

## Creating the conditions for effective investment

TCSP's approach to investment avoids directing financial contributions and other resources toward specific development projects and programmes. Certainly, such contributions from national governments, international financial institutions and the donor community remain important for reducing poverty and hunger in developing countries. Investment in public goods is essential. Public investment can compliment private investments in very positive ways. However, in TCSP's view, sustainable food security, poverty reduction and agricultural development depends primarily on creating conditions under which agricultural investment, domestic savings, farm-level investments in fixed capital are united in a self-perpetuating cycle. Foreign investment and aid should contribute to strengthening this cycle.

TCSP seeks to build a better understanding of the relationship between domestic and foreign investment in agriculture and sustainable development, poverty reduction and food security. It is working to formulate a policy framework that can enable countries to build an environment conducive to enhancing farm-level savings and capital formation and increasing agricultural production and productivity. Emphasis is placed on food production. As part of its work, TCSP is contributing to the preparation of a web-based database on investments in agriculture, including agricultural capital stock. The database, which will also include relevant information about the rules, regulations and procedures for foreign investment in the agricultural sector of developing countries, will be linked to FAO databases on public expenditures and official development assistance in agriculture.

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# Creating a framework for agricultural investment

FAO's Policy Assistance and Support Service (TCSP)

Recent food crises, the persistence of poverty and the realization that very few countries will meet the target set out in the Millennium Development Goals to halve the proportion of people suffering from hunger by 2015, have prompted governments in both developed and developing countries to give greater attention to investment in agriculture. The countries of the African Union, in the Maputo Declaration, have committed to allocating at least 10 percent of public expenditure to agriculture. Both the G8 and G20 countries have also made commitments to increase assistance and support to increase investment in agriculture.

This renewed interest in agricultural investment, coming after a 20-year period during which the proportion of public expenditure and international development assistance directed to agriculture declined considerably, is a welcome development. However, while embarking on a new programme for increasing investment in agriculture, it is essential to understand the reasons why poverty, food insecurity and hunger persist despite the considerable investments that have already been made to address these problems. In particular, it is important clarify:

- What is meant by investment and what drives agricultural investment?
- Can a lack of domestic savings be compensated by foreign loans and grants ?
- Can public investment compensate for lack of private corporate and household investment and vice versa?
- Can public investment complement and stimulate private investment?
- What conditions need to be in place for domestic and international private sector investment to have positive impact on agricultural development at the farm level?

TCSP, through FAO regular programme resources and support from a Japanese Trust Fund Project<sup>1</sup> is seeking to build a better understanding of these issues.

<sup>1</sup> GCP/GLO/267/JPN: Support to study on appropriate policy measures to increase investments in agriculture and to stimulate food production

## Investment comes in many forms

Investment can be defined as a change in the stock of existing capital. This change in capital can be both positive and negative. It goes almost without saying that an increase in capital is necessary for growth and development. Capital comes in many forms: financial capital, productive capital, fixed capital, working capital, as well as human capital, social capital and natural capital. Different forms of capital cannot be simply added together to determine the total amount of capital available. They overlap and complement each other. Diverse agents (individuals, households, the private and public sector) exercise varying degrees of control and ownership over these different types of capital.

Investment is only one element in the complex relationship that connects capital formation, economic growth, agricultural development and poverty and hunger reduction. Investment can be both the trigger for and the outcome of specific national policies and strategies. A wide range of policy issues (agriculture, land tenure, poverty reduction, natural resource management, education, research and development, infrastructure, climate change adaptation and fiscal and monetary regulations) affect investment. There are no unique set of policies for increasing international and domestic investment in agriculture and ensuring that it contributes to reducing hunger and poverty. However, there are several salient features that need to be addressed.

## The importance of savings for financing investment

Savings remain essential for financing investment. For sustainable development and poverty reduction, there is no substitute for increasing domestic savings. This view is borne out by the Commission on Growth and Development's 2008 Growth Report: Strategies for Sustained Growth and Inclusive Development. The Report, which investigated 13 countries classified as the most successful in achieving growth and development, noted that, among other things, they all mustered high rates of saving and investment. In addition, data collected by the World Bank from more than 32,000 private firms in 100 developed and developing countries, indicate that more than 60 percent of their investments are financed from their own savings. Less than 20 percent of their investments are financed by borrowing from banks. Similarly, the bulk of investments in agriculture is made by the farmers themselves out of their own savings.

