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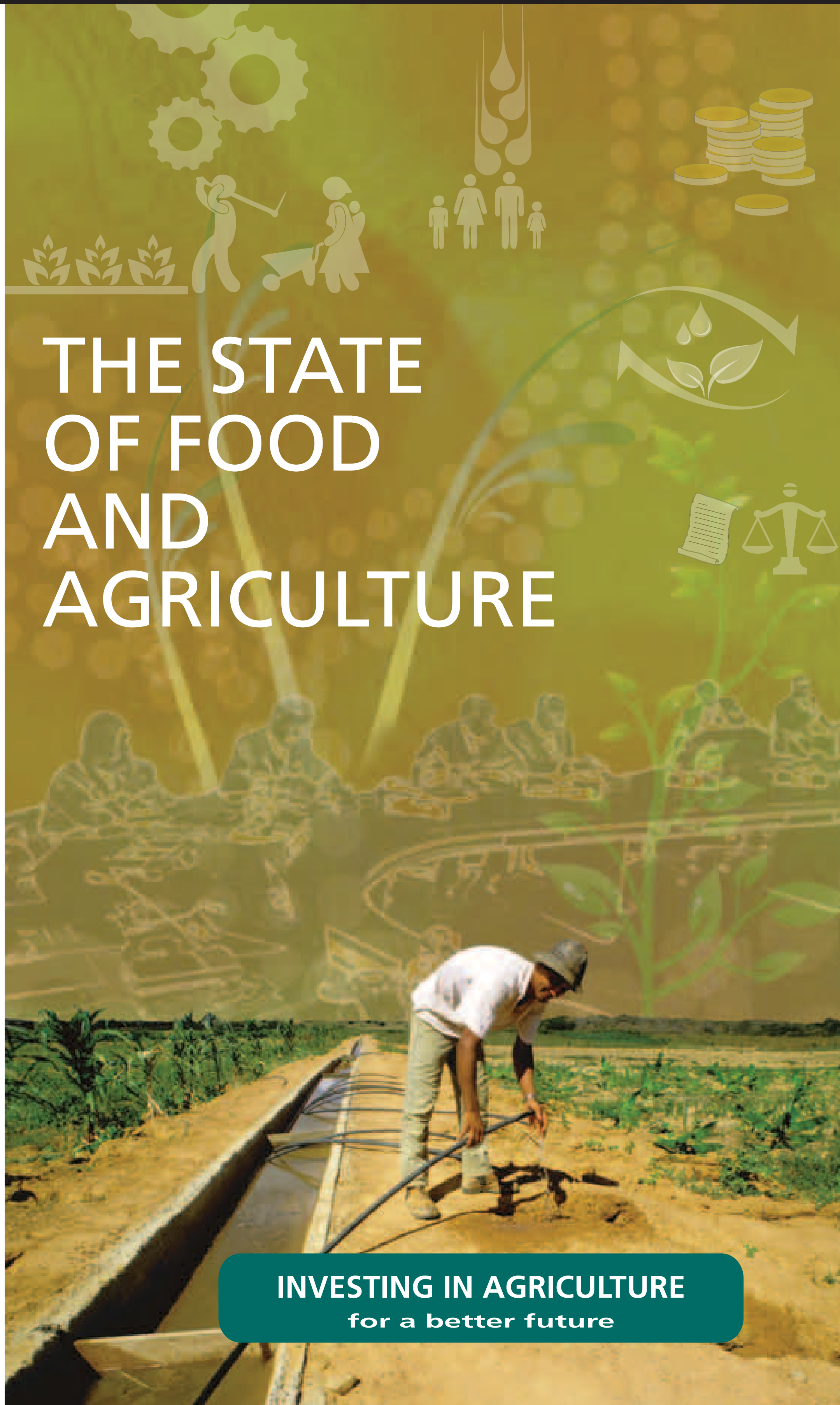

THE STATE OF FOOD AND AGRICULTURE

INVESTING IN AGRICULTURE
for a better future

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THE STATE OF FOOD AND AGRICULTURE

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Foreword

Heads of State and Government and high-level representatives from countries and organizations gathered at the United Nations Conference on Sustainable Development (Rio+20) in June 2012 to declare a common commitment to ensuring the promotion of an economically, socially and environmentally sustainable future for our planet and for present and future generations. Agriculture and hunger eradication have also taken their rightful place as one of the top priorities on the international agenda. During the Rio+20 gathering, the United Nations Secretary-General Ban Ki-moon announced The Zero-Hunger Challenge, calling for an end to world hunger. This edition of *The State of Food and Agriculture, "Investing in agriculture for a better future",* makes the case that increasing the levels and the quality of investment in agriculture is central to achieving these goals. It also argues that we need to change the way we invest in agriculture.

