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Investing in rural people

United Republic of Tanzania

Bagamoyo Sugar Infrastructure and Sustainable Community Development Programme

Addendum

Executive Board — 116th Session
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For: Information

Bagamoyo Sugar Infrastructure and Sustainable Community Development Programme

Addendum

1. An updated President's report on the Bagamoyo Sugar Infrastructure and Sustainable Community Development Programme (BASIC) for the United Republic of Tanzania has been submitted to the 116th session of the Executive Board. As requested by the Board, this addendum reports on the consultation process and on the sugar investment since the finalization of the updated report. It also provides clarification on the programme approach and how other issues raised in comments by Ireland have been addressed in the updated report.

2. Consultation process. Since September 2015, IFAD has undertaken an intensive consultation process at different levels with regard to BASIC. The IFAD Country Office in the United Republic of Tanzania has held discussions with the Government, the private-sector partner, and with the Swedish International Development Agency (Sida), the African Development Bank (AfDB) and a number of other development partners. IFAD Management has met with the management of Sida and the Ministry of Foreign Affairs in Stockholm (26-27 October), and AfDB management in Abidjan (14-16 October). Following the national elections on 25 October, the Ministry of Finance of the United Republic of Tanzania and the Presidential Delivery Bureau of Big Results Now convened a discussion about BASIC. The meeting was held on 17 November and was well attended by high-level government authorities and seven development partners.

3. Status of the private-sector investment project. Estimates for the total investment package for the private sector are fluid and depend on the pace of the investment over time and the technical choices made regarding expansion of the mill and construction of a distillery. The total financing package is currently estimated at US$450 million, which could be undertaken in two phases with the first phase requiring about US$350 million. For the first phase, the private-sector partner is expected to provide 40 per cent of the equity required (US$140 million) while the AfDB-led consortium will finance 60 per cent (approximately US$210 million) with a commercial loan of US$100 million from their own resources plus the additional debt consortium financing that will be mobilized by AfDB.

4. AfDB financing for the private-sector partner and the public-sector programme. The AfDB Executive Board approved a commercial loan of US$50 million to the private-sector partner in April 2014 and earmarked another US$50 million for the programme. AfDB management has informed IFAD that their public-sector intervention for BASIC will be submitted to the AfDB Board when the remaining conditions for effectiveness of the commercial loan have been met.

5. The commercial loan is awaiting final resolution of some policy and operational agreements. The AfDB has kept their commercial loan active because of the Government of the United Republic of Tanzania's strong commitment to the investment and the steady progress being made in 2015, as summarized below.

    (a) Sugar subsector policy environment. The key issue was the need for an enabling sugar policy framework both in the United Republic of Tanzania and within the East African Community (EAC) to ensure the financial viability of developing the domestic sugar subsector. With the approval of the new national sugar regulations in May 2015 and the adjustment of the minimum import tariff for the EAC in July, the financial viability of the project is assured and the private-sector partner has been able to proceed with mobilizing a strategic investment partner.

(b) Investment incentives for the agriculture. The Tanzania Investment Centre has provided specific incentives for the private-sector partner under the strategic investment category. The new Finance Bill 2015/2016 also provides special incentives for which the project qualifies.

(c) Operational agreements between the Government and private-sector partner. AfDB has provided legal technical support to the Government to assist in the drafting of the legal implementation and shareholding agreements with the private sector. Draft agreements have been prepared and are expected to be finalized once an agreement with a strategic investment partner acceptable to the Government, AfDB and Sida, is in place.

(d) Equity investor. In mid-November, the private-sector partner reported that it had identified and concluded an initial agreement with a strategic investment partner which will bring technical expertise and financing under an equal partnership share of the company – 45 per cent/45 per cent – while the Government will hold the remaining 10 per cent through a land-for-equity agreement. However, given that the concerned parties (including the Government of Sweden and the AfDB) have expressed concerns about the delayed financial closure by the private sector partner and prefer looking for other partners, IFAD has started working with them to pursue those alternatives as explained below.

