Finance in Common

The first global summit of all Public Development Banks

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INVESTING IN SUSTAINABLE FOOD AND AGRICULTURE SYSTEMS: THE ROLE OF PUBLIC DEVELOPMENT BANKS

AS OF 12 NOVEMBER

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On 10 – 12 November 2020, France will host the *Finance in Common Summit*, the first ever summit of Public Development Banks (PDBs), as a joint initiative of the International Development Finance Club (IDFC) and the World Federation of Development Finance Institutions (WFDFI).

The Summit aims to recognize the critical role of PDBs in financing and supporting investments that contribute to the realization of the 2030 Agenda and the Paris Agreement across all sectors.

In this context and with a focus on accelerating progress towards Sustainable Development Goals 1 and 2, eradicating poverty and hunger, a group of PDBs dedicated to agriculture or the rural sector in different regions of the world have been convened by the International Fund for Agricultural Development (IFAD) to form an "Agriculture Cluster."

Participants in the Cluster have agreed to put forth this joint contribution to the Summit, and to continue their collaboration beyond the Summit through a Working Group on Financing Sustainable Food Systems.

PREAMBLE

Catalytic investments in agriculture and the food economy are critical to realize the 2030 Agenda and Paris Agreement on climate change, and finance is recognized as a cross-cutting enabler of all the action tracks of the 2021 Food System Summit. This is because the sector sits at the nexus of many economic, social and environmental objectives, including poverty eradication, decent jobs, food security and nutrition, sustainable use of natural resources (such as water, soils, and biodiversity), and climate change mitigation and adaptation.

Inclusive and sustainable food systems, including agriculture, require a diverse combination of public and private investments. This reflects their capacity to provide both public goods (e.g. biodiversity, healthy soils, sustainable water management, carbon sequestration, contribution to a low carbon economy, food security and nutrition) and private goods (e.g. employment, investment returns).

The financial ecosystem around agriculture and food systems is diverse. It includes government, public and private banks, philanthropies, funds and facilities, agri-food corporates, insurance and lease companies, and – far from least – farmers, their families, their organizations and their communities. Given the important public goods delivered by these systems, development finance and green or climate finance play significant roles in the ecosystem, but commercial finance also plays a role, to a different degree and in different forms depending on context, value chain, and type of investment. In recent years, this ecosystem has been profoundly

1 This document is not legally binding.

transformed by digitalization, the emergence of new types of investors (including social lenders and specialized investment funds), and new practices in value chain finance, asset finance, insurance and trade finance, in particular.

All parts of the financial ecosystem need to play a role in promoting catalytic investments in agriculture and food systems. Each of the actors in the financial ecosystem can provide different types of capital to support investment, with different risk/return profiles and desired impacts. Enabling these systems to deliver on the multiple objectives of the 2030 Agenda and Paris Agreement requires all these sources and types of capital to work in alignment. There is room to expand the role that climate finance plays in this domain, given the vulnerability of food systems to the impacts of climate change as well as their potential contribution towards climate mitigation[2]. Development and green finance can be deployed both for direct investment and to mobilize, de-risk, or otherwise complement private finance.

Public Development Banks operating in agriculture and food systems are diverse in terms of capital base, mandate, and instruments. Non-sector specific PDBs can have significant portfolios in agriculture or in other activities within food systems (e.g. in financing rural infrastructure, agro- processing, or other). Additionally, many countries have PDBs with dedicated focus on rural development or on agriculture. Some of these are retail banks that serve farmers or companies in food and agriculture, others operate at the second tier and serve financial intermediaries (including commercial banks). Yet others have a primary focus on agriculture but their portfolio includes other sectors. Some have mandates and products that enable them to target small-scale enterprises including producers, while others focus their portfolios on larger agribusinesses or larger investments, for instance in agricultural infrastructure and markets. Depending on their specific mandates, PDBs in the sector may directly provide finance (to end clients or to financial intermediaries) and mobilize finance (from specific investors or by issuing financial products to raise capital from the market). This diversity, as well as the diversity of the contexts in which different PDBs operate, is essential to recognize when considering the role of different types of PDBs in advancing the 2030 Agenda.

Despite this diversity, there are some important common elements linking these institutions. Unlike other types of financial institutions operating in the sector, PDBs are typically expected to address market failures, with counter-cyclical roles, and greater risk tolerance than what other financial institutions have. Depending on context, history, and institutional mandate, they are also often seen by governments are one element of the institutional landscape that they can rely on – directly or indirectly – to realize sustainable development objectives set at the country level.

