Investment in Agriculture and Rural Development
Investment in Agriculture and Rural Development

by

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for the

FOOD AND AGRICULTURE ORGANIZATION OF THE UNITED NATIONS

FAO Policy Learning Programme aims at strengthening the capacity of high level policy makers in member countries in the field of policies and strategies for agricultural and rural development by providing cutting-edge knowledge and facilitating knowledge exchange, and by reviewing practical mechanisms to implement policy changes.

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1. **Summary**

This note outlines findings on the contribution of investment to agricultural and rural development and examines reasons why investment in agriculture, particularly in Africa, remains so low. It summarises the role of public policy in determining and directing investment to agriculture and outlines ways of increasing private investment through public investment and improvements to the business environment. The main elements of recent agreements on aid harmonisation and their implications for aid volumes, policy and management, and for public expenditure management are described.

2. **Introduction**

The most recent estimate of the number of chronically undernourished people in the world is about 854 million for the period 2001-2003, of whom 820 million live in developing countries. Although the number of undernourished has declined in Asia and Latin America, in Sub-Saharan Africa, the numbers have continued to rise and there are now estimated to be no less than 206 million people in this position. Virtually no progress has been made towards the World Food Summit (WFS) target of halving the number of undernourished people by 2015. The scale of the task involved in substantially reducing hunger is enormous. The solutions lie not only within agriculture, but also in the broader political, economic and social enabling environment. Stimulating strong economic growth and economic diversification in rural areas, are also part of the solution and food insecurity is itself a constraint on growth. This module looks at just one element in the fight against hunger, the mobilization of resources at all levels in order to increase production and productivity in agriculture and to enhance the productive capacity in rural areas where most of the poor and food insecure live. One of the principal constraints to increasing agricultural production is the lack of investment in the sector. Total lending by international financing institutions (IFIs) to agriculture and rural development in the world from external sources declined by 50 percent between 1990 and 1999. Though this sharp decline has decelerated in recent years, it cannot be said that agriculture is successful in attracting investment, particularly compared with other sectors. FAO’s Anti-Hunger Programme has calculated that worldwide, a resource flow of US$24 billion per year, a paltry sum when compared with the US$300 billion each year paid in subsidies to agriculture in OECD countries, is needed to achieve the Millennium Development Goal of reducing by half the number of food insecure people by 2015. Returns are estimated at US$120 billion per year.

This module looks at the different types of external resources available, including providing an overview of the effective results of international commitments for increased financing for development in terms of investment in agriculture. It will also examine factors affecting domestic resource mobilization and allocation, and at the constraints to channelling funds for investment by farmers themselves. It also examines issues of absorptive capacity constraints and the role that aid can play in addressing them, as well as the need for innovative financing mechanisms for agriculture.
Objectives

After reading this module, you should know about the main approaches to public and private investment in agriculture, aid harmonization and FAO’s role through the Investment Centre.

Target audience

The target audience is senior officials and decision-makers in ministries of agriculture, finance and planning in developing countries.

Required background

A general understanding of the partnerships between developing country governments, international financing institutions, bilateral and multilateral donors, private sector and civil society is a good starting point for this module.

Readers can follow links included in the text to other EASYPol modules or references. See also the list of EASYPol links included at the end of this module.

3. **WHY AGRICULTURAL INVESTMENT?**

There is growing consensus among international development partners that reducing the rate of global or national poverty means tackling the problems of the rural poor. This growing stress on reducing poverty, coupled with imperatives in improving food security and achieving the Millennium Development Goals (MDG) is leading to increased recognition of the importance of the agriculture sector. Agriculture is central to the achievement of many of the MDGs and hence attention to the sector is crucial in this commitment. This recognition is expected to help reverse the marked decline in Official Development Assistance (ODA) to agriculture.

At the World Food Summit in 1996, Heads of State and Government from around the world committed themselves to promoting public and private investment in agriculture as a contribution to the goal of reducing by half the number of hungry people by 2015. But, despite this, foreign aid for agriculture and rural development continued to decline. Over the past 20 years, it has fallen dramatically – from over US$9 billion per year in the early 1980s to less than US$5 billion in the late 1990s. And yet, estimates suggest that more than 850 million people around the world remain undernourished.

