Executive Summary of Evaluation

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<th>Poverty Literature Review Summary: Agriculture and Poverty Reduction</th>
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Background

Primary agriculture provides several paths to poverty reduction both directly and indirectly through broader inclusive growth. Directly, increase in agricultural activity results in creation of unskilled jobs, reduction in prices and hence greater affordability of food for the poor, and increase in small farm holder incomes. Increasing agricultural productivity also contributes to sector growth through potentially strengthening production or inter-sectoral linkages, generating consumption or final demand effects and increasing real wages through reduced prices. The strength of these links varies based on several parameters including and not limited to the stage of economic development of the country and share of agriculture in its GDP, level of inequality, the tradability of products, farming structure and labor intensity of production. However, the literature suggests that investments to raise productivity in primary agriculture have a unique ability to reach the Base of Pyramid (BOP), including the absolute poor, since most of this population lives in rural areas in regions where agriculture continues to play a critical role in economic growth.

Objectives

This note summarizes a literature review conducted by IFC on identifying the transmission links of primary agriculture to poverty and economic growth. This exercise was undertaken as part of IFC’s Poverty Action Plan, to better understand how IFC operations in specific sectors across its investment and advisory operations result in eradicating poverty and boosting shared prosperity.

As of February 2012, IFC commitments in this sub sector stood at US$ 599 mn for 49 projects. IFC comparative advantage in this sector lies in investing in large agricultural enterprises in traditional field crop agriculture, plantations and some in green house agriculture. Some of these activities are inherently integrated with some degree of processing (transportation, handling perishability etc). This partly explains the concentration of a large share of the portfolio in the Latin America and Caribbean region where the farm structures tend to be larger. IFC reaches the small holder farms indirectly through financial institutions or through processors, traders and input suppliers.

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1 This note has been summarized from the poverty literature review conducted by IFC MAS (Manufacturing, Agribusiness and Services). The note is available on the poverty website: [http://ifcnet.ifc.org/ifcint/deveffectiveness.nsf/Content/home](http://ifcnet.ifc.org/ifcint/deveffectiveness.nsf/Content/home)
Analysis

Impact of Agriculture on Poverty

The literature suggests that agriculture investments provide a solid foundation for people to escape poverty through both direct and indirect transmission links given that a large part of the poor are still engaged in this activity, specifically in rural parts of the world. For instance, each percent expansion of agricultural and agro-processing output is estimated to reduce national poverty by 0.6 – 1.2%.

**Improved farm incomes**: The immediate impact of an increase in agricultural productivity will be an increase in farm income and aggregate supply. Poverty-reducing effects of subsequent orders of impact will depend on the tradability of the product, which will determine the participation of smallholders and poor households in production.

**Increasing employment**: Increasing agricultural production impacts the poor through creation of jobs for unskilled labor in the agriculture sector, with many of these jobs filled by women.

**Increased food availability through reduced prices**: Aggregate supply increase may result in downward pressure on food prices and benefit food consumers. Food accounts for more than half of household budget spending among the BOP households in many countries, particularly in Asia and Africa, and within this population, the poorest income segments spend a disproportionate share on food. Hence, any decline in food prices has a significant positive impact on food affordability. Of course, this impact will depend on several things including the ability of the poor farmers to market their produce, and the price elasticity of food demand.

Impact of Agriculture through Economic Growth

The review suggests that there are three dominant transmission links from increasing agricultural supply and productivity to economic growth.

**Expanding production or inter-sectoral linkages** – Positive effects on agricultural production also impact the upstream and downstream linkages- ie the forward linkages to agro-processing activities and other services such as transportation and storage, and backward linkages to the input supply sectors (eg- fertilizers, seeds). For example, in Mercosur countries, some of the main unit functions of farming (agronomic advice, crop cultivation, chemical treatment etc) may be outsourced to specialized service enterprises, resulting in emergence of ‘virtual farms’. The importance of these linkages and strengthening them to enhance overall productivity, and to boost economic growth, forms the basis of the integrated approach to agribusiness in IFC’s Agribusiness Strategic Action Plan FY12-14 (ASAP).

