Foreign Direct Investment in Developing Country Farmlands: A case of acquisitions or land grabbing?

Presented at the

Sixth Annual conference
Theme:

"Foreign Land Acquisitions in Africa: Implications for Trade, Investment and Development Policies"

24 – 25 November 2011

Arusha, Tanzania

Chandrakant Patel

Introduction

Lack of adequate investment in the agriculture sector in many countries in the sub-Saharan Africa (SSA) has contributed to low productivity growth and stagnant or declining per capita food production. The gap between domestic supply and demand has meant a sharp rise in dependence on food imports throughout the region: the uncertainty and instability associated with food import dependence has further exacerbated food insecurity. Longer term trends associated with deteriorating eco systems (reflected in spread of desertification and recurrence of draughts) and civil strife has added to the challenges of modernising the farming sector in many countries of SSA.[1]

Against this background, the emergence of a vibrant new investment market for surplus agricultural land has thrown into sharp focus the dichotomy between food secure and capital surplus countries and food insecure and capital deficit countries: whilst the former are seeking to further cement their long term food security by outsourcing farming (and *ipso facto* land, water and similar scarce resources), the food insecure and capital deficit developing countries appear to be in a quandary. The challenge for the latter is one of husbanding their resources and at the same time ensuring higher levels of investment and productivity growth in agriculture.

Can the search for food security of these varying groups of countries be reconciled? Can there be, as argued by some, a win-win situation in consequence of foreign direct investment (FDI) in SSA farmlands? If so, what are the necessary conditions to bring this about?

This paper examines some of these issues. It argues the case for evolving binding multilateral agreements and for more rigorous evaluation of the economic and social costs and benefits associated with this form of foreign direct investment (FDI).It further argues that even if a binding international agreement or Code cannot be negotiated, it is incumbent upon national policy makers to at least undertake a thorough economic, social and environmental audit of a project prior to entering into any contractual agreement.

[1] Studies by FAO and others show that SSA agriculture has been experiencing declining productivity. Grain yield per hectare in SSA has remained constant compared to substantial increases in South and Southeast Asia. Generally, per hectare yield has barely increased since 1960 for the case of Africa. Of the total 1.6 per cent increase in food production, yield increased only by 0.1 percent. This means that the overall food production growth in Africa has been achieved mostly through expansion of area under cultivation. In other words, there has not been a significant technological change in African agriculture.

I Background

The world-wide surge in food prices during 2007-2008 has been explained by some as being symptomatic of a longer term trend of falling agriculture sector productivity. Whilst additional investments of at least $30 billion annually are needed in developing country agriculture , as has been has been noted by FAO[2], developing countries' capacity to fill that gap is limited and the share of official development assistance going to agriculture has trended downwards over the years to as little as five percent.[3]

There are three main reasons why farmland is being sought on a global scale: to secure alternative energy sources, to strengthen domestic food security in import dependent countries and to increase the financial returns of large investors. The latter two factors essentially represent two sides of the same coin. Volatility in commodity markets has, on the one hand, troubled countries that are heavily reliant on food imports and, on the other, signalled profit making opportunities to financial investors.

For host countries, the surge in interest to acquire farmlands is generally welcome in so far as it has the potential to improve food security: often, however, these transactions are carried out without any public scrutiny or accountability. They also provide opportunities for rent seeking, usually at the cost of rural farmers, tenants and landowners.

The growth in the acquisition of farm land in developing countries has been a source of considerable disquiet in the civil society : the phenomenon, often referred to as 'land grabbing' or even 're-colonisation 'of the South , has raised concerns such as:

- Implications of large scale farm land acquisitions on food security;
- Impact on farm employment, labour displacement and loss of tenure;
- Longer term development consequences of commercializing traditional agriculture;
- Role of bio fuels investments and land acquisitions in crowding out food crops and forcing conversion of existing food-producing land to Biofuel;
- Environmental consequences such as, for example, shifting scarce water from small holders to large commercial users.

