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Agriculture Finance & Agriculture Insurance: A Review

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Abstract

Agriculture and its many associated value addition agribusinesses and services must play a crucial role in order to meet the 17 new global Sustainable Development Goals (SDGs), including their important goals and targets toward ending hunger, poverty and reducing inequality by 2030. The SDG investment required is estimated at more than $4 trillion annually. Current investment in SDG-related areas leaves an annual financing gap of $2-3 trillion per year of which agriculture, water, climate change and related agricultural and rural infrastructure make up a majority. Global public goods are an important part of financing sustainable development but the private sector is clearly important. Due to the nature of the sector, and despite many efforts by the public and private sectors and private capital that exists, meeting the heavy demand for agricultural investment capital and providing sustainable financial services for rural areas and agriculture has proven to be extremely difficult.

Key words: Agriculture, Finance, Insurance**,** investment, capital etc.

Introduction

Agricultural finance is a subset of rural finance dedicated to financing agricultural related activities such as input supply, production, distribution, wholesale, processing and marketing. Financial service providers face distinct challenges when dealing with this sector. For example, the seasonal nature of production and the dependence on biological processes and natural resources leaves producers subject to events beyond their control such as droughts, floods or diseases. Land is the most widely accepted asset for use as collateral but there are often problems with title and property rights in rural areas and small loans rarely justify the costs of legal action to call in a claim on land and then liquidate it. Moveable assets such as livestock and equipment are also fairly high risk without proof of ownership and insurance

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cover. Because developing countries have large rural populations, policy-makers have frequently tried to intervene in agricultural finance with policies to provide subsidised credit through a variety of channels. Such programmes often created more problems than they solved and there was a move away from supply led credit towards a market based approach relying on commercially viable financial institutions. Governments are still tempted to control interest rates, however, and intervene in other ways, so policies relating to agricultural finance remain an important issue.

The development and commercialization of agriculture requires financial services that can support: larger agriculture investments and agriculture-related infrastructure that require long-term funding (given that currently transportation and logistics costs are too high, especially for landlocked countries), a greater inclusion of youth and women in the sector, and advancements in technology (both in terms of mechanizing the agricultural processes and leveraging mobile phones and electronic payment platforms to enhance access and reduce transaction costs). An important challenge is to address systemic risks through insurance and other risk management mechanisms and lower operating costs in dealing with smallholder farmers.

Agriculture finance and agricultural insurance are strategically important for eradicating extreme poverty and boosting shared prosperity. Globally, there are an estimated 500 million smallholder farming households – representing 2.5 billion people – relying, to varying degrees, on agricultural production for their livelihoods.

We primarily work on agriculture finance, agriculture insurance and its linkages with agriculture finance. Our key areas of work are described below:

1 **Policy and Regulatory Interventions – Agriculture Finance**: We conduct diagnostic studies on the state of agricultural finance within client countries and produce concrete action plans to reform public policies and regulations in order to create an enabling environment to mobilize agricultural finance. Some examples of policy and legal/regulatory intervention areas include lending quotas, interest rate caps, bank branch expansion regulations, prudential regulations impacting agricultural lending, warehouse receipt financing frameworks, and alternative dispute mechanisms for contract farming.

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2 **Policy (and Insurance Product Development) Advisory – Agriculture Insurance**: We advise governments on policies for agriculture insurance (e.g. financial incentives, premium subsidies, and the overall role of government to promote agriculture insurance) and on development of effective insurance products. On issues related to insurance, we collaborate and coordinate with the Global Index Insurance Facility (GIIF) and the Disaster Risk Finance and Insurance Program (DRFIP) on certain projects and activities.

3 **Strengthening of Relevant Institutions:** We provide technical assistance to reform and build capacity of public financial institutions, to establish commodity exchanges, and to build capacity of MFIs and other institutions. We operate a special program focused on financial cooperatives, given the importance of these entities as providers of financial services to smallholder farmers, rural MSMEs and households. This program aims to strengthen their performance as well as to enhance applicable regulations and oversight arrangements to better integrate them into their country's financial system. Furthermore, we design and implement risk-sharing mechanisms through various instruments, such as partial risk guarantees.

4 **Developing Innovative Products:** We assist in the design and develop a wide range of instruments, either as a technical assistance or part of lending projects: value chain finance, inventory finance (examples include warehouse receipts, CMA, and SMA), partial credit guarantee schemes for agriculture-sector loans, matching grants, crop insurance, price hedging instruments, and gender finance. We also work on developing mobile banking & payment platforms to enhance access to finance and reduce transaction costs within the eco-system. An important focus of our work in this area has been to develop solutions to reduce the riskiness of agriculture by addressing systemic risks (e.g. production and weather risks through insurance, and price hedging instruments) and also focus on ways to reduce operating costs in reaching to smallholder farmers and SME agribusinesses (for instance, the role of digital finance technologies).

5 **Focus on specific new topics:** We are exploring work in new areas such as access to finance for women in agriculture, the use of digital financial instruments in agriculture, and financial solutions for "green" agricultural investments promoting

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resilience of agriculture to climate change and reduction of agriculture's foot print on the environment.

6 **Knowledge Management and Community of Practice:** Informed by our in-house research and knowledge production, we carry out activities both at the internal level (including community of practices and training programs) and at the external level (global and regional dissemination events, South-South exchange and capacity building for policy reforms, among others). We lead two Community of Practice: one on agriculture finance (co-led with Agriculture GP) and another one specific to financial cooperatives.

7 **Global Engagements:** Since 2011, we have served as a technical advisor to the G20 Global Partnership for Financial Inclusion (GPFI) SME Finance Sub-Group on issues related to agricultural finance and insurance. Also, we haves formed a partnership with Rabobank on financial cooperatives that aims to contribute to the global knowledge on these institutions and their promotion building on concrete experiences.

8 **Collaboration:** We work closely with the Risk Management team in FCI when it comes to agricultural insurance solutions, and also collaborate with CGAP and the Agriculture Global Practice.

The growth and deepening of agriculture finance markets is constrained by a variety of factors which include:

- inadequate or ineffective policies
- high transaction costs to reach remote rural populations
- covariance of production, market, and price risks
- absence of adequate instruments to manage risks
- low levels of demand due to fragmentation and incipient development of value chains
- lack of expertise of financial institutions in managing agricultural loan portfolios

Conclusion

Agricultural finance is the provision of multiple types of services dedicated to supporting both on- and off-farm agricultural activities and businesses including input provision, production, and distribution, wholesale, processing and marketing. The market demand for smallholder agriculture finance is US$450 billion, most of which is unmet. Without access to credit, most smallholders are restricted to farming practices that result in low levels of productivity. Although many new types of formal financial institutions have spread to the rural areas of developing countries, the majority of smallholders have limited or no access to them.

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