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FOR THE

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FINANCING DEVELOPMENT – THE RURAL DIMENSION

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TABLE OF CONTENTS

BOXES

I. INTRODUCTION

1. Still today, more than one fifth of humanity live in conditions of extreme poverty, struggling for survival on less than one dollar per day. Recognizing that this is neither acceptable nor inevitable, world leaders at the United Nations Millennium Summit in September 2000 made a commitment to reduce extreme poverty by half by the year 2015.

2. IFAD for its part, throughout nearly a quarter century of operations, has focused on rural poverty and on developing innovative approaches to help poor men and women to raise their incomes and output and to work their way out of poverty. This is reflected in IFAD's mission statement "Enabling the rural poor to overcome their poverty" and inspires the new Strategic Framework for IFAD 2002-2006.

3. IFAD's *Rural Poverty Report 2001* highlights that the majority of the extreme poor live in rural areas and depend on agricultural and related activities for their livelihoods. Although international development cooperation is increasingly giving priority to poverty, it has not yet fully focused on reaching the poor where they live – in rural areas – and on providing them with the means to strengthen their sources of livelihood. As this document emphasizes, international support for agriculture has in fact fallen sharply over the last decade, and overall development assistance itself has declined substantially. It is time to recognize that if poverty is to be reduced substantially, the problem has to be addressed where it is, and the volume and direction of development cooperation adapted accordingly.

4. The United Nations International Conference on Financing for Development (FfD), to be held in Mexico in March 2002, will provide the first major opportunity after the Millennium Summit to bring together the different components of financing and evolve a consensus on the resources required to achieve the Millennium Development Goals (MDGs). In this regard, it is important not only to address the volume and effectiveness of financing for development, but also to look at the key strategic areas where attention and resources need to be channelled. Given the centrality of rural poverty in the overall 'poverty problematique', and the importance of agriculture as a source of employment and livelihood in poor countries, the rural sector should be one of the focal areas of the strategy to accelerate development and poverty reduction. It is for this reason that the theme "Financing Development – The Rural Dimension" was chosen for this year's Governing Council.

5. Given current trends in official development assistance (ODA) and private financial flows, and recognizing that development has to be based on domestic resources and capacities, this document looks at how enhanced international development cooperation could support a wide-based development process and more rapid poverty reduction. In this connection, it argues that for many poor countries, channelling external support and domestic investment to the rural sector constitutes one of the most effective ways to promote faster economic growth and sustainable development, as well as being the most direct means to reduce poverty, eradicate hunger and conserve the environment. Governors are invited to address these themes and thus highlight the relevance and importance of the rural dimension in financing development.

II. ENDING POVERTY AND HUNGER – A NEW CONTEXT AFTER THE MILLENNIUM SUMMIT

6. **More than one fifth of the world's population live in extreme poverty.** Some 1.2 billion people live on less than one dollar a day. About 75% of the poor, or 900 million people, live in rural areas and depend on agriculture and related rural crafts, trade and services for their livelihoods. Among the poor, women and households headed by women are the most vulnerable and account for a growing majority of the extreme poor. This 'feminization of poverty' is deeply worrying for the well-being of future generations.

7. **At the Millennium Summit, the international community took up the challenge to halve poverty and hunger by 2015.** In September 2000, world leaders at the Millennium Summit undertook to "halve, by the year 2015, the proportion of the world's people whose income is less than one dollar a day and the proportion of people who suffer from hunger". Low consumption is only one dimension of poverty: it is linked to other dimensions such as malnutrition, illiteracy, short life expectancy, insecurity, powerlessness and low self-esteem. Aware of the multi-dimensionality of poverty, Member States of the United Nations adopted a multi-targeted approach, including development, education and health goals in the United Nations Millennium Declaration, the apex of which is the poverty reduction goal.

8. **Achieving the MDGs requires more rapid, broad-based economic growth.** The rate of poverty reduction during the last decade was substantially lower than that achieved in the previous two decades. In fact, it was less than one third the rate needed to halve extreme poverty worldwide by 2015 – and in sub-Saharan Africa, six times less. In the case of the latter, an estimated rate of gross domestic product (GDP) growth of 7% a year is needed to achieve the Millennium poverty target. In many low-income countries, given the importance of the rural sector in employment and output, the best –sometimes the only – way to raise the overall rate of economic growth and promote broad-based and sustainable development is through more rapid rural development.

9. **Reaching the MDGs will require sound policy and governance and additional financing on highly concessional terms.** Development must come from within the countries themselves, based primarily on domestic capacities and resources mobilized through a self- sustaining process of production, savings and investment. In this context, the role of national policies cannot be overemphasized. Yet, an increasingly interdependent world requires enhanced collaboration among, and coordinated action by, all stakeholders, private and public, to foster a sustainable growth process and address the long-term challenges of financing development. Halving poverty and hunger by 2015 will require establishing a policy framework that encompasses, on the one hand, domestic policies that allow poor groups full and fair access to opportunities opened up by reform programmes and, on the other, international policies that improve access to export markets, enhance resource transfers to developing countries and promote international monetary and financial stability.

10. **The FfD conference comes at a particularly opportune time to focus world attention on an agenda for action to attain the MDGs.** The FfD conference is a major opportunity for the international community to translate the political commitments made at the Millennium Summit into concrete action. How best to mobilize the resources necessary to achieve the goals and determine the priority areas for allocating these resources should be at the centre of the FfD conference's deliberations. A key aspect in this regard is how to enhance the impact of development cooperation so as to reach the poor, where they live, and to mobilize greater support for their own efforts to earn a viable livelihood and thus work their way out of poverty.