[2] See David Hallam, "Expert Meeting on How to Feed the World in 2050 Food and Agriculture Organization of the United Nations, Economic and Social Development Department" 24-26 June, 2009. (FAO, IFAD and IIED 2009)

[3] "Land grab or development opportunity? Agricultural investment and international land deals in Africa" by Lorenzo Cotula, Sonja Vermeulen, Rebeca Leonard and James Keeley

- Issues of governance , notably transparency and accountability of the investors; compliance with national and international regulations; safeguarding rights and tenures of small holders ; asymmetrical power in negotiating the purchase and lease of land (between investors and host Governments on the one hand and between the investors and small holders, on the other)
- Net benefits of the foreign direct investment in the farm sector for the host economy.

These concerns have also raised some related questions: why is the current rise in land acquisitions qualititatively different from earlier, colonial driven episodes of land grabbing? And, what explains the acquiescence by the Governments in SSA regarding this phenomenon?

What are the facts about land acquisitions?

Information about the scale and scope of land acquisitions and the extent of related foreign direct investment (FDI) is generally media based and often anecdotal and unreliable. To be sure, some host country investors report the data, albeit on an *ad hoc* basis. Likewise, bodies such as the World Bank have attempted to establish a data base but even here, solid information remains elusive. This is not surprising given the sensitive political issues that have arisen in several host countries in the wake of large scale land transfers to non-residents. The public concern and outcry may well have forced information about contracts and leases further underground. However, a few stylized facts are generally known.

First, in terms of size, there has been a marked rise in FDI in agriculture in developing countries: in 2009 alone, nearly 60 million hectares– an area the size of France – was reportedly purchased or leased in comparison to an average annual global agricultural land acquisition of less than 4 million hectares before 2008. Others have suggested that the actual figure may be high as 90 million hectares[4].

Secondly, much of the investment appears to be concentrated in Africa: there is a perception in the investor community that Africa has a surplus of unused land. The Global Agro-ecological Assessment based on satellite imagery provides the most comprehensive survey of global agricultural potential. It suggests that 80 per cent of the world's reserve

---

4 IISD Publications Centre "A Thirst for Distant Lands: Foreign investment in agricultural land and water" Carin Smaller, Howard Mann, 2009 and GRAIN (2008) and 'Seized: The 2008 Land Grab for Food and Financial Security'. Barcelona: GRAIN.

agricultural land is in Africa and South America. These estimates, based on 1995-1996 data, give a total cultivable land in Africa of 807 million ha, of which 197 million ha are under cultivation.[5]

Since SSA reportedly uses only two per cent of its freshwater resources for irrigation, the region is often seen by investors as having an untapped potential for irrigated agriculture. Sudan, one of the countries interested to sell and lease land, greatly expanded irrigated agriculture in the 1970s with investment from Gulf States. Irrigated land now constitutes 10.2 per cent of total Sudanese cropland and provides more than half of total agricultural production. Mozambique also has strong potential for irrigation. It has significant renewable water resources and only withdraws a minimal amount. Irrigated crops only make up three per cent of agricultural production in Mozambique: in 2002, the cultivated area was estimated at 4.44 million hectares, and the total cultivable land was estimated to be much larger at 36 million hectares. The Gulf States, on the other hand, use around 80 per cent of their total water supply for agriculture.

Third, it is known that the lease period is typically 50–99 years and the land acquisitions are often in excess of 10,000 hectares, with some reports of deals of up to one million hectares. Answers to questions such as what is the scale of acquisitions of less than 10,000 remain unknown. But it is likely that acquisitions of around 1000 ha are not uncommon: much of the Chinese farm land deals in Africa fall under this range.

Fourth, there is an absence of transparency surrounding the land deals in sub-Africa. At the country level, lack of information, absence of public discussion and of scrutiny is the rule. Most often, international investors who are involved in these deals are not accountable to anyone. Not surprisingly, documentation related to these deals is generally not available for review[6].

Fifth, the investors come from a variety of backgrounds, sectors and motives: whilst the private sector investors dominate the inward flows, a number of governments and sovereign wealth funds, particularly from Middle Eastern and other Asian developing countries are also involved. There has been little doubt that for some investors, there has been considerable support from their own Governments as part of a longer term strategy to ensure domestic food

[5] The underestimation of the actual use ranges from 10 to 20%, which would increase the cultivated land up to about 227 million ha. However, it is not clear how land under shifting cultivation and fallow systems is included in these measurements.

