Food and Agriculture Organization of the United Nations

for a world without hunger

INTERNATIONAL INVESTMENT IN DEVELOPING COUNTRY AGRICULTURE – WHAT ARE THE ISSUES?

18 September 2009

Introduction

The recent surge of interest in foreign investment in agricultural land has attracted substantial international concern, including at the recent l'Aquila G8 summit where Japan called for "responsible investment" and proposed international cooperation to secure it. Certainly, complex and controversial economic, political, institutional, legal and ethical issues are raised in relation to food security, poverty reduction, rural development, technology and access to land and water. On the other hand, lack of investment in agriculture over decades has meant continuing low productivity and stagnant production in many developing countries, especially in Sub-Saharan Africa. Lack of investment has been identified as an underlying cause of the recent food crisis and the difficulties developing countries encountered in dealing with it. FAO estimates that additional investments of $83 billion annually are needed in developing country agriculture to meet food needs in 2050. Developing countries' own capacity to fill that gap is limited. The share of public spending on agriculture in developing countries has fallen to around seven percent, even less in Africa, and the share of official development assistance going to agriculture has fallen to as little as five percent. Commercial bank lending going to agriculture in developing countries is also small – less than ten percent in Sub-Saharan Africa – while microfinance loans are by definition small and may not be suited to fixed capital formation in agriculture. Private investment funds targeting African agriculture are an interesting recent development but actual investments are still small. Given the limitations of alternative sources of investment finance, foreign direct investment in developing country agriculture could make a significant contribution to bridging the investment gap. The question therefore is not whether foreign direct investment *should* contribute to meeting investment needs but how its impact can be optimised to maximise the benefits and to minimise the inherent risks for all involved. To answer that question we need to understand what is happening in foreign investment and why. FAO, UNCTAD, IFAD and the World Bank have been collaborating in research (including country case studies) into the extent, nature and impacts of international investments and cataloguing best practices in law and policy.

What do we know about recent investments in developing country agriculture?

Unfortunately, there are no detailed data on the extent, nature and impacts of these investments: international investment statistics are too aggregated and little is divulged by those involved in specific cases. Much information is anecdotal, probably exaggerated and difficult to verify. However, from what limited information is available, a number of observations can be made.

- Foreign investment in developing country agriculture does appear to have increased in the last two years although the number of projects actually implemented is less than the number being planned or reported in the media.
- The main form of recent investments is long-term leasing or purchase of agricultural land for food production
- Land investments can be large-scale with many involving more than 10 000 hectares and some more than 500 000 hectares but land under foreign control remains a relatively small proportion of total land areas in host countries.
- Some investments involve infrastructural developments such as construction of road or rail links or port facilities.
- The major current investors are the Gulf States but also China and Republic of Korea.
- The main targets for recent investment are countries in Africa but there are also investments in South-East Asia and South America.
- A particular pattern of bilateral investment flows emerged following established cultural, political and business ties and geographical restrictions on investment funds but the pattern is becoming more diffuse.
- Investors are primarily private sector but governments and sovereign wealth funds are also involved in providing finance and other support to private investors or directly including through state enterprises.
- Private sector investors are often investment or holding companies rather than agro-food specialists which means that necessary expertise for managing complex large-scale agricultural investments needs to be acquired in complex financial and management structures.
- In host countries it is governments who are engaged in negotiating investment deals.
- More traditional foreign direct investment continues but often emphasising various forms of joint ventures such as contract farming.
- Current investments differ from the recent pattern of foreign direct investment in several respects: they are resource-seeking (land and water) rather than market seeking; they emphasise production of basic foods,

including for animal feed, for repatriation rather than tropical crops for commercial export; they involve acquisition of land and actual production rather than looser forms of joint venture.

Key Issues

Why foreign investment?

A major underlying concern of the recent upturn in investments and which perhaps differentiates it from the normal run of foreign investments is food security. This reflects a fear arising from the recent high food prices and policy-induced supply shocks, notably the result of export controls, that dependence on world markets for foods supplies has become more risky. For those countries facing worsening land and water constraints but with increasing populations, incomes and urbanisation and hence increasingly dependent on imported food, these fears provoked a serious reassessment of their food security strategies. Investing in producing food in countries where the land and water constraints faced domestically are not present is seen as one strategic response. This offered investment opportunities to the private sector which governments have been willing to support. Investors outside countries with food security concerns have also seen profitable opportunities for portfolio diversification into food production investments, especially as returns on other investments became less attractive. Others have been motivated by the prospects offered by biofuel developments or expectations of rising land values.

At the same time, some developing countries are making strenuous efforts to attract and facilitate foreign investment into their agricultural sectors. For them, foreign direct investment is seen as a potentially important contributor to filling the investment gap. However, how far these investments go towards meeting their real investments needs is uncertain. The financial benefits to host countries of asset transfers appear to be small with low land rentals and tax revenues foregone through a variety of concessions offered, but foreign investments are seen as potentially providing developmental benefits through for example technology transfer, employment creation and infrastructural developments. Whether these potential developmental benefits are actually likely to be realised is a key concern.