This prominence of the MDGs may help this time in translating renewed interest in agriculture into increased resources and agricultural growth. Growth in agriculture is crucial to the MDGs because about 70% of the target group for the MDGs in Africa and Asia live in the rural areas, with agriculture central to their lives. Agriculture paves the way for economic growth and a productive and profitable agriculture sector is a necessary component of meeting the MDGs by the target date of 2015. Agriculture clearly contributes directly to...
halving those suffering from extreme poverty and hunger. And since the poor around the
globe are disproportionately farmers and herders, it also contributes to other MDGs,
particularly those on universal primary education, gender equality and child mortality.

Indeed, even though structural transformations are important in the longer term, more immediate gains in poor households’ welfare can be achieved through agriculture, which can help the poor overcome critical constraints in meeting basic needs. Studies have shown how agricultural growth reduces poverty and hunger, even more than urban or industrial growth. For example, the countries able to reduce hunger during the 1990s were those in which the agriculture sector grew. It can also be shown that those countries that have invested and continue to invest most in agriculture – both public and private – now experience the lowest levels of under nourishment.

4. PUBLIC INVESTMENT IN AGRICULTURAL DEVELOPMENT

Investment in agriculture – together with support for education and health – will be essential in food security and the achievement of the MDGs. The bulk of that investment will have to come from the private sector, although with public investment playing a crucial role, especially in view of its facilitating and stimulating effect on private investment. The upswing in interest in agriculture and rural development therefore represents a pivotal opportunity both to define the place of, and increase, public investment in agriculture.

Increased public investment is an acute need as public expenditure on agriculture has been falling in recent years, particularly in Africa, despite the greater challenges there in achieving the MDGs. In Malawi, for example, in 2004/05 it is estimated that only 5% of public expenditure was committed to agriculture, in Tanzania 6.6%, while in Ghana, over the period 1999-2003, expenditure on agriculture averaged nearly 6%. There are nonetheless exceptions and, for example, in 2003/2004 Ethiopia committed 18% of budgetary funding for agriculture and rural development. But, in general, public funding of agriculture in agriculture is low and, in response to these low levels, at the Maputo Summit in 2003, African Heads of State and Government pledged to commit "at least 10% of national budgetary resources for [the] implementation of [Comprehensive Africa Agriculture Development Programme] CAADP... and sound policies for agricultural and rural development within five years.

Why has public investment in agriculture fallen so sharply? Part of the reason is the disappointment with the performance of the agriculture sector in low income countries. Public expenditure in general has been constrained with caps placed on budgetary deficits. And, in Africa in particular, the expected gains in food production and rural incomes have not been realised, leading to consideration of other sectors as the principal targets for investment. This has dissipated the pronounced interest in rural development evident in the two decades after independence– a trend which is only now being reversed by the MDGs.

It is also linked to the reconsideration of the role of governments and hence the public sector in economic management. Early, post-independence, State-oriented solutions in agriculture and other

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3 The Comprehensive Africa Agriculture Development Programme – CAADP was prepared by FAO at the invitation of the NEPAD (New Partnership for Africa’s Development) steering committee. The CAADP has been prepared to promote interventions that best respond to the widely recognised crisis situation of African agriculture. It has been cast to deliberately focus on investment into the following three mutually reinforcing "pillars" that can make the earliest difference to Africa's dire situation: (a) extending the area under sustainable land management and reliable water control systems; (b) improving rural infrastructure and trade-related capacities for improved market access; and (c) increasing food supply and reducing hunger. The CAADP also pays attention to emergencies and disasters that require food and agricultural responses or safety nets; if ignored, the dislocation caused by these can undermine or reverse development achievements. In addition, it presents one long-term "pillar" on agricultural research, technological dissemination and adoption.
sectors stressed public investment and public ownership. Public sector input supply and marketing was commonplace, as was State-owned agro-processing. This has now been replaced by greater reliance on the private sector in primary production, agribusiness and in supply and marketing chains. Privatisation has led to the divestment of State-owned enterprises and the role of the State has shrunk significantly. This has in turn led to a reconsideration of public goods in agriculture and hence a redirection of where public resources are spent.

