Foreign direct investment – win-win or land grab?

THE CHALLENGE

The recent surge of interest in foreign investment in agricultural land has aroused substantial international concern. Certainly, complex and controversial economic, political, institutional, legal and ethical issues are raised in relation to property rights, 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. 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 gross annual investments of USD 209 billion are needed in primary agriculture and downstream services in developing countries (this in addition to public investment needs in research, infrastructure and safety nets) 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 7 percent, even less in Africa, and the share of official development assistance going to agriculture has fallen to as little as 3.8 percent in 2006. Commercial bank lending going to agriculture in developing countries is also small – less than 10 percent in sub-Saharan Africa and microfinance loans, while indispensable, have not proved sufficient to agricultural investment needs. Private investment funds targeting particularly 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 contribution to bridging the investment gap and realizing the hunger and poverty eradication goals. The question therefore is not whether foreign direct investment should contribute to meeting investment needs but how its impact can be optimized to maximize the benefits and to minimize the inherent risks for all involved. To answer that question we need to understand what is happening in foreign investment and why.

WHAT DO WE KNOW ABOUT RECENT FOREIGN 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 direct investment (FDI) 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. Inward FDI stock in agriculture in 2007 stood at some USD 32 billion, four times higher than in 1990.
- The inflow of FDI into agriculture amounted to more than USD 3 billion per year by 2007, compared to USD 1 billion in 2000. If food and beverages are included, the flow rises to USD 7 billion in 2007.
- The main form of recent investments is purchase or long-term leasing of agricultural land for food production. The area of land acquired in Africa by foreign interests in the last three years is estimated at up to 20 million hectares.
- 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 Southeast Asia and South America.
- 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.
- 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 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 emphasize 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

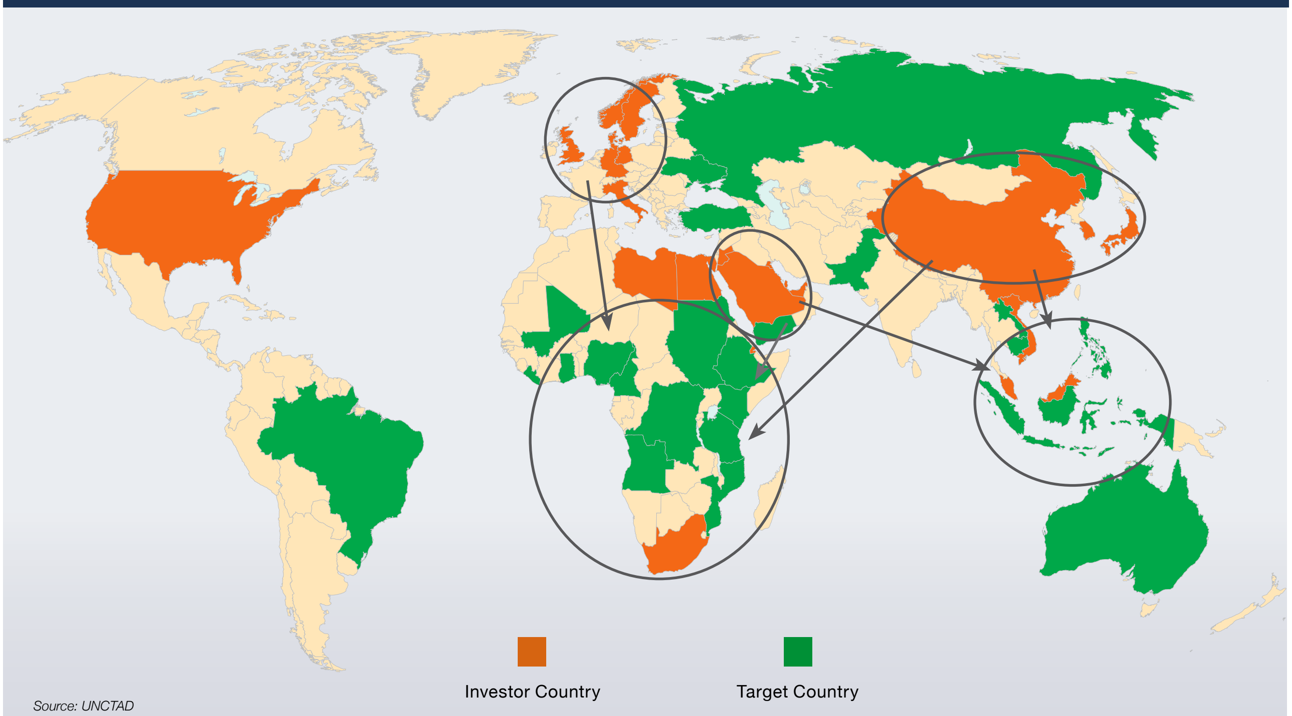
WHY FOREIGN INVESTMENT?