Investing in agriculture is one of the most effective ways of promoting agricultural productivity, reducing poverty and enhancing environmental sustainability. Making the transition to sustainable agriculture will not be possible without significant new investment to protect and enhance the efficiency of natural resource use and to reduce waste at all stages of production, processing and consumption. Yet levels of private and public investment per worker in agriculture are stagnant or falling in the regions where rural poverty and hunger are most severe. What's more, too often government spending on agriculture does not yield the highest returns in terms of agricultural productivity, poverty reduction and sustainability.

There is no doubt that more public resources are needed for agriculture. However, rather than just advocating more government and donor funding, this report calls for a new investment strategy that puts agricultural producers at its centre and focuses public resources at all levels on the provision of public goods and the creation of an enabling environment for investment by farmers. It calls upon governments at all levels and their development partners to channel both public and private investment towards activities that yield higher returns for society. All agricultural investors and rural businesses need good governance, macro-economic stability, rural infrastructure, secure property rights and effective market institutions in order to mobilize the resources and assume the significant risks that investing in agriculture entails.

Investors at the smallest and largest ends of the spectrum require special attention: smallholders need support in overcoming the constraints they face in saving and accumulating assets and in coping with the uncertainty and risk that are intrinsic to farming. Cooperatives and other types of producer organizations can help smallholders confront some of these challenges, and social safety nets can allow the poorest farm households to escape poverty traps that prevent them from building productive assets. Large-scale investment may offer opportunities in terms of increased production, export earnings, employment and technology transfer, but they require good governance to protect the rights of local communities and to avoid natural resource degradation.

Investing in agriculture for a better future involves more than simply accumulating physical capital in the sector, although this is part of the challenge; it requires building the institutions and human capacity that will allow the agriculture sector to contribute to a sustainable future. It is my hope that this report will stimulate the global community to put agricultural producers at the centre of their investment strategies for the sector. Only by catalysing investment by farmers and directing public investment appropriately can we achieve a world in which everyone is well nourished and natural resources are used sustainably.

José Graziano da Silva
FAO DIRECTOR-GENERAL

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Abbreviations and acronyms

AOI	Agricultural Orientation Index
ASTI	Agricultural Science and Technology Indicators
CAADP	Comprehensive Africa Agriculture Development Programme
CFS	Committee on World Food Security
EU	European Union
FDI	foreign direct investment
FPI	Food Price Index (FAO)
G20	Group of Twenty Finance Ministers and Central Bank Governors
G8	Group of Eight
GAFSP	Global Agriculture and Food Security Program
GDP	gross domestic product
GEF	Global Environment Facility
IFAD	International Fund for Agricultural Development
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund
MAFAP	Monitoring African Food and Agricultural Policies
MDG	Millennium Development Goal
NEPAD	New Partnership for Africa's Development
NFP	National Food Policy
NGO	non-governmental organization
NRP	nominal rate of protection
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
PRAI	*Principles for Responsible Agricultural Investment that Respects Rights, Livelihoods and Resources*
PSNP	Productive Safety Net Programme
PSTA II	Strategic Plan for Agriculture Transformation II
R&D	research and development
RRA	relative rate of assistance
ReSAKSS	Regional Strategic Analysis and Knowledge Support System
SPEED	Statistics of Public Expenditure for Economic Development
TFP	total factor productivity
UNCTAD	United Nations Conference on Trade and Development
USAID	United States Agency for International Development
VGGT	*Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security*

Executive summary

The State of Food and Agriculture 2012: Investing in agriculture for a better future shows that farmers are the largest investors in developing country agriculture and argues, therefore, that farmers and their investment decisions must be central to any strategy aimed at improving agricultural investment. The report also presents evidence showing how public resources can be used more effectively to catalyse private investment, especially by farmers themselves, and to channel public and private resources towards more socially beneficial outcomes. The focus of this report is on the accumulation of capital by farmers in agriculture and the investments made by governments to facilitate this accumulation.

Agricultural investment is essential to promoting agricultural growth, reducing poverty and hunger, and promoting environmental sustainability. The regions of the world where hunger and extreme poverty are most widespread today – South Asia and sub-Saharan Africa – have seen stagnant or declining rates of investment per worker in agriculture for three decades. Recent evidence shows signs of improvement, but eradicating hunger in these and other regions, and achieving this sustainably, will require substantial increases in the level of farm investment in agriculture and dramatic improvements in both the level and quality of government investment in the sector.

