Investments and financing for agriculture in developing countries

Spiralling food prices have sparked fresh international interest in agriculture. Years of neglect of agricultural investment in the developing world have been a key factor in the failure to tap productive potential. Moreover, the financing needs of the sector cannot be met with the financial products and instruments currently available.

Over the past 18 months food prices all around the world have escalated, some quite dramatically. According to World Bank figures, wheat prices have surged up by 181 percent in the past three years to February 2008. Over this same short period of time, overall food prices have risen by 83 percent worldwide. The FAO (Food and Agriculture Organization of the UN) food price index was 57 percent higher in March 2008 than in the previous year (see also the articles on pages 8–13 and 14–17 of this issue of Rural 21).

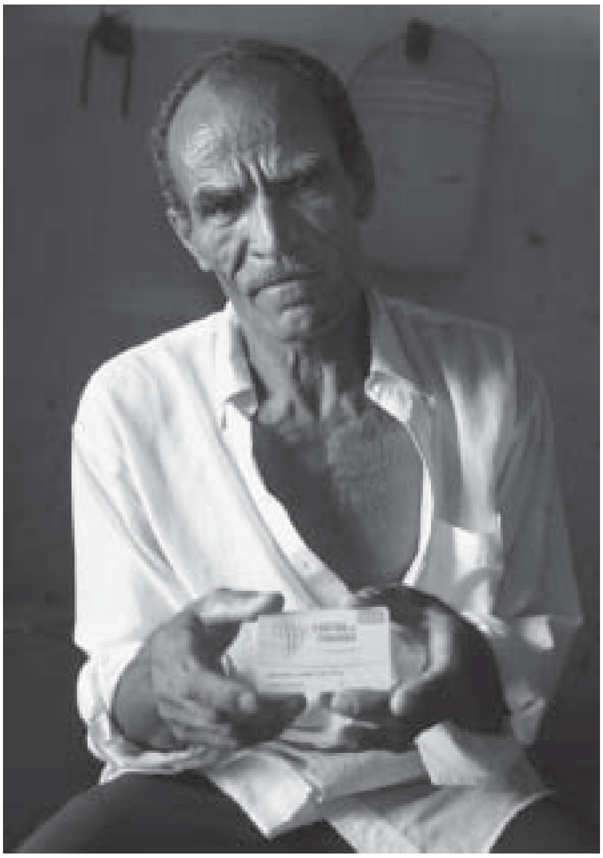
Food prices are rising – agricultural investment is lacking

In the short term the increase in food prices is having the most immediate effect on people in the developing and emerging market countries. The poorest countries and population groups are the hardest hit. At a recent meeting of the World Bank Development Committee, Germany's Development Minister, Heidemarie Wieczorek-Zeul, pointed out that each one percent increase in global food prices puts another 16 million people at risk of starvation.

However, the experts are unanimously agreed that a downturn in food prices should not be expected any time soon. The FAO predicts that during the next decade they are likely to rise by up to 50 percent compared with average prices over the past decade. According to World Bank estimates, 50 percent more grain crops and 85 percent more meat must be produced if we are to keep pace with the future demand for food.

As the latest developments show, supplies of cheap food imports are inadequate to provide for the growing populations in the developing countries. The policy of neglect, for which neither Europe nor the USA is blameless, is coming back to haunt decision-makers in the form of food scarcity and exploding prices. As subsistence farming in the developing countries becomes less viable, farmers are leaving the land in droves and migrating to the urban slums or other countries. The social and economic consequences of this development are all too familiar. Unprecedented food prices and the global crisis have focussed attention again on the question of food production in the developing world.

The result of this policy and development has been a constant decline in the food self-sufficiency rates of many developing countries. With huge price rises and shortages of agricultural commodities on the supply side, more and more countries are starting to experience food crises and mas-



The "Zero Hunger Programme" in Brazil is a successful model of direct income support.

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The "Association des femmes pour le développement de Ouidah" in rural Benin is a self-help group for microcredits to finance small-scale palm oil production.

sive hunger problems. The immediate effects of these developments can only be alleviated by foreign food aid.

Direct income support and international food aid for the poor, however, can only be a first, short-term and temporary solution to acute shortages in impoverished nations. The long-term remedy primarily involves agricultural investment in order to increase food production in the developing countries on a sustainable basis. This spending is needed both at farm level and in key areas upstream and downstream from agricultural production as such – these include irrigation, regulation of land ownership and land titles, provision of vital inputs such as seeds, fertilisers and crop protection as well as efficient agricultural technology and advisory services.

