Investment Contracts for Agriculture

Maximizing Gains and Minimizing Risks*

The recent increase in private investment in large-scale agricultural projects in developing countries has raised concerns about the implications for longer-term sustainability and food security in host countries. Recent research reveals the importance, both for developing countries and investors, that such investment be beneficial not only in the short term, but most importantly sustainable in the long term with minimal risks or negative effects and contributing to host country's development objectives.

PRACTICAL LEGAL GUIDELINES BASED ON CONSIDERABLE EMPIRICAL EVIDENCE

Carefully negotiated contractual arrangements between investors and governments can contribute significantly to the success of agricultural investment projects. This Note combines two bodies of research: 1) evidence of the impacts of investments based on field surveys of large-scale matured agricultural investments conducted by UNCTAD and the World Bank, and 2) practical guidance on legal options for maximizing the main beneficial outcomes and minimizing the main downsides through better drafting of contracts based on work conducted by IISD. It contributes to the growing body of international norms on the conduct of responsible agricultural investment to help turn investor interest into an opportunity for rural development.[1]

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DETAILED EXAMINATION OF KEY STAGES IN CONTRACT NEGOTIATION

Contracts are the most directly relevant legal instrument for agricultural investment, and greater attention is needed to the role that they play. They define rights and obligations, benefit-sharing arrangements, exit strategies, and modalities for redress. They help to fill the gaps in domestic laws.

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*Note: This *Note* is the summary of the latest report: Smaller, C., and W. Speller, with H. Mirza, N. Bernasconi-Osterwalder,and G. Dixie. 2015. "Investment Contracts for Agriculture: Maximizing Gains and Minimizing Risks." Washington, D.C.: World Bank Group; New York: United Nations; and Winnipeg: International Institute for Sustainable Development (IISD).

The preparatory stage is fundamentally important for maximizing the chances of positive outcomes, not only in commercial terms but also for longer-term sustainability. Aside from technical production and market assessments, feasibility studies and business plans, it's important to carefully evaluate the economic and social impacts on nearby communities. Host country governments should carefully vet prospective investors.

The actual negotiation of the contract involves defining the rights and obligations of the investor and those of the government. It should also reflect the interaction with local communities and other stakeholders initiated during the preparatory stage.

Monitoring and enforcement are often the most challenging stages for governments because of limited resources and capacity, but it is essential to assess whether investment obligations are being fulfilled for the benefit of all concerned stakeholders.

CLEAR GUIDELINES ON HOW TO MAXIMIZING POSITIVE OUTCOMES AND MINIMIZE KEY RISKS

The key five positive outcomes and the top five downsides from farmland investments are listed in Tables 1 and 2, respectively.

Guidelines on how to maximize the individual key benefits through the contract process (preparation, negotiation, and enforcement) are given in Table 3, while similar information to minimize the key risks of agricultural investment are presented in Table 4.

The legal options indicated in Tables 3 and 4 are not intended to be a blue print, but rather a guide to possible best practices to assist negotiations by governments, investors, and local communities.

SUGGESTIONS ON HOW TO GET IT RIGHT

Decisions should be made based on sound evidence and research about what works and what does not. This foundation of knowledge should

TABLE 1. Top five positive outcomes from farmland investments

Positive outcome 1: Employment creation

- Employment creation is the key benefit, and can involve provision of housing, education, and healthcare for employees and their families
- More is needed to improve working conditions, better integrate women, build the skills of the workforce and increase employment of nationals in senior positions

Positive outcome 2: Integration of local farmers

Investments in land that also integrated nearby farmers (through outgrower schemes) were the most successful business model and the only investments where there was a significant transfer of technology

Positive outcome 3: Expansion of market opportunities

- The investors who set up a processing facility were perceived more favourably
- A number of investments provided new markets for local contractors and suppliers of fuel, fertilizer, and machinery

Positive outcome 4: Establishment of community development programs

Where investors built relations with the community and provided social and economic development programs they were more likely to be financially successful

Positive outcome 5: Increased incomes improved food security

Some investments had a positive impact on food security due to increased incomes for those employed or contracted by the project

TABLE 2. Top five downsides to farmland investments

Downside 1: Loss of land and poor resettlement plans

The standout negative impact on local communities was reduced access to land, coupled with poorly executed resettlement plans

Downside 2: Lack of openness and engagement with local communities

Lack of transparency surrounding land deals and inadequate consultation with local communities led to a sense of fear, mistrust, and resentment, creating operational and financial difficulties for investors

Downside 3: Weak assessment of commercial viability

Many projects fail or are struggling due to factors that could have been identified by better pre-investment screening, feasibility studies, and due diligence

Downside 4: Poor management of environmental and social impacts

Impact assessments are treated as "box-ticking" exercises and not translated into management plans and not monitored

Downside 5: Insufficient mechanisms to raise grievances

There were insufficient mechanisms for local communities to raise grievances and seek redress.

then be translated into concrete and detailed provisions in contracts or through other legal frameworks and mechanisms applying to the investment. A significant amount of groundwork is needed prior to entering into negotiations. Even more work is needed after the investment has begun to ensure all parties live up to their commitments. Getting this right is an important step in generating positive, sustainable outcomes for governments, communities, and investors.

