BRIEFING NOTES

to improve our understanding and ability to ask the right questions and take effective action on land matters in West Africa

"Land Tenure & Development" Technical Committee

Reinstating Economic Evaluations as a Means of Determining whether Agricultural Investment Projects Will Serve the Common Interest

by Samir El Ouaamari[1], May 2015

Promoters of development projects usually rely on favourable financial evaluations to decide whether or not to implement them. Some follow non-binding frameworks to minimise the negative impacts of these projects, but these are entirely voluntary. Faced with this situation, what we can do is use economic evaluations to determine whether a project will help achieve common interest objectives – such as generating a net increase in wealth and ensuring that it is equitably distributed within the communities concerned. Therefore, we need to rehabilitate these methods to ensure that investments are better targeted.

Development projects are supposed to help achieve major global objectives such as poverty reduction, food security and sustainable natural resource use. Development agencies have also highlighted the need to increase agricultural investments in developing countries, but it is hard to evaluate the extent to which the projects they finance contribute to these global objectives. The two main principles promoted by cooperation agencies are that:

- companies should respect certain basic principles, such as the environmental and social performance standards set by the International Finance Corporation (the IFC, which is the financial arm of the World Bank), which are widely adopted by national development agencies;
- businesses should be "socially responsible". Rather than having to follow binding legislative frameworks, they are asked to improve their practices on a voluntary basis by following corporate social responsibility (CSR) procedures such as ISO 26000, the United Nations Global Compact, codes of good practice, etc.

These procedures set standards that projects have to meet in order to reduce or eliminate their negative impacts on human rights, food security, water quality, etc., and provide "fair" compensation for those who are adversely affected by the project. Loans may be conditional upon meeting the IFC standards, but compliance with the second group of procedures relies on the goodwill of the companies concerned.

In addition to environmental and social impact analyses, the main criteria that States and financial institutions use to decide whether they will support investment projects relate to their financial feasibility. They tend to focus on ensuring that capital is available and the project is financially viable, working on the implicit assumption that a viable investment for the company will inevitably generate economic growth and thus contribute to the country's development objectives.

This ignores the fact that a project's impacts may be experienced in very different (negative and positive) ways by the economic agents concerned (investors, local communities, upstream and downstream operators in affected value chains) or by society as a whole (the national community). The FAO's Voluntary Guidelines advocate that all

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major investments in land should be subject to an economic analysis that considers all the externalities and opportunity costs for the resources concerned.

This paper explains the key concepts behind those evaluation methods that explicitly measure a project's effectiveness in meeting common interest objectives.

How to Evaluate an Agricultural Project in Terms of its Benefits to Society as a Whole?

The General Interest: a Key Concept in Economic Evaluation

The different social groups within each society often have contradictory and even incompatible interests. As it is the State's responsibility to decide which development choices best serve the interests of the greatest number of people, decisions about what is in the common interest can be considered more legitimate when they are made by democratic governments.

This concept of the general interest may seem narrow when there are no mechanisms for improving citizen participation (especially by the most vulnerable social groups), but it can be a useful starting point when analysing a project's effects beyond those concerning some specific stakeholders.

The objectives set by the State in the name of the general interest include, among others, **economic growth, job creation, improving livelihoods, food security and sustainable natural resource management.**

Identifying the Advantages and Disadvantages Generated by a Project

The advantages (or disadvantages) that a development project creates for a particular economic agent may be experienced in a different way by the community as a whole. For example:

- **A subsidy for equipment** will benefit the entrepreneur concerned, while for the general community (or nation) it represents a transfer of resources between economic agents that neither benefits nor disadvantages them.
- Project implementation may be associated with **negative environmental externalities** that do not particularly inconvenience the entrepreneur, but which create problems for society as a whole.

Direct, Indirect and Knock-on Effects of Projects

An economic evaluation of a project will include a list of its effects. While it is easy to determine how the agents who are directly concerned with the project may be affected, it is harder to predict the possible effects of the new situation created by the project and their impacts on other sectors of society. A sound understanding of the way that agricultural changes operate in different geographic contexts is very useful in this respect.

