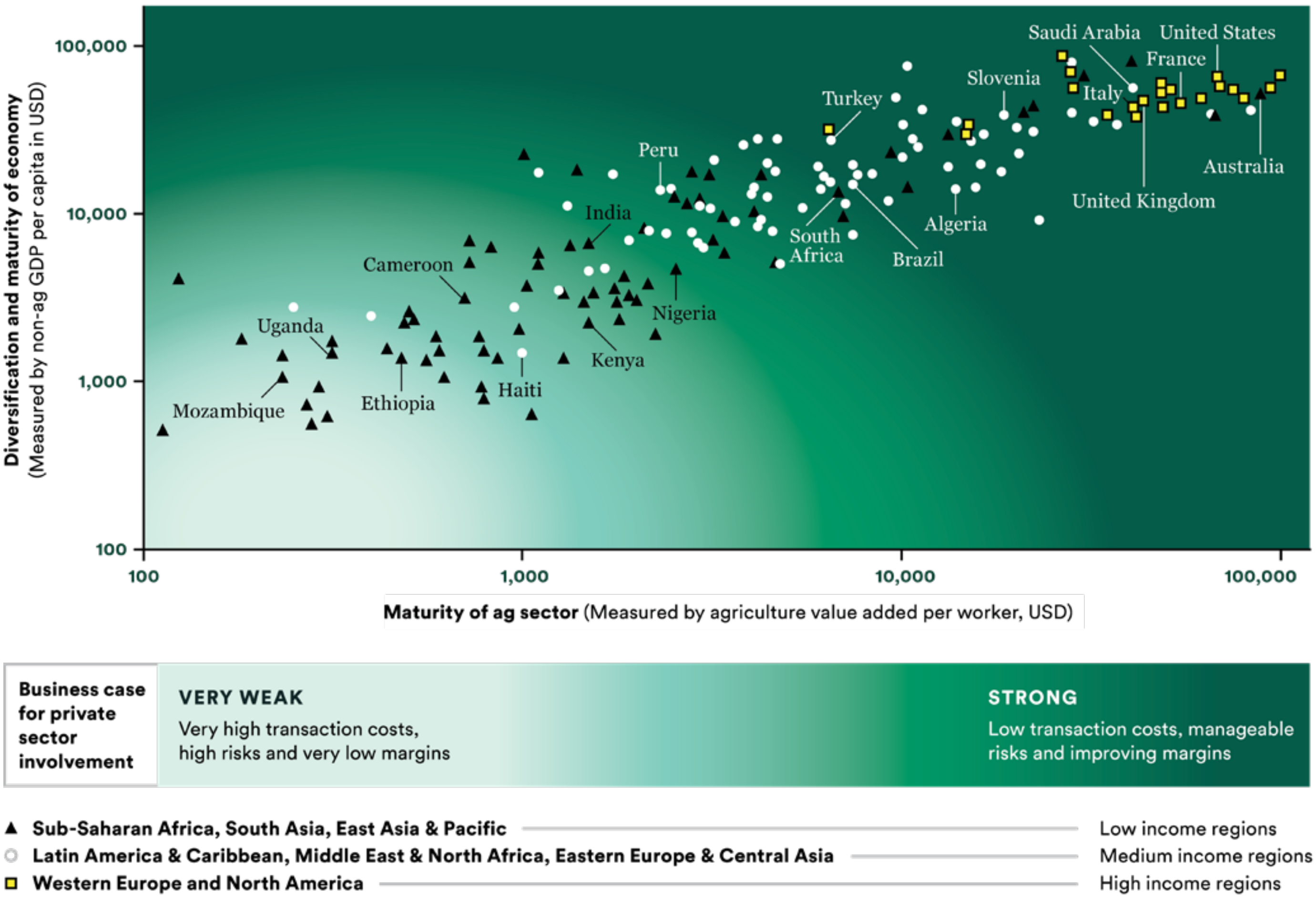
- Countries at on one end of the spectrum (lower left of **Figure 1**) have high transaction costs and risks, combined with small numbers of "bankable" clients, creating a **weak business case for private sector provision of credit, insurance, or payment services**.
- Countries at the other end of the spectrum (upper right quadrant of **Figure 1**) benefit from mature enabling infrastructure that lowers transaction costs and offers sophisticated risk management options (including hedging, insurance, securitization); at the same time, demand from a large number of agribusinesses supports a formal market and **strong business case for private sector provision of financial services**.

This analysis reveals a natural tipping point in countries where financial service providers will **voluntarily seek to enter the agricultural finance market**. It is important to note that even in these more mature markets, providers naturally target the most attractive segments, and targeted public sector support, including direct subsidies, continue for higher risk, lower return segments of the market. Meanwhile, in many lower left quadrant countries, the independent business case for financial service provision in agriculture simply does not exist without government subsidy and support; particularly when banks weigh agricultural service provision against lending to government treasuries or more profitable segments of the economy, such as telecommunications, infrastructure, and extractive industries.

