

## ***Framing note for the first meeting of the Global Alliance for Climate Smart Agriculture (GACSA) Investment Action Group on the role of private and public finance investments in climate smart agriculture***

### **A) Introduction**

This note has been prepared to guide discussions at the first meeting of the Investment Action Group of the [Global Alliance for Climate Smart Agriculture](#) (Box 1). The views expressed in this note do not necessarily represent the formal institutional views or policies of the members of ACSA or the Investment Action Group. If you have comments on this note please send them to the interim conveners of the Group: Richard Muyungi (email: [tanzania37@gmail.com](mailto:tanzania37@gmail.com)) and David Howlett (email: [d-howlett@dfid.gov.uk](mailto:d-howlett@dfid.gov.uk)).

### **B) Background**

In order to scale up actions to deliver climate smart agriculture access to finance (both in terms of liquidity, nature, and reach) will need to be improved dramatically. While some climate smart agriculture practices merely require improved agricultural techniques, many (especially for resilience) require access to longer term funding.

Access to private finance for the agricultural sector, of both short term and medium term nature, has been a challenge especially in developing countries for decades. After the introduction of a series of directed credit programs with large default rates across Latin America and Africa, it became clear that merely pushing short term liquidity to the farming sector would not be the solution. The lack of deposits and sound collateral in most developing countries has created a medium term liquidity gap which makes investments in farming equipment and other productive assets extremely challenging. Overarching all of these technical issues, the fundamental lack of profitability and lack of structured risk management approaches (both physical and financial) in the agricultural sector has led the formal banking sector in many developing countries to shy away from lending to the agriculture sector, while seeking to make more stable returns from other sectors of the economy (e.g. housing and energy). Where agricultural finance programs have flourished, they have tended to benefit from both direct and indirect support policies from government.

Increasing investment into climate smart agriculture will also need to ensure all women and girls are economically empowered this will require a stronger focus on strengthening women's status in, and

#### **Box 1: Global Alliance for Climate Smart Agriculture (ACSA)**

ACSA, launched last September at the UN Climate Summit by the President of Niger and the Prime Minister of the Netherlands, seeks to improve people's food security and nutrition in the face of climate change.

ACSA will help governments, farmers, scientists, businesses, and civil society, as well as regional unions and international organizations, to adjust agricultural, forestry and fisheries practices, food systems and social policies so they better take account of climate change and the efficient use of natural resources.

ACSA Members recognise the urgent need to act at scale and to contribute towards three aspirational outcomes:

- i. Sustainable and equitable increases in agricultural productivity and incomes;
- ii. Greater resilience of food systems and farming livelihoods; and
- iii. Reduction and/or removal of greenhouse gas emissions associated with agriculture (including the relationship between agriculture and ecosystems), where possible.

To take forward the work of ACSA three action groups have been set up:

- Knowledge Action Group;
- Enabling Environment Action Group
- Investment Action

ACSA is supported by a Facilitation Unit hosted by FAO.

Further details of ACSA can be found on

<http://www.fao.org/gacsa/en/>.

returns from, agriculture, while also considering how to promote opportunities that offer better earning opportunities in the rural non-farm economy. Investments will need to help overcome constraints to innovation and investment in agriculture and support women's economic empowerment in agriculture alongside interventions to improve women's access to non-farm employment opportunities.

A strategic approach to agriculture that supports economic transformation and contributes to growth that is resilient to climate risks and delivers poverty reduction and nutrition outcomes needs to find the right mix between the following three approaches and adjust this mix as the transformation progresses:

A. 'Stepping out': long-term investment in labour-intensive growth in manufacturing and services to create productive jobs, including efforts to boost growth in the rural non-farm economy, and interventions to improve poor people's ability to access these jobs through migration, skills and good health and nutrition.

B. 'Stepping up': promoting growth in commercial agriculture and agribusiness to raise incomes, create jobs and create demand. This should include a strong focus on small-scale commercial family (smallholder) farms coupled with strategic interventions to unlock catalytic investments by larger agribusinesses.

C. 'Hanging in': appropriate investments in subsistence agriculture as a safety net alongside other interventions to build human capacity, assist migration and improve access to non-farm (self-) employment opportunities, and build resilience to current and future climate risks. This is based on the recognition of the timeframe required to create large numbers of productive jobs outside of agriculture and that the extreme poor will face the greatest challenges accessing these jobs as they emerge.

'Hanging in' does not imply that the large numbers of households that depend on subsistence agriculture and cannot make the transition to commercial agriculture should merely be left to eek out an existence on the edge of survival for the coming decades until sufficient productive jobs can be created in other sectors. The term intends to capture where agriculture has limited potential to contribute to a pathway out of poverty in this contexts, however important it is in the medium term as a means of survival. For example, interventions that increase poor rural households food self-sufficiency from 3 to 6 months a year and build resilience to droughts and floods may provide an important part of the foundation that enables them to invest in more remunerative non-farm income-earning opportunities.

Getting the mix right between investment in these three approaches (and the right kind of interventions under each) and adjusting this mix appropriately over time is critical to achieving a 'benign' sectoral and spatial transition (from agriculture to other sectors and from rural to urban) that minimises upheaval and dislocation and does not create instability by exacerbating existing inequalities

However, in the past decade, the agricultural financial landscape has literally undergone a structural change – one which has raised a number of opportunities, while posing some traditional and emerging challenges and responding to a changing shape of agriculture and the distribution/retail of its products:

In terms of opportunities:

- Since 2006, prices for major agricultural commodities have risen across the board, in most cases settling at levels twice their long term average of the past three decades. This has brought a new value proposition to agriculture, both in developed and developing countries.

