6. A policy framework for better investment in agriculture

No one disputes the importance of investing in agriculture as one of the most effective strategies for fighting hunger and poverty and making the transition to sustainable agriculture. Yet those parts of the world where hunger and poverty are most severe have seen stagnant or negative rates of investment over the past three decades both by farmers and governments. They face ongoing challenges of enhancing equitable productivity growth while dramatically improving the environmental sustainability of the sector.

Farmers are and will remain the largest source of investment in agriculture, which means they must be central to any investment strategy. Focusing only on public investment, official development assistance and foreign domestic investment is therefore not enough. Hundreds of millions of farmers worldwide have shown their willingness to invest in their productive activities often despite adverse conditions. However, too often their investments in agriculture are constrained by an unsupportive policy and institutional environment. Imagine what they could achieve with a supportive enabling environment.

A clear understanding of the incentives and constraints farmers confront in different contexts is required to unlock their potential to invest. The public sector plays an indispensible role in creating and fostering a conducive investment climate within which private investment – primarily by farmers but also other rural entrepreneurs and investors – can thrive and generate socially beneficial outcomes. Governments and donors have a fundamental responsibility in this regard. The elements of a conducive investment climate are well-known, but they remain elusive in many regions. Indeed, in many regions, a large and growing share of public spending for agriculture is not directed towards the most economically or socially beneficial investments. If so much is known about how to improve investment in agriculture, why is so little progress being made?

Creating a conducive investment climate for private investment in agriculture: context matters

The preceding chapters have reviewed the challenges involved in creating a supportive environment for private investment in agriculture. However, the priorities and the importance of the different challenges vary by country and region, depending on context. The overall level of economic development and the role of agriculture in the economy, the extent and depth of rural poverty and hunger, the degree of environmental degradation, the quality of governance and level of institutional capacity all must be taken into consideration. Broadly speaking, countries at different income levels will have different investment priorities and challenges.

High-income countries typically have highly developed and highly capitalized agriculture sectors and a generally favourable enabling environment for agricultural investment. They have the capacity to respond to growing effective demand, through *inter alia* enhanced investment. However, in many countries, incentives to invest in agriculture relative to other sectors are heavily influenced by economic and sectoral policies, in many cases creating a strong bias in favour of agriculture.

From an agricultural investment perspective, a key challenge in these countries is to ensure that economic incentives are not tilted towards (or against agriculture) as a result of policies and to ensure a level playing field for investment in agriculture and other sectors. This may mean reducing high levels of direct government support and protection for the sector. This is critical for ensuring an economically efficient allocation of resources and investment patterns in agriculture, both domestically and at the international level. A further key challenge is to ensure that environmental costs and benefits are reflected in incentives so as to promote the sustainability of production.

Middle-income countries have already reached a certain level of accumulation of capital in agriculture, beyond what characterizes the low-income countries (see below). They tend to also have a relatively more diverse agriculture sector both in terms of products and types of entities operating in the sector. The role of agriculture in poverty alleviation is generally moderate, though differing from country to country. Private investment in these countries comes from a multitude of sources (small-holder on-farm investment, corporate investment, FDI) and flow into different types of activities, ranging from small-scale private commercial farms to large-scale enterprises. Some segments of producers may be disadvantaged in terms of their ability to invest relative to others.

In addition to ensuring a level playing field in terms of economic incentives for investment in agriculture *vis-à-vis* other sectors and the incorporation of environmental costs and benefits into agricultural services, improving the enabling environment for investment is in many cases an important challenge. A key policy challenge in these countries is also to avoid discrimination among different types of investors, with a focus on removing factors that may particularly constrain smaller investors and those in less favourable regions. This is important not just for reasons of equity and fairness, but also to ensure an efficient allocation of investment capital. Special support to help farmers invest in sustainable production methods can also be necessary in many contexts.

The **low-income countries** are very far from realizing the potential of the agriculture sector in terms of productivity, production, income generation and poverty alleviation. For a large number of farmers, enhancing agricultural productivity is a core component of strategies to exit poverty. Building farm-level capital endowments – physical, human and natural capital – is critical to achieving this. Increasing the productive assets of smallholders and enhancing their ability to invest is therefore a cornerstone of poverty alleviation efforts.

Unbiased incentives to invest in agriculture, both *vis-à-vis* other sectors and among different investors within agriculture, are as important as in the previously discussed country categories. In addition, improving the enabling environment for investment in agriculture is an indispensable condition for promoting agricultural investment in a large number of countries. However, this alone cannot ensure adequate levels of capital accumulation. Policies and programmes need to be directed towards overcoming constraints to accumulation of productive assets by smallholders. Specific support to investment in sustainable production methods with long pay-off periods is also likely to be critical to ensure improvements in the sustainability of production. Large-scale investment may contribute to capital formation in agriculture, but is unlikely to present a solution to poverty and food insecurity for large numbers of people and poses serious risks to resource-poor rural people unless properly managed. Policies and programmes need to be in place to ensure that such investments are indeed conducive and not detrimental to food security and poverty alleviation of local populations.