[6] Bodies such as the Oakland Institute and GRAIN (both prominent NGOs in the vanguard of research in this area) are making available documentation on deals and investors, collected in the course of research so that the general public, policy makers, media, civil society organizations, and individuals with funds linked to these investments can learn about the impact of such investments and make more informed decisions

security and protection of national resources (such as water) by substituting domestic food production (and the attendant resource costs). Saudi Arabia, which for many years encouraged wheat production at home, has decided to phase out its own wheat production by 2016 because it has significantly depleted its own fresh water resources. In 2008, Saudi Arabia established a new agricultural fund whose prime concern includes preserving water resources by investing in agricultural production overseas and securing cheaper imports through land acquisitions in Africa.

Private sector investors are often supported by government or sovereign wealth funds, making it difficult to separate them out and judge the extent of public sector involvement. Sovereign wealth funds are now known to have been diversifying their portfolios to include developing country investments in agriculture. The support and involvement of hedge funds and sovereign wealth funds in this process has further heightened concerns about, on the one hand the speculative nature of such flows and on the other, the hidden costs to the host economy of such large scale acquisitions. The extent of interest by private institutional investors is suggested by the growth in the investor conferences exclusively focussed on SSA farmlands (Box 1).

Box 1

What Are Agriculture Investment Conferences?

Lured by the investment potential of agriculture in Africa, and inventive provided by host Governments in the form of land concessions, tax holidays, investment protection agreements and an accommodative investment climate, a whole range of new entrepreneurs have joined the scramble for farmland in Africa. This new breed of consulting firms, individual consultants, fund ,managers now regularly meet in so-called Investment Summits to make the right "connections" to "smoothen" the road to lucrative investments in Africa. The following is an illustrative list of such Conferences held this year alone.

Agriculture Investment Summit, Miami, USA, October, 2011

Jetfin Agro, Geneva, June, 2011

Jetfin Agro, Zurich, June, 2011

Agriculture Investment Summit, London, June 2011.

Their objectives are summarized in a document disseminated for the Conferences:

1 How to invest in agriculture as an asset class

2 How to allocate capital across public and private market investment

3 How to optimize portfolios to reflect risk and soft commodities outlook

4 How to profit from international farmland, crop production and agribusiness

5 How to quantify farmland investment risk and returns in emerging market

Source: Oakland Institute, Oakland, California, 2011.

Why is the current land acquisition different from earlier episodes of land grabbing?

Under colonial rule, most developing countries experienced a variety of punitive measures directed at forcible land acquisitions. Given the asymmetrical power and capacities, the signing of unequal treaties for commercial exploitation was the norm. In more extreme cases, there was no pretence even of signing unequal contracts: land was simply seized without compensation or any effort to deal with those who became landless. If things have changed in the post-independence period, it is largely on account of the fact that foreign investors now have to deal with national, sovereign Governments with wider policy options and conditions to deal with land grabbing. In theory, at least, the host country now has the option of enforcing internationally accepted principles of sovereignty over resources in the event of disputes.

However, such awareness has not prevented the signing of many opaque contracts and lease agreements. A few governments such as Liberia have started publishing contracts or improving legislation on transparency. Liberia is leading the way. When President Ellen Johnson Sirleaf came to power in 2006, she initiated a review and renegotiation of all extractive industry concessions and contracts in the country (agriculture, mining, oil and forestry). In 2009, Liberia introduced the Liberia Extractive Industry Transparency Initiative Act (the LEITI Act), which requires all payments by individual companies and contracts and licenses to be reviewed.
A number of countries (Liberia, Sierra Leone and Ghana) also require large investment projects to be ratified in parliament, ensuring a layer of public scrutiny.

Unlike earlier periods, there is greater awareness about the relatively finite character of natural resources and the need to husband them in the face of massive new and emerging claims on natural resources. Growing populations and urbanisation now require greater care and attention to preserve national resources.

Finally, unlike earlier period, new actors and players are now engaged in the process: in addition to the involvement of the financial services sector via hedge funds and sovereign wealth funds, several developing country investors including from China, India Malaysia and several countries in the Middle East are now actively engaged in the process. This latter phenomenon may have added to the complexity of negotiating a binding regime.

What explains the general silence from Governments in SSA regarding this phenomenon?