A recent analysis of bank portfolios in East Africa conducted by Aceli Africa and Dalberg Advisors found a -1% Return on Assets for agri-SME lending vs. an average of 3-5% Return on Assets for lending in other sectors. This represents a quantified opportunity cost of 4-5% for banks choosing to deploy capital to the largest segments of agricultural sector, a claim lenders across the globe have been speaking to anecdotally for decades. (Aceli Africa / Dalberg Advisors, forthcoming report)

This context is an important starting point in considering the transition of agricultural finance markets. In the remainder of this Briefing Note, we build on existing research and analysis to consider a new framework depicting how governments have worked to stimulate the involvement of private sector financial service providers in agricultural finance *before* a clear business case exists for them to enter the market.

Figure 1: Economic diversification and maturity of the agricultural sector



Source: World Bank data, ISF analysis

THE STAGES OF AGRICULTURAL FINANCE DEVELOPMENT

In 2013, ISF Advisors published a briefing note on "The Role of Government in Developing Agricultural Finance," which characterized four "stages" of agricultural development: 1) the informally-served stage; 2) the government-entry stage; 3) the bank-based stage; and 4) the market-based stage (outlined in **Figure 2**).

These stages were informed by case studies on the development of agricultural finance in three developed countries: Germany, South Korea, and the US. This research presented a progressive picture of the journey from government-driven to more market-based financial structures. An important finding of this analysis was that in the transition from government-led to bank-led agricultural finance, the key shift the government is making is from being a direct funder and provider to being a regulator and facilitator of incentives for private sector financial service provider involvement - a finding explored further below.

Figure 2: Timeline of agricultural finance development

STAGE	The informally-served stage	The government-entry stage	Bank-based stage	Market-based stage
GOVERNMENT ROLE	Little to no involvement	Expanding available credit, working through farm-level organizations; enhancing agricultural productivity more broadly	Oversight and regulation	Deregulation
SOURCES OF FARM DEBT	Non-institutional moneylenders	Government-supported community lenders	Commercial lenders' share of agricultural debt is greater than or equal to government-sponsored institutions; informal lenders a minority	Banks, securities, and "merchant creditors"
FARM STRUCTURE	Smallholders and tenant farmers	Decrease in smallholders as land consolidation increases	Land consolidation intensifies	Split between large commercial and smallholder with links to merchant creditors
FARM PRODUCTIVITY	Low	Increased input use drives rising productivity	Profitability increases	High

For more information on these stages of development please refer to the preceding ISF Briefing Note on the "Role of Government in Agricultural Finance" (2015).

However, the research did not set out to make normative judgements on how governments should develop the agricultural finance sector; not all countries decide to fully transition to market-based systems in support of their national development goals and approach. These stages of progression merely described the way in which financial systems involved the private sector in financial services provision.

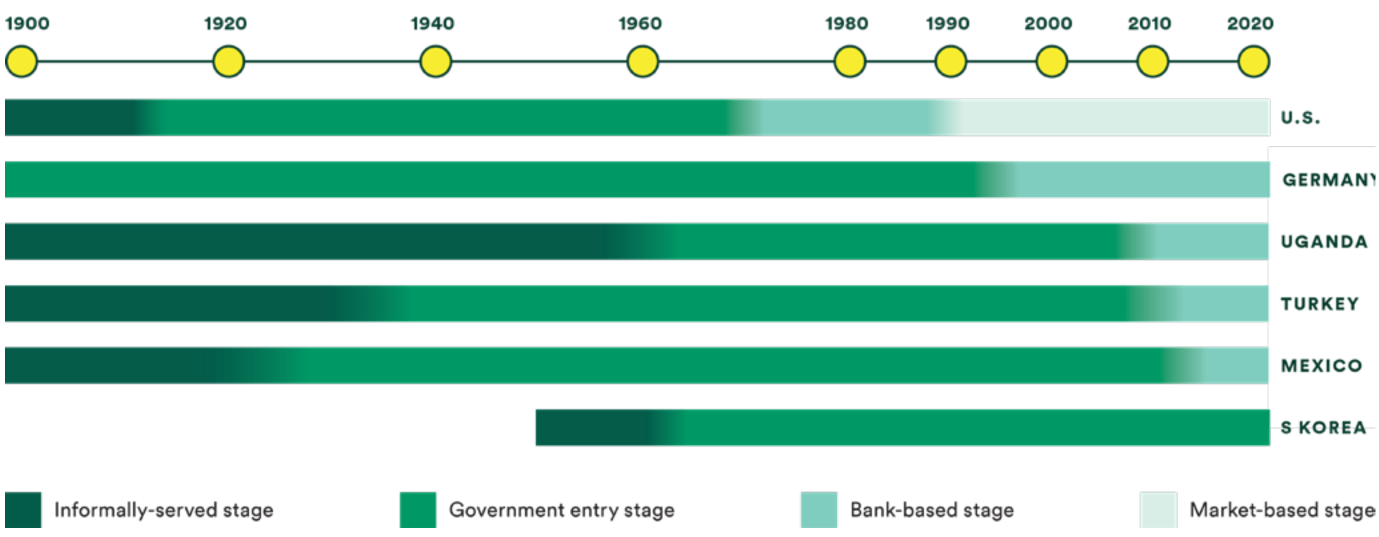
The research also raised important questions, including:

1. How do countries typically make the transition to more bank- and market-led agricultural finance systems?
2. What types of government actions support these transitions, and at *what levels* of government are actions typically taken?
3. What can we learn about *how* governments can pursue specific actions?