6. At meetings with AfDB, Sida and IFAD on 6 and 17 November, the Government confirmed its strong commitment to ensuring that the sugar investment goes ahead as planned. Now that there is a supporting policy environment for the sugar investment, the enabling conditions are in place to move forward with the pending actions, in line with AfDB requirements. The current target for reaching financial close is the third quarter of 2016. However, even if tangible progress can be made with an equity investor by then, the investor may still need more time to finalize the deal and start operations.

7. As the private-sector partner has not yet been able to mobilize the required equity financing, IFAD is also looking into two other scenarios, either: (i) an alternative investor is found, e.g. from amongst the four existing incumbent sugar industrialists in Tanzania; or (ii) the investment in the nucleus estate and the mill does not materialize and the project will be revised accordingly. If the private-sector investment cannot be secured, then the outgrower programme will be reformulated or partly reduced in scope. Strong safeguards are in place in the negotiated IFAD financing agreement concerning the required conditions precedent to withdrawal and for suspension. Programme activities for component 2, climate-resilient community development, could start as soon as the Government has recruited key programme staff and irrespective of the sugar investment. Activities for the component 1, outgrower development, will only be initiated if and when financial close is reached.

8. Cost and time for preparing the investment. Inclusive business models that involve local producers in direct foreign investment in agriculture are the most successful ways to generate widespread benefits for local communities. According to a recent review of best practices in investment design by the World Bank and the Food and Agriculture Organization of the United Nations (FAO), the most successful inclusive business model for foreign direct investment in agriculture over the past 50 years has been the nucleus estate-outgrower model with a processing facility.[1] This is the model that will be used under BASIC. The nucleus estate-outgrower

[1] Impacts of Foreign Agricultural Investment on Developing Countries: Evidence from Case Studies, FAO commodity and trade policy research working paper no. 47, FAO, Rome 2014; Investing in Agribusiness: a retrospective view of a Development Bank's investment in agribusiness in Africa and Southeast Asia and the Pacific, World Bank, August 2013; and Review of smallholder linkages for inclusive agribusiness development: Good practices in investment design, prepared under the FAO/World Bank Cooperative Programme, Rome 2013.

model is the least risky for farmers because: modern cropping technologies are validated by the private sector and then shared with farmers; the private-sector partner often provides inputs at cost, ensuring quality, quantity and value for money; and the nearby processing facility assures farmers of a ready market at a known price.

9. The initial capital required for an inclusive nucleus estate-outgrower model is considerably higher for the investor than a stand-alone investment. Long lead times are inevitable and the costs are high because: (a) the investors must engage with local communities from the outset to build ownership and understanding about their participation as organized outgrowers; (b) the processing facility must be expanded by 30-50 per cent to handle the production from local farmers; (c) detailed feasibility and design studies must be carried out in order to mobilize financing; (d) crop varieties and technologies must be tested; and (e) agreements must be reached with the Government. It is more risky for the private sector to make an investment with the expectation that one third or more of the farm yields to be processed will come from local farmers rather than its own production.

10. The World Bank has developed the term “patient capital” to characterize the long lead time, high transaction costs and innovation required for the private-sector partner in the nucleus estate-outgrower inclusive business model. In the long-run, patient capital is expected to be rewarded by a more stable social setting and lower risks because of local acceptance and economic growth for neighbouring communities.

11. Bagamoyo sugar project. The development of the inclusive business model for the Bagamoyo sugar project reflects the conclusions of the FAO and World Bank studies. The long lead time required is similar to that of other nucleus-outgrower projects and indicative of the level of preparation needed. The preparatory work has included: the operation of a 200 hectare cane seed farm for varietal selection and multiplication since 2007; hydrology studies; detailed infrastructure design studies to ensure that the nucleus estate and sugar-processing mill are compliant with International Organization for Standardization (ISO) 14000 standards; development and approval of a resettlement action plan and an environment and social impact assessment for the nucleus estate; feasibility studies for the outgrower programme; initial development work with outgrower groups and neighbouring villages to prepare land-use plans.

BASIC

12. Programme approach. The programme approach for working with target groups will be flexible and based on the principle of free, prior and informed consent at each step of implementation. Through village consultations, BASIC will assist target groups in evaluating available options for the legal establishment of production groups, and in making decisions about how they wish to be registered and hold their land rights, thus empowering target groups to undertake self-defined and self-organized initiatives. Various options will be considered during the village consultations. Other key issues to be addressed as part of the village consultation and decision-making process are: (a) current land ownership; (b) technical requirements and costs of farming sugarcane; (c) mechanisms for members to exit an outgrower group; and (d) measures for safeguarding against elite capture.

