European Fund for Sustainable Development (EFSD) Guarantee

Potential areas to be covered by Investment Windows

Title: Sustainable Agriculture, Rural Entrepreneurs and Agro-business

1. Policy Rationale

Background analysis: Potential Investment Windows in this area will contribute to achieving the United Nations Sustainable Development Goal #1 on ''Ending poverty in all its forms'', Goal #2 on ''Ending hunger, achieving food security and improved nutrition and promoting sustainable agriculture'', as well as Goal #13 on ''Taking urgent action to combat climate change and its impacts''.

Agriculture provides the main source of income for around half a billion smallholders in the world today. Agriculture is a major sector in the economic fabric of all EU Eastern Neighbourhood countries as it employs a large part of their population. Many of the countries of that region have large rural populations relying to some extent on small and fragmented land plots and the use of communal or state-owned pasturelands for their livelihoods. In the Neighbourhood South, the economic importance of the agricultural sector varies considerably among the different countries: it represents between 2 % and 4 % of the gross value added of Israel, Jordan and Lebanon respectively but a little over 15 % in Morocco and 20 % in Syria. Nevertheless, there was a broad decline in the economic importance of agriculture in the region in recent years[1].

In Africa, agricultural production has increased steadily over the last 30 years. However, there has been very little improvement in production factors (labour and land tenure). Agricultural growth in Africa is generally achieved by cultivating more land and by mobilising a larger agricultural labour force, which produces very little improvement in yields. More so than in other continents, Africa is dominated by family farming, 33 million farms of less than 2 hectares, account for 80% of all farms[2].

The agriculture sector is also coming under pressure from growing water scarcity, poor natural resource management and other climate change impacts that can affect production. These pressures imply that agricultural production will increasingly need to adopt production methods which make more efficient use of resources. Thus investment seeking to increase production will need to reflect these concerns by focussing on sustainable production systems and methods as drivers of growth in the agriculture sector.

Resilience to adverse weather events also needs to be enhanced both at the enterprise and country level.

[1] Eurostat: http://ec.europa.eu/eurostat/statistics-explained/index.php/Agriculture_statistics_North_Africa_and_Eastern_Mediterranean.
[2] NEPAD, Agriculture in Africa, transformation and outlook, 2013.

While investment in agriculture in countries in Africa and in the Neighbourhood regions is slightly increasing, initiatives to support the investment capacity of small producers and rural MSMEs remain largely insufficient. This is not only due to the inherent high risk in agricultural production (environmental conditions, quantity and quality of produce, prices), but also to higher risks associated with small producers (limited technological and innovative capacities, market inefficiencies and disruptions, limited access to financial services and markets, etc.), as well as the high cost of doing business in small rural markets. Banks and financial institutions also have less experience in providing financial services in this sector and often lack the appropriate tools to assess smallholders' creditworthiness. Across both regions, liquidity for working capital purposes and long-term capital expenditure financing is lacking as a result of the absence of suitable policy frameworks and financing instruments. Capital access has proven a persistent challenge over the years – lending to the 33 million smallholder farms in Sub-Saharan Africa, amounts to $700 million per year, thus around $21 per farm. Of this $600 million is provided by microfinance institutions and only $100 million by State Banks[3]. Less than a quarter of the financing needs of smallholder farmers in developing countries are met, leaving an annual financing gap of more than US$150 billion (according to the Initiative for Smallholder Finance[4]). It is indicative that only 4% of equity investments in Africa between 2011 and 2016 were in the food and agriculture sector[5].

Investment windows developed in this area will respond to the lack of financing mechanisms adapted to farmers and agri-entrepreneurs, particularly for smallholders, cooperatives and agricultural MSMEs, in the aim of promoting inclusive and sustainable growth. The potential windows may also explore mechanisms to increase the availability and affordability of insurance solutions for farmers as well as mechanisms to enhance food security at country level.

EU Policy objectives: In line with EU policy commitments concerning food security challenges[6], resilience[7], nutrition[8] and sustainable agriculture and food security[9], gender equality[10] support under this window will promote the emergence of investments designed to create sustainable jobs in agriculture and income-generating activities in rural and peri-urban areas, and addressing relevant risks in order to ease and extend access to capital and increase investments.

A value chains approach will be adopted, focussed upon income-generating activities for private sector operators and job creation in rural and peri-urban areas, developing and

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[3] Initiative for Smallholder Finance: A roadmap for growth: positioning local banks for success in smallholder finance", 2013.

[4] Initiative for Smallholder Finance, RAF Learning Lab, and Dalberg, "Inflection Point: Unlocking growth in the era of farmer finance," 2016.

[5] A growth engine: Trends and outcomes of private equity in Africa, The Economist Corporate Network, 2017.

[6] COM(2010)127 final, "An EU policy framework to assist developing countries in addressing food security challenges".

[7] COM(2012)586 final, "The EU approach to Resilience: Learning from Food Security Crises".