**Need to define public goods in agriculture.** In other words, the view of the proper role of the State in agriculture has been challenged and, whereas there is now growing consensus on what are public goods in agriculture, the diminished role of the State has led to fewer public resources for the sector. This has obvious implications for public policy and for the contribution the public sector can properly make to agricultural development. This has yet to be compensated by a clear understanding of where public investment needs to be made in support of the private sector in agriculture and agro-processing which has in turn impeded the commitment of resources to this end.

**Limited domestic capability for investment project and programme preparation particularly, though not exclusively, in African countries has also been contributory.** Within public services that are generally weak, strong capability for project and programme has yet to be created and hence there is still pronounced reliance on external assistance (such as that provided by the FAO Investment Centre, international consultants and other organisations). This has limited the throughput of high quality ideas and proposals for public sector investments in agriculture from domestic sources.

The slow development of domestic capability in programme preparation is despite concerted efforts by national governments and donors. Support has been provided to national training and public administration bodies in developing and implementing training and other professional development programmes in this area. This includes national training institutions specifically targeted at the agricultural and rural sector. In addition, western universities and training institutions have for many years offered short training programmes aimed at mid-career public sector professionals from low income countries covering all elements of the programme cycle, including preparation. Despite this, public and private sector capability remains patchy and standards low, partly because of the decline of the higher education sector in Africa, staff turnover and low capability in the African public administration in general.

**New training and professional approaches, using formal, informal and on-the-job approaches, will thus need to be developed and embedded within the new environment for assistance.** This emphasises increased national ownership (with attendant greater powers for national staff) and retaining key staff in public sector positions (rather than creating project or programme management units which divert them out of ministerial structures). This in turn creates a new environment for professional development through the empowerment of national staff. There will also be stress on private sector in low income countries as a provider of expertise for programme preparation. This target group has been neglected in the past but provides a key capacity at much lower cost than international expertise.

**5. PRIVATE INVESTMENT IN AGRICULTURE**

Most of the world’s farmers are small-scale farmers and, as a group, these men and women are the biggest investors in agriculture. They also tend to be food insecure; that is, their access to food is inadequate or precarious. If they make a profit from farming, they can feed their families adequately throughout the year and reinvest in their farms by purchasing fertilizer, better quality seed and basic equipment. But small producers face obstacles that are beyond their control: lack of credit, insecure land tenure, poor transport, low prices and poorly developed business relations with agribusinesses at the commercial end of the agricultural supply chain – to say nothing of natural factors such as drought, flood, pests and disease. Their scope for investment and hence for adding value is thus severely constrained.
Partly in consequence, **investment in private sector agriculture has been limited, particularly in Africa.** It will nonetheless be essential, as it has been in Asia, if agricultural sector growth rates are to be increased significantly. It will also be important in commercialisation (i.e. in raising the share of farm output produced for the market rather than for subsistence) and hence in stimulating agro-processing which is likely to be a major source of jobs.

**Private investment in agriculture needs, as in all sectors, a predictable level playing field** which gives farmers and processors good incentives to adopt new and sustainable technologies and diversify production into higher value crops. But, instead, doing business in Africa is generally difficult with World Bank studies showing that 27 of the 35 least business friendly countries in the world are in Africa. The state thus has an important role in change since, although low incomes economies are increasingly market-driven, the State must set the regulatory environment (i.e. the laws and policies that allow the market to operate) and so determine the business environment. Thus, for example, protection of commerce through strong legal systems and clearly defined property rights makes possible more reliable and lower cost markets.