A major underlying driver of the recent upturn in investments, 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 food supplies has become questionable. For those countries facing worsening land and water constraints but with increasing populations, incomes and urbanization, 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, water and labour constraints faced domestically are not present is seen as one viable strategic response. This offered investment opportunities to the private sector that governments have been willing to support. 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 and stimulating domestic economic growth. 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, but foreign investments are seen as potentially providing developmental benefits through, for example, technology transfer, employment creation, income generation and infrastructural developments. Whether these potential developmental benefits will actually be realized 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 underutilized. 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

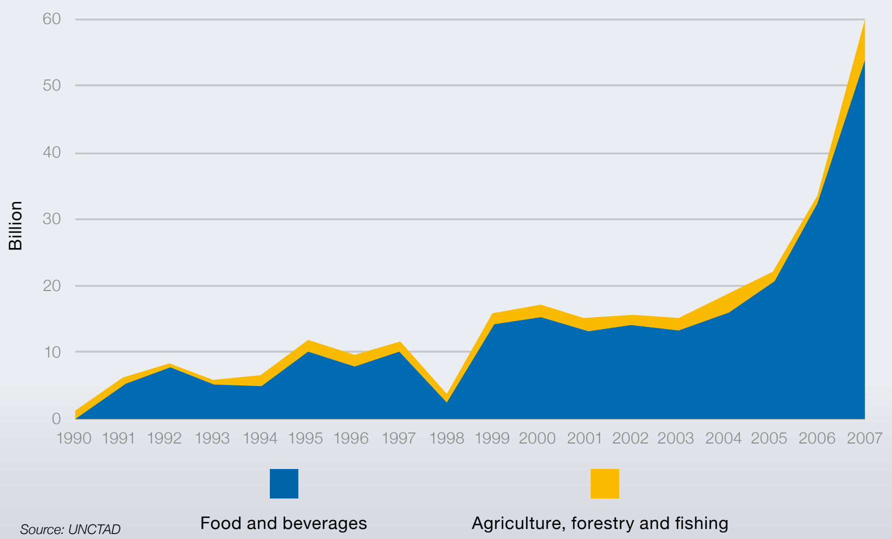
Figure 1: Investor and target regions/countries in land investment for agriculture, 2006-2009



Source: UNCTAD

previously being utilized, 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 local culture. While much land in sub-Saharan Africa may currently not be utilized to its full potential, apparently "surplus" land overall does not mean land is unused, unoccupied or unclaimed. Its exploitation under new investments involves reconciling different claims. Change of use and access may involve potentially negative effects on local 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 mutual arrangements for investments.

Figure 2: FDI in agriculture, food and beverages 1990-2007, billions of dollars



Source: UNCTAD

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, social and economic conflicts. Other forms of investment such as contract farming and outgrower 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. The development of East African horticultural production for export by European supermarket chains is a case in point. 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 smallholder 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.

WHAT ARE THE DEVELOPMENTAL BENEFITS OF FOREIGN INVESTMENT?

The key issue is the extent to which benefits from foreign investments spill over into the domestic sector in a synergistic and catalytic relationship with existing smallholder production systems. Benefits should arise from capital inflows, technology transfer leading to innovation and productivity increases, 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, which smallholders cannot emulate. The historical evidence on the effects of foreign direct investment in agriculture suggests that the claimed or intended benefits do not always materialize and catalogue concerns over highly mechanized 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, however, there is also evidence of longer-run benefits in terms of improved technology, upgrading of local suppliers, better marketing systems and improved product quality and sanitary and phytosanitary standards, for example.

Additional political, social and ethical concerns are raised where the receiving country is itself 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.

CODE OF CONDUCT

Fears that local concerns are not emphasized in investment contracts and international investment agreements, that foreign investments in land acquisition do not always lead to local long-term developmental benefits and that domestic law is inadequate have prompted calls for an international code of conduct or guidelines to promote responsible investment in agriculture. In fact many countries lack the necessary legal or procedural mechanisms to protect local rights and take account of local interests, livelihoods and welfare.

FAO, UNCTAD, IFAD and the World Bank are collaborating to develop a voluntary code of conduct highlighting the need for transparency, predictability, sustainability and stakeholder involvement and including domestic food security and rural development concerns. Such a code of conduct, based on detailed joint research concerning the nature, extent and impacts of foreign investment and best practices in law and policy, could provide a framework to which national regulations, international investment agreements, global corporate social responsibility initiatives and individual investment contracts might refer.

FAO is also developing voluntary guidelines on responsible governance of tenure of land and other natural resources in collaboration with other international organizations including UN-Habitat and the World Bank. The rationale for a code of conduct includes the considerations that: foreign investment has a great potential to help meet the investment needs of developing countries and provide broader long-term developmental benefits; international concern has been raised over the impacts on small farmers and food security of recent large-scale foreign land acquisitions and leasing; there are fears that local concerns may not be sufficiently taken into account in investment contracts and international investment agreements, and that sometimes domestic law provides inadequate safeguards; and international guidelines might promote responsible agriculture investments that would benefit all stakeholders.

QUESTIONS FOR POLICY CONSIDERATION

FOR DEVELOPING COUNTRIES:

- What policy and legal frameworks are needed to maximize benefits, particularly for local populations?
- How can targeted inward investment be encouraged? How can a receptive domestic sector be created?
- How can a positive investment climate be created?
- How can consistency be achieved between encouraging inward investment and existing food security and rural development strategies?
- What safeguards are required regarding land-use rights and the involvement and compensation of stakeholders?

FOR INVESTORS:

- Why focus on acquisition? What alternatives are there to equity investment?
- How can outward investment be encouraged? What information and incentives are required?
- How can private sector finance be mobilized?
- What kind of national code of conduct is needed?

FOR THE INTERNATIONAL COMMUNITY:

- How can investment programmes be devised to meet investment needs – matching capital to opportunities?
- Is there a need for an international mechanism to cover covering investment agreements and dispute settlement?
- How can global corporate social responsibility initiatives be brought into the process?

For further information

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