III. LOOKING AT THE NUMBERS AND BEYOND – THE POOR AND THE CHALLENGES FACED

11. **Most of the world's poor live in Asia and Africa, but there is significant poverty elsewhere.** Of the 1.2 billion people living in extreme poverty, more than two thirds live in Asia and the Pacific; South Asia alone accounts for nearly half of this group. About one fourth live in sub-Saharan Africa, where people in extreme poverty account for about half of the population. Poverty, life expectancy and related social indicators have actually worsened in sub-Saharan Africa in recent years under the assault of civil strife, the AIDS pandemic and natural disasters. There are also serious pockets of poverty in Latin America and the Caribbean and in the Near East and North Africa, especially in uplands and other marginal areas in the former, and in semi-arid zones in the latter.

12. **Some 75% of the world's poor currently live in rural areas, and rural poverty is likely to predominate for decades to come.** Countries use different national consumption/poverty thresholds and rural-urban borderlines to estimate poverty. Taking into account these considerations, IFAD's *Rural Poverty Report 2001*[1]. and World Bank studies, such as its 1997 *Rural Development – from vision to action,*[2] estimate that about three quarters of the extreme poor currently live in rural areas. Even under high assumptions of economic development and rural-to-urban migration, 60% of the extreme poor are likely to be in rural areas in 2020 and 50% in 2035.

13. **Who are the poor and what challenges do they face?** Most of the poor are smallholder farmers, landless agricultural labourers and other poor rural groups such as artisans, fisherfolk and forest dwellers. Rural women, tribal and indigenous peoples and populations living in dryland, resource-poor zones prone to degradation are particularly vulnerable to both chronic and transient poverty. The *Rural Poverty Report 2001* underlines that among the main elements entrenching poverty are the lack of access of poor groups to assets such as land and water, technology, equitable markets, financial services and supportive institutions. Moreover, while enhancing the poor's access to productive inputs is essential, creating the conditions in which they can participate in local decision-making, what is sometimes called the *empowerment of the poor*, is crucial to enable them to become agents of change themselves.

14. In **Asia and the Pacific**, where over 800 million people are poor, poverty is mainly concentrated in rural areas. Nearly 40% of the rural poor are found in less favoured areas – remote uplands and mountains, marginal coastal areas and drylands. The most common feature of the rural poor is lack of access to productive assets. Major constraints facing small and marginal farmers include lack of access to appropriate technology for rainfed and marginal areas and to financial and other support services. About 70% of the world's indigenous peoples, many of whom are particularly vulnerable, live in Asia and the Pacific. Women run an especially high risk of being extremely poor, often facing great difficulties in raising their incomes and lifting themselves out of poverty. Improving women's ownership and control of assets, reforming the property and usufruct rights of marginalized minorities and indigenous peoples, and expanding the capabilities of the poor and the vulnerable are essential to reduce rural poverty in the region.

15. In **Africa**, there are 290 million poor, the large majority of whom live in rural areas. In Western and Central Africa, poverty is mostly concentrated in the drought-prone Savannah agro-ecological zone, which depends on cereals, cotton, groundnuts and livestock. Poverty is related to household size, education and the sex of the household head. The poorest households are subsistence food growers without livestock. In Eastern and Southern Africa, the incidence of poverty is highest among smallholder farmers, herders and fisherfolk. Nonetheless, the growth potential of smallholder agriculture is quite high, providing that measures are taken to ensure more equitable access to land and water, and the development of market linkages and infrastructure.

16. In **Latin America and the Caribbean**, according to the World Bank poverty assessment methodology, there are 78 million poor, whereas poverty estimates from the Economic Commission for Latin America and the Caribbean (ECLAC), using a different methodology, place the number of poor at 211 million, with 77 million in the rural areas.[3] Indigenous groups and peasant communities constitute the largest groups of the rural poor. Smallholder farmers in arid and semi-arid regions and landless workers throughout the region are other substantial poor groups. Some 64% of the rural population in the region live below the poverty line. Rural impoverishment is strongly associated with the gradual loss of productive land, reflecting abuse, discrimination, civil strife and limited information regarding property rights. Other factors affecting rural poverty are low public investment in education and health in rural areas; lack of

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1 IFAD, *Rural Poverty Report 2001*: *The Challenge of Ending Rural Poverty*, IFAD, Rome, 2001.

2 World Bank, *Rural Development – from vision to action*, Environmental and Socially Sustainable Development Studies and monograph series; no 12, The World Bank, Washington, D.C., 1997.

3 ECLAC, *Social Panorama of Latin America, 2000-2001*, ECLAC, Santiago, 2001.

investment in rural infrastructure; insufficient delivery of agricultural support services; and failures in dealing with heterogeneity, gender and ethnicity in rural areas.

17. In the **Near East and North Africa**, where there are 55 million poor, the incidence of poverty is higher in rural areas. The major groups of the rural poor include rainfed farmers, artisan fishermen, pastoralists and wage labourers. The highest incidence of poverty is found among displaced persons, woman-headed households and ethnic minorities. Inadequate access to land and water and the negative effects of droughts and floods have a major impact on the livelihoods of the rural poor. They face such challenges as water and land constraints, small farm size, technological constraints, and the lack of informal or community-level financial institutions. Low population density makes it more difficult to market output and to provide access to education and health services. Civil-society institutions (marketing cooperatives, savings and credit associations and local resource management committees) that allow interaction with modern political, administrative and economic institutions are underdeveloped.

18. In the **transition countries of Central and Eastern Europe**, where there are between four and 12 million poor, depending on the poverty line parameters chosen to account for the characteristics of some middle-income countries, there is significant poverty in all countries in rural areas – especially among pensioners and farmers who cannot produce enough food for self-sufficiency. The rural poor are mostly small-scale farmers, wage earners, woman-headed households and displaced persons, with the most severe poverty found in upland and mountainous areas. Poor farmers are characterized by small farm size, fewer livestock, and irrigation or water control on only a small proportion of their land. Since there are few off-farm income opportunities in upland areas, most of the men migrate, leaving women, the elderly and children on the farms. The breakdown of institutions has been at the root of poverty at the household level, particularly in rural areas, where there is less access to medical care and education than in urban areas. However, in most of the transition countries, literacy rates are high, as is life expectancy. Moreover, child mortality and population growth rates are well below the developing-country average.