To better answer these questions, we expanded the initial data set by conducting research on three additional countries—Mexico, Turkey, and Uganda—as well as specific initiatives in other countries around the world. The objective was to understand the more recent experience of countries with lower market maturity to enrich our understanding of the many different pathways that countries can take in developing their agricultural finance markets, and how specific government actions are often used to drive the evolution of agricultural finance in different country contexts. Furthermore, in light of the COVID-19 pandemic, it is a valuable exercise to understand the tools governments have at their disposal as an entire sector of the economy could be shifting rapidly.

In conducting this research, one of the first reflections on the previous ISF research was that transitions between "stages" never happen immediately but are part of a progression that typically happens over years as a result of multiple actions and initiatives by government and the private sector. In the **Figure 3**, six country experiences are displayed on a historical timeline of agricultural finance development.

Figure 3: Timeline of agricultural finance development (Combined Data Set)



The experiences of countries studied in this Briefing Note series—including the United States, Germany, South Korea, Turkey, Mexico and Uganda—reveal six key insights:

1. **Macro changes lead everything:** In all countries studied, major changes in the structure of agricultural finance were preceded by changes at the macro level that shifted the positioning or nature of the agriculture and finance sectors. Often, these changes happened in response to a crisis (e.g., when Mexico's neoliberal government emerged in response to a major recession). However, key macroeconomic decisions around the openness of the economy, trade, or political associations can also be in response to perceived opportunities, such as Turkey joining the EU.

2. **The importance of meso-level enablers:** All long-term structural change requires the development of meso-level infrastructure, policy, and systems. As highlighted earlier, these enablers can take a long time to emerge; but they create the operating environment for both financial service providers *and* the producers and agri-SMEs they serve. To be effective in the longer term, government interventions at the micro level must be complemented by more structural, enabling investments at the meso level.

3. **The power of integrated government action:** The agricultural finance market is often not thought of as a primary market, but as a sub-segment of the financial sector (in the same way as finance for manufacturing, telecommunications, or mining are sub-segments). As such, any government action or development of this market typically sits between governing bodies. This often includes the ministries of agriculture, finance, and planning at a minimum—but can also involve government management of telecommunications and infrastructure. Integrated action therefore needs to involve many areas of government in both the planning and execution of shared priorities.

4. **The early emergence of niche lending markets:** While broad-based agricultural finance may take decades to move from government-led to more bank- and market-led models, in most countries high-value niche products will emerge where private banks naturally get involved. These niche products (such as coffee, flowers, or tea) typically have an export market that brings in valuable foreign exchange and therefore attracts more attention from policymakers, a structured value chain, and a set of large anchor producers and processors that can manage finance.

5. **Not just what is done, but how and how well:** The experience of many countries suggests that the quality of implementation of micro- and macro-level enablers is critical. Many state banks and parastatal institutions have failed over the years due to mismanagement and governance issues. Successfully creating the space and incentives for the private sector to be involved in the agricultural finance market is as much about successfully implementing initiatives as it is about choosing the right initiatives in the first instance.

6. **There is no "best" agricultural finance system:** Moving to a market-based system, for example, is not the de facto pinnacle of a "successful" agricultural financial system evolution. Given the unique role agriculture plays in each economy - and society for that matter – the optimal relationship between the government and private sector financial service providers is one that appropriately serves each country's national development priorities.

*Please refer to the accompanying document **"Case Study Compendium"** for a more detailed snapshots of the experiences of Mexico, Turkey, and Uganda in their transition from government-led to bank-based agricultural finance. It is important to note that these snapshots are highly synthesized descriptions of the major events in each country, and that the efforts of these governments to pull back from directly providing agricultural finance did not immediately lead to more private sector participation.*