[8] COM(2013)141 final, "Enhancing Maternal and Child Nutrition in External Assistance: an EU Policy Framework"

[9] COM(2017) New European Consensus on Development

[10] COM(2017) New European Consensus on Development

diversifying agricultural production, and promoting the accompanying local skills. Sustainability of investments represents an integral part of the actions, and special attention will be paid to its economic, environmental and social dimensions. This includes full respect of due diligence requirements, such as those relating to land tenure.

Geographic area: Sub-Saharan Africa and the Eastern and Southern Neighbourhood regions.

Domain: All agriculture-based production in its broader meaning can be covered, notably including agriculture, livestock, forestry, fisheries, aquaculture and related agricultural MSMEs.

Sectors of intervention: The value chain forms an important element of the operations to be funded under this window. Proposals should reflect investment opportunities for the private sector arising at any point on the value chain, provided that the investment promotes sustainable and inclusive growth. This allows for a broad view of eligible sectors and a comprehensive approach to eligible activities, including production, post-harvest, aggregation and marketing, as well as trade facilitation and promotion., with links to smallholders and agricultural MSMEs. Cooperative sector development and domestic-oriented production agriculture will also be supported. Financial instruments proposed should go clearly beyond partner financial institutions traditional product ranges, including potentially insurance solutions.

2. Operational Concept

The EFSD guarantee shall be structured in such a way as to promote innovative financing solutions promoting private funding sources, in order to ensure sustainable production and increased food security across Sub-Saharan Africa and the Neighbourhood regions.

The guarantee seeks to bring in private and cooperative sector investment with both its skills and funds. The level of coverage provided to individual operations could be differentiated to reflect a focus on the disadvantaged, the young and women, or certain geographic areas which are considered more difficult to service.

Type of operations: Different types of eligible operations may be considered, including but not limited to:

- Credit enhancement for investment funds attracting private institutional investors into developing country investments in agricultural value chains as well as support to cooperatives.
- Risk mitigation mechanisms for commercial banks and non-banking financial institutions for medium-long term lending towards investments in agricultural value chains.
- Financial guarantees to cover part of the portfolio risk of an investor or group of investors promoting comprehensive value chain investments, combining TA for skill development and financing mechanisms.

- Guarantees to mitigate risk attached to launching new financial tools for agricultural investment promotion.

The operations listed above are indicative and non-prescriptive/exhaustive. Priority will be given to innovative initiatives clearly going beyond existing products available in the market and optimising leverage and cost efficiency, mobilising private funding sources and in countries/regions where private sector participation is low. Cooperative sector development will also be encouraged to help small holders or landless farmer mutualise risks.

Type of risks: Risks to be mitigated may include: i) Commercial risks (payment risk, off-taker payment no honoured, off-take bankruptcy, etc.), ii) Political and country risk (expropriation, coup d'état, civil war, etc.), iii) Legal and regulatory risk (change in law, cancellation of license, tariff adjustments, etc.), iv) Currency risks (e.g. exchange rate fluctuation, convertibility, transferability, etc.), v) Climate change and environmental risks (e.g. droughts, flooding, extreme weather events, temperature rises, etc.) and vi) Disease and pests; sanitary and phytosanitary risks.

Expected Additionality*:* i) Improved potential to mobilise both local and international private sector investment; ii) Catalysing and demonstrating the effect of sector reforms; iii) Improved project sustainability via project structures designed to facilitate the commercial scale up and replication of financially sustainable projects; iv) Innovation through the demonstration of the viability of new business models or technologies, lowering market barriers and changing entrenched behaviours; v) Decent job creation with the promotion of good labour standards, gender equality and improved working conditions in the sector; and vi) sound due diligence procedures promoted.

Envisaged Impact: i) Increased agricultural yields, output and income; ii) Increased and better distributed added value in value chains; iii) Decent job creation; iv) Gender Equality v) Improved productive environment and sustainability (natural resources management, such as land and water use, management and conservation); v) Improved food security.

Complementarity/Risk of potential overlapping with other Investment Windows: This window is closely linked to the window addressing ''MSME Financing'', which can equally address some activities relating to agricultural value chains, as well as ''Digital for Development''. Outreach to these windows will be ensured.

3. Supporting policy actions

Links will be established between the investment pillar (pillar 1) and enabling policies (pillar 3) to foster conducive business environment and investment climate in agriculture as well as technical assistance to strengthen this dialogue (pillar 2).

The most relevant policy actions may relate to:

- A wider framework conducive to private sector investment, including both regulatory aspects in order to facilitate private investment, as well public investment policies, such as for improved market access and skills development.
- Implementation of a robust framework for analysing and monitoring value chains (Value Chain Analysis for Development), established by the Commission and implemented through a network of European knowledge centres and universities.
- Technical capacity building, to be defined at the proposal stage, reflecting the main risks to the success of the investment.
- Working towards progressive alignment of the agricultural products standards with the EU quality, technical, sanitary and phytosanitary standards as well as with environmental protection measures, thereby benefiting local customers and boosting exports to the EU and beyond.