19. **In all regions, defending the environment requires improving the asset base of the poor and developing effective community-based institutions**. Experience demonstrates that the alleged conflict between poverty and the environment is a false problem. Improved access to and control of different types of assets enables the poor to use resources more sustainably, raise their output and reduce their vulnerability. Equally important is developing effective community-based institutions for the management of common resources. Creating the conditions that allow the poor to identify their problems and develop their own solutions, enabling them to become agents for change, is the key to environmentally sustainable development and poverty reduction. Evidence from Africa, Asia and Latin America shows how communities can strongly influence the environmental impact of economic activities located in their areas.

IV. THE MILLENNIUM DEVELOPMENT GOALS AND THE FINANCING FOR DEVELOPMENT CONFERENCE

20. **Six main themes have been agreed on for the FfD Conference.** These are: (i) mobilizing domestic financial resources for development; (ii) mobilizing international resources; (iii) integrating developing countries into the world trade system; (iv) increasing international financial cooperation; (v) promoting debt reduction and viability; and (vi) enhancing the coherence of the international monetary, financial and trading system in support of development. While the Conference concentrates on these separate themes, its focus of course should be on the attainment of the MDGs. The fact that the bulk of the poor live in rural areas, and will do so for the near future, underlines the centrality of rural poverty and rural development in the ‘poverty problematique’. The financing and policy requirements of the rural sector thus merit specific attention and priority. Indeed, “Financing Development – The Rural Dimension”, the theme of the Governing Council, will become increasingly crucial as the international community seeks to implement the commitments made at the Millennium Summit.

21. **Agriculture and the rural sector, as a source of food, raw materials, employment and markets, have crucial backward and forward linkages with virtually every other part of the economy.** In fact, the poorer the country, the larger the share of agriculture in GDP, total employment and exports. Promoting agriculture and rural efficiency and eliminating the bottlenecks that these sectors face in such countries should therefore be at the core of a development strategy that bases poverty reduction on national assets and capabilities. Yet, paradoxically, even as the international focus on poverty has strengthened over the last decade, the share of ODA going to agriculture and the rural sector, where the bulk of the poor live, has decreased, while total ODA itself has declined significantly. Consequently, the volume of ODA for agriculture has fallen by nearly 50%, from USD 4.9 billion in 1988 to USD 2.5 billion in 1999.[4] In parallel, domestic resources for agriculture and other productive activities of the rural poor have dropped in many developing countries. In sub-Saharan Africa, for example, government expenditure on agriculture has fallen from 6.2% of total expenditure in 1990 to 3.9% in 1998; in South Asia, from 8.4 to 5.4%; in Latin America, from 3.2 to 1.9%; and in the Near East and North Africa, from 4.1 to 1.1%.[5]

22. **These declining trends in investment in agriculture and the rural sector – domestic and external – must be reversed for the Millennium Summit poverty goal to be achieved.** Together with appropriate policies that encourage savings, investment and output, substantially greater resources must be mobilized to finance the development efforts required. As noted earlier, in the medium run, sustainable development has to be – and can be – based on growing domestic savings and investment, especially private investment. Nonetheless, external resources have often played a significant part in launching the development process in many countries. One example is provided by the United States in the nineteenth century, when British long-term capital financed the growth of the railway system and helped to open up the farmland of the Midwest. Such external resources can come from foreign direct investment (FDI), trade exchanges and development assistance. However, FDI, like its domestic counterpart, requires a certain level of human skills, transport, communications, power and other physical infrastructure, together with a supportive policy and legal environment. The skewed geographic distribution of FDI underlines this point. Rapid growth of exports, on the other hand, requires better market access, and growing domestic supply capacity to take advantage of such access.

4 Organisation for Economic Co-operation and Development (OECD) data.
5 International Monetary Fund (IMF), Government Financial Statistics, 2000.

Box 1: Other Forms of Financing Access to Land, Water and Related Productive Assets

Among the main elements that entrench poverty are the lack of access by poor people to assets including land, water, technology, markets, financial services and supportive institutions. While mainstream efforts to finance development should provide for the resource needs of the rural poor, the available financing can be complemented by newly emerging innovations.

Debt for agrarian reform. The Jubilee Debt Campaign of the late 1990s aimed to link two central pillars of social justice. The biblical references in Leviticus 25 advocate that the jubilee year is a time when the poor are to be freed of their debts and land is be returned to the people. In respect of the role of citizen movements in catalysing debt relief and the growing understanding that secure access to land is essential to many poverty reduction strategies, it is important for the international community to incorporate access to land and security of tenure as activities eligible to access debt for development funds.

The collateral value of secure land tenure. Secure land titles can improve access to credit and provide small-scale producers with the incentives to invest in sustainable land management practices, thereby increasing household incomes and expanding the rural economy. While security of tenure is not a panacea for expanding rural finance in all areas, there is significant scope to combat poverty using collateral-based financing.

Remittances from migrants and overseas workers. Researchers and development professionals have started to acknowledge that remittances can provide a wide range of benefits beyond consumption to include seed capital for small-scale producers, financial services and the establishment of development funds. The growth trend for remittances shows that these resources could outstrip financing by multilateral financial institutions. Innovative mechanisms are being tested that provide incentives for migrants to set aside a portion of each remittance into a development fund, using special financial instruments to reduce the transaction costs and channel gains to development objectives and forming hometown associations of migrants to pool monies into a critical mass needed for substantial poverty reduction programmes. A recent study involving Colombia, the Dominican Republic, El Salvador, Guatemala and Mexico found recorded remittances of USD 8 billion with an average 26% annual growth rate. Several years ago, Mexican banks began offering ‘remittance bonds’ backed by money sent home from migrant labourers. Also, the Mexican state government of Guanajuato is promoting investment in garment maquiladoras to its émigré home town associations.