**Agribusiness is, in particular, key to agriculture sector growth** since the employment created by the many businesses in the supply chain enables still more people to live a decent life. Hunger declines and the quality of rural life improves. But agribusinesses in developing countries face serious problems. These include lack of good roads, railways and market infrastructure, lack of recognized grades and standards to define product value, weak legal structures for enforcing contracts, and practical difficulties in developing business arrangements with large numbers of small-scale farmers.

### 6. **The Paris Declaration and Aid Harmonisation: What it Means for Investment in Agriculture**

Partly in response to these imperatives, a new environment for development assistance has emerged. Commitments aimed at increasing aid effectiveness were made in the 2005 *Paris Declaration* by multilateral and bilateral development institutions and by low income countries. These ambitious reforms foresee new approaches in the way aid is managed by partner countries and donors, specifically by increasing predictability of aid flows, strengthening national ownership (with national partners setting the agenda through the policy environment and national sector programmes), alignment (using partners’ systems) and harmonisation (through establishing common arrangements, simplifying procedures and sharing information). The new aid environment and the so-called “new aid architecture”, has also increased attention to the way in which assistance is planned and delivered, with strong emphasis on programme-based approaches (PBAs), sectorwide approaches (SWAps), basket funding arrangements, and direct budget support. These are all designed to address needs in an integrated way, but also to obtain the greatest synergies in the use of the available external assistance.

The increased use of new instruments for aid harmonisation (sectorwide approaches, direct budgetary support and basket funding) has implications for programme preparation, implementation and financing. Indeed, a new programme cycle is emerging with additional stages not previously found in the traditional project or programme cycle where finance was provided by single donor. This arises partly because coordination and consultation needs are more complex and must take place between donors, between donors and beneficiaries, as well as amongst beneficiaries. Arrangements for procurement and monitoring also need to be adapted. This extends and makes the preparation process more complex and increases the time that needs to be spent on preparation.

**There are also additional demands on national public financial management systems.** Donor funds under sectorwide programmes, direct budgetary support and basket funding involve untied

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financing flowing through national budgets. Arrangements for the allocation and disbursement of funds must therefore be agreed as part of the process of programme preparation and donors will obviously want confidence that there will be adequate financial management, control and accountability. This is particularly the case since the greater flexibility of these instruments as compared to the project approach is likely to come under close scrutiny. Experience of these delivery mechanisms and the attendant requirements for public financial management is relatively new and there is limited understanding of their operation. Further analysis and the documentation of the lessons of experience will thus be important in refining their design, operation and use and so avoiding problems which would undermine use of the new planning and delivery systems. In this context, the public expenditure review (PER) is becoming an essential analytical tool that can be effectively applied to the agriculture sector, identifying constraints and inefficiencies in service delivery that undermine the impact of the public resources invested in the sector.

**Actions on harmonisation in agriculture development have, as in other sectors, centred on diversification from reliance on projects to use of programme-based sectorwide approaches, direct budgetary support and basket financing.** Thus while projects will remain appropriate in certain circumstances, there is increased reliance on the new instruments both as a way of achieving a broader and more coherent impact, but also as a way of delivering much greater volumes of assistance to the sector. These products facilitate compliance with the key aims of the new aid environment since they strengthen national ownership, promote alignment (aligning aid with national partners’ agenda and using partners’ systems) and harmonise the assistance by use of common arrangements and procedures.

An additional advantage is that the assistance that can be delivered through these new aid products is substantially greater in monetary terms than is normally possible through project-based approaches. The objective will thus be increasingly to prepare investment programmes in agriculture predominantly using these approaches. This will tend to involve larger (in monetary terms) and more complex programmes since the extent and coverage will normally be greater than has been the case with projects. This in turn demands that more resources be committed to programme preparation.

**The Global Donor Platform for Rural Development (GDPRD has been created as an aid effectiveness mechanism for the agriculture sector.** The GDPRD was set up in 2003, led by World Bank, a number of bilateral donors and including FAO, which co-chairs it. There are now 30 members including all the main financing institutions, bilaterals, development agencies and UN. A small steering committee directs its affairs. It had three main areas of work: advocacy, shared learning of experiences by different institutions in agriculture and rural development, and facilitation of aid effectiveness measures at the country level. It is attempting to translate the principles of the Paris Declaration in the agriculture sector and is aiming to establish a Code of Conduct for donors in this sector.