The "land grab"

The much-publicised "land grab" involving the purchase or leasing of agricultural land in developing countries for food production is just one form of investment and one which arguably is least likely to deliver significant developmental benefits to the host country. Some countries are seeking foreign investments to exploit "surplus" land currently unused or under-utilised. One reason land may not be used to its full potential is that the infrastructural investments needed to bring it into production are so significant as to be beyond the budgetary resources of the country. International investments might bring much-needed infrastructural investments from which all can benefit. However, selling, leasing or providing concessional access to land raises the questions of how the land concerned was previously being utilised, by whom and on what tenurial basis. In many cases, the situation is unclear due to ill-defined property rights, with informal land rights based on tradition and culture. While much land in Sub-Saharan Africa may currently not be utilised to its full potential, apparently "surplus" land overall does not mean land is unused or unoccupied. Its exploitation under new investments involves reconciling different claims. Change of use and access may involve potentially negative effects on food security and raise complex economic, social and cultural issues. These issues and the question of entitlement to compensation are obviously more difficult to resolve in the absence of clear land rights. Such difficulties at least demand consultation with those with traditional rights to land, and may favour alternative arrangements for investments which explicitly provide for local involvement.

Alternatives to land acquisition

It is also not clear that land acquisition is necessary or desirable even for investors. Acquisition of land does not necessarily provide immunity to sovereign risk and can provoke political and economic conflict. Other forms of investment such as contract farming and out-grower schemes can offer just as much security of supply. It is interesting to note that in other contexts, vertical coordination tends to be based much more on such non-equity arrangements than on the traditional acquisition of upstream or downstream stages. Such looser arrangements may be more conducive to the interests of the receiving country. However, even here there are likely to be questions as to the compatibility of the volume and quality needs of investors with dispersed small holder agriculture. Where this leads to increasing size and concentration of suppliers it can raise questions about poverty reduction potential. Nevertheless, joint ventures might offer more spillover benefits for the host country smallholders. Under contract farming or outgrower schemes, smallholders can be offered inputs including credit, technical advice and a guaranteed market although they do sacrifice some freedom of choice over crops to be grown. Mixed models are also possible with investments in a large-scale core enterprise at the centre but also involving outgrowers under contracts to supplement core production. What business model is most appropriate will depend on the specific circumstances and the commodity concerned.

Alternatives to foreign investment

Land investments abroad are only one strategic response to the food security problems of countries with limited land and water. A variety of other mechanisms, including creation of regional food reserves, financial instruments to manage risk, bilateral agreements including counter-trade and improvement of international food market information systems can also improve food security. Investment could be in much-needed infrastructure and institutions which currently constrain much developing country agriculture especially in Sub-Saharan Africa. This, together with efforts to improve the efficiency and reliability of world markets as sources of food might raise food security for all concerned more generally through expanding production and trade possibilities. Such developmental investments can be similar to official development assistance but with a potential indirect benefit to the donors through increased export availability.

What are the developmental benefits of foreign investment?

The key issue is the extent to which benefits from foreign investments spillover into the domestic sector in a synergistic and catalystic relationship including with existing smallholder production systems and other value chain actors such as input suppliers. A prerequisite for such a relationship is a domestic agricultural sector with absorptive capacity. Benefits should arise from capital inflows, technology transfer leading to innovation and productivity increase, upgrading domestic production, quality improvement, employment creation, backward and forward linkages and multiplier effects through local sourcing of labour and other inputs and processing of outputs and possibly an increase in food supplies for the domestic market and for export. However, these benefits will not flow if investment results in the creation of an enclave of advanced agriculture in a dualistic system with traditional smallholder agriculture and which smallholders cannot emulate. The necessary conditions for positive spillover effects may often not be present in which case policy interventions are needed to create them.

The historical evidence on the effects of foreign direct investment in agriculture is mixed. Some studies suggest that the claimed benefits do not always materialise and catalogue concerns over highly mechanised production technologies with limited employment creation effects; dependence on imported inputs and hence limited domestic multiplier effects; adverse environmental impacts of production practices such as chemical contamination, land degradation and depletion of water resources; and limited labour rights and poor working conditions. At the same time, there is also evidence of longer-run benefits in terms of improved technology, upgrading of local suppliers, improved product quality and sanitary and phytosanitary standards, for example. In considering the benefits or otherwise of foreign investment in agriculture it is important to take a dynamic perspective.

Additional political and ethical concerns are raised where the receiving country is food insecure. While there is a presumption that investments will increase aggregate food supplies this does not imply that domestic food availability will increase, notably where food produced is exported to the investing country. It could even decrease where land and water resources are commandeered by the international investment project at the expense of domestic smallholders. Extensive control of land by other countries can also raise questions of political interference and influence.