Source: The Popular Coalition to Eradicate Hunger and Poverty.

23. **Development cooperation in the form of ODA, used imaginatively and effectively, can play a crucial catalytic role.** ODA, unlike FDI, is within the realm of government decision-making. Used properly, ODA can leverage and combine with domestic investment to help foster the institutional and physical infrastructure necessary to attract private investment and thus jump-start a sustainable and dynamic process of private investment and growth. It has to be underlined in this context that the role of ODA is not to substitute private resources, whether national or international, but to contribute to creating the policy and material conditions in which they can be mobilized and used effectively to promote sustainable development. In IFAD’s experience, microfinance and other rural financial institutions are particularly important in this context. Such institutions can mobilize very substantial domestic resources for the productive activities of the poor – including the resources of the poor themselves. They can also serve as a cost-effective means to channel assistance to the poor (see Box 2).

Box 2: The National Microfinance Programme in India

Over the last two decades, IFAD has collaborated with the Government of India and other official and non-official Indian institutions to promote microfinance in the country. The success of these initiatives led to the development of the National Microfinance Programme, which seeks to support a variety of microfinance institutions across the country.

IFAD is providing a loan of USD 22.0 million for the programme, which will also be cofinanced by a grant from the United Kingdom of USD 23.5 million. The remainder of the financing of this USD 134.0 million programme will be provided by the Small Industries Development Bank of India from resources raised in domestic financial markets. The programme is expected to bring lending and savings facilities to 1.3 million poor borrowers, many of whom have never had access to formal credit before. Previous experience in India has shown that poor men, and especially poor women, have made effective use of microfinance, with repayment rates close to 100%. These loans have helped large numbers of the rural poor to increase their incomes by 50% or more and so start to work their way out of poverty.

The programme demonstrates the potential of microfinance institutions to mobilize resources, including private resources, for the productive activities of the poor. It also shows that such institutions have the capacity to serve as a link between external development assistance and the very poor.

24. **In spite of the critical role that ODA can play in launching development, ODA to developing countries actually decreased in real terms by some 22% between 1991 and 2000.** Against the United Nations target of 0.7% of the gross national product (GNP) of the donor countries for ODA, in 2000 ODA as a percentage of the GNP of the 23 donor countries forming the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) was 0.22% (about USD 53.7 billion). Moreover, this declining ODA flow had to be shared by a growing number of recipient countries, due to the emergence of new countries in transition during the 1990s. In fact, Eastern Europe and Central Asia received 23.5% of ODA in 2000 as against 3.5% ten years earlier. The brunt of the reduction in ODA flows fell on sub-Saharan Africa, whose share over the 1990s fell from 37.2 to 27.2%, while that of South Asia fell from 12.2 to 10.1%.[6] Thus, the two regions with the largest concentration of poverty saw significant reductions in ODA flows.

25. **Achieving the MDGs will require a doubling of ODA.** The International Monetary Fund (IMF)/ World Bank Development Committee has estimated that an additional USD 54 billion per year would be required to achieve the MDGs (see Box 3). This would mean approximately doubling the present ODA levels to about 0.45% of DAC member countries' GNP, which is still far below the international 0.7% target. Recently high-level representatives of some G-8 countries have called for the effective doubling of ODA. Progress in this regard would provide a strong and welcome sign of global solidarity at a time of considerable uncertainty in the international economy and polity. The current global economic downturn is affecting developing countries harshly just

Box 3: Uses of Increases in ODA

Of the total USD 54 billion identified by the IMF/World Bank Development Committee as the incremental requirement to finance the achievement of the MDGs, about USD 40 billion is proposed for health and education investments. While it is not specified in the report, from the urban/rural population distribution ratio in the low-income countries under consideration, approximately 70% of that USD 40 billion should be allocated to the health and education needs of people in rural areas. The same consideration is valid for other types of ODA investments, with the exception of any funds allocated specifically for urban development. Thus, out of the additional ODA of USD 54 billion per year, USD 28-38 billion should be allocated to the rural sector (USD 28 billion for health and education and up to USD 10 billion for infrastructure and institutional development, particularly for the productive activities of the poor) in order to achieve the Millennium Summit poverty goal.

Source: IMF/World Bank Development Committee, "Financing for Development", 18 September 2001.

[6] OECD DAC and World Bank Data System.

when poverty reduction has been given a new international focus. In this context, it would be a sad commentary on the strength and character of international financial cooperation if developing countries were forced to tighten their belts further in the face of recession while industrialized countries adopted expansionary policies to support their employment and growth. To achieve the MDGs, it is also necessary to extend gender equality and women's empowerment with necessary budgetary allocations for mainstreaming in financial resources and development. Of similar importance is the promotion of women's participation in financial institutions.

26. **International assistance for agriculture and rural development has fallen sharply.** As noted earlier, the volume of ODA for agriculture fell from USD 4.9 billion to 2.5 billion between 1988 and 1999. The share of agriculture in multilateral development bank lending has also declined. World Bank lending to agriculture, two decades ago over 25% of its total lending, has now declined to about 7%, or about USD 1.1 billion in 2000. Lending to agriculture from the regional development banks has also fallen substantially. In fact, except IFAD, all other multilateral financial institutions have reduced lending to agriculture.[7]

27. **Financing for agricultural research has been one of the victims of declining ODA flows.** Global public goods, like their domestic counterparts, tend to be underfunded. Agricultural research is a particularly important example. Funding for the research institutions of the Consultative Group on International Agricultural Research (CGIAR), for instance, fell steadily through the 1990s and at the end of the decade was some 10% lower than at the beginning. As a consequence of the decline in publicly financed research, agricultural research is now increasingly in the hands of private corporations, which respond to market demands rather than to the needs of poor farmers who have limited purchasing power. Thus, their focus is on the crops and animals of rich farmers in temperate zones, and not on those of poor farmers in dryland conditions. This is especially true with regard to the new research methods provided by biotechnology, which are directed largely towards crops grown in the richer countries. In parallel with this decline in resources for research, growth rates in crop yields of cereals, roots and tubers, which provide the bulk of food to poor people, have declined quite substantially. In the case of cereals, for example, rates have fallen from 2.8% in 1971-1981 to 1.6% in 1991-1998.