Farmers must be central to any investment strategy

This report presents the most comprehensive data that has been prepared to date on the relative sizes of investment and expenditure flows by farmers, governments, donors and private foreign investors in low- and middle-income countries. Public and private investors spend their resources on different things and for different reasons, and it is not always easy to distinguish between investment and expenditures. In simple terms, investment involves accumulating assets that generate increased income or other benefits in the future, while expenditures also involve current expenses and transfer payments that are not normally considered investment.

Despite these conceptual and empirical limitations, the best available data show that farmers in low- and middle-income countries invest more than four times as much in capital stock on their own farms each year as their governments invest in the agriculture sector. What's more, farmers' investment dwarfs expenditures on agriculture by international donors and private foreign investors. The overwhelming dominance of farmers' own investment means that they must be central to any strategy aimed at increasing the quantity and effectiveness of agricultural investment.

A conducive investment climate is essential for agriculture

Farmers' investment decisions are directly influenced by the investment climate within which they operate. While many farmers invest even in unsupportive investment climates (because they may have few alternatives), a large body of evidence discussed in this report shows that farmers invest more in the presence of a conducive investment climate and that their investment is more likely to have socially and economically beneficial outcomes.

The existence or absence of a conducive investment climate depends on markets and governments. Markets generate price incentives that signal to farmers and other private entrepreneurs when and where opportunities exist for making profitable investments. Governments are responsible for creating the legal, policy and institutional environment that enables private investors to respond to market opportunities in socially responsible ways. In the absence of an enabling environment and adequate market incentives, farmers will not invest adequately in agriculture and their investment may not yield socially optimal results. Indeed, building and maintaining the enabling environment for private investment is itself one of the most important investments that can be made by the public sector.

The elements of a good general investment climate are well known, and many of the same factors are equally or more important in the enabling environment for agriculture: good governance, macroeconomic stability, transparent and stable trade policies, effective market institutions and respect for property rights. Governments also influence the market incentives for investment in agriculture relative to other sectors through support or taxation of the agriculture sector, exchange rates and trade policies, so care must be taken to ensure equitable treatment of agriculture. Ensuring an appropriate framework for investment in agriculture also requires the incorporation of environmental costs and benefits into the economic incentives facing investors in agriculture and the establishment of mechanisms facilitating the transition to sustainable production systems.

Governments can help smallholders overcome challenges to investment

Farmers in many low- and middle-income countries face an unconducive environment and weak incentives to invest in agriculture. Smallholders often face specific constraints, including extreme poverty, weak property rights, poor access to markets and financial services, vulnerability to shocks and limited ability to tolerate risk. Ensuring a level playing field between smallholders and larger investors is important for reasons of both equity and economic efficiency. This is particularly the case for women engaged in agriculture, who often encounter even more severe constraints. Effective and inclusive producer organizations can allow smallholders to overcome some of the constraints relating to access to markets, natural resources and financial services. Social transfers and safety net schemes can also play a role as policy instruments to allow the poorest smallholders to expand their asset base. These can be instrumental in overcoming two of the most severe constraints faced by poor smallholders: lack of own savings and access to credit and lack of insurance against risks. Such mechanisms can allow poor smallholders and rural households to build assets and overcome poverty traps, but their choice of assets (human, physical, natural or financial capital) and activities (farming or non-farm activities) will depend on the overall incentive structure as well as the households' individual circumstances.

Large-scale private investment offers opportunities but requires governance

The increasing international flow of funds directed towards large-scale land acquisitions by private companies, investment funds and sovereign wealth funds has been receiving significant attention. The limited scale of such investment means it is likely to have only a marginal impact in terms of global agricultural production. However, the potential impact at the local level as well as the potential for future growth has led to concerns about possible negative social and environmental impacts, especially in low-income countries, which often have less capacity to establish and implement a regulatory framework to address these issues.

Large-scale investment may offer opportunities to increase production and export earnings, generate employment and promote technology transfer, but can involve risks in terms of overriding the rights of existing land users and generating negative environmental impacts. A clear challenge is to improve the capacity of governments and local communities to negotiate contracts that respect the rights of local communities as well as their ability to monitor and enforce them. Instruments such as the *Principles for Responsible Agricultural Investment that Respects Rights, Livelihoods and Resources* and the *Voluntary Guidelines for the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security* offer a framework in this regard. Alternative and more inclusive business models for large-scale investors that offer opportunities for greater direct involvement of local farmers in agricultural value chains should be promoted.

Investing in public goods yields high returns in agricultural growth and poverty reduction

The provision of public goods is a fundamental part of the enabling environment for agricultural investment.