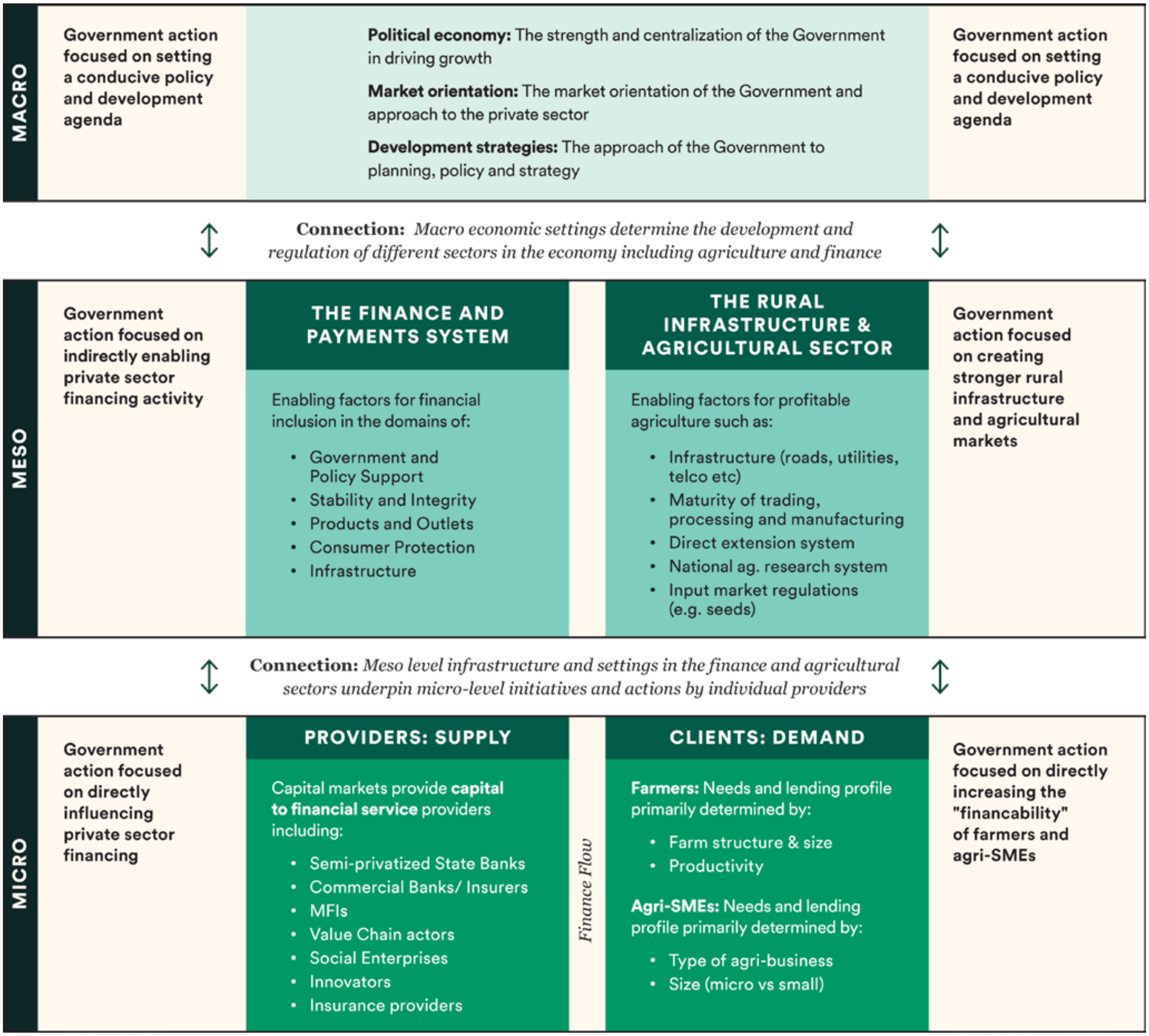
A HOLISTIC MODEL FOR UNDERSTANDING GOVERNMENT ACTION

Often, agricultural finance in the context of lower maturity markets is portrayed primarily at the micro level in interactions between financial service providers (e.g., banks, microfinance institutions) and their clients (smallholder farmers and agricultural SMEs). But this is an oversimplification. Agricultural finance markets are also reliant on infrastructure, regulation, investment, and policies at both the meso and macro levels. Thus, to build a holistic understanding of how governments can accelerate the development of agricultural finance in their countries, we have to look at available actions at three levels:

1. At the **micro** level, where government action focuses on directly influencing private sector financing;
2. At the **meso** level, where government action focuses on indirectly enabling private sector financing activity; and
3. At the **macro** level, where government action focuses on setting a conducive overall policy and development agenda.

The conceptual model depicted below shows a simplified view of many of the interdependencies between the micro, meso, and macro levels. This model will guide our consideration, in the following pages, of how the three case study countries evolved toward the market-based stage of agricultural finance. Using this model, we can also think more systematically about the range of choices available to governments to support that market transition.

Figure 4: Agricultural finance market conceptual model



In the case studies within this briefing note, we focus more on capital supply-side government actions. This was done to create a clear focus for the analysis: how do governments help transition agricultural finance to more private sector approaches at the micro, meso, and macro levels. While it is outside the scope of this brief, we recognize that the demand side of agricultural finance is just as critical.

The "bankability" of smallholder farmer households and agricultural SMEs is a fundamental precondition to private sector participation—and that bankability is affected by a plethora of demand-side factors. Other ISF research on these topics have been covered as part of our latest State of the Sector report - Pathways to Prosperity as well as past research into the global technical assistance landscape.