## Fixed capital and property rights

Different players within a given economy, (public sector administrations, private corporations, small businesses, including farms, as well as individual households) have different savings and investment behaviour. For farming households, the savings and investment behaviour is not well understood. However, it is clear that most of the savings of farming household goes into formation of fixed capital, such as real estate and other assets. With fixed capital, farmers gain access to financial markets and can borrow working capital for further investment. No financial institution lends without collateral. However, as indicated above, borrowed capital is always a smaller proportion of fixed capital and total investment.

For this reason, fixed capital formation is a driving force for economic growth, development, and poverty and hunger reduction. The crucial factors that allow for the formation of fixed capital are clearly defined property rights that are applied fairly and equitably to all under the rule of law. Property rights do not necessarily imply individual rights to land. What is essential is that these rights clarify who has access to and 'ownership' of the land. Unless these issues are addressed, any attempt to increase household investment in fixed capital is unlikely to succeed.

## Capital formation at the farm level is what matters

For any investment to have positive impact on production and productivity, it must contribute to capital formation at the farm level. In this respect, it is investments made by the farmers themselves that are indispensable. Their investments constitute the motor for sustainable development and the reduction of poverty and hunger.

For farmers, the main sources of investment finance are their own savings and their fixed capital, which is used as collateral for credit. Capital formation is certainly higher for farming households with positive savings and clear ownership of their land as recognized by law. The same is true for farmers with larger than average land holdings, more fixed assets and more diversified production. However, in countries where the levels of poverty and hunger are high, such as India and Bangladesh, the average farmer does not even earn half of what is needed to cross the poverty line. For small and marginal farmers with below average land holdings, the situation is even worse, both in terms of their ability to save and to secure their rights to the land.

The fact that farmers who are unable to save are also unable to invest is not a new finding. However, in the current context of renewed interest in investment, the policy implications of this situation are relevant. Public sector support and investment are not a substitute for the investment that farmers themselves need to make to increase production. Public sector investments mainly play a complimentary role. Providing support to farmers without savings to gain access to credit often contributes to their indebtedness. It can even increase the number of poor and hungry. As noted earlier, evidence indicates that wherever farm investment is taking place, the greater proportion of the resources come from the farmer's own savings. Credit plays a relatively small role in farm investment.

## Examining policy options for foreign direct investment

Evidence indicates that domestic and international corporate investment in agricultural production is marginal and contributes little to farm-level capital formation. From 1970-2008, of the total foreign direct investment directed to Thailand, less than half of one percent went to agriculture. In China during the 1990s, agriculture received only 1.3 percent of total foreign direct investment. In Brazil, foreign direct investment in agriculture in 2008 accounted for only US\$420 million out of US\$ 288 billion.

Extensive consultations and surveys of the domestic and international corporate investors carried out by FAO revealed that investors tend to avoid investing in primary production because of: the high level of risk in production; the almost universal government interference with production, price and trade of primary food crops; inadequate clarity about property rights and lack of laws to uphold these rights; and the difficulties encountered in recovering investment in fixed capital when disputes arise.

For these reasons, investors are mainly directing their investments to post-harvest processes and high-value crops. TCSP, with the help of the previously mentioned Japanese Trust Fund Project, are analyzing policy options and best practices for increasing foreign direct investment in agriculture.

## Investigating 'land grabbing'

The purchase of land by more affluent countries in land-abundant developing countries, a practice commonly referred as 'land grabbing', is emerging as new form of foreign direct investment. The practice has the potential to affect global food security. Currently, data is lacking on this issue, but scenarios suggest that 'land grabbing' would affect, at most, no more than one percent of the arable land in the countries involved; a small amount in the global context. Nevertheless, the practice may have significant impact at the local level.