

Redefining Finance for Agriculture: Green Agricultural Credit for Smallholders in Peru



ABOUT THIS BRIEF

MEDA's **INNOVATE** project is a three-year initiative assessing the potential of non-traditional finance to stimulate agricultural innovation adoption among smallholder farmers in South Asia, South America and East Africa.

MEDA's partners across these regions have tested products or services targeted towards smallholder farmers or produced case studies documenting learning from ongoing or completed non-traditional finance projects and initiatives.

Under INNOVATE, Global Canopy conducted research to identify the gaps and opportunities to support and scale up green agriculture in Peru. This summary builds on the case study produced by Global Canopy in April 2019, titled: [Redefining finance for agriculture: green agricultural credit for smallholders in Peru](#).¹

TRANSITIONING TO SUSTAINABLE AGRICULTURE IN RURAL PERU

Peru as a country has committed to reduce its greenhouse gas emissions by 30% by 2030. Most of Peru's greenhouse gas emissions comes from land use change, primarily caused by agricultural expansion into native Amazon forest. This occurs mostly in small patches and has historically been associated with smallholder agriculture. It is critical to find ways to incentivize smallholder farmers who are contributing to deforestation to switch from an extensive strategy of land expansion to using their existing parcels more intensively. This shift could improve food security, reduce poverty, increase equality and enhance climate change mitigation. However, intensifying land use to increase productivity requires farmers to make significant investments that generally exceed their available capital and capacity.

Finance therefore has the potential to play a key role in the transition to more sustainable farming methods, specifically through supplying green agricultural credit – loan products that support farmers to make this transition. Global Canopy found smallholder farmers have a good understanding of and interest in financial services, but face inadequate access to appropriate and flexible financing options. Current lending to the agricultural sector is limited and products are characterized by short payback periods, high interest rates, and lack of grace periods. In turn, financial institutions (FIs) lack incentives to enter the market for agricultural credit. Lending to smallholders is risky due to lack of access to assets by producers, weather, and other factors. With rural areas being low-demand zones, loans are typically small, but require a significant amount of due diligence. Transaction costs are thus too high to justify.

¹ "Redefining finance for agriculture: green agricultural credit for smallholders in Peru." Global Canopy, 2019. <https://www.globalcanopy.org/publications/greenfinanceperu>.

Multi-stakeholder approaches, and the support of government, are therefore needed to align the goals of smallholders and FIs and achieve sustainable agriculture. Global Canopy identified the following key recommendations for government actors and FIs in order to achieve the transition to sustainability in agriculture (Table 1).

RELEVANCE TO INNOVATE'S LEARNING THEMES

The case study contributes to INNOVATE's learning themes on the features required for smallholder adoption of products and services, as well as the role of the public sector in incentivizing firms to better meet smallholders' needs.

Smallholder products and services – required features for finance

The expectation by farmers is that the transition to sustainable practices may cause an initial fall in income over the first few years. A previous report issued by Global Canopy examines financing for sustainable cocoa production in Peru and provides a detailed analysis of the estimated rate of return for farmers making the transition.² The high initial costs, and negative rate of return for the first few years, is referred to as the “valley of death,” and it represents a major barrier for farmers wanting to make cocoa production more sustainable. FIs need to recognize that sustainable practices therefore require long-term investments in new products with longer repayment schedules and lower interest rates, with additional grace periods where appropriate. For farmers to see agricultural credit as a feasible option for making investments to

² “Conquering the ‘Valley of Death:’ overcoming pitfalls in financing sustainable agriculture. The case of improving cocoa yields in San Martin, Peru.” Global Canopy, 2017. <https://www.globalcanopy.org/publications/conquering-%e2%80%98valley-death%e2%80%99-overcoming-pitfalls-financing-sustainable-agriculture>.

TABLE 1. Key Recommendations for Government Actors and Financial Institutions

For Government/Policy-makers

1. Build capacity of FIs to increase their ability to develop and price green credit products
2. Build capacity of smallholders, including technical assistance and financial education, to ensure adoption of technological improvements and ability to maintain accounts
3. Facilitate risk mitigation and transfer, such as through guarantee funds and insurance products, to incentivize FIs
4. Collect and disseminate national data, including price and geographical data, to assist in assessing risks and opportunities specific to agriculture
5. Facilitate access to capital with lower costs and longer payback periods, such as development finance, to reduce barriers to entry into the agricultural finance market

For Financial Institutions

1. Ensure strong commitment and continued engagement by FI Senior Management with the green finance agenda
2. Seek alliances with organizations that can engage with and build capacity of farmers to ensure the benefits of the transition to sustainable agriculture reach the farmers and mitigate risks
3. Consider gender when developing credit products given the traditionally higher barriers to credit for women in the region

improve their agricultural productivity, they would need access to credit that is payable in a few years time, with interest rates closer to one digit and preferentially with grace periods. FIs have begun to identify how they can meet these requirements but will need to invest in further market research before viable products can be created.

Policy and ecosystems change

Global Canopy's report highlights the role of policymakers and the government in creating a more efficient market for green agricultural credit. To encourage FIs to create appropriate products, the government can help de-risk initial investments by providing credit guarantees, and by increasing public information with which FIs can make investment decisions, such as reliable price data, and geographical information that allows for better assessment of agriculture-specific risks. To encourage FIs without experience in agricultural lending to enter the market, policymakers can provide guarantees, or favourable finance terms, to make initial investments less costly for first movers. Finally, both smallholders and FIs recognize the benefits of capacity building alongside credit to increase its efficacy, and the government could potentially play a role in funding technical assistance for farmers.

CONCLUSION

If environmental sustainability in agriculture is not prioritized, Peru will not meet its climate targets and the risk to farmers will increase. Global Canopy's research demonstrates that there is appetite for financial services that support the transition to sustainability, as well as an increasing number of FIs that are willing to engage. However, there are a number of areas that require work and further coordination to align capacities and meet the requirements for achieving the transition to sustainability. One option is balloon payment products for farmers, but further pilot research could explore alternatives through a process of 1) identifying existing opportunities to provide risk mitigation/transfer vehicles that enable financial institutions to invest in resilient agriculture; 2) evaluating (by FIs, governments, and others) how these opportunities can be put into practice with a focus on aligning incentives, clear rules and access to longer-term concessional capital; and 3) using this information to develop and test financial products that are tailored to the specific opportunities identified.

In summary, Global Canopy's report highlights the challenges for achieving sustainable agriculture in Peru, as well as provides a vision for how they can be overcome.

About MEDA

Since 1953, Mennonite Economic Development Associates (MEDA) has been implementing effective market-driven programs which have enabled millions of people around the world to realize their economic and social aspirations. MEDA combines innovative private sector solutions with a commitment to the advancement of excluded, low-income and disadvantaged communities. As a dynamic technical innovator, MEDA has expertise in market systems and value chains, climate-smart agriculture, inclusive and green finance, impact investing, women's empowerment, and youth workforce development. MEDA partners with local private, public and civil society actors, strengthening individuals, institutions, communities and ecosystems, and thereby contributing to sustainable and inclusive systemic change.



About IDRC

The International Development Research Centre (IDRC) funds research in developing countries to promote growth, reduce poverty, and drive large-scale positive change. A Crown corporation, it supports leading thinkers who advance knowledge and solve practical development problems. IDRC provides the resources, advice, and training they need to implement and share their solutions with those who need them most. In short, IDRC increases opportunities — and makes a real difference in people's lives.

Its head office is located in Ottawa, Canada, while four regional offices keep us close to our work. They are located in Montevideo, Uruguay; Kenya; Amman, Jordan; and New Delhi, India.