If the public authorities in SSA have acquiesced and remained silent actors in the land grab, it is likely to be on account of the secretive and opaque processes of signing contracts on the one hand and related open door policy of welcoming FDI on the other.

Most Governments in SSA have embraced the policy of encouraging inward FDI: the rationale frequently cited in favour of this policy is that it funds payments gaps and deficits; is non-debt creating; brings with it many of the skills and managerial expertise in short supply in their economies and yields technology transfers and facilitates entry into new markets. Given that most countries have established institutions to facilitate such growth, through investment promotion bodies, special incentives in the form of tax holidays and special access to credit and subsidised access to domestic resources such as land, water and power. Clearly, most Governments in Africa (and elsewhere) have revealed a strong preference for this form of international capital.

Under this approach, there is now a strong ***a priori*** presumption that FDI flows are perforce beneficial and therefore an open door and accommodative approach to FDI is the best means of securing them. Integral to this strategy is the embrace of bilateral investment agreements and treaties[7].

According to UNCTAD, there are now close to 3,000 such treaties that have been signed, though somewhat fewer are actually in force. Given the proliferation of such treaties, it is likely that a significant percentage of foreign investments in agricultural land and water will fall under the scope of a BIT, a free trade agreement or a regional agreement. When this is so, they provide a range of rights and remedies for the investor additional to those in domestic law or the contract. These rights are layered over the domestic law, which must comply with the terms of the treaty. In addition, there are a growing number of chapters in free trade agreements that include the same type of provisions as those found in bilateral investment treaties. Finally, there are a growing number of regional investment treaties, for example in the COMESA region of Eastern and Southern Africa, and the ASEAN region of Southeast Asia.

These agreements have been designed to protect foreign investors from a range of governmental measures. The theory is that, in so doing, they make investments more secure and will attract investment. While it is by no means clear that this goal has been met, any laws or other government activity inconsistent with the treaty can be challenged by the investor. Among the key features of such an agreement include the requirement of national treatment. This is a commitment by the host state to treat foreign investors that are “in like circumstances” to domestic investors in a manner no less favourable than the domestic investors. It also frequently includes provisions that prohibition against expropriation without compensation. This is one of the critical elements common to all investment treaties. While treaties do not bar expropriations from taking place, they do require proper compensation to be paid when they do take place. Equally important are some of the provisions of so-called performance requirements (e.g. local content requirements or the obligation to export a share of the products produced.) It is commonplace in investment agreements to provide investors with the capacity to operate their investment.

[7] See, for example, Uche Odofile “ Africa-China Investment Agreements: Trends,Tricks,and Traps-Implications for Broader Africa-South Economic Cooperation TRAPCA, Arusha, August 2011

Proponents of these deals say they are necessary if sufficient food is to be produced for the world's growing population. They argue that farmland investments represent efficient allocation of factor resources: from land poor/capital rich countries to land rich/capital poor ones. The evidence, however, suggests that land deals to date have created more insecurity than security: they take place predominantly in poor countries with low levels of transparent governance where poor farmers, rural workers, nomads and pastoralists are displaced without regard for their formal and informal rights or customary relations. There are grounds for thinking that many host Government officials derive significant pecuniary benefits from signing such deals.

III. The way forward

In examining the scope of policy interventions to deal with many of the more egregious consequences of land acquisitions (such as ,for example ,displacement of labour and/or of traditional crops, switch from domestic food to exportable commodities, unequal contracts, below market pricing of land and corruption), two broad approaches can be considered : an internationally binding framework to govern land acquisitions and secondly, a rigorous assessment of the direct and indirect social costs and benefits of a given land acquisition transaction. The following paragraphs discuss these two approaches. To sure, they are complementary and can help render the transaction both more transparent and in the larger public interest.

During the 1960s and 70s, UNCTAD and other UN agencies addressed the role of FDI and how best to manage it in furthering development. A preferred approach was the creation of a multilateral framework or Codes of Conduct (CoC) that set out the respective rights, duties and obligations of host and home countries with respect to flows of FDI. The issues covered under the draft codes included, among others, matters such as sovereignty and dispute settlement, rent seeking, royalties and profit remittances, respect for social and cultural objectives and policies, human rights, non-discrimination and consumer and environmental protection. In the event, the Codes (whether in respect of technology transfers, FDI and multinational corporations or restrictive business practices) did not find favour with developed countries and failed get adopted-even as a non-binding instruments.

