Foreign Direct Investment in Developing Country Agriculture – Issues, Policy Implications and International Response

David Hallam, FAO

The recent high international food prices and policy-induced supply shocks led some countries, especially those facing land and water constraints and hence dependent on imports, to seek to secure their future supplies of food and other agricultural products through investment and production abroad. These investments, particularly in developing country agricultural land, have attracted substantial international concern. 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 $70 billion annually are needed in developing country agriculture and related downstream activities to meet global 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 in general too small and not suited to 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. Many developing countries are making strenuous efforts to attract such investments to exploit what is regarded as underutilised land, encouraging international access to land and other resources whose ownership and control in the past have typically been entirely national. The question 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.

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. The lack of transparency surrounding these investments has been widely criticised. Much information is anecdotal, probably exaggerated and difficult to verify. The weakness of the information points to the importance of country case-studies of the extent and impact of inward investments and these are being undertaken by several international organizations. The main form of recent investments is purchase or long-term leasing of agricultural land for food production. The amount of land in Africa acquired by foreign interests in the last three years is estimated at up to 20 million hectares but land under foreign control remains a relatively small proportion of total land areas in host countries. However, international investments are more likely to target good land and the local impacts of individual large investments can be significant. Investments can include 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 South 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-owned enterprises as in much Chinese investment. 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 host countries it is governments who are typically engaged in negotiating investment deals. 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.

Issues

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 or requiring flows of agricultural raw materials for processing 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. While some developing countries are seeking to attract and facilitate foreign investment into their agricultural sectors, 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, 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 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. Such difficulties at least demand consultation with those with traditional rights to land, and favour alternative arrangements for investments.

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 and 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 needs of investors with small holder agriculture and this in turn raises 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 enterprise at the centre but also involving outgrowers under contracts to supplement production. What business model is most appropriate will depend on the specific circumstances and the commodity concerned.

In any case, land investments 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 are possible. 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.

The key issue is the extent to which benefits from foreign investments spillover into the domestic sector in a synergistic and catalytic relationship including with existing smallholder production systems. 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 benefits 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 suggests 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 FDI in agriculture it is therefore important to take a dynamic perspective. However, it is also important not to overlook questions of the sustainability and longevity of investments including the possibility of exit and reversal of capital flows.

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.

Policy implications

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” rather than “neo-colonialism”. 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 tend to be rather short and unspecific on such issues. 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 countries have sought to attract and facilitate inward investment through the
establishment of investment agencies and authorities which provide a one-stop shop to attract investments and
steer investors through the various bureaucratic procedures involved.

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. Bilateral investment contracts may by-pass WTO
rules more generally and may conflict with commitments under regional trade agreements. Consistency with the
Agreement on Trade-related Investment Measures (TRIMS) may be an issue where investment incentives are
offered.

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.

**International response**

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 highlight host country interests but could also be seen as a guide for investors to socially responsible
investment. The case for a voluntary international code of conduct or guidelines which highlighted the need for
transparency, sustainability, involvement of local stakeholders and recognition of their interests and emphasised
concerns for domestic food security and rural development appears to have broad political support.

FAO, together with UNCTAD, IFAD and the World Bank is developing such a code. A voluntary 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.

A minimum set of principles for responsible agricultural investment that respects rights, livelihoods and
resources proposed by the four organizations and to be reflected in a code of conduct or guidelines would
include the following.

i) **respect for land and resource rights**: existing rights to land and natural resources are recognized and respected

ii) **food security and rural development**: investments do not jeopardize food security and rural development, but rather strengthen it

iii) **transparency, good governance and enabling environment**: processes for relating to investment in agriculture are transparent, monitored, and ensure accountability by all stakeholders

iv) **consultation and participation**: all those materially affected are consulted and agreements from consultations are recorded and enforced

v) **economic viability and responsible agro-enterprise investing**: projects are viable economically, respect the rule of law, reflect industry best practice, and result in durable shared value

vi) **social sustainability**: investments generate desirable social and distributional impacts and do not increase vulnerability

vii) **environmental sustainability**: environmental impacts are quantified and measures taken to encourage sustainable resource use while minimizing and mitigating negative impacts.
However, while there appears to be broad support for a code promulgating these principles, agreement on how to operationalize and implement them is likely to prove more difficult to achieve. A rigorously enforceable international code of conduct embodying these principles is likely to be problematic. However, a voluntary 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.

The development of a voluntary code of conduct would demand widespread consultation with all stakeholders including governments, farmers’ organizations, NGOs, the private sector and civil society more generally. Such a consultative process would inevitably be lengthy but without inclusive, comprehensive and effective consultation and input it is unlikely that a workable code of conduct could be achieved. However, experience shows that the very process of developing codes or guidelines can be beneficial in terms of promoting more responsible investment behaviour.