We will use the case of **a private investor who turned a forest concession in Ethiopia into a 200-hectare coffee plantation** to show the different kinds of effect that a project may generate. Before the coffee plantation was created, farmers who lived and grew cereals in nearby clearings used

Direct, Indirect and Knock-on Effects

TYPE OF EFFECT	EXAMPLES
Direct Effects on economic agents that implement the project and project beneficiaries: investors, administrations, daily labourers and local people.	• Increased coffee production and inflow of foreign currency. • Reduction in farmer incomes from honey and spices. • Lack of fodder and manure, which leads to reduced cereal harvests. • Coffee plantations provide more work for daily labourers and increase seasonal workers' incomes.
Indirect Effects on economic agents upstream and downstream in the value chain, and on competing sectors that are adapting to the new situation created by project implementation.	• Increased activity and incomes from coffee-drying units. • Increased activity and incomes for coffee transporters. • Reduction in activities by honey and spice buyers and mead outlets.
Knock-on Effects of the new distribution of incomes resulting from the direct and indirect effects.	• The entrepreneur invests the profit in other projects. • Agricultural workers buy cereals on local markets, local food demand increases.

the forest for various purposes. They needed access to the forest lands for their units of production to function effectively: their livestock grazed there and deposited manure that fertilised their crops, they used wood from the forest to make tools, earned money by selling local spices and honey they collected in the forest, and set up small coffee plantations that could be partially cleared to increase the land under cultivation when the population increased.

The plantation employs daily labourers to weed and harvest coffee between September and December, but hires seasonal workers from neighbouring regions because local people are busy with their food crops at this time of year.

Comparing Situations "with" and "without" the Project

Having listed all the foreseeable effects of the project, the next step is to quantify their monetary value. This involves calculating the differential between all the values gained and lost in the situation **"with the project"** and the situation **"without the project".**

The situations "with" and "without" the project should not be confused with those **"before"** and **"after"** the project. When it is based on the comparison between the situation before the project and the one after the project, the evaluation works on the rather unrealistic hypothesis that the observable situation before project implementation would not change if the project did not take place. In the context of an *ex ante* evaluation it is necessary to construct a "without project" scenario whose accuracy is based on analysis of the probable changes in agriculture that would occur in the region affected by the project if it did not take place.

We will use the earlier example of the coffee plantation to illustrate this point.

Most Likely Changes in the Amount of Land under Local Coffee and Cereal Crops without the Project

WITHOUT THE PROJECT

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Farmers used to use the land that was granted to the investor before the plantation was created. They removed resources from this land (fodder, wood, spices, honey) and used it more intensively for small coffee plantations or to increase the area under crops.

In order to take account of the values lost due to project implementation, we need to consider two hypotheses in the **'without project' scenario**:

- changes in the amount of forest land that local producers use for coffee;
- changes in the amount of land under cereal due to demographic growth.

The plantation created by the investor will have the direct effect of blocking these changes and result in a loss of values over the lifetime of the project.

All the **lost values** shown in the suggested 'without project' scenario should be **compared with the added values** generated if the project is implemented (including a net increase in wealth associated with production by the coffee plantation). This comparison should help determine whether the project will generate a net increase in available wealth for the community.

WITH THE PROJECT

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How to Evaluate the Extent to Which a Project Contributes to the General Interest

Consider the Real Value of the Advantages and Costs to the Community…

There are two main methods of economic evaluation that enable us to estimate the extent to which a project can help increase the wealth available to society as a whole. Both use the key concepts explained above.

The **"reference price" method** focuses on measuring the benefits to the community by calculating the net growth in income associated with the project. In order to do this, the goods produced and means of production consumed are given theoretical prices that better reflect their value for the society as a whole than market prices. This method was developed by the World Bank, and was widely used in the 1970s and 1980s.

… and Show its Effects on Income Redistribution

In the meantime, French researchers associated with cooperation institutions devised another kind of economic evaluation to determine the redistributive effects of a project. This **"effects" method** focuses on how the additional added value associated with the project is distributed between different kinds of economic agents, and the project's effects on the State budget and balance of payments. This type of economic evaluation also shows how much the income of each economic agent can be expected to rise (or fall) as a result of project implementation. It is particularly useful in the current context of deepening income inequalities, which runs counter to the dominant discourse on poverty reduction.

Useful Decision-making Tools

These methods were widely used in the 1990s but then superseded by outcomes-based ex-post evaluations of project and the introduction of safeguarding practices for private projects, which are quicker and cheaper but do not show a project's effects on the wider community or how the wealth it generates is distributed.

It is hard to determine the extent to which project implementation will generate real benefits, and especially whether these benefits will outweigh the costs to the communities concerned (which is not always the case). In a context of State disengagement and cuts in external aid budgets, economic evaluations of large-scale development programmes and projects can provide some answers to these questions and act as a useful tool for decision-makers.

FOR FURTHER INFORMATION ON THIS TOPIC SEE:

>> DUFUMIER, 1996, *Les projets de développement agricole. Manuel d'expertise*, Paris, CTA-Karthala.

>> "Land Tenure and Development" Technical Committee, *Guide to Ex-ante Analysis of Agro-industrial Projects that Affect Land and Property Rights*, Paris, AFD. *http://www.foncier-developpement.fr/publication/guide-danalyse-ex-ante-projets-dinvestissements-agricoles-emprise-fonciere/*

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