Together with the rise of liberalization as a guiding doctrine of the multilateral financial institutions, the attitude of many developing-country policy makers toward FDI has undergone a sea change in recent decades, even more so than in the case of exports.

Multinational enterprises used to be seen as the emblem of dependency; they now appear to have become the saviours of development.

Among those at the forefront of the drive to establish global norms in respect of investment in areas such as mining are bodies such as the International Bar Association (IBA). In collaboration with the World Bank, the IBA has initiated a major programme of work to develop a model mining development agreement (MMDA) based on international best practice principles to serve as a negotiating template for investor-state agreements in the mining sector in developing countries.

There is a growing global consensus in favour of contract transparency. Both the IBA and the UN Special Representative on Business and Human Rights explicitly called for transparency in contracts.[8] A set of principles for responsible agricultural investment, prepared by the World Bank, FAO, IFAD and UNCTAD also call for transparency in accessing land and making investments. The UN Special Rapporteur on the right to food calls for full transparency in land leases and purchases. Likewise, the NGO, Grain, is making a major contribution to the drive for transparency, by regularly leaking investment contracts on their website. [9]

As a means by which to get foreign investors to voluntarily improve the terms upon which they engage in such investments, in 2009 the FAO joined with the World Bank, the International Fund for Agricultural Development (IFAD) and the United Nations Conference on Trade and Development (UNCTAD) to draft the Responsible Agricultural Investment (RAI) principles, a set of best practices and principles that foreign investors can pledge to adhere to (Box 2).

---

[8] A Thirst for Distant Lands : Foreign investment in agricultural land and water by Carin Smaller and Howard Mann , *International Institute for Sustainable Development* May 2009

[9] The mining sector in a number of LA countries has set the pace for managing mining activities undertaken by MNCs. The role of legal reform has been to reduce both real and perceived risks by designing legal safeguards, and to enable an environment appropriate for investment (World Bank, 1996). In this regard, Chile first and Peru later, as well as Argentina, Bolivia, and other countries in Latin America, drafted highly competitive legal frameworks for mining. Their aggregate features have come to be known as 'the Latin American Mining Law Model' and the World Bank has recommended the adoption of this model in processes of mining sector reform in developing countries.

Box 2

Responsible Investment in Agriculture (RAI)

Principle 1: Existing rights to land and associated natural resources are recognized and respected.

Principle 2: Investments do not jeopardize food security but rather strengthen it.

Principle 3: Processes for accessing land and other resources and then making associated investments are transparent, monitored, and ensure accountability by all stakeholders, within a proper business, legal, and regulatory environment.

Principle 4: All those materially affected are consulted, and agreements from consultations are recorded and enforced.

Principle 5: Investors ensure that projects respect the rule of law, reflect industry best practice, are viable economically, and result in durable shared value.

Principle 6: Investments generate desirable social and distributional impacts and do not increase vulnerability

Principle 7: Environmental impacts due to a project are quantified and measures taken to encourage sustainable resource use while minimizing the risk/magnitude of negative impacts and mitigating them.

Source: World Bank, 2011.

The FAO, the World Bank and its partners claim that adherence to the RAI principles can make such investments a "win-win" situation for all parties concerned. On the other hand, this approach is seen by many in the civil society as an effort to rationalise and justify land grabbing under an international umbrella of a code of conduct. For example, a statement jointly issued by several NGOs [10] argues that

[10] See The statement released by Centro de Estudios para el Cambio en el Campo Mexicano, FIAN International, Focus on the Global South, Friends of the Earth International, Global Campaign on Agrarian

"Large-scale land acquisitions are designed to open up new spaces for export oriented, industrial, plantation agriculture"...... "There is no point in sanctioning that through any set of investor 'principles' or code of conduct. This is not an agriculture that feeds people in a just and sustainable way."

RAI has been regarded as an insufficient response that can actually result in legitimising a process that is rife with exploitation and rights abuses. First of all, the principles are only voluntary and cannot be enforced. For this reason, many small farmers' associations and community organisations oppose the RAI principles since they encourage land grabbing. The NGO Focus on the Global South has argued that the proposed.RAI principles are "dangerously deceptive" for couching the act of annexing land in the language of human rights and corporate social responsibility. If the RAI principles are in the right direction and spirit, in the absence of binding provisions they appear largely hortatory.