- Indeed, opportunities in developing countries may be better, as the underlying cost structure has not increased as much there (especially the costs of land).
- While the value proposition of agriculture has increased, the potential rates of return for financiers in other sectors have decreased, as competition has increased and banking regulations are requiring increased portfolio management and diversification of asset holdings.
- The increasing demand for feed has driven an increasing trade of grains and oilseeds, which has furthered the globalization of food and reduction in spatial price differentiation of commodities, thereby leading to new trade finance opportunities, viable export markets for domestic produce and greater degrees of price correlations between domestic and international pricing.

Versus the challenges:

- As demand for food has increased and supply has lagged, stocks of food have dwindled from their previously all-time highs and now any production shocks are often followed by periods of high price volatility.
- The impact of current and future climate risks in agriculture are becoming increasingly apparent, increasing both the severity and frequency of weather and disease related shocks to agriculture production systems.
- The need to reduce the environmental impacts of agriculture and produce more from less and to move towards more sustainable production.
- The continued high disaggregation of agriculture producers makes loan distribution and monitoring expensive.
- The continued lack of participation of large numbers of smallholder farmers in the financial system.
- Increased international banking regulation and risk aversion has impacted the liquidity of a number of sources of finance that would be useful to the agriculture sector.

Changing shape of the sector:

- As impact of climate change becomes increasingly clear, so do the spatial impacts. Traditional procurement strategies for major processors and fresh food retailers have relied on multiple suppliers. The increased covariance of shocks both at a country and regional level has rendered this approach vulnerable – with multiple suppliers facing similar challenges at the same time.
- As retailers and processors seek to vertically integrate in order to better control their supply chains, they are forced into new types of supply and financial relationships, all of which expose their traditional business model to new risks and demands.
- The rapid rise of product labeling schemes signal – to a greater or lesser extent – elements of climate resilience and sustainability in the production or value chain.
- The dramatic increase in the use of mobile technology across the global agriculture community has dramatically reduced the asymmetry of information and has led to a flattening of margins for most trading companies, many of whom are now seeking to develop more integrated and horizontal business models in order to maintain margins and to manage price volatility.

As we move forwards, the challenge of feeding 9 billion people in 2050 the nutritious food that they demand is becoming an increasingly daunting challenge, while opening up a host of opportunities. A new strategy for managing agriculture and landscapes is emerging, one which focuses on the traditional goal of increasing productivity, but also concurrently on the goals of enhancing resilience and reducing the environmental impacts of agriculture including emissions of greenhouse gases. This approach is

termed climate smart agriculture. This has many of the same elements of other terms (e.g. sustainable agriculture, sustainable intensification) to deliver on the combined three climate smart agriculture goals at the producer, landscape or country level whenever and wherever possible – basically producing more with less while making agriculture practices more sustainable. The main difference is that climate smart agriculture provides a strong focus on building resilience and managing the trade-offs between the three goals, however it does prioritize productivity and resilience above reducing GHG emissions especially for developing countries.

### ***C) Stakeholders' Interests***

A farmer or group of farmers following a climate smart agriculture strategy (i.e. focusing on productivity and resilience, as well as reduced footprint) is fundamentally a better credit risk than one who is not following a practice or approach which has such a specific focus. There is likely to be a medium term positive productivity impact, and possibly short-term too if the gains are from more efficient input use, it may well be for the climate change community and climate funds. It is this bankable set of interests that provide the key for unlocking the finance for climate smart agriculture:

- For farmers, especially small holders, access to finance at cheaper rates will enable them to increase their productivity, adapt to climate change and manage their short term risks.
- For investors, bankers, farmers who support or use climate smart agriculture practices they are reducing risk and maximizing their profits.
- For traders, these farmers are a more stable source of supply and thereby help them to manage their supply risks.
- For processors, the increase stability of supply enables them to better manage their cost structures and commodity procurement pipeline.
- For retailers, more stable and sustainable supply chains will result in better margins and more stable cost structures.
- For climate financiers, access to a new supplier of mitigation actions enables them to buy down their commitments more quickly.

### ***D) London meeting of the Investment Action Group***

The first meeting of the Investment Action Group is bringing together a number of private and public sector representatives to consider a range of options, in a pre-competitive space, for increasing investment in climate smart agriculture and how this can deliver new and/or cheaper financial products and liquidity to farmers practicing climate smart agriculture. This will include considering the role of climate finance (public and private) and policy as tools to remove traditional constraints, to catalyze product development or to enable pilot development. The meeting has three main objectives:

- To identify and share current work and initiatives on public and private investment into climate smart agriculture.
- To identify challenges and opportunities to increase public and private investment into climate smart agriculture.
- To agree priority actions members of the Group and interested observers can take to address these challenges and realise opportunities, and use these as inputs into the Group's work plan.

**Participants to the meeting are asked to come with answers to these three questions. The meeting's outcomes will be used to finalise the Investment Action Group's work plan that will include concrete actions that ACSA members and interested organisations will take forward in the coming year.**