Increasing investment in agriculture

For decades now flagging investment in the agriculture of developing countries has led to a lack of production capacity, energy, infrastructure, technically sound management systems and cultivable land. As there are so few incentives to encourage farmers to expand production, productivity is at a virtual standstill. For example, FAO studies indicate that productivity growth in Asia has declined from 2.5 percent per annum in the 1980s to a mere one percent since 2000.

However, if the developing countries wish to attract more long term investment in agriculture, these nations must change their own policies. Instead of heavily subsidising food to keep prices artificially low, mainly for the benefit of urban populations, they need to introduce agrarian reform and agricultural investment programmes. Germany's Development Minister Heidemarie Wieczorek-Zeul is therefore calling on the developing countries themselves to "honour their obligation to invest at least ten percent of their resources in agriculture and rural development".

The African Development Bank claims that Africa, one of the regions most affected by the current food crisis, has considerable unused potential for expanding agricultural production. Many countries with an underdeveloped agricultural sector are nonetheless largely self-sufficient in agricultural products, including Burkina Faso (94 %) and the Democratic Republic of Congo (80 %). This suggests that improved access to funding by farmers and good framework conditions for agriculture could generate substantial production increases in Africa.

Private investment in agriculture will not be increased unless public funding is spent on the "public goods" which are crucial for the farming community, such as infrastructure, communications, and transport and technology. However, there has been

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Better access to funding for farmers and a positive environment can generate a substantial production increase, also in Africa.

a general decline in ODA (Official Development Assistance) investment in the agricultural sector for many years now. According to the World Development Report (WDR) 2008, the percentage of ODA invested in the agricultural sector of the vast majority of countries during the 2003–2005 period was only in single digits. In response the World Bank has already doubled its development aid commitment to agriculture in Africa from 400 million US-Dollar (USD) to 800 million USD for the coming financial year.

South America, Brazil, Russia and Ukraine in particular have large areas of land which would lend themselves to increased agricultural production. However, expanding the cultivated area brings various problems and risks in its wake. These include rainforest destruction and biodiversity loss, erosion, salinisation and the threat to regions inhabited by indigenous peoples and traditional communities. Intensifying agriculture and boosting yields per unit area is therefore more important than expanding the overall area cultivated. There is great potential in this regard in the developing countries. Farmers there produce an average of one to two tonnes of grain per hectare, whereas farmers in Europe produce five to eight tonnes per hectare. It therefore makes economic sense to invest in the developing world rather than the EU. The EU Commissioner for Development and Humanitarian Aid, Louis Michel, agrees. It is easier and more cost-effective to increase yields from two to four tonnes per hectare than it is to increase from eight to ten tonnes. An added advantage is that the food is produced where it is consumed. This will have the additional benefit of creating jobs and income in the rural areas of the developing countries.

Small farmers have little access to credit

The decline in agricultural investment is directly linked to cutbacks in lending for agriculture in many developing countries. The decline began in the 1980s, triggered by the finding that most state-funded "supervised credit programmes", until then widespread, were inefficient, and that hardly any of the funds were reaching the small and medium-scale holdings which needed them most. Increasingly, therefore, international and bilateral development cooperation funds flowed into microcredit programmes in other sectors, along with the local budgetary funds formerly earmarked for the supervised credit programmes operated by agricultural credit banks or development banks. This resulted in a major loss of availability of agricultural credit facilities, mainly for small and medium-scale farms.

The WDR 2008 asserts that, despite the increase of financial services in rural areas, the majority of small farmers today are unable to access agricultural credit. A study of selected states in India, for example, shows that 87 percent of poor small farmers cannot obtain loans from formal financial institutions. In Peru, Honduras and Nicaragua more than 40 percent of farmers are in the same position.

The credit available for family farms in the form of informal loans or credits from small financial intermediaries (banks, savings clubs, etc.) and NGOs is very limited, because the risks involved in smallholder farming are comparatively high. The amount of funding falls far short of the levels needed, meaning that these farms are failing to reach their potential in terms of productivity. According to the WDR 2008, farms with limited access to agricultural loans are utilising only 50 to 75 percent of the inputs for production employed by farms which do not experience funding shortfalls. At the same time they are earning an average of only 60 percent of the income of their more fortunate counterparts.

The lack of tangible securities – particularly the absence of secure land tenure – is a major cause of the inability of small farmers to access finance. Also, small farmers are often unwilling to mortgage – and possibly lose – their most valuable production factor, their land, in order to take out a loan. Studies in Peru, Honduras and Nicaragua have shown that in 40 to 50 percent of the farming enterprises with limited access to credit, the issue of "risk rationing" is involved.

