

Potential Public Private Partnership within the resurgence of risk management and private investment support in World development agenda

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1. A RESURGENCE OF RISK MANAGEMENT AND PRIVATE INVESTMENT SUPPORT IN DEVELOPMENT AGENDA?

Agriculture is one of the most important sources of income for poor people, but is also one of the riskiest. Without enough rain, crops wither and die. Too much rain and floods wipe out an entire harvest. Interest in finding the right insurance to protect poor farmers from such losses has understandably been strong, but generally the products that have resulted have been costly and unsuccessful (IFPRI, Insuring the World's Poor, 2007).

Public intervention can facilitate better risk management through improved information systems, development of financial markets, promotion of market-based price and yield insurance schemes, and ensuring that the poor are able to benefit from these interventions and from participation in emerging systems. Risk in agriculture is pervasive. Several risk and vulnerability assessments by the World Bank have shown that commodity price, yield (mainly due to weather), and health risks are the most important risks that rural households face. Households are vulnerable to those risks when a significant loss threatens the sustainability of their livelihood base, a common situation for many small-farm households in developing and transition economies

Poor households whose livelihoods depend on agriculture face numerous setbacks, some potentially catastrophic. The general level of risk facing poor rural households has risen in recent decades with increased market exposure linked to globalisation and governments moving away from providing support to agriculture. . New policies should also be examined through a risk and vulnerability lens to assess the trade-offs, when evident, between promoting growth and reducing risk. Policies increasing the risk of those most vulnerable should be tempered with stronger risk management instruments (Promoting pro-poor growth, Agriculture, OECD, Advancing new Agenda, 2006)

In line with OECD recommendations of “*reducing risk and vulnerability as an essential element in sustainable pro-poor growth through agriculture*” (promoting pro-poor growth policy guidelines for Donors, www.oecd.org/dac/poverty), Worldbank¹ recently recommended to mainstream risk reduction in policies and programmes for sustainable development : “*It is possible to reduce risks by improving pre-event preparedness, designing and implementing risk mitigating strategies, developing reliable and timely early warning and response systems, and spreading residual risks through innovative risk financing instruments. Therefore risk reduction must be mainstreamed in policies and programs for sustainable development*”.

Among the main potential entry areas proposed by OECD and World Bank partners in terms of risk management policy, the following are highlighted:

- *An enabling country framework should include both public roles and incentives for the evolution of private sector solutions to commodity risks.* The on-going public role is as catalyst and facilitator, but there are also times when certain large and catastrophic risks with social implications require stronger public sector intervention Insurance, hedging, and external financial assistance can present improved methods for managing such risks.
- *Public sector initiation of agriculture risk management services.* A critical public sector priority is to address large systemic risks that affect agricultural production and allow the private sector to develop insurance products for less severe events and for individual, independent farm risks.
- Simple cash forward markets, such as warehouse receipt systems, offer some advantages of a commodity exchange and can offer performance guarantees, improve credit accessibility, and reduce price risks. Warehouse receipt systems enable farmers to store their products in a reliable warehouse until prices increase, using the product as loan collateral and accessing funds before the product is sold.
- *Price risk management tools.* Commodity derivatives markets present opportunities to hedge commodity-related risks through products like futures and options, or specialized physical contracts such as minimum price guarantee contracts, price to be fixed contracts, or long-term contracts with fixed or floating prices. Market-based tools can effectively insulate producers from short-term price volatility, but they are not yet available in most developing countries, and producers and traders (especially small-scale and resource-poor farmers and traders) typically lack access.
- Commodity risks are severe in developing countries, and they are felt by not only farmers but all the way up through the commodity trading chain. Demand for education about risk management solutions is high. Within the existing supply and financing chain, where there are organizations in the “business” of commodity trade (companies, farmer associations, and banks), it is possible to develop commercially based risk management solutions that strengthen the sector overall.
- A key factor in implementation of risk management tools is the maturity of support institutions and the performance of credit and micro-credit networks and the existence of a private sector of service providers. It is where public policy support and capacity building are making the difference. Scope for new implementing institutions to identify within appropriate public private partnership.

