

## Sequencing of Investments for Agricultural Growth, Poverty Reduction and Food Security<sup>1</sup>

As investment in agricultural development gains increasing prominence in Africa, among governments and donors, there is renewed interest in developing strategic understanding of the investments that are needed to effectively and efficiently promote agricultural growth to benefit the poor and improve food security. This is a matter of particular concern in the design and implementation of NEPAD's Comprehensive Africa Agriculture Development Program. NEPAD and its partners are therefore planning to establish Regional Strategy and Knowledge Support Systems (to be called ReSAKSS) to develop information and analytical capabilities to support the prioritization, design, implementation, and monitoring and evaluation of investment programs and activities. A meeting was held in Washington in June 2006 to discuss the establishment of these ReSAKSS. Attended by representatives from research institutions, regional economic communities, and donors, the two day meeting discussed first critical analytical issues that these systems and need to address and process for the successful establishment of these systems.

A critical issue for design of investment programmes is to ensure that investments are correctly sequenced. To understand this, it is a necessary first to understand the major processes and stages of agricultural development, of economic growth, and of poverty reduction.

Agricultural growth, poverty reduction, and food security require complementary changes in people's livelihoods and in the local and national economic environment. Livelihoods can be helpfully considered in terms of their contribution to three broad strategies which we term "hanging in" (maintenance and survival), "stepping up" (improvement and expansion of current activities), and "stepping out" (branching out to new activities). These strategies are not mutually exclusive: most of us have some concerns to "hang in", but development involves increasing opportunities for "stepping up" and "stepping out". These transitions are particularly important to poor rural people, for whom agriculture is a major vehicle for "hanging in", and, with agricultural growth, for "stepping up". In the long run, however, agriculture is something from which most people "step out" to employment in non-farm activities. The growth of non farm employment opportunities, however, depends upon growth and structural change in the wider economy, including, of course, "stepping up" growth in agriculture.

The processes of livelihoods and economic change and growth are highly inter-related and dependent upon each other. They depend upon, and are driven by, technical and institutional change which again interact and depend upon each other to raise the productivity of resources and facilitate capital accumulation. Unfortunately, though, these processes can be impeded by a set of micro-, meso-, and macro- poverty traps. Micro traps are well known, a vicious circle where people have limited resources, which lead to low productivity, which leads to low incomes, which then prevent the accumulation of resources. The trap is exacerbated by vulnerability to health, climate, and economic stresses and shocks, vulnerability which is increased by the low incomes and limited resources of poor people.

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<sup>1</sup> This is a summary of a PowerPoint presentation made by Andrew Dorward at the ReSAKSS meeting .

It should be possible for firms to invest in credit systems to expand people's resources, to develop input and output services to support new technologies and raise productivity, and to provide insurance to reduce people's vulnerability. Here, however, supply chain or meso- poverty traps become important. Low levels of economic activity, poor roads, poor health facilities and conditions, and weak institutions lead to high business (or transaction) costs and risks. These apply particularly to small farmers who operate with long production and sales cycles involving high climatic and price risks. Small scale production leads to small volumes of input purchases and produce sales, and increasing business costs for farmers, inputs suppliers, lenders, and produce buyers. Suppliers of inputs to small farms face further difficulties as seasonality of crop production means that seeds and fertilizers are needed only for short time periods each year, but farmers' input demand is uncertain, so stocking and purchase decisions are risky as unsold stock is expensive to hold as inventory, with high interest and storage costs or losses. The challenges to input suppliers are related to challenges in delivering financial services to farmers to support their input purchases – small scale lending to dispersed farmers with uncertain credit demand and engagement in risky enterprises leads to high transaction costs and high risks of default. These have to be covered by high interest rates, which make borrowing more risky for farmers and hence both depress demand for loans and increase default – which further increases the costs of lending.

Problems in input supply and in financial service delivery to small scale farmers in poor rural areas are mutually reinforcing, and they can also have negative effects on output market development: without greater use of purchased inputs, farm production is low, reducing opportunities and incentives for large scale produce buying, raising transaction costs and risks for output buyers, depressing farm gate prices, and further reducing farmers' demand for inputs and seasonal finance.

The result of these difficulties facing rural economies and farming and service delivery activities within them can then lead to a 'meso- trap' of supply chain failure which prevents markets from developing to address the micro-level traps constraining farm livelihood development.

Can firms and governments provide the coordination and make investments to overcome these supply chain failures? For traditional export crops (such as sugar or tea) where large investments in processing facilities offer high potential returns, it will often be attractive for large firms to invest both in these processing facilities and in coordinated produce purchase, input supply and financial services needed for small (but not the poorest) farmers to deliver raw materials for processing. Unfortunately no such incentives exist for large firms to supply and these coordinated services for intensifying smallholder production of staple foods. Widespread successes in increasing staple food production have generally involved governments providing or facilitating critical coordination of these services and of infrastructural investments. Here unfortunately rural economies are often caught in a macro trap and paradox: provision of these services and investments requires significant administrative and financial capacity, but these capacities are most needed in the very economies where they are most scarce, or, to put it another way, the challenges of coordination and investment are greatest in situations where capacities to provide them are weakest. A further paradox arises because incentives for politicians, bureaucrats, and donors to develop and mobilize these capacities also tend to be weak and distorted in foreign economies. Short term political horizons, uncertainty with regard to development success, changing donor fashions, and large aid flows combine to reduce the incentives for politicians, bureaucrats and donors to make the long term commitments needed for capacity development and sustained investment and action.

What can we learn from this analysis about the sequencing of investments in agricultural development? Fundamentally, constraints are different in different areas, varying between different types of crop and over time. In particular, increasing productivity of staple crops in poor areas requires explicit and coordinated attention to these micro, meso, and macro traps. This demands long periods of sustained investment, first of all establishing basic productive technologies and administrative and political capacity and commitment. Only when these are in place are

investments in market coordination and stimulation likely to yield benefits. These too need to be sustained long enough to establish farmer and trader confidence, but they also need to be designed and implemented in such a way that they draw in and encourage rather than discourage and displace the development of private markets.

Limitations of market development and administrative capacity, together with the importance in poor rural areas of food prices and supplies for both agricultural development and social protection (poverty alleviation and food security), also suggest that agricultural development and social protection policies should be pursued in an integrated way. However the nature of and need for such integration will change over time as the economy and its markets develop. Again it is important that early interventions which do not rely on market mechanisms should promote rather than stifle market development.

This analysis and agenda raises a number of questions. It is clear that there are complex questions about what should be done, when, and how, and answers to these will vary across areas and over time. We need better understanding of these processes and issues, and systems for characterizing different areas and stages in development. There are particularly challenging questions about how governments and markets should interact, and how the problems of distorted political, bureaucratic, and donor incentives can be addressed.

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