28. **In order for agriculture to grow more rapidly and stimulate stronger rural development, farmer productivity must be increased**. Given the constraints on land availability and the scarcity of capital, research that leads to higher yields for smallholder farmers is especially important to allow them to increase their output and income, work their way out of poverty and reduce their vulnerability. In this regard, a sharp increase of funding is vital to strengthen publicly financed agricultural research, including biotechnology, to develop more productive and drought-, pest- and saline-resistant varieties of the crops of interest to poor farmers. Genetically modified crops, while offering significant potential, do raise serious issues relating to food safety, biodiversity, the environment and intellectual property rights. It is all the more important, therefore, that public policies and public financing should be closely involved in taking advantage of the potential of genetically modified crops for helping poor farmers while ensuring that the serious issues raised are carefully reviewed and addressed.

29. **A number of innovative mechanisms for concessional resource transfers to developing countries have been explored in recent years.** One example is the Italian Debt Swap initiative, under which Italy has cancelled official debts in countries like Egypt, and the local resources released are to be used for poverty eradication and social sector investments (see Box 4). Other mechanisms are also being explored and need to be reviewed carefully.

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[7] Annual reports of various institutions.

Box 4: The Italian Debt Swap (IDS) Initiative: A New Initiative in Rural Development With a Human Face

Under its Rome Millennium Initiative, part of the Jubilee Year initiative, the Italian Government made a decision to cancel part of its official debt assistance in a number of middle-income indebted countries. Under the programme, countries commit to use the local equivalent of the cancelled debts to support projects aimed at reducing rural poverty and enhancing the food security of the rural poor. The IDS has several unique features. This is the first time that debt swap funds will be mobilized and exclusively used for rural poverty alleviation in the Near East and North Africa Region. Furthermore, IDS funds are earmarked for projects designed and implemented with the involvement of the Rome-based United Nations Food and Agricultural Agencies (the Food and Agriculture Organization of the United Nations (FAO), IFAD and the World Food Programme (WFP)).

Under the IDS programme in Egypt, the IFAD-financed West Noubaria Rural Development Project will receive USD 30 million equivalent in cofinancing for a total investment cost of around USD 55 million. The project is expected to improve the quality of life of about 36 000 families through investment in irrigation infrastructure, rural finance, social infrastructure and technical measures aimed at improving farm management.

V. FOREIGN DIRECT INVESTMENT – ITS ROLE IN CAPITAL INFLOWS AND TECHNOLOGY TRANSFER

30. **FDI has become a major element of external financing.** Notwithstanding the fall in ODA, external financing to developing countries has doubled over the last decade. This increase was entirely due to the fourfold increase of private flows, which overshadowed the reduction in ODA. FDI to developing countries rose dramatically during most of the 1990s, from USD 35 billion in 1991 to USD 185 billion in 1999, before falling back to USD 176 billion in 2000. The share of FDI in the GDP of developing countries jumped from less than 1.0% to about 2.5% over this period. However, FDI went largely to the more advanced middle-income developing countries, which, according to World Bank data, received nearly 93% of FDI in 2000.

31. **Low-income countries failed to participate in the surge in FDI flows.** While FDI to low-income countries rose from USD 3 billion in 1991 to USD 12 billion in 2000, their share of total FDI fell to 7%, substantially below the 1991 proportion. Least-developed countries (LDCs) received only an estimated USD 4.5 billion in FDI in 2000. Moreover, the bulk of capital flows to LDCs went to five countries that attract FDI for extractive industries such as petroleum and minerals. As noted earlier, FDI will go to countries that provide the appropriate physical and policy environment. For low-income countries, ODA and public investment can play a critical part in helping to create such conditions. Enhanced ODA flows should therefore be seen as a complement to private flows to low-income countries, in fact almost as a precondition.

32. **Sub-Saharan African countries have had particular difficulties in attracting FDI.** Their difficulties reflect insufficient market size, poor infrastructure, political uncertainty, the quality of governance and restrictive policy regimes towards foreign investment. However, several African countries have recently improved the environment for FDI by easing restrictions on FDI inflows, entering into international agreements involving investment guarantees and dispute settlements, and concluding bilateral investment treaties to protect foreign investors' interests. These reforms have led to some diversification of FDI inflows towards activities outside the resource-based sectors that have traditionally dominated FDI to sub-Saharan Africa. Countries that are not major exporters of oil or minerals received about half of FDI inflows to sub-Saharan Africa from 1995-2000, compared with only 24% in 1991-94. For example, Lesotho, Mozambique, the United Republic of Tanzania and Uganda (countries that receive the bulk of their FDI in agriculture, light manufacturing and utilities) saw sharp increases in FDI flows. African countries over the last year have taken the initiative to establish the New Partnership for Africa's Development (NEPAD). This initiative, originating in Africa itself, provides the opportunity to create the

conditions to attract investment (including foreign investment), raise savings and launch the region on a process of sustained development and more rapid poverty reduction. It has been widely welcomed by the international community and merits sustained external support.

33. **There are some areas in which FDI could play an important role in helping poor groups.** The provision of agricultural services linked to input supplies and marketing services are important examples. Manufacturers of fertilizers, pesticides and other inputs have shown interest in helping to set up distribution systems and in providing information on the use of these inputs, much as they do in their home markets. Similarly, international food processing companies are already providing marketing services for certain types of crops. Under proper conditions and with full information about prices, these services could grow to the mutual benefit of both poor farmers and the companies. Another area of interest is agro-processing. Agricultural businesses are already active in some countries in agro-processing activities; and here again, under proper conditions and balanced agreements, investment in agro-processing could generate employment for the rural poor while providing remunerative markets for smallholder production. Horticulture and vegetable and fruit processing are examples of areas in which such activities have already started and could expand.