PDBs can be strategic enablers of investments that combine public and private goods, including a shift to greener – more sustainable and climate resilient – food systems. Agriculture and the food economy generally operate in market contexts that do not provide effective signals to drive investments into more inclusive, sustainable, and climate-resilient practices. While selected environmental and climate-related externalities are increasingly being "internalized" into specific markets, directing finance towards sustainable development impact in this sector broadly requires addressing a range of market failures. Within the broader financial ecosystem, PDBs (both those with a dedicated agricultural and rural mandate and others) may contribute to this both as providers of capital for sectors not (yet) attracting sufficient commercial capital, and as catalysts of investment by other finance providers, allowing them to bridge between public and private goods. Depending on their capabilities, this peculiarity positions PDBs uniquely to support the realization of national SDG plans and of Nationally Determined Contributions (NDC) investment plans. In so doing, PDBs can be mobilizers, assemblers, or implementers of investments funded through development finance, green or climate finance, and commercial finance.

2 According to the Intergovernmental Panel on Climate Change, around 23% of global greenhouse gas emissions come from food and agriculture https://www.ipcc.ch/report/srccl/

The role of PDBs as mobilizers of private commercial capital requires more focus at this time. The case for private investment in the sector is clear and well recognized, given the current magnitude of agricultural and food markets globally and upward trends in demand for food associated with demographic growth and urbanization. The World Bank estimates (primary) agricultural value-added at $3.2 trillion and that the value of the global food system is at roughly $8 trillion, or 10% of the $80 trillion global economy[3]. Moreover, the Food and Land Use Coalition estimates that transitioning to more sustainable practices in the sector may require $300-350 billion per year until 2030, but deliver an "economic prize" of $5.7 trillion saved in "hidden costs" associated with current practices, and unlock $4.5 trillion annual opportunities for business[4]. Yet, private investment is often hindered by a variety of risks, costs (e.g. due to poor infrastructure), and poor economic returns. In this context, PDBs are under pressure to increase their capacity to crowd in, de-risk, and help align commercial finance to the SDGs and to climate-related goals such as those set under the NDCs.

Continued focus of PDBs on smallholder farmers and agri-SMEs is also critical at this time. Smallholder farmers and small and medium enterprises (or SMEs) are typically the backbone of agricultural and food markets, particularly in Africa and Asia. Their ability to access finance for investment is often particularly constrained by their size, asset base, fragmentation, and by poor information and coordination systems in both agricultural and financial markets. Smallholders and agri-SMEs are also often on the front line of climate change and of environmental shocks and stressors, as well as stewards of fragile ecosystems.

Attention to social inclusion – and in that context, to gender equality and the empowerment of women as well as youth – is also important on the PDB agenda. In many contexts, women and youth are particularly at a disadvantage in accessing finance for investment – whether as farmers or as agri-SME entrepreneurs – but they also represent a large share of operators in the sector, depending on demographic trends and on migration flows. Many PDBs have specific programmes or initiatives to address the disadvantages of young or female agri-food and rural entrepreneurs and farmers in relation to access to finance (including credit, equity, insurance, trade and asset finance) as well as to related services (including business development services and financial literacy). Food systems and agri-food value chains can also offer a variety of green jobs for women and youth.

The COVID-19 pandemic has intensified existing challenges in food and agriculture in many parts of the world, with supply chain disruptions and negative impacts on incomes, jobs, and the asset base and finances of thousands of agri-SMEs. Many of these have faced liquidity crunches, higher operating costs, and market losses. Agricultural finance providers have faced increases in non- performing loans as well as pressure to disburse more, under conditions that made loan management challenging due to restrictions on movement. Overall, the pandemic has brought out with greater clarity the urgency of investments across agricultural supply chains, while also putting unprecedented stress on the financial ecosystem serving the sector, with PDBs facing increased demands and, at the same time, constraints on their asset base.

At the same time, the pandemic has underlined the need to shore up resilience to a variety of shocks, particularly for small-scale producers and rural SMEs. This includes the ability to adapt in the face of supply chain disruptions (including inputs), and building of local value chains and green agricultural practices.

3 https://blogs.worldbank.org/voices/do-costs-global-food-system-outweigh-its-monetary-value
4 https://www.foodandlandusecoalition.org/wp-content/uploads/2019/09/FOLU-GrowingBetter- GlobalReport-ExecutiveSummary.pdf

IN CONCLUSION

The financial ecosystem for food and agriculture needs to effectively enable smallholder farmers, agri-SMEs, and other operators in the sector to invest more and in ways that contribute to the realization of the 2030 Agenda and Paris Agreement, as well as to advance progress on all elements of the agenda of the Food System Summit. Both the agendas of combating climate change and that of recovery from the COVID-19 pandemic can bring new momentum to this role in the coming months. In this context, PDBs can be key investors as well as catalysts of investments that are conducive to realizing the objectives set under these agreements. The Finance in Common Summit is an opportunity to recognize this role and to strengthen dialogue and learning among PDBs with capacity and commitment to invest in different parts of food systems.

