

Some Key Insights on the Role of Foreign Direct Investment in Agriculture

The contribution of foreign direct investment (FDI) to economic growth in developing countries is of particular interest to policy makers.

In theory, agriculture could benefit from FDI, which are mainly of non-equity forms, because of the following 10 positive expectations: 1) inflows of financial resources, 2) increased investment in fixed and infrastructure capital, 3) technological spillovers, 4) increased investment in human capital, 5) creation of more job opportunities, 6) transfer of knowledge, managerial, organizational and institutional capital, 7) new business opportunities for local and satellite companies through service contracts, 8) exploitation of agribusiness opportunities and promotion of new value chains, 9) integration in the world economy, 10) the stimulation of productivity growth.

At the same time, there also 10 competing potential negative effects to balance the net effect: 1) crowding out effect and disincentive to local competitors, 2) reduction of foreign exchange and of (taxable) public revenue as a consequence of profit repatriation, 3) obstacles to local firms inhibited by TNCs' monopolistic dominance of market, 4) diversion of production from food for local market, 5) increased dependence on external technology, management and human capital, 6) increased dependence on international value chain, 7) increased income inequality between rich and poor and dualistic structures in agriculture, 8) adoption of inappropriate capital-intensive technologies of production, with limited employment, 9) land degradation and depletion of water resources due to the adoption of unsustainable farm practices, 10) distortive influence on political decisions and institutions induced to a "race to the bottom" to attract FDI.

In any case, agricultural FDI should not be explained by single theories and excessive positive expectations may be misleading as well as the rhetoric on FDI as the engine for development in the context of globalization, just because FDI is not the firm (and its assets), but just one of the sources of financing for the firm. Moreover, if one considers the basic idea of the Pecking Order Theory, according to which companies prioritize their sources of financing according to the principle of least effort, or of least resistance, preferring to raise equity (and FDI) as a financing means of last resort, this is a confirmation of the fact that more profitable firms rely on retained earnings for their investment finance and that in the poorest countries with inadequate markets and property rights, foreign firms don't rely on local partners and prefer FDI.

In the case of agriculture, there are no detailed data on the extent of FDI, but according to the most recent available data, if total inflows of FDI are highly concentrated in a few developing countries, agriculture, with inward FDI stock in 2007 at US\$32 billion appears, to be marginal in terms of sectoral concentration of FDI inflows (for example, agricultural FDI inflows accounted for only 1.3 percent of the actual FDI inflows in the 1990s in China, and some 85 percent of Agricultural FDI inflows were into the Eastern region: the coastal provinces plus Beijing and Hebei), and large-scale agribusiness industry plays a relevant role within the limited share of agricultural FDI, whereas greenfield investments are concentrated in natural resources. Although FDI tax policy is favorable to agriculture, frequently it has been an insufficient incentive to attract significant investment in agricultural inputs.

The bulk of TNC investment in developing regions is aimed at cash crops. There is also a growing interest in crops for biofuel production through -- for example -- projects related to oil-seed crops in Africa and sugarcane in South America. Among types of produce targeted by foreign investors in developing and transition economies, some regional specialization is apparent. For example, South American countries have attracted TNC investment in wheat, rice, sugarcane, fruits, flowers, soya beans, meat and poultry; while in Central American countries, TNCs have focused mostly on fruits and sugarcane. In Africa, foreign investors

have shown a particular interest in crops such as rice, wheat and oilseed; but there is also TNC involvement in sugarcane and cotton in Southern Africa, and in floriculture in East Africa. In South Asia, foreign investors have targeted the large-scale production of rice and wheat, while their activities in other Asian regions are concentrated more in a number of cash crops, as well as meat and poultry. Finally, TNCs in transition economies are largely involved in dairy products, although more recently they are also seeking to invest in wheat and grains.

There are indications that South-South investment in agriculture is on the rise, and that this trend is set to continue over the long term. Recent interest among new global players (such as China and Brazil) in land acquisitions and concessions for food and (bio-)energy security has drastically changed what was the main characteristics of South-South FDI: it is no more true that most of the investment by Southern corporations is concentrated just in regional contexts, even though some regional arrangements provide incentives (lower tax and tariff rates) for investment within the regions.

The largest investing countries from the South include Bahrain, China, Qatar, Kuwait, the Libyan Arab Jamahiriya, Saudi Arabia, the Republic of Korea and the United Arab Emirates. The most important developing host countries are in Africa, with Ethiopia, Sudan, and the United Republic of Tanzania among the foremost agricultural FDI recipients.