Supporting the conducive investment climate through public investment

A favourable climate for private investment must be supported by public investment. There have been increasing calls for more public investment in agriculture and for enhanced spending on agriculture in general. However, expanding overall expenditures on agriculture may not be a simple proposition. It is therefore important to enhance the impact of scarce public funds for agriculture, based on some core principles.

Focusing scarce funds on investment in public goods

Evidence suggests that in many cases the impact of existing levels of public expenditure on agriculture – in terms of both agricultural production and productivity and poverty reduction – can be enhanced by shifting expenditures from subsidies on private goods towards investment in public goods. For example, credit subsidies typically generate low returns for society, but public investment in strengthening financial institutions can facilitate the provision of better credit services and generate higher returns for society.

Targeted social transfers can generate public good benefits by enabling poor smallholders retain and expand their assets.

Investing in research and development

Substantial evidence on the high social returns to public investment in agricultural research and technology in developing countries suggests, quite unambiguously, that there is clear underinvestment in this area. The impact of R&D public spending on agricultural production or productivity is greater than that of spending on other activities directly related to the sector as well as key investments for agriculture, such as rural infrastructures, education, electrification, health, and telecommunication. Expenditures on productivity enhancing agricultural R&D have also been shown consistently to have a very strong poverty reduction impact.

Choosing judiciously among agricultural investments

Not all types of agricultural investment are equal in terms of their returns. When advocating for more funds to agriculture, it is critical to make distinctions between high and low-payoff activities in terms of productivity, poverty reduction, or other outcomes. When choosing among agricultural investments, a series of points are important to consider.

- While the evidence shows that investments in R&D have consistently high returns and poverty reduction impacts, the pattern for other types of agricultural investments depends on country and context.
- Public investment in certain other sectors can make very significant positive contributions to agricultural performance and poverty alleviation. Key areas in this regard are rural roads and education.
- A careful geographic strategy for investment is needed, as returns to government resources on agricultural development are likely to be highly heterogeneous across space. Specifically, evidence presented in the report suggests that in several instances there may have been underinvestment in less-favoured as compared to high-potential areas.
- Policy-makers and other stakeholders should be aware that benefits from some public types of investment may materialise with a long lag, so that short-term analysis may conceal the economic gains from public investments with long gestation periods.

Improving the policy and planning process for agricultural investment

The principles required for promoting investment in agriculture and channelling it towards activities with higher economic and social return are well-known, but translating these principles into policy action is more difficult. Improving public policies and planning of investment in and for agriculture involves a series of key elements.

Defining the objectives

Effective policy and investment planning for agriculture requires a clear definition of the objectives and identification of how the policies and public investment relate to the overall development strategy of a country. Objectives are country specific and must be developed with effective participation of relevant stakeholders. In broad terms, the relative weight of key objectives such as expanding food supply, alleviating poverty and ensuring environmental sustainability are likely to differ among countries at different stages of development.

Ensuring coherence between policies and public investment planning

Ensuring coherence between public policies and investment planning can enhance their impact and improve the likelihood of meeting objectives effectively and efficiently. This means ensuring that policies and public investments are directed towards the defined objectives and are mutually reinforcing rather than contradictory. If policies and investment plans are not consistent and coherent among each other, the impact of both will be significantly diminished. In the absence of an appropriate policy framework public investment funds risk being wasted.

Improving the empirical base for policies and investment planning and impact analysis

Ensuring coherence and effectiveness of policies and public investment requires a solid base of evidence on their nature and impact.

However, this is not necessarily an easy task. Public expenditure reviews for agriculture can provide a crucial overview of actual patterns of public expenditure allocation as a basis for further improvements.[28] Public expenditure tracking surveys focus on budget implementation and can allow the tracking and measurement of expenditures from allocation to final user and assess the extent to which public funds are actually spent for their intended purpose and identify points of leakage. Understanding the impact of policies on incentives for private investors is equally important.[29] Closely linked to this is the need for capacity development for policy-making at all levels.

Ensuring coordination across sectors, governments, ministries, agencies and development partners

Agricultural investment can contribute to outcomes usually seen as the concern of other sectors and agencies (for example health and nutrition), and investments undertaken by agencies not centrally concerned with agriculture (such as road infrastructure, electrification, education, etc.) can be among the most important contributors to increasing agricultural growth. This points to the need for addressing any administrative and institutional obstacles that hinder coordination across agencies – not only across ministries in developing country governments, but also across units in donor agencies. Also, coordination between different layers of government investing in and for agriculture is important in many contexts. A first (and easier) step may be improving the sharing of information about these types of cross-sectoral effects of public investment, and about the amount and features of investment activities being undertaken by different agencies. A second and more challenging step would be to attempt to improve allocation across and within agencies for mutual benefit and achievement of multiple development goals.