¹ Agriculture Investment sourcebook, module 11: Managing Agriculture Risk , Vulnerability and Disaster June 2006 <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTARD/EXTAGISOU/>

2. PUBLIC PRIVATE PARTNERSHIP AND RISK MANAGEMENT

2.1. Appropriate balance between public and private roles

Although the private sector is generally assumed to be more efficient than the public sector, involvement of the private sector does not automatically lead to economic efficiency from the point of view of the society as a whole. The best approach to this issue is first to seek a balance between public and private roles by identifying the minimum responsibilities the government should assume (to ensure that these public goods are supplied and broadly consumed at near optimal levels) and the sector functions that could be carried out effectively by the private sector. Second, it is essential to explore ways in which the characteristics and mechanisms of free markets that are associated with efficiency can be introduced into sector operations, for example, determining how competition can be introduced into sector operations. "Which institutional and legal arrangements can be used to ensure that privatization actually improves efficiency- When privatization is not feasible or when a market is not contestable, what market surrogate mechanisms can be used to create incentives for efficiency, rational investment planning, and adequate maintenance-"²

The implications of institutional arrangements for private and public sector capacity should be examined. In specific countries, the comparative strengths of the private and public sectors and their incentives to perform effectively, as well as the official attitude toward the private sector, must be considered. Since the strength of the public sector and its ability to adapt to changing circumstances vary considerably from one developing country to another, the choice of arrangements will depend greatly on local conditions. The division of labor and specialization between the private and public sectors will vary from country to country depending not only on economic situation and level of development, but also on cultural and socioeconomic factors. In most instances, the choice is not an either-or proposition, but a question of balancing the roles of the various actors.

2.2. What is Public – Private partnership?

What is a PPP?

it is a cooperation between a private agent and a public agent fixed by contract. The outputs delivered by partners are complementary of each other so that both manage to reach their objectives through PPP. The two partners define clearly their objectives. Within development cooperation, other important criteria are :

- the public partner does not fund the activity of private partner, he provides a subsidiary support
- PPP should not generate concurrence distortion.
- the private partner should pursue his economic objectives (financial returns, new market access) and the public partner his development objectives (sustainable growth, poverty reduction).

PPPs are commonly defined as collaborations between public- and private-sector entities in which partners jointly plan and execute activities with a view to accomplishing mutually agreed-upon objectives while sharing the costs, risks, and benefits incurred in the process. Collaborations of this type can help overcome many of the impediments posed by market failure, institutional constraints, and systemic weaknesses in agricultural research, services and development support by building on complementarities, exploiting synergies, and distributing costs and risk between the public and private sectors.

² PPP for infrastructure delivery: a study of water and wastewater treatment and irrigation sectors, by Vanita Gangwal, 2001

The term public–private partnership first came into popular use during the 1980s in the search for alternatives to the privatization of public services. These PPPs focused primarily on outsourcing public services to private operators in the fields of education³, health, and infrastructure, or more comprehensive programs of urban and rural economic development that directly engage both the public and private sectors (Osborne and Boughn 1990; Gerrard 2001). Arguably, such PPPs offered an alternative to privatization by combining assets from both the public and private sectors to improve efficiency and reduce risk, while balancing the private sector’s standard profit motives with contractual limitations on the accumulation of profits.

In the field of science and technology⁴, PPPs are typically designed to enhance sectoral competitiveness by combining resources from the public and private sectors to achieve economies of scale and scope, exploit complementarities, and realize synergies in R&D

The recent UN Commission on the Private Sector and Development, entitled “Unleashing Entrepreneurship: Making Business Work for the Poor” underlined the need for cross-cutting partnerships which should involve micro-entrepreneurs, multilateral development institutions, civil society and large-scale private sector companies

2.3. Public interventions in risk management

Public policy can intervene at different levels: A field of action can be to set-up the necessary legal framework for the creation of markets for risk coverage. Public policy can also provide incentives for the development of such markets (e.g. by encouraging training in the use of risk management tools) or lower the costs of such tools (e.g. by providing In the framework of the WTO Uruguay Round Agreement on Agriculture, insurance subsidies and disaster aids are, under certain conditions, exempt from reduction commitments (green-box).