13. Land tenure. Under BASIC, IFAD and AfDB will cofinance the sugarcane outgrower programme, and IFAD will finance sustainable village investments in the wider community. Under BASIC, the outgrower programme design has been strengthened by placing land-titling at the start of the community mobilization process before any physical investments are undertaken. For all 27 villages in the programme area, BASIC will support boundary surveys and adjudication according to the mandated national participatory process, to enable villages to obtain their land certificates and establish village land offices. Once this step has been successfully completed,

villages will be able to issue certificates of customary right of occupancy to individuals or groups to provide them with tenure security as a first step in accessing programme-supported financial incentives and investments.

14. The design of the outgrower development component is very advanced compared to the wider community component. This is because of the work undertaken by the private-sector partner since 2011 in support of the villages which, as a result, are now well placed to participate as sugarcane outgrowers. Drawing upon the lessons learned under the Lower Usuthu Smallholder Irrigation Project (LUSIP) in Swaziland and the Vegetable Oil Development Project (VODP) in Uganda, the field mobilization, initial land surveying and boundary delineation work has been the first step in the mobilization process and is well appreciated by the local communities. The land surveys and preparation of participatory village land-use plans, which are required under the existing national policy framework, were being financed out of a US$18 million loan from Standard Bank to the private-sector partner, backed by a 90 per cent loan guarantee from Sida. Since the support was terminated before the achievement of objectives, some of these activities, albeit on a much reduced scale, will now be supported using the IFAD implementation readiness grant of US$450,000.

15. Impact of uncertainty about outgrower programme and risk of elite capture. The greatest risk posed by delayed conclusion of the financing package for the construction of the nucleus estate and mill is uncertainty being experienced by the future outgrower villages. Activities agreed with farmers to begin building their business and management skills for growing sugarcane are at a standstill, partly undermining the credibility of the programme with the local communities and political authorities. If communities feel that the opportunity to become sugarcane outgrowers may be lost, local people will be more tempted to sell their land. This will compromise the potential socio-economic benefits of the investment and leave a gap for possible elite capture should the programme start much later or fail to start at all.

16. Cost of BASIC investments. The total cost of BASIC is US$136.5 million, with IFAD financing about 41.5 per cent of that amount. The high cost per beneficiary household is a result of the low level of infrastructure development in Bagamoyo District and the high cost of land preparation for the investment. In many countries, infrastructure development would be part of a separate programme in support of an agricultural development initiative. However, given the very low level of public investment in the programme area, the Government has requested that BASIC undertake the infrastructure investments. These are the principal reasons for the high costs per beneficiary household and for the considerable differences in total programme cost per household of US$28,600 for component 1, US$4,827 for component 2 and US$5,500 under the IFAD loan. Because of the substantial cofinancing from partners (IFAD's share of financing is 41 per cent) leveraged by the programme, costs per beneficiary household overall appear high.

17. The cost of land preparation, installation of irrigation equipment, farm machinery and crop establishment for outgrower development is about US$10,000 per hectare, which is in line with costs in Kilombero (United Republic of Tanzania), Malawi and South Africa for the development of irrigated sugarcane, not including the cost of intensive farmer capacity-building and mentoring, support to national sugar institutions and long-term environmental monitoring. The cost of land preparation, i.e. transforming potentially arable land into arable land that is ready for investment and cultivation, contributes to the high investment cost.

18. IFAD's experience with the oil palm production (VODP) in Uganda is significant in that considerable time (more than six years) was needed to ensure that all the organizational arrangements were in place and the costs per beneficiary were very high because of the cost of the required infrastructure. The income earned for oil

palm has within a 10-year period literally bootstrapped one of Uganda's poorest districts up to among the top seven most prosperous districts in the country. Similar income and development gains were achieved by LUSIP in Swaziland. BASIC is expected to increase beneficiary household income four- to tenfold, thus creating huge knock-on development incentives for rural communities not directly targeted by the programme to support their economic transformation.