It is now accepted that 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 and investing countries. The scope for forms of investment other than land acquisition – such as contract farming, out-grower schemes and other joint ventures - and which are more likely to yield development benefits to host countries needs to be evaluated and best practices promoted.

For the host country, an international CoC should strike a balance in ways that protect local people and environments, while still allows them to be profitable in the conventional sense. The core requirement of any CoC is to make agreements based on predefined principles of acceptable behaviour and outcomes. Three principles must be stressed here: first, transparency in negotiations; second, environmental sustainability and third, economic and social viability.

The first would require that all local landholders must be informed and involved in negotiations over land deals. Free, prior, and informed consent is the standard to be upheld. Particular efforts are required to protect the rights of indigenous and other marginalized ethnic groups. The media and civil society can play a key role in making information available to the

---

Reform, GRAIN, La Via Campesina, Land Research Action Network, Rede Social de Justiça e Direitos Humanos, World Alliance of Mobile Indigenous Peoples and World Forum of Fisher Peoples.

public. Respect for existing rights. Those who lose land should be compensated and rehabilitated to an equivalent livelihood.

In organizing the framework of relations between investors and the host country, the primary source of law to regulate investments in agricultural land and water should domestic law in the host state. Given the range of issues involved, this might typically include laws relating to the admission of foreign investors, laws and regulations on incentives for foreign direct investment (FDI), taxation, property law, water rights and rates, and an array of laws relating to the potential impacts of the investment on the local community: environmental, human health and safety, worker safety, labour rights, and possibly others. An environmental impact assessment may or may not be required prior to the conclusion of investment agreements[11]

The second core principle requires careful environmental impact assessment and monitoring are required to ensure sound and sustainable agricultural production practices that guard against depletion of soils, loss of critical biodiversity, increased greenhouse gas emissions, or significant diversion of water from other human or environmental uses. Adherence to national trade policies when national food security is at risk (for instance, in case of an acute drought), domestic supplies should have priority. Foreign investors should not have the right to export during an acute national food crisis.[12] This type of two-pronged approach (favourable policy environment plus an international CoC), offers the best chance for the big land deals to lead to “win-win” outcomes for all concerned.

A win-win outcome is one in which the development needs of both the resource-poor countries and resource-rich countries are met, while at the same time the investors’ needs and interests (i.e. profits) are served and poor people’s incomes and livelihoods are enhanced. The concerns of resource-poor countries are to secure supplies of food and fuel in order to sustain their current patterns of food consumption and production. What the resource-rich countries need are new investments in agriculture that would create jobs, support small

[11] Smaller et al, op cit.
[12] For more information see, TNI's Agrarian Justice work at http://www.tni.org/work-area/agrarian-justice and on the Land Deal Politics Initiative at http://www.smu.ca/academic/arts/ids/icas_ldpi.html 8.

farmers, and bolster exports. What investors need is an improved, clear, stable, and secure investment climate (indeed, clear property rights to secure investments). [13]

The prospects of securing any binding commitments from the investor countries are far from clear: but it is also clear that in the absence of such commitments, benefits of farm acquisitions will be largely secured by the investors.

Is social cost benefit analysis an answer?

Given the unique role of land in all societies and cultures, assessment of economic viability of an investment decision in farmlands transcends private profitability calculus. First of all, there is likely to be significant variation between market prices and social costs. A farming project may be highly profitable to the private investor but the costs to the society in consequence of, for example, shifting water resources from small holders to the large farms may be quite high. The latter are social costs whose value would clearly be wrong to exclude in any decision relating to the approval of a given project. In the final analysis, however, FDI in farmlands is fundamentally similar to investment in any other sector such as mining, infrastructure or agro-industry.

To arrive at an economic justification for an investment decision, perhaps the most common and accepted method is to undertake an analysis of costs and benefits (CBA) of undertaking a project[14].