34. **FDI can boost technology transfer, but technological levels are not likely to converge without substantive actions by all stakeholders to bridge the technology or 'digital divide'.** Increasing return-to-scale properties of innovation, relevance of the size of the market in providing incentive to innovate, and the need for a complex system of supporting institutions to encourage innovations make the technology levels in the North and the South less likely to converge. Enhanced policy coherence across the North and the South and complementary actions by all stakeholders are necessary conditions to boost FDI inflows, spur knowledge diffusion and enable all developing countries to develop and bridge the technology/digital divide. Developing countries have the primary responsibility to adopt policies that attract and expand the benefits of long-term private capital inflows. This includes improving the investment climate, human skills and social and physical infrastructure, and promoting regional integration. Industrialized countries are responsible for establishing codes of conduct, emulating best practices, disciplining investment-diverting and monopolistic behaviour – including expanding consumer protection – and ensuring that comparative advantage is the predominant determinant in the deployment of FDI flows. Development and financial institutions are responsible for providing technical assistance for capacity-building, advisory services for information-sharing and financial leverage for investing in human capital, connecting marginalized regions, promoting production and export diversification, and catalysing public and private funds for investment-enhancing development programmes.

VI. TOWARDS A DEVELOPMENT ROUND OF TRADE NEGOTIATIONS

35. **International trade has long been recognized as an engine for development, but to play this role, developing countries need better market access for products of interest to them and support in expanding capacity.** The agreement reached at the Fourth World Trade Organization (WTO) Ministerial Conference in Doha, Qatar, (November 2001) to launch a new round of trade negotiations creates the expectation that the international trading system will be significantly improved. The hope is for a *Development Round* that will truly stimulate development worldwide, benefiting both industrialized and developing countries.

36. **Trade openness enhances growth and welfare by improving production efficiency through specialization based on comparative advantage**. Trade openness also stimulates investment efficiency, due to increased market size and greater access to capital goods. It further helps raise productivity, as a result of the diffusion of technological advances and faster knowledge growth and allocative efficiency arising from stronger competition. But to benefit fully from trade, developing countries need to establish

appropriate institutions and policies and the necessary infrastructure and services that encourage growing export production capacity.

37. **The comparative advantage of many developing countries lies in labour-intensive production such as agriculture and low-technology manufactures.** Textile quotas are to be abolished by 2005, but tariff barriers remain high. High tariffs for agriculture commodities and continued subsidization of agriculture in many OECD countries have detrimental effects on agriculture exports and world commodity prices, and severely affect developing countries' export earnings and growth possibilities. The application of phytosanitary requirements can serve as an additional barrier. Such obstacles are particularly difficult for small-scale producers of export crops and labour-intensive manufacturers since they have less access to market information and less assistance to attain the required standards. Special measures are needed to help such producers benefit more fully from greater market access.

38. **Reducing tariffs for agriculture commodities and eliminating OECD agricultural subsidies and trade barriers against agricultural and textile products will be part of the forthcoming WTO negotiations.** These subsidies and other measures are estimated to amount to USD 324 billion annually (i.e. more than six times the amount of ODA flows) and ought to be eliminated. Their elimination, however, could increase prices of food and other agriculture commodities. In the transition period, this may adversely affect vulnerable groups in poor, food-deficit countries. In this context, greater technical and financial support is essential to stimulate the production response from higher prices. At the same time, additional food aid may be needed during the transition period.

39. **Some industrialized countries are starting to provide tariff-free access to the products of LDCs.** In the "Everything but Arms" initiative, the European Union is offering tariff-free access for LDC exports. If similar measures were adopted by other OECD countries, it has been estimated that the benefit would be equivalent to a significant proportion, perhaps as much as one fourth, of the net annual ODA flows to LDCs.[8] If measures were accompanied by adequate technical and financial support to promote a strong supply response, this would constitute a solid base for building a trade-oriented development strategy and validate the courageous reforms that many LDCs have introduced in recent years.

40. **Enhancing the supply response of developing countries to trade opportunities is essential.** Multilateral and bilateral financial and development institutions should complement national efforts to remove supply-side constraints, improving trade infrastructure, diversifying export capacity, strengthening institutional development, and enhancing overall productivity and competitiveness. Multilateral assistance is also needed to stabilize the export revenues of countries that still depend heavily on commodity exports, e.g. activating the IMF Compensatory Financing Facility.

VII. REDUCING THE DEBT BURDEN ON POOR COUNTRIES

41. **The burden of debt on poor countries has been recognized over the last few years as a major issue in their efforts to promote development and reduce poverty.** The Debt Initiative for Heavily Indebted Poor Countries (HIPC) was an imaginative response to try to address this issue and to reduce the debt of these countries to sustainable levels. At present, 38 countries qualify for assistance under the Initiative. As of December 2001, 24 countries had reached their decision point under the enhanced Initiative framework and are receiving debt service relief, which will amount to about USD 36 billion, a reduction of some USD 20 billion in the net present value of their outstanding stock of debt.

[8] Elena Ianchovina, Aaditya Mattoo, Marcelo Olarreaga, *Unrestricted Market Access for Sub-Saharan Africa: How Much Is It Worth and Who Pays?*, Development Research Group, World Bank, 2001.

42. **Linking debt relief to poverty reduction: the Poverty Reduction Strategy Paper (PRSP).** Countries seeking assistance under the Debt Initiative are required to have a poverty reduction strategy in place at the decision point, and to have made demonstrable progress in its implementation by the completion point. PRSPs, prepared by country authorities with broad participation by civil society, are vehicles for developing such strategies. They translate the principles into practical plans for action and are intended to strengthen country ownership of poverty reduction strategies, broaden the representation of civil society – particularly local institutions and associations of the poor – in the design of such strategies, improve coordination among development partners and reduce overlapping conditionality (see Box 5).