**7. Public policy: key lessons of experience for investment in agriculture**

Public policy and public investment can create an environment that makes agriculture a good investment. What then should the State do in facilitating investment? Any person or business with money to invest, including a smallholder, must decide where to invest its money. If returns on investment are better in another sector – such as land speculation or a small business in town – then an investor will logically put money there. An attractive climate for investment is one where there is good governance and transparent public administration, where there is macroeconomic discipline and stability, and where there is political stability. Cumbersome tax systems coupled with inefficient or corrupt tax administrations are amongst the greatest obstacles to investment and entrepreneurship. Lack of support for rural finance, venture capital and microfinance will starve agribusinesses of the nourishment needed to flourish.
The State also has the principal role in putting in place public infrastructure necessary for the efficient operation of the private sector. Roads, rural transport systems, and reliable electricity and water supply are essential preconditions of private sector growth. Electricity in particular has been shown to make a major contribution to food self-sufficiency. Electrically powered pumps are more efficient than those powered by diesel and can increase the area under irrigation and thereby improve crop yields. Industrial activities, including food processing, consume about 40% of energy supplied by rural electric systems, creating jobs and pumping money into the rural economy. Overall, investment in infrastructure in rural areas has been shown to have a crucial role in kindling agricultural growth. And, although the private sector is likely to contribute in some of these areas, the state will remain important particularly in rural areas. It is important to pursue opportunities for public-private partnerships (PPP) in infrastructure development as a way of leveraging investment in the sector and to better guarantee sustainability.

Governments also need to enact and enforce rules and regulations that create a safe and predictable environment for private investors. Take grades and standards, for example. Buyers and consumers of produce – in both developed and developing countries – are increasingly demanding high-quality food produced to rigorous standards of size, colour and shape. They are setting strict controls to make sure food is safe and is produced under environmentally friendly and sustainable systems. Standards for humane treatment and slaughter of livestock have become a big issue. The more detailed and widely known the standards are, the easier it is for all the players in the sector to conform. Such standards can even be set by producer associations or buyers. The public sector is responsible for the development of laws and regulations, control, inspection and approval mechanisms as well as for supplying the manpower needed to enforce and operate the system.

The State also beneficially retains a regulatory role in land tenure, ensuring through land registration and enforceable contracts that land ownership is secure. Secure land ownership systems are a precondition of farm investments and a stimulus to the development of bank and non-bank intermediated rural finance (since land can thereby be taken and recovered as collateral). Governments may also provide market information systems, so that the farmers and traders know where and when to sell to get the highest prices. Such systems are now universally seen as a public good, as is agriculture research and extension provision, notwithstanding the role of private companies in the development of crop varieties and in animal breeding. However, some public goods can be delivered privately, for example market information systems, where the mobile phone brings modern technology that can be effectively applied to old problems.

Interest in sectorwide approaches and other methods of delivery through national budgets has implications for public financial management systems and hence for actions in strengthening such systems. Donors need confidence that such systems provide accountability and appropriate safeguards against fraud since, clearly, major fraudulent use of aid passing through national budgets would bring into question the new approaches to delivery. Strengthening public financial management (which, clearly, is a State role) is thus a new imperative in aid delivery.

Overall, if countries get the mix and conditions for public provision in agriculture right, dramatic benefits to agriculture and poor rural households can be expected. For example, when China introduced secure household land contracts and started investing heavily in rural infrastructure and agricultural research in the late 1970s, agricultural production soared and hunger fell rapidly. Over the following two decades, total grain output increased by 65% and the prevalence of hunger was reduced by almost two-thirds. In contrast, the public sector in many parts of the developing world has been slow to respond to the changes that globalization has brought to markets.
8. **What the FAO Investment Centre does**

Since 1964, the FAO Investment Centre has been a key player in the UN system helping developing countries and countries in transition to mobilize international and domestic financing for agriculture. Over the last 40 years, through its cooperation agreements with financing agencies, FAO has helped 165 member countries to obtain funding for almost 1,600 agricultural and rural investment programmes and projects, with funding commitments by these partners and governments of nearly US$82 billion. Governments themselves, recognizing the importance of such investment have, together with the private sector, committed some US$33 billion to agriculture and rural development.

