CONCEPT NOTE

Conditions and impact of private investment in the food and agriculture sectors: What governments and business can do

Why further agricultural investment is urgently needed?

Private investment in the food and agriculture sectors can enhance productivity, drive job creation and income growth, increase food supply and offset price rises, thereby improving food security. In fact, investing in agriculture is one of the most effective strategies for economic growth and poverty reduction in rural areas. GDP growth originating in agriculture is at least twice as effective in reducing poverty as GDP growth originating outside agriculture. While the agricultural sector has been neglected in most developing countries over the last three decades, food price hikes caused riots in 2008, demonstrating the urgent need to increase investment in this sector. In the absence of further investment, food prices are likely to remain high as a result of world's population growth, rising income levels and diet diversification, as well as increasing fuel prices, stronger links between food and energy prices following the rise in biofuel production, and the effects of climate change. FAO has estimated that meeting expected growth in food demand by 2050 would require US$ 209 billion of annual investment in primary production and downstream services.

Has investment in agriculture been increasing?

Farmers remain by far the largest investors in agriculture and must remain central to any strategy for increasing investment in agriculture. Their investments are crucial to enhance capital accumulation, labour productivity and farm incomes, thereby to reduce rural poverty. However, in many developing countries, investments by farmers have not been sufficient to match the increase in the supply of agricultural labour and governments have not been able to mobilise sufficient capital, which led to stagnating labour productivity. Private investments by agro-food industries as well as institutional investors, such as hedge funds, private equity groups, insurance companies and pension funds, can help fill the gap. State-owned or state-controlled entities acting like private investors, such as Sovereign Wealth Funds (SFWs), can also meet some financing needs. In fact, numerous investors, including some with no previous experience in agriculture, have been attracted in the sector by higher food prices and profitable investment opportunities. Consequently, global foreign direct investment flows in agriculture have tripled between 1990 and 2007, and have increased even further following food price hikes in 2008 (UNCTAD, 2009).

What are the constraints faced by agricultural investors in frontier markets?

While mature markets are confronted with constraints such as the lack of available arable land as well as stagnating yields and productivity, investment opportunities in frontier markets are often hampered by weak legal and regulatory frameworks. Insecure and complex land rights and a difficult and long process to access land feature among the main impediments to agricultural investment. Tenure insecurity is often associated with rapid resource depletion and low investment in land improvements, and thus dampens agricultural productivity growth. Furthermore, agricultural investors are often deterred by weak governance which creates uncertainty and raises transaction costs. In fact, weak governance is correlated with low levels and low growth rates of agricultural capital stock per worker. Heavy regulation and excessive red tape also undermine investment by increasing costs and delays for investors and result in higher corruption levels among public officials, as shown by the World Bank's 'Doing Business' reports. Inefficient credit markets, unpredictable trade rules, high levels of taxation, and inadequate infrastructure and public services provision in rural areas, all undermine investment in agriculture.

How to attract further agriculture investment?

Attracting private investment in agriculture depends on a wide set of policy measures that are beyond the scope of agricultural policy, including macro-economic and sectoral policy measures. A coherent policy framework and well-targeted public investments focusing on public goods such as agricultural research, rural infrastructure and education, can help enhance agricultural investment. An enabling environment for agricultural investment might rely in particular on:

- ***Clear, transparent and accessible legislation and policies*** designed through broad consultation processes involving investors as well as various bodies and levels of government;
- ***Secure and well-defined land and water rights*** that can incentivise land owners to promote investments enhancing land productivity;
- ***Adequate agriculture-related infrastructure***, including transportation and logistics systems, irrigation networks, electricity supply, and information and communication technologies which all contribute to connecting investors to customers and suppliers and to enhancing value addition;
- ***Open and reliable agricultural trade*** to facilitate sourcing, processing and distribution of goods and services within agricultural value chains;
- ***Large and competitive financial markets*** with adequate prudential safeguards to lower transaction costs, mobilise savings and allocate financing efficiently to investors;
- ***Enhanced agricultural research and development (R&D)*** to stimulate innovation, increase productivity and address new challenges, such as climate change;
- ***Efforts in human capital development***, including through targeted education, health and skills enhancement programmes and policies tailored to the needs of the agricultural sector;
- ***Efficient tax policy and administration***, which strike an optimal balance between creating a business and investment-friendly tax regime and leveraging sufficient revenue for public service delivery which, in turn, makes economies more attractive to investors;
- ***Available risk management instruments***, such as information-sharing arrangements, index insurance, mutual funds, hedging in futures and options, etc.

As each country context is unique, defining and sequencing priorities will play a key role in creating an enabling environment for agricultural investment. The OECD Policy Framework for Investment in Agriculture (PFIA) can assist host governments in this regard. Several countries – including Burkina Faso, Indonesia, Tanzania and Myanmar – have already used the PFIA to assess and reform their policies for agricultural investment.

How to maximise the benefits of agricultural investment for host countries and societies?

Well-designed laws, regulations and policies promoting responsible business conduct (RBC) along agricultural supply chains, supported by effective enforcement mechanisms, can help ensure that investments in agriculture do bring benefits to both investors and host countries. To support this objective, the Committee on World Food Security is undertaking an inclusive consultation process to develop principles for responsible agricultural investment (rai). The OECD aims to contribute to this process, in particular through providing concrete guidance to private investors involved in agricultural supply chains.

Governments can take specific measures to promote responsible investment in agriculture. In particular, they can establish mechanisms to identify right holders, including holders of customary rights potentially affected by investments, and provide clear and transparent rules for consultations and negotiations between investors and affected stakeholders. Governments should also support the creation of local and simplified grievance mechanisms to facilitate quick, affordable and fair dispute resolution between investors and local communities.

To promote sustainable resource use by investors, environmental legislation should be well-designed and effectively implemented. In particular, high-quality, comprehensive and independent environmental impact assessments should be conducted prior to the investment and be made publicly available in order to mitigate adverse environmental effects.

Private investors can also take specific measures aimed at enhancing the benefits of agricultural investment for local communities and small farmers. Partnerships between investors and local land rights holders offer an effective way to mitigate social and environmental risks by avoiding land acquisitions. Inclusive business models, such as contract farming, out grower schemes or joint ventures, can maximise the benefits of both investing companies and smallholders, if contracts ensure equitable benefit-sharing. They can offer agro-food companies as much security of supply as direct production, spread the risks between companies and smallholders, reduce transaction costs, and help smallholders increase their production and productivity. The success of a specific model is context-specific, and contingent on tenure rights, culture, history, and biophysical and demographic considerations.