Evidence from many countries over five decades shows that public investment in agricultural research and development (R&D), education and rural infrastructure yields much higher returns than other expenditures such as input subsidies. Investing in public goods for agriculture yields strong returns in terms of both agricultural productivity and poverty reduction, indicating that these are usually compatible, not competing, goals. Investments in public goods in rural areas are also likely to be complementary in nature; investments in education and rural infrastructure tend to enhance agricultural investment and are often ranked among the top sources of agricultural growth and overall economic growth in rural areas. The relative impact of alternative investments varies by country, so priorities for investment must be locally determined, but the returns to investment in public goods in rural areas are mutually reinforcing.

Improving the performance of public expenditures

In spite of the extensive body of evidence documenting high economic and social returns on investment in public goods that directly and indirectly support agriculture, government budget allocations do not always reflect this priority, and actual spending does not always reflect budget allocations. A number of political economy factors are to blame, including collective action by powerful interest groups, difficulties in attributing responsibility for successful investments that have long lead times and diffuse benefits (as do many agricultural and rural public goods), poor governance and corruption. Strengthening rural institutions and promoting transparency in decision-making can improve the performance of governments and donors in ensuring that scarce public resources are allocated to the most socially beneficial outcomes. Many governments are making efforts to improve the planning, targeting and efficiency of their expenditures, including more transparent and inclusive budget processes. Much more needs to be done to encourage these efforts.

Key messages of the report

- **Investing in agriculture is one of the most effective strategies for reducing poverty and hunger and promoting sustainability.** The regions where agricultural capital per worker and public agricultural spending per worker have stagnated or fallen during the past three decades are also the epicentres of poverty and hunger in the world today. Demand growth for agricultural products over the coming decades will put increasing pressure on the natural resource base, which in many developing regions is already severely degraded. Investment is needed for conservation of natural resources and the transition to sustainable production. Eradicating hunger sustainably will require a significant increase in agricultural investment and, more importantly, it will require improving the quality of investment.
- **Farmers are by far the largest source of investment in agriculture.** In spite of recent attention to foreign direct investment and official development assistance, and in spite of weak enabling environments faced by many farmers, on-farm investment by farmers themselves dwarfs these sources of investment and also significantly exceeds investments by governments. On-farm investment in agricultural capital stock is more than three times as large as other sources of investment combined.
- **Farmers must be central to any strategy for increasing investment in the sector, but they will not invest adequately unless the public sector fosters an appropriate climate for agricultural investment.** The basic requirements are well known, but too often ignored. Poor governance, absence of rule of law, high levels of corruption, insecure property rights, arbitrary trade rules, taxation of agriculture relative to other sectors, failure to provide adequate infrastructure and public services in rural areas and waste of scarce public resources all increase the costs and risks associated with agriculture and drastically reduce incentives for investment in the sector.

Governments must invest in building the institutions and human capacity necessary to support an enabling environment for agricultural investment.

- **A favourable investment climate is indispensable for investment in agriculture, but it is not sufficient to allow many smallholders to invest and to ensure that large-scale investment meets socially desirable goals.**
  - **Governments and donors have a special responsibility to help smallholders overcome barriers to savings and investment.** Smallholders often face particularly severe constraints to investing in agriculture because they operate so close to the margins of survival that they are unable to save or to tolerate additional risk. They need more secure property rights and better rural infrastructure and public services. Stronger producer organizations such as cooperatives would help them manage risks and achieve economies of scale in accessing markets. Social safety nets and transfer payments may help them accumulate and retain assets, either in agriculture or in other activities of their choice.
  - **Governments, international organizations, civil society and corporate investors must ensure that large-scale investments in agriculture are socially beneficial and environmentally sustainable.** Large-scale investments, including by foreign corporations and sovereign investors, may offer opportunities for employment and technology transfer in agriculture but may also pose risks to the livelihoods of local populations, especially in cases of unclear property rights. Governance of these investments must be improved by promoting transparency, accountability and inclusive partnership models that do not involve transfer of land and that allow local populations to benefit.
- **Governments and donors need to channel their limited public funds towards the provision of essential public goods with high economic and social returns.** Public investment priorities will vary by location and over time; but evidence is clear that some types of spending are better than others. Investment in public goods such as productivity-enhancing agricultural research, rural roads and education have consistently higher payoffs for society than spending on fertilizer subsidies, for example, which are often captured by rural elites and distributed in ways that undermine private input suppliers. Such subsidies may be politically popular, but they are not usually the best use of public funds. By focusing on public goods, including sustainable natural resource management, governments can enhance the impact of public expenditures in terms of both agricultural growth and poverty reduction. Governments must invest in building the institutions and human capacity necessary to support an enabling environment for agricultural investment.