Box 5: Poverty Reduction Strategy Papers

At the September 1999 annual meetings of the World Bank Group and IMF, ministers endorsed the proposal that country-owned poverty reduction strategies should form the basis for all World Bank and IMF concessional lending, and should guide the use of resources freed by debt relief under the enhanced Debt Initiative for Heavily Indebted Poor Countries. The PRSPs are expected to diagnose obstacles to poverty reduction; specify targets for poverty reduction, and macroeconomic, structural and social policies to achieve these outcomes; estimate the external support needed; and describe arrangements for consulting with civil society.

The enhanced Debt Initiative aims at making progress in the formulation of poverty reduction strategies while avoiding delays by basing initial approval of debt relief on interim PRSPs, which do not require a fully articulated poverty reduction strategy, but only an action plan and timetable for developing a full PRSP. However, full PRSPs must be ready by the completion point, which could present a challenge in some cases.

43. **Early indications suggest that relief under the Debt Initiative has helped governments to raise social spending, but the rural sector has often been by-passed by this increase.** Social spending in countries of the enhanced decision point are projected to increase by an average USD 1.7 billion per year during 2001-02, or some 1.2% of GDP.[9] Unfortunately, many PRSPs have paid inadequate attention to agriculture and the rural sector, and to ODA flows as a whole. In most of the poor countries eligible for the Initiative, agriculture is especially important as a source of livelihood for the poor. Accordingly, it is critical that PRSPs give appropriate priority to strengthening resource allocations for the rural sector, and this issue should be addressed in the review of the PRSPs that is being undertaken. For its part, IFAD has participated fully in the Initiative and is working with the World Bank, IMF and other concerned institutions, and in particular with the countries themselves, to ensure that the needs of rural development are reflected fully in the PRSP process. This is an issue that requires urgent attention.

VIII. SYSTEMIC ISSUES AND POLICIES SUPPORTING DEVELOPMENT AND POVERTY REDUCTION

44. **Systemic issues regarding the coherence and consistency of international monetary, financial and trading systems in support of development are critical in determining the external context of development efforts.** Actions taken in the trade field can undermine efforts made in development cooperation, and the stability (or lack of it) in the international financial system can impinge severely on poverty reduction. This was seen in 1998 when some countries in South East Asia saw sharp increases of poverty levels arising from a financial crisis whose origins were primarily outside the countries involved.

45. **The FfD conference provides a good forum for a systematic consideration of these issues with participation from developing countries.** Stronger coordination of macroeconomic policies in ways that allow developing countries to play a meaningful part is important in today's globalized world. It will help to promote a more open trading system and more predictable and stable financial flows to developing and

9 World Bank, "Financial Impact of the HIPC Initiative", World Bank, Washington, D.C., December 2001.

transition countries. In the current global circumstances, developing countries face the prospect of lower commodity prices and exports, and declining revenues and economic growth, leading to severe pressure on government budgets. Consequently, they are being forced to undertake fiscal tightening, which will aggravate recessionary pressures within their economies. In this context, it is essential for developed and developing countries to work together to devise policy responses that ensure that the poor countries do not have to bear the brunt of global economic adjustment.

46. **Good governance at the international level is also essential for sustainable development worldwide.** Broadening and strengthening the representation and participation of developing countries in global economic decision-making and norm-setting bodies is essential to ensure the soundness and ownership of agreements, codes and standards, and their effective implementation. To these ends, further action should be taken to help developing countries build their capacities to promote and defend their interests in multilateral fora. This should include providing adequate funding to initiatives such as the Integrated Framework for Trade-Related Technical Assistance[10], which helps coordinate the technical assistance provided to developing countries to enable them to derive greater advantage from the world trading system.

IX. SUMMARY ISSUES FOR CONSIDERATION

47. In the new context created by the Millennium Summit, there is a now greater urgency for the international community to ensure that economic trade and development policies are made more coherent and supportive of the goal of halving the proportion of people living in extreme poverty by 2015. In this connection, the following are a number of issues that Governors may need to consider:

(i) The rate of poverty reduction in the 1990s was far below the level required to achieve this goal: only one third the rate required overall, one sixth in sub-Saharan Africa. To accelerate the rate of poverty reduction overall, economic growth also needs to be accelerated to an estimated 7% in sub-Saharan Africa.

(ii) To be sustainable, development and poverty reduction has to be based on domestic capacities and domestic resources, especially private resources. Nonetheless, international resources from foreign direct investment, trade and development cooperation have a crucial role to play in creating the conditions to launch such a sustained development process.

(iii) A certain level of human skills and physical infrastructure and a supportive policy environment are needed to attract foreign direct investment. To take advantage of trade, developing countries need better market access for agricultural produce and low-technology manufactures such as textiles. They also need support in helping to expand capacity and achieve the necessary quality, health and phytosanitary standards.

(iv) Development cooperation in the form of ODA can play a key catalytic role in helping developing countries to create the conditions for sustained development and to mobilize private investment, both domestic and foreign. It can do this by combining with domestic public resources and leveraging private resources for programmes in support of the poor. An example of ODA's catalytic role is the development of microfinance and other institutions that can mobilize private resources for the poor and serve as a channel for transferring public resources to them.

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10 Drawn up following the WTO Ministerial Conference in Singapore in December 1996.

(v) ODA is also entirely within the realm of government policy-making and can therefore be enhanced with any other preconditions, unlike FDI or earnings from trade. In fact, ODA can be seen as helping to mobilize both FDI and private domestic investment to create the material conditions for expanding export capacity.

(vi) To reduce poverty by half by the year 2015, international development cooperation should focus increasingly on who the poor are, where they live and how they earn a living.