When markets for risk management tools are incomplete or missing, public intervention can be justified. Reasons can be found both on the supply and the demand side. The main reasons on the demand side are:

- Know-how to make use of certain risk-management tools (e.g. futures and options markets) can be acquired only at high start-up transaction costs and is, therefore, not always available to farmers.
- Farmers perceive risks they face as being smaller than they actually are, resulting in low demand for risk-management tools (“Cognitive failure”). Events of low probability, which are associated with high potential losses (catastrophes), are very likely to be neglected in individual decision making.
- Even if farmers do not underestimate the risks they face, they might count on other safety nets, including off-farm income and therefore might not use available risk management tools.

On the supply side, the reasons vary from product to product:

- Insurance products might not be offered on the market because the conditions for insurability (independence of risk, symmetry of information) are not sufficiently fulfilled.

³ *The Global Education Initiative of the World Economic Forum is designed to create public private partnership. It is focused more at the school level, but includes higher education and is now partnered with UNESCO. Perhaps the most encouraging sign is support from the Gates Foundation and the Rockefeller Foundation towards a partnership of 12 African universities to offer joint PhDs in subjects concentrating on agriculture (IEE FAO 2007)*

⁴ *FAO must work for overall reforms in education, the public sector etc. At the same time agriculture is so fundamental to human welfare that action is needed now. New technologies, networked approaches and public-private partnerships are opening-up new avenues for higher education (IEE FAO 2007)*

- Re-insurance is often necessary in order to cover big natural hazard risks. However, re-insurance can be very expensive, especially after catastrophes have happened, making an insurance product commercially inviable. Furthermore, agricultural reinsurance markets are limited, because of the special know-how involved and because the expected returns for covering the high set-up costs might not be attractive enough.
- The conditions for a successful establishment of futures and options markets are not always fulfilled. Not only do farmers need a certain amount of know-how, there is also a need for substantial price variability, sufficient traders and speculators and products with standardised grades and quality.

Services sustainability drives to build innovative partnership with private service providers or existing service agencies to implement public sector supported⁵ risk-management services. The next chapter is describing some risk management services proposed within the last IFAD Rural micro-enterprises and regional economies support programme in Madagascar (PROSPERER⁶), with their specific foreseen public –private partnership framework.

3. EMERGING PUBLIC PRIVATE PARTNERSHIPS IN RISK MANAGEMENT TARGETING DEVELOPING COUNTRIES

3.1. Micro-Credit Guarantee Fund : the European Micro-Credit Guarantee Fund

The recent UN Commission on the Private Sector and Development, entitled “Unleashing Entrepreneurship: Making Business Work for the Poor” underlined the need for cross-cutting partnerships which should involve micro-entrepreneurs, multilateral development institutions, civil society and large-scale private sector companies.

The European Micro-Credit Guarantee Fund which is a Public-Private Initiative, was launched in view of fostering the contribution of the European public and private sectors in the context of the UN Micro-Credit Year, in support to the Millennium Development Goals (MDG's) and the WSSD Partnerships, and in accordance with the Monterrey conclusion which are encouraging, new forms of public-private partnerships.

The European Micro-Credit Guarantee Fund is aimed to stimulate Microfinance Institutions (MFI) working for the Poor. It will increase the quantity of credit financing available for micro enterprises by stimulating:

- As principal or on behalf of their clients European and Local Development Banks to offer credit
- EU “Social-Ethical investors” to launch new initiatives (for example philanthropic venture capital)
- European Foundations to increase their support to projects in Developing Countries and convert limited donations into broader micro credit funds
- Lending from a strong currency environment to a country with a weaker currency.