As in all markets that involve the private sector, the government is not the only actor that determines how the market functions. However, in any context, the role of government is critical. To this end, there are two different types of government interventions in the agricultural finance market: 1) **indirect actions at the meso level** that create the preconditions for private sector participation and 2) **direct actions at the micro level** to influence a specific market outcome. As stated earlier, a key shift the government makes is from being a direct funder and provider to being a regulator and creator of the incentives for private sector involvement.

Investing In Meso-Level Supply-Side Enablers

According to the Economist Intelligence Unit's Global Microscope for Financial Inclusion, there are a number of key enablers that help facilitate financial markets and financial inclusion. The framework and metrics from this diagnostic have been used to systematically compare 55 countries to create important benchmarks for government progress. As depicted in **Annex 1**, enablers are grouped into five domains that include: 1) government and policy support, 2) stability and integrity, 3) products and outlets, 4) consumer protection, and 5) infrastructure.

As governments invest in meso-level enablers, we must consider how this impacts private sector financial service providers in terms of costs and risk to serve. For private sector financial service providers, infrastructure such as digital IDs, national payment switches, and credit registries can have a significant impact on the cost to serve. Along with shared physical infrastructure that can create a communications and service delivery gateway to customers, these are elements that are very costly for a single institution to build independently. When the government steps in to establish these enablers, it significantly reduces costs for individual service providers. Similarly the maturity of government policy around market entry, compliance, and consumer protection can have a major impact on how risk is captured and managed.

One of the most important things governments can do at the meso level is work directly with the private sector financial service providers to identify priority enablers and constraints to their involvement. In Kenya, the emergence of mPesa over the past decade was a private sector innovation that went from launch to running annual transactions valued at 50% of the country's GDP in 7 years. That evolution involved a close and iterative dialogue with the government about how to effectively enable *and* regulate the new service as it evolved. In many countries, digital currency and mobile money providers had to wait—sometimes several years—for appropriate government policy and legislation to be introduced before they were able to legally launch services or build service delivery networks. However, in Kenya, mPesa was regulated through a "test and learn" approach in a collaboration between the Central Bank of Kenya (CBK) and the Communications Authority. At the time of introduction there was no national payments System and the Communications Authority had no jurisdiction on financial transactions. The CBK developed draft national payments system guidelines to regulate the emerging retail electronic payments system. These meso-level enablers created the space for the service to emerge through a close dialogue between Safaricom (the operator) and the government.

Moving the needle through micro-level supply-side interventions

While the list of meso-level enablers that governments can help put in place is long, the list of direct actions they can take at the micro level to support the agricultural finance market is relatively short. Looking at a broad set of cases studies and literature reviews on government actions from across the world, this research identified five types of levers that governments have used to directly influence private sector involvement in the agricultural finance market. As outlined in **Annex 2**, these levers (and associated interventions) impact the business case for private sector participation in different ways, including:

- **Changing the risk to serve** through credit guarantees and public insurance schemes;
- **Reducing the cost or increasing the availability of capital** through dedicated funds and refinancing facilities;
- **Adjusting the profitability of serving rural customers** through differential taxation, differential reserve requirements, and rewards for reaching service thresholds;
- **Reducing the cost to serve** rural customers through institutional capacity building; and
- **Mandating participation** through creating lending requirements.

Each of these micro-level supply side interventions directly influences the incentives that private sector financial service providers have to be involved in the agricultural finance market. The most common instruments used by governments to build the agricultural finance market are credit guarantees and dedicated funds. These were found in all of the cases reviewed, with targeted funds for agriculture using subsidized interest rates or a grant component (as in Uganda) and often linked to access to a credit guarantee (as in Colombia). In the last six to eight years, index-based insurance has presented a new option for direct government support, with leading examples in Kenya and India. However, uptake by farmers has been slow. There are indications that financial service providers and aggregators are more likely to find index-based insurance appealing.

Less often used (but vigorously debated) are hard requirements around portfolio lending and reserve levels. India is a leading example of credit allocation rules, but has not yet shown a substantial increase in lending to agriculture—in part because loopholes around the definition of "priority sector" lending abound. There are also relatively few examples across the cases reviewed of how other direct interventions, such as capacity building or differential taxation and rewards, are utilized. Successful institutional capacity building interventions that are not linked solely to agricultural finance may still have a substantial impact on rural finance more generally. For example, Mexico and Albania both underwent restructuring and strengthening of their financial cooperative sectors, resulting in much improved financial services in rural areas where those types of providers have a large presence.

