Farmers display their bountiful cereal yield. Photo Credit: Lominda Afedraru

Time to walk the talk on agricultural financing

By Dr Timothy Njagi

DESPITE the agricultural being recognised as the backbone of the economy and governmental commitments made nearly two decades ago to allocate at least 10 per cent of total expenditures to agriculture, financing in this sector, whether from the public or private sectors, has remained disappointingly low in Kenya. The public sector goal of dedicating this percentage was to catalyse economic growth, address issues of hunger and poverty, and bolster rural development. The allocated funds were intended for expanding agricultural and rural infrastructure, promoting research and development, enhancing access to technology, and ensuring the sustainable use of land and water resources. However, the realisation of this commitment has fallen short over the years, even as the government has bet on the agricultural sector to drive economic transformation. For example, the Kenya Kwanza administration plans for the sector to address food productivity growth, reduce the food import bill, which stands at Kshs500 billion annually, and grow exports.

There is a worrying trend is the decline in the share of resources allocated to the sector. The reasons behind the declining resource allocation include budget constraints due to fiscal distress in the country and changing priorities for the government and the sector. For example, although the majority of the functions in the sector were devolved, county governments have prioritised the health and infrastructure sectors, with the average allocation at 6.0 percent.

The agriculture sector's Medium Term Framework (MTEF) shows a financing deficit of 50 percent for the 2024/25 financial year. In previous years, the financing gaps have been wider. The ambitious nature of public sector budgets and variance with expenditure means that the intention and action are always different. Financing challenges to the agriculture sector extend to the region as well. Africa has a resource gap of about 80 percent to finance agricultural transformation adequately. Notably, the figure highlights the importance of crowding in private sector investments.

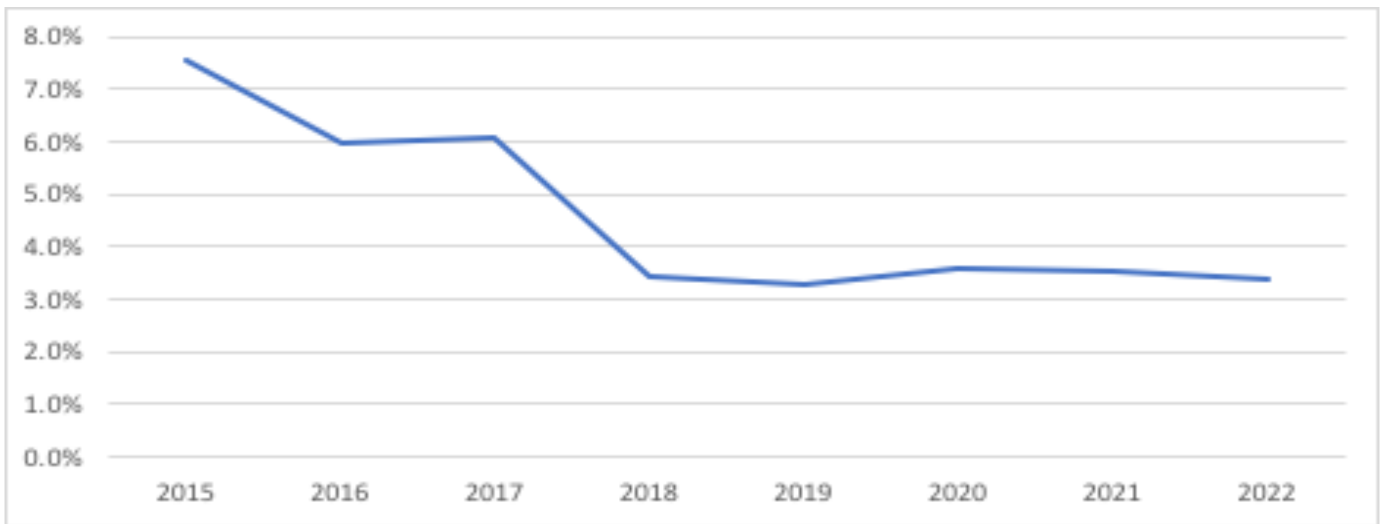

Figure 1: Government Agricultural Expenditures as a Proportion of Total Expenditures
Source: MOALD

As indicated in Kenya's Agriculture Sector Transformation and Growth Strategy (ASTGS), with low public investments, the private sector was expected to fill the sector's financing gap. However, despite its crucial role in economic development, the private sector encounters its own challenges in agricultural financing. These include risk aversion, a lack of collateral, limited financial literacy among farmers, and market fragmentation. The inherent riskiness of agriculture, coupled with the absence of organised value chains, creates a hesitancy among the private sector to invest robustly in the sector. For instance, it is estimated that the formal banking sector credits in agriculture only account for about 4.0 percent of total lending. Furthermore, commercial lending tends to favour large-scale farming enterprises, completely marginalising smallholders.

The constraining of smallholder access to agricultural financing creates a paradox, especially since the agriculture-led economic transformation pathway chosen by the country and region requires a significant infusion of funding to help transform smallholder agriculture into viable business enterprises. This means that the risk-assessment tools employed by commercial lenders need to onboard the uniqueness of the sector and innovate to cater to the diversity of financial requirements in the sector. Another paradox is that although much of the country has very impressive financial services access, it does not translate to better access and terms for financing.