3.2. Indian Capital risk Venture : Small Farmers Agri-Business

Low capital asset in rural micro-enterprises is a main break to fund new investments due to credit access and cost (prudential rate used by banks, high financial credit cost...). Capital-

⁵ eventually with donor-cofunding

⁶ Programme de soutien aux poles de micro-entreprises rurales et aux economies régionales de Madagascar

risk promotion should allow micro-enterprises to increase their capital investment without being submitted to high financial charges linked to any rural credit.

The Small Farmers Agri-business Consortium (SFAC) was registered in India by Department of Agriculture and Cooperation as a Society under the Societies Registration Act, 1860 on 18 January 1994. Members at present include private companies, banks and public partners (RBI, SBI, IDBI, EXIM Bank, Oriental Bank of Commerce, NABARD, Canara Bank, NAFED, United Phosphorous Ltd., etc.). . The mission of the Society is to support innovative ideas for generating income and employment in rural areas by promoting private investments in agribusiness projects. The Central sector scheme for agri-business development implemented by SFAC was approved by the Government in 2005 for implementation during remaining period of the Tenth Plan with an outlay of Rs 48 crore. The scheme is being implemented by SFAC in close association with commercial banks for providing venture Capital Assistance to agribusiness projects.

The main objectives of the scheme are to facilitate setting up of agribusiness ventures in participation with banks, catalyse private investment in setting up of agribusiness projects and thereby providing assured market to producers for increasing rural income and employment, strengthen backward linkages of agri-business projects with producers, assist farmers, producer groups, and agriculture graduates to enhance their participation in value chain through project development facility, arrange training and visits, etc., of agripreneurs setting up identified agribusiness projects. SFAC provides financial assistance to agribusiness projects by way of equity participation. The quantum of SFAC venture capital assistance depended on the project cost and will be the lowest of the following : (i) 10 per cent of the total project cost assessed by the bank, (ii) 26 per cent of the project equity, (iii) Rs 75 lakh

The outlay for implementation of the scheme during 2005–2006 was Rs. 10 crore which has been utilised. During the year venture capital assistance has been sanctioned to 44 agribusiness projects.

3.3. Partnership research with development Agencies: Swiss Re

Roger W. Ferguson, Jr., Chairman, Swiss Re America Holding Corporation was recently interviewed on What potential he does see for partnership with development agencies with regard to insurance in developing countries: *“Swiss Re is actively looking at opportunities to join in partnership with development agencies and other actors in the field because we believe we have a number of common interests. I believe that today more than ever, development agencies, governments, and nongovernmental organizations (NGOs) are looking more closely at the various risks that their activities entail and how such risk can be managed most efficiently. This is where a company like ours can bring in its vast risk management expertise and offer a variety of products, services, and solutions to assist the process. Extracting risk allows capital to be released and made available for an organization to use it to fulfill its basic mission, whether that is fighting poverty, reducing hunger, or pursuing other valuable causes.”*

Swiss Re is organizing an international conference in October 2007 to discuss on modern agricultural risk transfer instruments for emerging markets. The subjects target the following areas

- *Shaping the risk management framework – the role of government, development banks, and NGOs including governmental solutions, macro risk management framework of aid organizations and the role of insurance in Public Private Partnerships.*

- *Innovative microinsurance products*, such as microinsurance coverage for agricultural losses, successful property insurance policies for the rural sector and microinsurance catastrophe solutions.
- *Commercial risk management products* covering product offering including demand patterns, distribution, obstacles & case studies and the role of profit organizations in marketing, distribution, and risk taking. Case studies and appropriate risk management practices will be discussed.

3.4. FAO : towards a rethinking on Potential PPP in targeted areas

At national level

- Targeted agriculture income insurance support
- National value chain support (price –based contracting, contract –farming)
- National Micro-credit expansion, support through network support, risk-oriented guarantee funds, capacity building...
- Agri business investment support (venture-based)
- privately funded decentralized energy, radio, telecommunication delivery in rural areas within rural industry and rural micro enterprises promotion

At international level

- Partnership on PPP network to generate wide scale service delivery in high monetary demand potential new markets (credit, technology transfer, risk-sharing...)
- Donor Partnership on public service delivery (research, promotion of innovations, co-funding of pilot innovative service delivery)