The World Bank/FAO Cooperative Programme was created in 1964 and is managed by FAO’s Investment Centre, which is a Division of the Technical Cooperation Department. The scale and scope of its work has expanded over time to include agreements with some 20 financing institutions and agencies, including the International Fund for Agricultural Development, the World Food Programme, the African Development Bank, the Asian Development Bank, and the European Bank for Reconstruction and Development. It works in collaboration with development financing partners to promote investment in agriculture and rural development with annual field operations that cover some 100 developing and in transition countries each year.

The Centre dispatches an average of two missions per working day, composed of one to five specialists from its own diverse staff, partner financing staff, FAO technical experts and consultants, to work with the concerned national government teams on all aspects involving the identification, formulation and appraisal of investment projects and programmes. In a typical year, the Investment Centre’s total operational budget is around US$ 25 million which is cost-shared with financing institutions, with FAO providing some US$ 4 million. Each year it works on projects and programmes that represent a total investment of approximately US$3 billion.

In response to the low levels of investment in African agriculture, National Medium Term Investment Programmes (NMTIP) were prepared by FAO in conjunction with the New Partnership for Africa’s Development (NEPAD). The NMTIPs are in a common format, summarise government objectives and strategy in the agriculture sector, major donors’ strategies and priorities, and the focus of the project and programme pipeline. They also estimate the gap between actual public expenditure on the agriculture and rural sectors and the 10% target established in the Maputo commitment, and identify key projects and programmes aimed at closing the gap.

The FAO Investment Centre has also had a major role in boosting capacity in project and programme preparation capacity. This includes development and use of Ruralinvest. This is a “toolkit” comprising manuals, training materials and computer software, that together provide a basis for a relatively simple, yet reliable, approach to the identification, formulation, implementation and evaluation of small-scale community or family investment projects in rural areas. In addition, it was responsible, in collaboration with the World Bank, for the design of Costab, software which facilitates the assembly of cost tables and financial and economic analysis. It has also prepared and disseminated several technical publications including Guidelines for the Design of Agricultural Investment Projects and for Socio-Economic and Production System Surveys. Increasingly, on-the-job training is seen as a crucial role for the Investment Centre and one of the central tasks of the Investment Officers posted to the new Sub-Regional Offices (SROs).

9. **Conclusions**

Substantial extra resources for development have been released over the last five years as a result of international aid commitments, though maybe not at the desired pace. However, it is not clear that the agricultural sector has benefited from this. Although aid for agriculture has increased in absolute terms, driven by overall aid increases, its share of total aid remains...
stagnant and by no means reflects the importance of agricultural GDP in developing countries. The sector needs to find innovative financing mechanisms and substantially improve its effectiveness in using the resources at its disposal, if it is to secure a share of financing commensurate with its importance in the economies of many developing countries and its role in reducing poverty.

10. **Readers’ Notes**

10.1. **Time requirements**

Time required to deliver this module is estimated at about two hours.

10.2. **EASYPol links**

This module belongs to a set of modules which are part of the EASYPol training path *Policy Learning Programme, Module 3: Investment and Resource Mobilization, Session 1: Investment in agriculture and rural development*.

Readers can follow other EASYPol documents under Module 3, which is structured as follows:

**Module 3: Investment and Resource Mobilization**

**Session 1:** Investment in agriculture & rural development  
**Session 2:** Environment for private investment in agriculture & rural development  
**Session 3:** Sources and uses of financial resources  
**Session 4:** Strategies for increasing farm financing resources  
**Session 5:** Risk mitigation in agricultural investment  
**Session 6:** Sector-wide approaches (SWAps)  
**Session 7:** Socio-economic & livelihood analysis

11. **Further readings**