The international private equity (PE) community is investing more and more in agriculture as they seek diversification and perhaps a new found appreciation for “hard assets” in light of the derivative debacle that occurred in a number of markets over the last year or so. These investments by the PE funds seem to know no geographic bounds in the South.

What data confirm is also that against the background of the drastic FDI decline all over the world in the context of current crisis, many countries have implemented policy changes aimed at further liberalizing and facilitating FDI entry and operations.

The main form of recent agricultural investments is purchase or long-term leasing of land for food production. The area of land acquired in Africa by foreign capitalists in the last three years is estimated at up to 20 million hectares. For what concerns the phenomenon of the so called “land grabbing”, major (private and public, including Sovereign wealth funds) investors are from the Gulf States, China and Republic of Korea; they are concentrated in Africa, taking the form of purchase or long-term leasing of agricultural land for food (and biofuel) production, but also for livestock, and they still represent a small proportion of total land areas. The expected food price increase is inducing an increase of competition for land and water resources for agriculture as well as of farmland prices.

However, in concrete terms, given these stylized general facts, the specific objectives of each FDI, the terms and conditions of the investment agreements and the effectiveness of the policy and legislative frameworks are the key determinants in terms of real impact of FDI in agriculture on local development and productivity. What business model is most appropriate will depend on the specific circumstances and the commodity concerned.

Therefore, it is important to conduct contextualized case-studies, taking into account what literature review suggests:

- (1) Agribusiness research evolved along two parallel levels of analysis: the study of coordination between vertical and horizontal participants within the food chain and the study of decision-making within the alternative food chain governance structures. The specific arrangements, tailored to the characteristics of the farm sector, emphasize the importance of different FDI in agriculture;

(2) The so called “land grabbing”, has received increasing media attention but is not adequately investigated in terms of analytical research and is just one of a variety of actual or planned investment flows with different motivations;

(3) At least six different arrangements involve large-scale and small-scale farmers into the international value chain: (i) pre-agreed supply contract farming between farmers and buyers, (ii) management contracts in the form of lease or tenancy, carrying the connotation of managing the land on behalf of the owner through profit-sharing; (iii) tenancy and sharecropping agreements, as a specific version of management contracts in which individual farmers work the land of larger-scale agribusinesses on the basis of a fixed rental fee (tenancy) or split of the crop along as pre-agreed percentage (sharecropping); (iv) joint ventures with co-ownership, sharing of risks, benefits and decision-making authority; (v) farmer-owned businesses to pool assets, often through the structures of cooperatives; and (vi) upstream/downstream business links, involving the set of businesses beyond direct agricultural production. These different types of business models are not necessarily alternative and can be assessed in terms of value sharing and convenience for local development by considering ownership of the business, the ability to influence decision (voice), the sharing of economic costs and benefits (reward) and commercial and political risk sharing. Again, no blueprint exists, as what works best for a given local development reality is context-specific, contingent on tenure, policy, culture, biophysical and demographic considerations;

(4) The supermarket revolution which is sweeping the globe has fundamentally altered supply chains for widely traded products and (vertical) market structure/coordination and competition and performance become crucial factors. And searches for alternative energy sources coupled with increased overseas investment on food supply and food security portends many vital challenges for developing countries;

(5) Several efforts have been launched to establish international principles for responsible investment in agriculture – such as the UNCTAD-FAO-IFAD-WB initiative or the the Santiago Principles adopted by SWFs to improve transparency – to enhance the benefits of FDI in agriculture while mitigating its potential downsides;

(6) Many sustainable agricultural practices exist and are all key mitigation technologies and practices currently commercially available to be promoted;

(7) National regulatory frameworks are essential for avoiding predatory business practices affecting local welfare and politically sensitive areas;

(8) Linked to the phenomenon of “land grabbing”, property rights and land tenurial situation in Africa, including informal rights based on tradition, are important aspects to monitor and take into account in order to analyse the risk that selling, leasing or providing concessional access to land may raise the question different claims on available land. At this regard, collective ownership and user rights might not necessarily be less efficient than individual property rights and that the formalization process has to carefully analyze local social context, underlying the multiple nature of rights over land

It is true that increased policy emphasis on developing the demand side of agriculture is necessary in order to assist in creating sustained demand for agricultural products, and linking agricultural producers directly with processors and retailers (so that FDI may play a positive role and more policy focus should be given to promoting the linking of small scale producers to high value agricultural commodity chains). However, this should be matched with equal policy focus on significantly enhancing the productivity of local agriculture which is extremely underperforming due to long term underinvestment, and FDI cannot be a panacea for national agricultural investment and development in many poor countries.