The current state is that farmers are left to borrow from the informal financial sector, which can be both predatory and exploitative.

What can be done?

Crowding in private sector investments is a realistic policy objective that can be easily achieved with the right policy and political choices. For starters, the government needs to establish a friendlier business environment. This can be achieved through policy incentives, including taxation, providing space for risk-adjusted returns and enhancing innovations that derisk the sector, including public goods investments, specifically data, and financing flexibility, including blended financing.

In the past, public expenditures have often led to crowding out of private sector investments due to poor policy choices, conflict of interest among policymakers and continued pursuit of policies that are purely informed by political economy considerations rather than solid data and evidence.

Given the inadequacy and constraints of public sector financing, I would propose that the public sector resources be ringfenced around

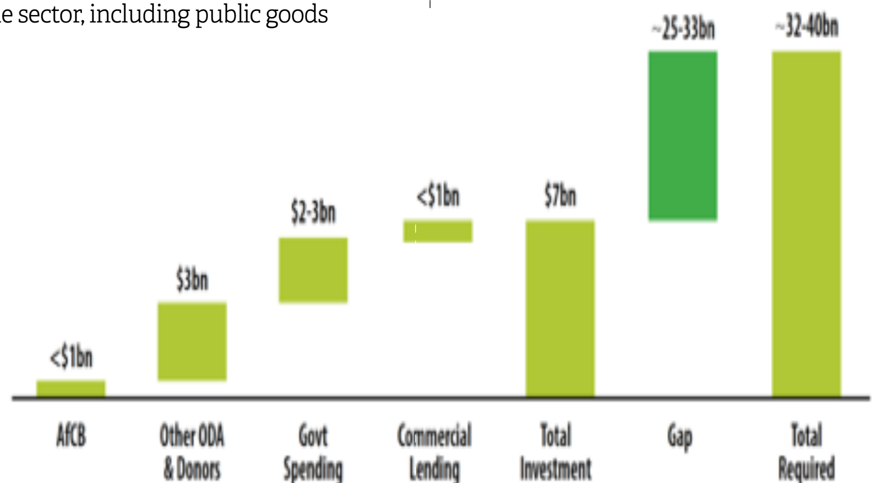

Figure 2: Available financing for agriculture development in Africa vs. requirements for transformation (US$bn/year) Source: AfDB

A past agricultural expo. Photo Credit: Lominda Afedraru

public goods provision. These investments would go to finance rural infrastructure, including irrigation, markets, and roads; support research and knowledge systems, data, and pest and disease control; and enhance the regulatory environment within the sector. This would be the opposite of current practice, where the bulk of the funds go to subsidies implemented in a way that hurts the private sector and creates disincentives for their investments.

Another intervention would be to work with commercial lenders to create innovative products to finance the sector. First, the government can leverage data on farmers, such as that being collected under the Kenya Agriculture Management and Information Systems (KAMIS) to estimate effective demand for agriculture financing. This can enhance the uptake of interventions on blended financing and risk guarantees. In addition, innovation to finance small and medium enterprises (SMEs) in the sector will require partnerships between the public and private sectors to come with models that address the unique challenges in the sector.

Addressing these multifaceted challenges demands a collaborative effort. The government must reaffirm its commitment to the promised financial allocation, employing effective implementation mechanisms and rigorous monitoring. Meanwhile, the private sector should explore innovative financing models, risk-sharing strategies, and targeted financial literacy programmes to unlock the full potential of the agricultural sector as a catalyst for economic growth and poverty alleviation.

Dr. Timothy Njagi is a Development Economist and Research Fellow at Tegemeo Institute of Agricultural Policy and Development.

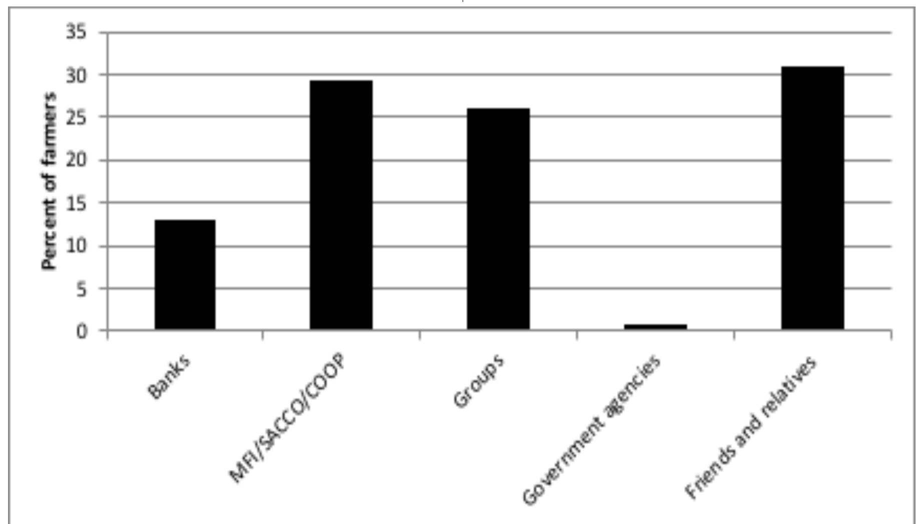

Figure 3: Proportion of credit sources among households that received credit
Source: Tegemeo Institute, 2017