In so far as the CAB method poses some basic strategic questions and sets out the related choices and alternatives, it is a useful tool for organizing priorities for decision making. It is a given that good project analysis warrants clear statement of development policy objectives (just as development policy and plans would consist of sound projects). Accordingly, projects have to be evaluated in line with factors such as their balance of payments implications, impact on growth and distribution of income, employment consequences, and contribution towards absorbing new technologies and management systems.

Under this approach, there is no presumption that FDI ***is a priori*** beneficial. The question whether a particular FDI decision is socially and economically profitable remains an empirical one and depends on specificities of each case in question. The home country

---

[13] "Land Grabbing" in Developing Countries: Risks and Opportunities by Joachim von Braun and Ruth Meinzen-Dick, IFPRI, April, 2009.

[14] See Cost Benefit Analysis in the World Bank, World Bank, Washington D.C; 2010.
The World Bank's assessment of its own effectiveness and evaluation of CBA in its lending has recommended that CBA should be more widely practiced and better integrated in its lending policy and decisions.

investor is presumed to have undertaken a private CBA; likewise, it would be reasonable to expect that the host country would undertake a similar CBA, but one that goes beyond private costs and benefits and includes a full audit of the social costs and benefits, including externalities associated with the project.

Any evaluation of FDI should per force require examination of available alternatives (such as, for example, encouraging domestic enterprises to undertake the same investment project). Additionally, there are alternative modalities of foreign participation: for example, joint ventures or some form of public-private investment may be a useful alternative policy option instead of allowing full private participation. This approach can be attractive to the foreign investor by assuring direct access to local markets, knowledge and expertise. Likewise, it would also ensure greater security for the foreign investor by safeguarding the investment against appropriation.

At a general level all CBA should start with four basic elements around which CBA would be conducted: financing modalities; the objectives and expected economic outcomes of a given FDI; externalities-positive and negative --associated with the project and an analysis of environmental and ecological consequences. Effective CBA requires that the key parameters and commitments remain clearly stated and understood at the outset of any CAB analysis : these may include objectives such as maximisation of exports and employment, improving income distribution, raising consumption levels, strengthening balance of payments and enhancing agricultural output and productivity.

Data about the exact amount to be invested, the share of total investment that is financed domestically, the source of financing e.g. whether it is largely private or public or a combination of the two and about likely import costs and repatriation of profits should be the starting point for a sound CBA. Then again, there must be clarity about the financial implications of the incentives provided to the investor such as fiscal concessions, subsidised water, transport and provision of infrastructure, concessions for imports duties etc. Provisions for guarantee to underpin the financial transaction, likewise, would need to be monetized and made integral part of the contractual agreements.

In addition to questions about financing (a major attraction for the host country) there are several other questions that arise , including the use to which the farm land is put (i.e. nature of crops and of farming),the share of output that is to be exported ,employment of local labour and related training ,if any.

Thirdly, and arguably the most critical from the standpoint of the host country are the social costs (and benefits) associated with the investment. In most developing countries, important divergences arise between market prices and values and social costs. Given the divergence between market prices and social values, one approach is to arrive at a ‘true ‘value-price or shadow/accounting prices correct the discrepancy. Among the divergences most relevant for the purposes of CBA, the following are most frequently encountered[15]

- The possibility of wage rates being overstated, given the abundant supply of labour[16]
- The possibility that aggregate savings and investment is less than desirable
- Divergences between market and social values due to distortions introduced by public policies ,notably subsidies, taxes and price controls.

Thus, in the above cases, distortions in wage rates can be corrected by using an accounting or shadow wage rate; likewise for interest and foreign exchange rates. The latter rate then is the social opportunity cost of capital. In the approach now well known and promoted by OECD Manual on CAB, the third set of distortions and divergences are tackled by valuing prices at those that would be commanded at international level or at the border, the so-called border prices.

Finally, a related category of questions revolve around ecological and environmental costs and consequences of the project. Many of the social and ecological costs stem from their nature as public goods and consequently under provisioned and priced. It is now common, at least in all the developed countries to undertake an environmental impact analysis for all major projects, particularly those involving large scale infrastructure and use of scarce resources such as water. For projects involving farm acquisitions, an environment impact analysis may include claims on natural resources (such as water), on future productivity and yield in consequence of using modern methods of cultivation (fertilizers, seeds, use of insecticides). If GM seeds are used, are they consistent with national policy? Acquisition of farm land for promoting bio fuels results in conversion of land and farming practices with important long term implications. How these conversions are priced (i.e. the opportunity costs of switching from traditional to export oriented crops) would critically determine the viability of the project.