Separating interventions from how they are delivered

It is important to note that the interventions identified here sit outside of the mechanisms or institutions that are used to deliver them. A fairly common model for micro-level interventions in developing economies has been to task a state-owned institution (such as a state bank) with a number of interventions to carry out, such as establishing a refinance facility, managing a credit guarantee, or developing a subsidy scheme for agricultural insurance. For example, in Colombia, the state-owned entity (Finagro) centralizes several micro interventions in agriculture. But this model has gradually been phased out in other countries (as many state banks have failed) in favor of more diversified mechanisms that engage the private sector in delivery (e.g., Mexico, Rwanda). Interventions that involve mandates for banks (e.g., credit allocation, differential reserve requirements, or taxation) are typically enacted through financial supervisory agencies, since the interventions are codified as bank regulations. Mechanisms to facilitate other micro interventions, such as capacity building, usually vary based on the initial state of the institutions to be supported, the government entity under which they are licensed, and the existing knowledge brought in to support them. With a broad variety of institutions and mechanisms used to deliver different micro-level interventions, it is very difficult to separate the intervention from the mechanism when considering its efficacy.

APPLYING THIS MODEL

Any model that is used to break down and understand the complexities of markets needs to be used with some caution. While this research has not set out to assess the relative efficacy of different instruments or mechanisms, we believe our analysis sets up a new way of considering how different countries have attempted to facilitate more private sector involvement in the agricultural finance market. In applying this model, it is important to note the following points:

- **The macro position:** At the macro level, governments vary in their philosophical approaches and policy frameworks related to overall economic development. How governments conceive of the role of the private sector, for instance, creates the framework and context for sectoral developments at the meso level, and is one of the most important guiding positions of government, affecting almost all actions at the meso and micro levels.
- **Flow-through effects:** Government actions may affect all three levels. For example, significant macroeconomic changes (or crises)—such as the enacting of North American Free Trade Agreement (NAFTA) in Mexico in the mid-1990s or Turkey's economic crisis in 2001, followed by beginning an accession process into the European Union in 2005—had substantial effects on the structures of their agricultural sectors and the stability of their financial markets. In both cases, meso-level initiatives followed, notably to adjust the legal and regulatory frameworks of the financial system and to improve conditions for export-oriented agriculture. Improvements in information systems, such as Turkey's agricultural registry system or Mexico's restructuring of agricultural insurance legislation, are examples of meso-level enablers. Digitalization of information and transactions has played a

role in both countries. Micro-level interventions consistent with these new directions, such as credit guarantees (both Mexico and Turkey) or regional support schemes for crop and livestock production (Turkey), have encouraged private sector participation in agricultural finance.

- **A market within a market:** Agricultural finance markets exist within a broader financial system, and many of the enabling macro- and meso-level actions of governments are not made purely with agricultural finance in mind. For example, establishing credit bureaus, governance standards, licensing structures for banks, and liquidity requirements are all part of improving the capacity and maturity of the financial system overall.

- **Broader linkages:** While this conceptual model limits the meso level to the primary enabling finance and agricultural sectors, there are also important adjacent sectors, including manufacturing, transport, and the legal system, that should be considered (but that are outside the scope of this report).

A PATH FORWARD TO DEEPEN THE AGRICULTURAL FINANCE CONVERSATION WITH GOVERNMENT

The role of the government in helping to facilitate private sector involvement in agricultural finance markets across the world is an extremely complex and multifaceted issue. While this research in no way claims to be comprehensive enough in scope or depth to provide definitive guidance, considering the experience of different countries through a systems lens reveals a number of recommendations to continue to take the agenda forward.

1. Donors have an important role to play in promoting private sector involvement, but government engagement and integration with the policy environment is critical to sustainable participation

In many countries, the micro, meso, and macro enablers needed to create “viable commercial space” for the private sector to be involved in the agricultural finance market simply do not exist. For example, in Mexico, the transition to NAFTA in the 1990s made it impossible for smallholder farms to compete with cheaper imports, making them ineligible for any form of commercial lending. In Turkey, prior to the elimination of credit subsidies through Ziraat Bank, commercial banks could not compete with subsidized interest rates. And in Uganda, the macro-level instability and lack of meso-level enabling infrastructure made it too risky for commercial banks to lend to anyone other than the most profitable, niche agribusinesses. Each of these constraints creates a rationale for donors to get involved with blended finance or grants that can be used to incentivize private sector participation. However, in these environments, donors have been too quick to create major subsidy-based incentives without acknowledging the lack of underlying micro, meso and macro enablers needed to support private sector participation in the longer term. This approach all but guarantees that the private sector stops lending as soon as subsidy is withdrawn.

Going forward, donors must specifically diagnose the macro, meso, and micro enabling environment created by the government before launching new products or initiatives, establishing expected levels of subsidy and risk. From there, any short-term subsidies should be complemented by specific actions, working with government, on the micro, meso, and macro enablers to support ongoing private sector involvement beyond the life of a donor program. In addition to engaging directly, existing platforms for this engagement could be used (such as the Comprehensive Africa Agriculture Development Programme, Alliance for a Green Revolution in Africa, the World Bank, and Internationl Fund for Agricultural Development) to connect these program-specific conversations with broader government strategy and policy discussion. As these policy positions are typically developed and implemented over years, more connectivity between donors working on private sector engagement in the agricultural finance market and broader government policies is an important link to make.