However, the special terms and conditions – especially high risk levels and transaction costs – faced by small farmers wanting to gain access to credit cannot simply be ignored or brushed aside by passing a few regulations. Innovation is needed in microfinance in the developing countries, to allow smallholders to enhance their ability to borrow. Following the example of India's Grameen Bank, tangible securities are replaced in many cases by repayment guarantees of each other's loans by group members. But the limitations of this form of loan security for agriculture soon become obvious, as all the farms belonging to a local group are subject to the same cultivation factors and weather risks, which are impossible to balance out within the group. Microfinance institutions (MFI) often grant credits only to small farmers and cannot usually expand their services to include larger loans. To avoid these problems, some MFIs have introduced innovative new ideas when granting credit facilities to family farms. For instance, FUNDEA (Fundación para el Desarrollo Empresarial y Agrícola) in Guatemala now accepts standing crops as collateral, thus improving the availability of agricultural credit for smallholders.

Despite these positive trends, the World Bank estimates that MFIs will not be capable of meeting the major demand for agricultural credit in a significant and sustained manner. For this reason it considers the strengthening or formation of promotional banks and financial institutions as one of the most critical challenges facing many developing countries wishing to develop agriculture and the rural areas. It is not a matter of resurrecting the state agricultural credit and development banks which – with good reason – fell into disrepute in many countries in the 1980s. Many, including those in Peru and Bolivia, were closed down completely.

New instruments needed to finance farming

The structures of those banks which still exist must be reformed and protected against political despotism and influence, taking the objective of financial sustainability into account. Forming an alliance with the private sector in a "public-private institution" is one instrument which shows promise, as evidenced by BANRURAL in Guatemala. Other restructured state agricultural credit banks which are proving successful are the Bank Rakyat in Indonesia and the Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand. The use of existing structures and branch offices of state development banks or agricultural credit banks has the advantage of establishing a presence in rural areas at short notice without significant initial investment. Costs can be avoided or at least reduced through economies of scale and spatial coverage.

The creation of self-help groups and credit cooperatives are other models of loan provision for agriculture. Despite the negative experiences of the past, credit cooperatives in particular are now being viewed in many countries as a promising tool for agricultural sector borrowing. They can combine the advantage of customer proximity with the efficiency of modern management systems and, as part of a network, with a broader product range. A successful example for this is the RCPB (Réseau de Caisses Populaires de Burkina) in Burkina Faso. Other innovative instruments, such as the use of up-to-date communications technology, especially mobile phones, and of "branchless banking" through post offices, shops or service stations can help to reduce transaction costs and improve the coverage of lending facilities.

Zusammenfassung

Weltweite Verknappung und steigende Preise für Nahrungsmittel haben dazu beigetragen, die Landwirtschaft wieder verstärkt in den Mittelpunkt der internationalen entwicklungspolitischen Diskussion zu rücken. Die langjährige Vernachlässigung von Investitionen in die Landwirtschaft der Entwicklungsländer, auch als Folge des Zusammenbruchs vieler Agrarkreditbanken in den achtziger Jahren, hat maßgeblich dazu geführt, dass vorhandene Potenziale zur Steigerung der Produktion und Produktivität der bäuerlichen Landwirtschaft nicht ausgeschöpft wurden. Alternative Finanzintermediäre sowie Finanzierungsinstrumente für den ländlichen Raum haben zwar die Kreditversorgung im ländlichen Raum verbessert, sind aber überwiegend nicht in der Lage, den Finanzierungsbedarf der Landwirtschaft zu decken. Viele Familienbetriebe haben keinen Zugang zu Produktionskrediten. Eine Neubesinnung über die Möglichkeiten und die Rolle öffentlicher Förderbanken für den Agrarsektor ist deshalb erforderlich.

Resumen

La creciente escasez mundial y el alza en los precios de los alimentos han contribuido a colocar la agricultura nuevamente en el centro de la discusión internacional sobre política de desarrollo. Durante largos años se descuidaron las inversiones en la agricultura de los países en desarrollo, también como consecuencia del colapso de muchos bancos de crédito agrícola durante los años ochenta. Esto ha llevado a que no se aprovecharan debidamente los potenciales existentes para incrementar la producción y la productividad de la pequeña agricultura. La existencia de intermediarios financieros alternativos e instrumentos de financiación para el ámbito rural ha mejorado la oferta de créditos en las zonas rurales, pero estos factores carecen en gran medida de la capacidad para cubrir las necesidades de financiamiento de la agricultura. Muchas explotaciones agrícolas familiares no tienen acceso a créditos de producción. Por lo tanto es necesario reflexionar en torno a nuevas posibilidades y el rol de los bancos públicos de fomento para el sector agrario.