---

[15] For a comprehensive review of the issues involved in CAB, see “Symposium on the Little-Mirelees Manual of Industrial Project Analysis in Developing Countries” in Bulletin of the Oxford University Institute of Economics and Statistics, February, 1972.

[16] In establishing an appropriate shadow price for labour, for example, the first step is to estimate its marginal product in an alternative use. In developing economies, the direct and indirect source of extra labour is from the rural sector. Accordingly, the marginal product of labour then provides the basis for calculating the shadow wage rate.

Also see Heather Joshi ‘’World Prices as Shadow Prices’’ in Oxford Bulletin 1972. Loc cit.

CBA is essentially concerned with comparing the benefits of an investment decision or project with its alternatives: typically, policy makers in a developing economy, when confronted with proposals from foreign (or domestic) investors will have to answer questions that essentially focus on alternatives or the opportunity costs. What, for example, would be the impact of the project if it is scaled down (or up)? What, likewise, would be the impact on decision makers if the project is deferred to a later date? Then again, the question may be posed: is a smaller (or bigger) project at a later date more likely to yield success and support from the public.

Most developing countries have a savings and foreign exchange gap gap-i.e available savings-domestic and foreign earnings from exports do not meet the requirements of long term investment. Accordingly, the available foreign exchange does not reflect the true scarcity value of foreign exchange. In such a situation the case for putting a premium on foreign exchange is a straight forward one: an additional dollar of foreign exchange can be valued for the purposes of CBA in terms of its maximum contribution to social welfare as outlined in development policy and plans. Policy makers would then have to compare its alternative uses such as expansion of imports and reduction of exports and choose the feasible alternative that yields the best returns in terms of social welfare in units of consumption. This return represents the social value of expenditure.

Box 3

<u>How to go about CBA?</u>

The evaluation of a project can be divided into five specific steps:

1. Identification of expected streams of inputs and outputs resulting from the investment along with non-market influences (externalities), if any;
2. Conversion of input-output streams into streams of net benefits of different types corresponding to different objectives;
3. Deriving one stream of total net benefits by applying appropriate relative weights to different types of benefits;
4. Estimation of present value of the total net benefit streams by using the relevant social rates of discount
5. Selection or rejection of the proposed project based on the present value estimated.

At the first stage, adjustment in the prices of all resource inputs but most commonly foreign exchange; skilled labour and unskilled labour should be made. Thus, foreign exchange component of costs and benefits can be adjusted upwards just as cost of unskilled labour component can be adjusted downwards by a factor to be determined on the basis of available information such as, for example, informal market rates for foreign exchange .As regards steps 2 and 3, it should be noted that the net benefit is the difference between benefits and costs : thus, costs are nothing other than benefits foregone in selecting a particular project rather than the best alternative. Once the present value of a project is obtained (by summing up the discounted series of net benefits).This sum expresses the total net benefits of the project, i.e., net contribution of the project to social welfare evaluated in terms of public objectives. The final step is straightforward: if the present value is positive or zero, it should be chosen and if negative, it should be rejected.[17]

Benefits and costs of an investment project have to be expressed in terms of equivalent money value as well as in terms of values of a particular time. Thus, a dollar available in one years time is not equivalent to a dollar value today: this is because a dollar available one year from now can be invested and earn interest for one year: if the interest rate is *r*, then a dollar invested for t years will grow to be $(1+r)^{t}$.[18]

Challenges of obtaining data and converting them into a coherent framework of the type outlined above cannot be underestimated nor can the claims on scarce skilled resources to undertake the tasks. But, given the importance of the issue of land acquisitions and its implications for the future, there appear to be few alternatives to a rigorous CAB, however imperfect the data and indeed the methodology.

[17] Based on UNCTAD report prepared by A.K.Sen on cost benefit analysis (TD/B/C.3/94/Add.1)1972.

[18] To put it differently, the amount of money that would have to be deposited now so that it would grow to be one dollar t years in the future would then be $(1+r)^{-t}$.