2. Governments need more, and more reliable, evidence to guide integrated policy making and implementation

Exploring dependencies between types and levels of government action (at the micro, meso, and macro levels) seems natural when considering the role of government in a nascent market such as agricultural finance. However, in an extensive literature review we found little evidence of integrated models that consider: 1) how agriculture and finance markets truly interact to support private sector participation; 2) how government actions at different levels and across different ministries and sectors affect the private sector in different ways; 3) clear cataloguing of the types of government actions that can be used to directly (micro) and indirectly (meso) enable private sector participation; or 4) historical case studies of how more developed markets have evolved. Past research has looked disproportionately at government-led (and implemented) actions, leading decision-makers to rely on state banks and parastatal models to achieve desired outcomes. In a world where most developing countries are moving to more market-based economies and financial systems, **a more thorough application of lessons from global experience** is needed to determine how policy can support private sector engagement and involvement in agricultural finance.

Global agricultural research institutions have a wealth of knowledge, experience, and networks to support governments in the area of agricultural finance. However, we believe there is a need to complement this experience with more private sector expertise and perspectives (including from banks, investors, agribusinesses and industry bodies) to develop new, enabling research, including:

- Deeper analysis to **enhance the integrated conceptual model presented in this brief** in ways that can be effectively used to support conversations with government;
- Research into the **efficacy of catalogued micro interventions** within broader meso and macro policy frameworks, to deepen historical reference points and start to develop different integrated policy guidance;
- Research into different private sector service delivery models that seeks to **quantify the cost and risk differentials of different micro- and meso-level settings** to make the commercial realities more evident to policymakers; and
- Research that **tests new approaches to data collection** and rapid assessment of micro-level government interventions to allow for more adaptive and responsive policymaking

3. Governments need new ways of managing the agricultural finance agenda across the macro, meso and micro levels, as well as ministries to enable sustained private sector participation

Often, government enablers of agricultural finance that support private sector engagement are put in place over decades and under successive governments and national development plans. However, where positive changes have occurred, multiple actions have tended to work together. Most notably, the removal of state agricultural finance subsidies in Turkey was complemented by supporting changes in banking policy, insurance markets, and export markets that created a viable space for commercial banking participation. While this may not have been specifically considered under an overarching agricultural finance strategy, it illustrates the interconnected nature of required actions.

Government agendas around agricultural finance should be intentionally elevated above individual ministries to the level of national development plans. These plans should define how ministries work together on actions that mutually support each other, in sequence and in close collaboration with the private sector. In Ethiopia, the Agricultural Transformation Agency (ATA) is playing this role and has rapidly accelerated initiatives that would typically fall between government ministries. To be optimally effective, a strong mandate from the most senior leadership should enable governments to work with relevant donors and providers, and with the latest research and evidence (outlined above) to develop and implement these national plans.

For many years, economic growth, global trading systems, and the complexity of agricultural markets have put pressure on governments around the world to shift their role in providing capital and directing the distribution of agricultural finance to one that is inclusive of private financial service providers. Extensive research has begun to shed light on the multiple pathways and specific government actions that have historically been utilized to facilitate this transition. From this effort, a holistic model that outlines how interrelated macro-, meso-, and micro-level interventions can guide governments as they seek progression toward effectively engaging private sector financial providers. Donors and international partners can assist governments by deploying these learnings as they seek agricultural finance markets in line with their own national objectives.

About ISF

ISF is an advisory group committed to transforming rural economies by delivering investment structures and partnerships that promote financial inclusion for rural enterprises and smallholder farmers. Combining industry-leading research with hands-on technical expertise, ISF develops practical, profitable, and sustainable financial solutions. ISF's primary role is to act as a "design catalyst." The emphasis is on mobilizing additional financing for rural enterprises and seeding replication of innovative models.

About Aceli

Aceli Africa is a market-enabling facility to increase lending to agricultural SMEs so they can realize their growth and impact potential on farmer and worker livelihoods, regional food security, and sustainable environmental practices. Drawing upon new data from 32 lenders on the economics of financing agricultural SMEs, Aceli Africa will offer financial incentives to lenders and technical assistance to SMEs to mobilize $700M in private sector lending and improve livelihoods for 1 million farmers and workers by 2025.

Authorship

This research was led by Matt Shakhovskoy (ISF) with support from Carlos Cuevas, Cor Wattel (Wageningen Economic Research), Monika Sopov (Wageningen Center for development Innovation), Marcel Van Assendonk (Wageningen Economic Research) and Haki Pumuk (Wageningen Economic Research). Brian Milder (Aceli), Dan Zook (ISF) and Thomas Carroll (GDI) provided valuable advisory and editorial support, with design and publishing support provided by Meredith Husar (GDI). The research team would like to acknowledge the generous support of the United States Agency for International Development's (USAID) Feed the Future Initiative and Aceli Africa that made this research possible.