(vii) However, in spite of the new focus on poverty, ODA has fallen sharply over the last decade by about 22%, and the number of recipient countries has grown with the new demand from countries in Eastern Europe and Central Asia. Consequently, the share of ODA for sub-Saharan Africa and Asia has fallen.

(viii) Among the 1 200 million people in extreme poverty, struggling to survive on less than one dollar a day, three-quarters – 900 million – live in rural areas and depend on agriculture and related rural crafts, trade and services for their livelihoods. Most of the rural poor are smallholder farmers, landless labourers and artisanal fisherfolk. Women are a particularly vulnerable group and now account for a growing majority of the poor.

(ix) Although the majority of the poor live in rural areas, depending on agriculture for their livelihoods, external assistance for agriculture in the form of ODA has fallen sharply (by nearly 50% between 1988 and 1999). Domestic public expenditure for agriculture has also fallen in parallel. One example of the decline of funding is agricultural research. Financing for the CGIAR system, for example, decreased by 10% between 1990 and 2000, even as growth rates of crop yields declined significantly in the 1990s.

(x) It is essential to halt and reverse these declining trends of investment in the rural sector in both private and public investment. While in the medium term it will be private investment (national and international) that will drive the development process, in low-income countries, ODA in conjunction with domestic public investment needs to play a catalytic role to help foster the policy and material conditions to enable investment to take place.

(xi) To achieve this, overall ODA needs to be sharply raised by about USD 54 billion per year, by doubling ODA to about 0.45% of DAC member countries' GNP as against the present level of 0.22%, thus making progress towards the 0.7% ODA target.

(xii) The enhanced ODA should be channelled increasingly for poverty reduction and directed to where the poor live, in rural areas, and it should focus on supporting their productive activities in small-scale agriculture and related activities.

(xiii) The macro and sectoral policy framework should incorporate the needs of the rural sector, and particularly of poor producers, through targeted support for the poor and more effective access by the poor to the benefits generated by larger-scale investments.

(xiv) At the external level, trade negotiations should improve market access for products of interest to poor producers, in particular agriculture and low-technology manufactures. At the same time, development agencies and normative institutions should collaborate in assisting poor countries to improve their supply response, both in quantitative and qualitative ways, to the new opportunities that market access opens.

(xv) At the level of systemic global issues, economic trade and development policy should be coordinated and made coherent to support the achievement of the MDGs.

X. THE MILLENNIUM DEVELOPMENT GOALS – IFAD'S ROLE

48. Poverty and chronic deprivation have throughout history been a sad but seemingly inevitable aspect of human society. Yet now, the experience of the last 40 years of development and poverty reduction gives grounds for real hope that poverty can be reduced substantially within a reasonable period of time. It was this understanding that inspired the Millennium Summit Declaration. In fact, ending mass poverty and chronic hunger has been recognized as perhaps the most important challenge facing humanity in the first decades of this new Millennium.

49. For the first time, multilateral and bilateral development agencies are all starting to focus on this challenge. This creates important new opportunities for IFAD to reinforce its own efforts and to use its extensive experience of reaching the poor to contribute, in collaboration with its national and multilateral partners, to achieving the goal of reducing poverty by half by 2015.

50. IFAD's current lending level of about USD 450 million per year draws forth considerable cofinancing from its development partners, allowing the Fund to support poverty reduction programmes with a total annual investment of about USD 1 billion. Each year these programmes directly reach about two million households – or about ten million men, women and children –offering them fundamental support for their productive activities. By 2015, IFAD programmes are likely to reach some 150 million poor people directly, and many million others indirectly.

51. Inevitably, not all these direct beneficiaries will be able to use the support to work their way out of poverty in a sustainable way. The poor are vulnerable to far too many uncertainties, natural and man-made, for that. Nonetheless, evaluations of IFAD programmes, including a study undertaken in 1999 of a representative sample of some 40 completed projects, suggest that a large proportion of beneficiaries do succeed in raising their incomes very substantially and do move out of poverty. What is perhaps even more important – in their own eyes – is that these very poor groups, especially women, can gain a position of dignity in their communities.

52. IFAD programmes, of course, depend on the investments made by many other partners, especially the countries themselves, which finance infrastructure, help develop financial and other institutions and provide health, education, extension and other services. At the same time, the Fund's experience shows that the introduction of an innovative poverty programme, supported by an external agency, helps to leverage domestic resources in favour of these poor rural groups, which otherwise may not have occurred. This catalytic effect, together with the direct support for their productive activities that IFAD-type programmes bring, is especially important for the poor since it helps them to take advantage of infrastructure and other development programmes. A large-scale water-control programme, for example, will be of little benefit to poor farmers unless tertiary canals are built that reach their farms. Similarly, a major national road is useful to them only if their isolated villages are connected by local-level roads and they can increase their productivity to generate produce for sale. These are elements that are covered in IFAD interventions, helping the poor to access benefits from investments by the larger financing institutions and governments.

53. To achieve the poverty goal endorsed by the Millennium Summit, a much larger volume of support that directly helps smallholder farmers and other rural groups to increase their productivity and incomes is essential. IFAD has the capacity to expand its programmes and outreach significantly and quickly. Its programmes could reach 15 million people a year or about 225 million over a 15 year period. This would be a significant contribution to the MDGs, which envisage a reduction in the number of poor by about 600 million by 2015.

54. The main constraint for IFAD is the availability of resources. Spokesmen of major donor countries have in recent months called for substantial increases in ODA. It would be reasonable to hope that some of these additional resources could be channelled through an institution like IFAD, which has a strong foundation of experience in undertaking innovative and successful programmes that help very poor people to overcome deprivation and achieve lives of dignity.

55. The Fund’s resource requirements are to be reviewed this year. This review would provide an early opportunity to translate the new commitments made by the international community to accelerate poverty reduction into resources that can be effectively used to accomplish this.