[28] The World Bank and DFID have developed guidelines for the conduct of public expenditure reviews (World Bank, 2011e). IFPRI has conducted a range of studies on returns on different types of public expenditures and investment in different countries (some of them cited in Chapter 5).

[29] The Monitoring and Analyzing Food and Agricultural Policies in Africa Project (see Chapter 3) is one initiative aiming at improving the analysis of both policies and public expenditures.

Improving governance, transparency and inclusiveness in policies and planning

Improving governance, including transparency and inclusiveness, in public policies and investment priorities is crucial to maximizing impact of policies. As an extension of the coordination across sectors and agencies, it is important to ensure the involvement of all relevant stakeholders in defining and implementing policies and investment programmes. Administrative and political decentralization can often contribute to increased transparency and accountability.

Overcoming the political economy constraints

Directing policies and public expenditures towards clear development and poverty reduction objectives is often made difficult by the specific political economy constraints prevalent in different countries and contexts. The main problems are those of avoiding elite capture and of overcoming resistance to change on the part of the beneficiaries of current policies. Overcoming the political economy constraints may be the most difficult hurdle towards improved policies for the promotion of private investment and better public investment in agriculture. However, progress in the areas above – clarification of objectives and development strategies, policy coherence, improvement of the evidence base for policy and investment decisions, better coordination and greater transparency – can contribute towards creating the political support that is necessary for change.

Key messages of the report

The State of Food and Agriculture 2012: Investing in agriculture for a better future offers the following key messages:

- **Investing in agriculture is one of the most effective strategies for reducing poverty and hunger and promoting sustainability.** The regions where agricultural capital per worker and public agricultural spending per worker have stagnated or fallen during the past three decades are also the epicentres of poverty and hunger in the world today. Demand growth over the coming decades will put increasing pressure on the natural resource base, which in many developing regions is already severely degraded. Investment is needed for conservation of natural resources and the transition to sustainable production. Eradicating hunger sustainably will require a significant increase in agricultural investment and, more importantly, it will require improving the quality of this investment.

- **Farmers are by far the largest source of investment in agriculture.** In spite of recent attention to foreign direct investment and official development assistance, and in spite of weak enabling environments faced by many farmers, on-farm investment by farmers themselves dwarfs these sources of investment and also significantly exceeds investments by governments. On-farm investment in agricultural capital stock is more than three times as large as other sources of investment combined.
- **Farmers must therefore be central to any strategy for increasing investment in the sector, but they will not invest adequately unless the public sector provides a favourable climate for agricultural investment.** The basic requirements are well known, but still too often ignored. Poor governance, absence of rule of law, high levels of corruption, insecure property rights, arbitrary trade rules, taxation of agriculture relative to other sectors, failure to provide adequate infrastructure and public services in rural areas and waste of scarce public resources all increase the costs and risks associated with agriculture and drastically reduce incentives for investment in the sector.
- **A favourable investment climate is indispensable for investment in agriculture, but it is not sufficient to allow many smallholders to invest and to ensure that large-scale investment meets socially desirable goals.**
  - **Governments and donors have a special responsibility to help smallholders overcome barriers to savings and investment.** Smallholders often face particularly severe constraints to investing in agriculture because they operate so close to the margins of survival that they are unable to save or to tolerate additional risk. They need more secure property rights and better rural infrastructure and public services. Stronger producers' organizations would help them manage risks and achieve economies of scale in accessing markets. Social safety nets and transfer payments may help them accumulate and retain assets, either in agriculture or in other activities at their choice.
  - **Governments, international organizations, civil society and corporate investors must ensure that large-scale investments in agriculture are socially beneficial and environmentally sustainable.** Large-scale investments, including by foreign corporations and sovereign investors, may offer opportunities for employment and technology transfer in agriculture but may also pose risks to the livelihoods of local populations, especially in cases of unclear property rights. Governance of these investments must be improved by promoting transparency, accountability and inclusive partnership models that do not involve transfer of land and allow local populations to benefit.
- **Governments and donors need to channel scarce public funds towards the provision of essential public goods with high economic and social returns.** Public investment priorities will vary by location and over time; but evidence is clear that some types of spending are better than others. Investments in public goods such as productivity-enhancing agricultural research, rural roads and education have consistently higher payoffs for society than spending on fertilizer subsidies, for example, which are often captured by rural elites and distributed in ways that undermine private input suppliers. Such subsidies may be politically popular, but they are not usually the best use of public funds. By focusing on public goods, including sustainable natural resource management, governments can enhance the impact of public expenditures both in terms of agricultural growth and poverty reduction. Governments must invest in building the institutions and human capacity necessary to support an enabling environment for agricultural investment.