Annex 1: Meso level enablers

DOMAIN	SUB-DOMAIN	EXAMPLE
GOVERNMENT AND POLICY SUPPORT	• Broad strategies for financial inclusion • Promotion of financial and digital literacy • Incentives for digitization and emerging technologies	**Example: Colombia** *A National Financial Inclusion Strategy is under implementation since 2014, by an inter-institutional committee. Recent changes have lifted restrictions on remote account opening and customer due diligence.*
STABILITY AND INTEGRITY	• Market entry • Ongoing requirements • Customer due diligence • Supervisory capacity • Commitment to Cybersecurity	**Example: Rwanda** *Revised market entry requirements, such as ownership rules, initial capital, and other licensing requirements (e.g., number of branches) are allowing for diverse financial service providers to enter the market.*
PRODUCTS AND OUTLETS	• Accounts at financial institutions and e-money • Credit portfolios for middle and low-income customers • Emerging services • Inclusive insurance • Financial outlets	**Example: Brazil** *A strong commitment to advancing digital transactions and financial technology, as well as improving financial literacy has led to extensive rural agent network, managed within proportionate regulations.*
CONSUMER PROTECTION	• Financial services users • Inclusive insurance users • Data privacy and cybercrime protection	**Example: South Africa** *Financial services regulation has led to some of the highest scores for protection of financial service users, and promotion of diversity among financial service provider agents.*
INFRASTRUCTURE	• Payments infrastructure • Digital IDs • Connectivity • Credit information and other data-sharing systems	**Example: Costa Rica** *Improvements in electronic KYC (e-KYC) systems has cut costs for service providers in account opening, fraud management and compliance.*

Annex 2: Micro level government interventions that influence private sector financial service provider participation

INTERVENTION	DESCRIPTION	BUSINESS CASE LEVER	OUTCOME TARGETED	EXAMPLE COUNTRIES
Credit guarantees	A credit guarantee facility is established usually at a second-tier state-owned bank, or as a separate "fund" administered by such second-tier entity. The guarantee is provided directly to financial institutions to absorb a portion of the lender's losses on loans made to agri-SMEs and smallholder farmers in the case of default.	Changing risk to serve	Increased lending to target segments	• Colombia (FAG) • Mexico (FIRA for agriculture) • Madagascar • South Africa
Lending requirements with banks (credit allocation rules or quotas)	Government determines, through the financial regulatory authority, a minimum share of banks' loan assets to be held in agriculture with specific types of client segments. Incentives to meet the quotas vary from facing penalties, to requiring holding the shortfall in cash.	Mandating participation	Maintaining a minimum share of loan book in agricultural sector	• Bolivia • India • Ghana • Zimbabwe
Dedicated funds & refinance facility	Subsidized funds are made available through a refinance facility, typically a second-tier bank. Funds may be pre-allocated to specific crops/livestock lending, or allocation may be left to the discretion of the fund's management. Retail lenders apply for refinancing of existing outstanding loans so as to extend additional credit. In market-oriented systems, funds are allocated via auction based on, for example, the volume of own funds the retailer will commit to the sector, or the magnitude of the cost-of-funds subsidy that the retailer will accept.	Reducing cost,and/or increasing availability of capital	Increased lending to target segments	• Brazil • Colombia • Chile • Mexico • India • Ghana • Kenya • Nigeria • Senegal • South Africa
Differential taxation of agricultural finance lenders	Creates an incentive for lending to agriculture, similar to bonuses on lending rates. The magnitude of the incentive is likely contingent upon share of agriculture in the lending portfolio.	Adjusting the profitability of serving agricultural clients	Increased agriculture share in loan portfolio	• China
Rewards for reaching lending thresholds	Incentive structure targeting marginal portfolio areas where bonuses are awarded to the service provider for reaching specific lending targets or thresholds.	Adjusting the profitability of serving agricultural clients	Additional lending to targeted segments	• China
Establishing differential reserve requirements	This intervention aims to create incentives to allocate funds to agricultural lending through reducing the reserve requirements for lenders meeting lending portfolio thresholds.	Adjusting the profitability of serving agricultural clients	Increased agriculture share in loan portfolio	• China
Public insurance schemes	Publicly subsidised insurance is structured to provide insurance coverage for smallholder farmers production and price risks. A variety of indemnity, and indexed products have been developed with applications to specific value chains or producer segments.	Changing risk to serve	Protecting the borrower (and lender) from agricultural shocks	• Mexico (Agroasmex) • India • Turkey • Kenya • Indonesia
Institutional capacity building	Working with financial service providers to develop capacity and expertise to work with rural clients. It usually involves "smart-subsidy" interventions that provide high-quality technical assistance and know-how at a reduced cost to the FS provider, sometimes scaling down the subsidy over time. Support may involve, for example, IT platforms able to process transactions faster and cheaper, and creating new and improved outlets - agents, electronic channels (including mobile banking).	Reducing cost to serve agricultural clients	Increased capacity and expertise to serve rural borrowers	• Colombia • Mexico