The strength of these impacts depends on several factors including the level of economic development in a country. As a country develops, the production linkages gain importance as demand for both upstream and downstream activities in the supply chain increases.

**Expanding consumption linkage or final demand effects** –Increasing agricultural production may also result in the development of the local economy through the increased demand for locally produced non-traded goods and services. This happens when households with increased income increase consumption. Literature shows that these linkages are in general four to five times more important than production based linkages, irrespective of
other factors. However, the strength of these linkages depends on various factors including the level of employment in this sector, spread of income gains and structure of tradable and non tradable sectors.

**Increasing real wages due to lower food prices:** This wage-goods effect flows through the reduction of lower food prices (with growth of agricultural productivity) on real wages, which directly benefit both the urban and rural poor wage earners.

**Creating demonstration effects:** Firms, who are working with adopting new techniques of production new standards or processes, have the potential of creating a demonstration effect for other competitor firms to follow. This can a ripple effect on overall productivity of the sector leading to improvements in sector efficiency and hence growth. For example, a study on demonstration effects of a sample of IFC projects highlights the demonstration effect that a client has had through designing and implementing quality standards.\(^2\) Jain Irrigation Systems is an agricultural processor that sources inputs form Indian small holders. IFC helped Jain to design and implement ‘JainGAP’, a voluntary certification program for small farmers upstream in its supply chain. This was the first Good Agricultural Practices (GAP) certification program for food processing firms in India. JainGAP processes and certification enabled Jain to be compliant with the food safety, and sustainability requirements of its international clients. JainGAP also increased farmer yields, and revenues. Inspired by JainGAP’s success, the Quality Council of India created the simplified IndiaGAP standard, which incorporated many of the practices in JainGAP.

**Factors Affecting the Strength of the Linkages to Poverty Reduction**

While agriculture’s contribution to poverty alleviation is well established, the magnitude and distribution of the impact is very context specific and depend on a number of parameters including but not limited to: (i) the level of development of the country; (ii) the tradability of the products; (iii) the labor intensity of production; and (iv) the structure of farming. For instance, the World Bank defines the country’s development status as “the three rural worlds” which are *agriculture-based, transforming or urbanized*. The larger the share of agriculture and the poor the economy is, the more important the growth in agriculture for fostering overall economic growth.

Studies have also reviewed the relative performance of agriculture for poverty alleviation and found that agriculture is much more powerful in reducing poverty among the poorest (S1-day) when inequality is not too high; this advantage declines as countries become richer and inequality increases. For impact on the S8-day “base of the pyramid” (BOP) population, we note that even defined by this higher level of income, still almost 70% of the poor so defined live in rural areas and more than 40% of them are associated with agricultural smallholding activities. Further, in terms of geography, for land-locked countries where geographic distances prevent effective transmission of price signals, more commodities tend to be non-tradable and improvement in agricultural productivity would more effectively lower product prices and reduce consumer poverty.

Factors that impact the strength of the production and consumption linkages have been mentioned above. Literature also suggests that the magnitude of the agricultural multiplier effects probably lie in the range of 1.6 to 1.8 for Asia and 1.3 to 1.5 for Africa and Latin America.\(^3\) The strength of the multiplier effect depends on a country’s economic structure – smaller economies with larger tradable sectors tend to have smaller multipliers.

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\(^2\) Demonstration Effects Study, IFC, January 2013

\(^3\) That is, every dollar in direct income generated in agriculture triggers another 30 to 80 cents in second round income gains elsewhere in the economy.
Conclusions and Recommendations

Agriculture is a sector dominated by the poorer segments of population, especially in lower income and largely rural economies. Hence, improving productivity in the sector directly impacts the poor and indirectly affects economic growth. The direct transmission links to the poor are affected through increasing farm incomes, job creation and increased food supply at lower prices. Therefore ensuring that the enabling environment that will allow these outcomes to occur is critical. Indirectly, activity in agriculture has impacts on inter sectoral linkages along the agricultural supply and distribution chain and from the induced effects of increased agricultural activity in the local economy. Strengthening these linkages through complementary investment and capacity building will therefore support maximizing the poverty impacts in this sector.

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