TABLE 3. How to maximize key benefits of agricultural investment through the contract process

	Preparing for contract negotiations	*Drafting the contract*	*Monitoring and enforcement*
Employment creation	Give priority to business models which maximize job creation Consider likely composition of employees and jobs, e.g., local/national people, gender, permanent/temporary jobs Consider investor plans for training, and employee benefits	Include targets for employment of locals and/or nationals State applicability of domestic labor, health, and safety laws Require training programs for local staff Ensure commitments for employee benefits (housing, education, health benefits, etc.) are included	Monitor adherence to domestic labor, health, and safety laws Monitor job creation, training, and employee benefit commitments Require annual reporting on employment targets and training programs
Integration of local farmers	Give priority to investors that have outgrower schemes Ensure the business model is resolved before outgrowers are introduced Treat new crops, technology, and business models with caution, but do not exclude them entirely	Include provision requiring establishment of an outgrower scheme Set requirements for technical support or provision of inputs to outgrowers Set framework for establishment of a fair, transparent pricing mechanism	Monitor outgrower scheme and support provided Require annual reporting on the performance of outgrower schemes Participate and monitor price-setting mechanisms
Expansion of market opportunities	Give priority to investors who will set up local processing facilities, where commercially viable Consider whether the investor plans to import inputs or purchase them locally	Establish commitments for setting up a processing facility Require the investor to give preference to local suppliers, where available Require the investor to establish local business development plans	Monitor adherence to local business development plan Monitor development of processing facility Require annual reporting on implementation of local business development plan and processing facility
Establishment of community development programs	Consider investors' plans for community development programs Give priority to financially-inclusive business models Ensure proper consultation, engagement, and access to information for local community	Require investors to establish community development agreements that are annexed to the contract Establish terms of, and process for, community development agreements or financially-inclusive business models	Monitor adherence to community development agreements and financially-inclusive business models Failure to set up and comply with community development agreement amounts to a material breach of contract Require annual reporting on implementation of community development agreement
Increased income improved food security	Consider all food security implications of investments Give priority to investors whose operations support local and national food security strategies	Include a provision on local community food programs Require a certain percentage of food crops be sold in the national market, where appropriate	Monitor adherence to local community food program commitments Monitor impact of investment on local food security

TABLE 4. How to minimize key risks of agricultural investment through the contract process

	Preparing for contract negotiations	Drafting the contract	Monitoring and enforcement
Loss of land and poor resettlement plans	Map out and identify all existing users of the land, including formal and informal rights Verify through community consultation that no residual land disputes exist Consider investor plans for resettlement and/or working with existing users of the land	Define rights of investor to use and access the project site Annex map with geographical boundaries and special features to be left in tact Prepare resettlement plan, if needed, with consent of resettled persons	Monitor investors to ensure they remain within allocated land and use land for the agreed purposes Create mechanism for local community to raise grievances about land issues Require investor to report on land disputes that arise
Lack of openness and engagement with local communities	Conduct full and transparent consultations with communities prior to negotiations Ensure transparency about the process for investors to access land and make investments	Engage with local communities during the design of the project and during the drafting of its terms Include a disclosure provision which outlines which documents will be made public	Make contracts and other related documents public, excluding confidential business information Ensure commitments made during consultations with communities are upheld
Weak assessment of commercial viability	Screen investors with respect to their technical and financial capabilities Give priority to business models that are most likely to be financial and operational successes Conduct business feasibility studies and prepare a business plan based on outcomes Ensure feasibility studies and business plans are approved by government and verified by an independent third party	Specify elements to be included in the feasibility study Incorporate milestones of the business plan Require that material changes to the business plan be reported Include assignment and termination clauses to address potential failure	Failure to prepare feasibility studies and business plans is a material breach of the contract and is grounds for termination Monitor financial and operational performance of the project Report changes to the business plan Design contingency plans for cases in which investors fail, including return of unused land, transfer of rights to a third party, or contract termination
Poor management of environmental and social impacts	Conduct social and environmental impact assessments and incorporate findings into management plans and wider business plan Ensure assessments and management plans are approved by government and verified by an independent third party	Supplement domestic legislation with specific guidance for elements to be included in assessments and plans Incorporate findings of impact assessments and management plans Include social and environmental impact assessments as binding obligations	Failure to conduct impact assessments and prepare management plans amounts to a material breach of the contract and is grounds for termination Annual reporting on implementation of social and environmental plans Monitor water quantity and quality, soils, and changes in climatic conditions
Insufficient mechanisms to raise grievances	Design grievance and redress mechanisms in line with the community consultations Establish ongoing channel of communication between investor and community	Include a provision for establishment of a grievance and redress mechanism, based on IFC performance standards	Report annually on grievances and how they have been addressed

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