PDB RECOMMENDATIONS AND COMMITMENTS

In view of the above, the members of this Agriculture Cluster and other signatories to this document affirm:

- Their collective **commitment to increase their contribution to investment in food and agriculture** towards sustainable landscapes and food systems, in line with their mandates and with government-endorsed plans for agriculture, rural development and sustainable food systems, including the 2030 Agenda and the Paris Agreement;

- The importance of **an enabling environment empowering PDBs** to effectively integrate climate resilience, environmental sustainability, and inclusion into their work. This includes enabling policy and regulations, PDB governance and institutional capacity, and effective and efficient provisions to allow PDBs to take the risks attached to their roles while remaining sustainable. It also includes opportunities for PDBs to contribute actively to national dialogues and planning for sustainable development in agriculture and food systems;

- The importance of **effective measures and instruments for risk management**, underpinned by new technology solutions, data systems, information flows, and partnerships, to support the work of PDBs and other actors in the financial ecosystem. In this context, PDBs affirm the importance of more effective use of guarantee and other de-risking schemes and facilities. They also affirm the important role of institutions that decrease information asymmetries hindering financial flows, such as credit bureaus. De-risking may include packages of services that improve the resilience of small-scale producers (e.g. information services, financing for adaptation, and products such as insurance);

- The need to **review the range of financial products and services offered by different types of PDBs**, to identify areas of mismatch between current offerings and the prospective needs of clients – including smallholder farmers (women, men, youth), agri- SMEs and financial intermediaries. This should include products and services in the areas of credit, insurance, trade and value chain finance, asset finance, financial literacy and consumer protection, set against a vision of the needed transformations in agriculture and food systems. It may consider issues of pricing, collateral, currency, overall design (e.g. green lines of credit to incentivize sustainable practices), delivery (including use of digital technology), and monitoring and evaluation;

• The need to **review the current financial investment product offerings of PDBs** (e.g. bonds and other securities), to increase their capacity to mobilize finance from impact-minded market investors. This requires strengthening institutional capacity in product design and product management, standardization of sustainable agriculture investment products to reduce transaction costs and achieve scale, and robust impact management tools and metrics. Special attention should be given to the need to expand investment products designed to mobilize capital for green investments in agriculture and food systems, such as agriculture green bonds and climate bonds, as well as other instruments to help countries deliver on commitments made through NDCs and the Paris Agreement;

• The importance of **closer collaboration among PDBs operating in different parts of the financial ecosystem**, and between PDBs and other actors in the financial sector more broadly, in order to advance investments that spur progress against the SDGs and Paris Agreement. In this regard, they note in particular the need for alignment among financial institutions to promote holistic frameworks to identify both investment needs and possible sources of revenue across different dimensions of food systems (e.g. environmental services such as carbon sequestration in addition to agricultural production);

• **The commitment of the PDBs to strengthen dialogue and collaboration with private investors**, in a perspective of building inclusive and competitive local financial markets, crowding in private capital, know-how and innovation, increasing resources for the SDGs through harmonized sustainable development finance frameworks and reporting, and pursuing financial and development additionality by following the Banks' Articles of Association. In this regard, the PDBs acknowledge in particular the need to expand the universe of investable opportunities in the sector, aggregate small-scale projects and transactions as well as different sources of revenue into investable portfolios, and de- risk and catalyse sustainable private capital;

• **The importance of sharing knowledge, particularly around data and learning** that can help strengthen local financial markets and de-risk the overall environment for SDG-aligned food and agricultural investment by private finance. In this context, PDBs recognize the importance of reporting on the climate risk exposure of their portfolios as well as to work together to promote standardization around sustainability and impact metrics for investment portfolios in food and agriculture;

• **The need to continuously cultivate the knowledge and skills of all operators** in the area of agricultural finance, with a view to addressing both long-standing and new challenges in the sector, and the opportunities that lie in identifying, strengthening, and/or better leveraging the capabilities of PDBs in training and capacity building. In this regard, they note the importance of building capacity to take advantage of digitalization to improve the business models of PDBs as well as of their clients and partners;

• **The importance of sharing good practices and achievements within and beyond the PDB community**. In this context, members of the Agriculture Cluster agree to continue to engage in knowledge-sharing and dialogue through an ongoing Working Group on Financing Sustainable Food Systems. This may work in collaboration with ongoing partnerships and coalitions of PDBs brought together through the Finance in Common Summit.

List of signatories (as at 10 November 2020):

- **African Rural and Agricultural Credit Association** (AFRACA)
- **Agricultural Development Bank** (ADB) Ltd, Nepal
- **Agricultural Development Fund** (ADF), Afghanistan
- **Asia Pacific Rural and Agricultural Credit Association** (APRACA)
- **Banco de Desarrollo Rural** – BANRURAL, Guatemala
- **Banco de Fomento Agropecuario** (BFA),
- **El Salvador Development Bank of Samoa** (DBS)
- **Development Bank of Solomon Islands** (DBSI)
- **Fideicomisos Instituidos en Relación con la Agricultura** (FIRA),
- **Mexico International Fund for Agricultural Development** (IFAD)
- **La Banque Agricole** (LBA), Senegal
- **Near East-North Africa Rural & Agricultural Credit Association** (NENARACA), Tanzania **Agricultural Development Bank Limited** (TADB)

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- **Agence Française de Développement** (AFD)
- **Association of bilateral European Development Finance Institutions** (EDFI)

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