Some policy options and considerations

International investment should bring development benefits to the receiving country in terms of technology transfer, employment creation, upstream and downstream linkages and so on. In this way, these investments can be “win-win”. However, these beneficial flows are not automatic: care must be taken in the formulation of investment contracts and selection of suitable business models; appropriate legislative and policy frameworks need to be in place to ensure that development benefits are obtained and the risks minimised. However, the information base for design and implementation of effective policies and legislation is very weak. There is an urgent need to monitor the extent, nature and impacts of international investments and to catalogue best practices in law and policy to better inform both host countries and investors. Detailed impact analysis is needed to assess what policies and legislation, whether national or international, are needed and what specific measures are most appropriate.

If foreign direct investment is to play an effective role in filling the investment gap facing developing country agriculture, there is a need to reconcile the investment objectives of investors with the investment needs of developing countries. Investment priorities need to be identified in a comprehensive and coherent investment strategy and efforts made to identify the most effective measures to promote the matching-up of capital to opportunities and needs.

The onus to attract investments to where strategic needs are greatest and to ensure that those needs are met falls primarily on the host countries. Apart from the financial terms and conditions of the investment, consideration needs to be given to *inter alia* local sourcing of inputs including labour, social and environmental standards, property rights and stakeholder involvement, consistency with food security strategies, distribution of food produced between export and local markets, and distribution of revenues. Such issues might be part of an investment contract between the investor and the host government although in practice investment contracts are sometimes rather short and unspecific on such issues. Where investments are joint ventures which include host governments as a partner, local interests might be better protected.

The actual investment contract is one element of the legal framework surrounding international investments. Domestic law and international investment agreements provide the legal context for investment contracts with the latter generally prevailing over the former. Investment contracts can also override domestic law, especially where as in many cases domestic law is not comprehensive or clear in terms of defending local stakeholder interests. In general, the legal framework tends to favour the investor rather than the host country and in particular to favour investors' rights over those of host country stakeholders. This points to the importance of strong investment contracts which reference host country concerns, although the scope for this may be limited where international investment agreements preclude so-called "performance requirements". Clear and comprehensive domestic law is essential.

Beyond policy and legal frameworks to minimise inherent risks and maximise benefits, a variety of policy measures are available to host countries to attempt to attract international investment and steer it towards priority areas in support of their food security and poverty reduction strategies. Provision of information concerning investments needs and priorities can bring opportunities to the attention of foreign investors and incentives such as tax concessions or local financing initiatives can help focus investment in priority areas. Investing countries can use similar measures to encourage outward investment.

Host countries can also create a more positive investment climate through policies which reduce transactions costs and reduce investor risks. Many developing countries have introduced extensive policy reforms in this respect in recent years. Many have signed international investment agreements, although as noted above, the commitments these can entail need to be balanced in domestic law. Some participate in bilateral treaties and other international agreements and conventions for contract enforcement, arbitration and dispute settlement such as the Multilateral Investment Guarantee Agency. Some countries – Ghana, Mozambique, Senegal and Tanzania, for example - have sought to attract and facilitate inward investment through the establishment of investment agencies and authorities to promote inward investment and assist investors with the bureaucratic procedures involved. However, the frequent lack of clear property rights, especially to land, remains a concern of some international investors. Lack of adequate infrastructure may also be a deterrent to some investors which can be overcome by public infrastructural development: the Zambian Farm Block Development Plan, for example, provides for government investment in basic infrastructure such as roads. However, other foreign investors may see provision of infrastructure as a necessary and integral component of their investments.

Policy in a variety of other areas beyond that focused specifically on investment are also relevant in governing international investments. Trade policy is involved where investors intend to export food produced back to their own countries since this may conflict with the host country's right under WTO rules to impose export controls in times of domestic food crises. Some host countries appear to have offered to waive their rights under WTO rules and agreed not to impose export controls even in food crises.

No matter how successful developing countries are in attracting foreign investments, no positive developmental impacts will result if their agricultural sectors are not capable of capitalising on any spillover benefits of these investments. Appropriate domestic agricultural and rural development policy measures need to be in place to ensure that local agriculture can benefit from new technologies and the local economy can respond to new demands for inputs and services. Policy towards foreign investment needs to be an integral part of comprehensive agricultural and rural development strategies.

The call for an international code of conduct

Recent large-scale land acquisitions by foreign investors have attracted international concern and the perceived risks attached to such investments are such that there have been calls for an international code of conduct to regulate them. In the absence of strong domestic legislation and equitable investment contracts, such a code could emphasise host country interests but could also be seen as a guide for investors to socially responsible investment. The elements to be included in an international code of conduct or guidelines would presumably follow from the perceived risks to host country interests: the need for transparency and accountability; economic, social and environmental sustainability; involvement of local stakeholders and recognition of their rights and interests; and concerns for domestic food security and rural development. A code of conduct or guidelines based on detailed research concerning the nature, extent and impacts of foreign investment and best practices in law and policy could distil and encapsulate the lessons learned and provide a framework to which national regulations, international investment agreements, global corporate social responsibility initiatives and individual investment contracts might refer. Investors as well as host countries might benefit from the existence of such a reference standard and guide for planning and implementing investments.

A rigorously enforceable international code of conduct along these lines is likely to be problematic and would not gain widespread support from investing or host countries. However, a voluntary code against which compliance could be monitored would be workable provided it is formulated on the basis of widespread consultation.