



## “PROMOTING GOOD PRACTICES FOR AGRICULTURAL INVESTMENT”

20 November 2015

### The importance of a secure legal environment for agricultural investments

**Prof. A. Mazzoni – President of UNIDROIT**



*Distinguished Panel members, Ladies and Gentlemen*

It is a great pleasure to have you with us today for this morning session on “Promoting Good Practices for Agricultural Investment”. As you are already aware, the focus of session will be first on Contract Farming and second on land investment contracts, both of which represent important types of agricultural investments in terms of economic and social impact. In particular, and logically in the context of the Global Forum’s Law, Justice and Development Week, the broad objective is to illustrate how *legal* standards, in particular standards developed by intergovernmental organisations, can enhance good practices and make investments economically sound and sustainable for farmers, investors and other stakeholders.

Before leaving the floor to the panelists, please allow me to share some considerations in three connected areas: (1) on investments in agriculture, (2) the importance of a secure legal environment for agricultural investments, and (3) the contribution that private law-formulating organisations can make in setting legal standards for good practices and fair relationships.

#### **A - INVESTING IN AGRICULTURE**

##### **1. – Agriculture: a local matter with global concerns**

Whether for subsistence purposes or profit, agricultural production has relied mainly if not exclusively upon farmers’ initiative, control, and risk-taking. Inherently based on land, agricultural-related activities have essentially been characterised by localism.

However, in hardly more than half a century, this situation has changed dramatically. As a result of increases in the demand for food, agricultural activities have become ever more integrated into the business environment. Both as a cause and as a consequence, production and marketing of agricultural products have become increasingly subject to global tensions and challenges, deriving in particular from (1) food security concerns, (2) the development of value chains and (3) global competition.

*Food security concerns:* global demographic growth in particular in urban areas requires increased agricultural productivity, fostering productive investment and securing stable food supplies for the world’s population. Food security also requires special attention on environmental impact and is also a priority in many countries where the mainly rural family and small-scale farmers who are main actors in food production are particularly vulnerable to famine crisis risks and volatility of agricultural commodity prices.

*Value chains*: refer to linkages between operators supplying goods – such as inputs, raw commodities, final products as well as capital and technology – and multiple services, and enable an appropriate alignment of operations to meet the required economic objectives and increasingly used technical standards. In highly integrated systems, one actor may own or control a significant part of the chain.

*Global competition*: as a result of trade liberalisation in most countries and open international trade at the global level, there is increased competition, with concentrated actors in food processing and distribution operating internationally through organised value chains, linking production places and distant markets in foreign countries.

## **2. – Increasing investment needs in agriculture**

Large amounts of financial resources are crucially needed for the creation of productive assets and capital formation, to meet the food security concerns and to support economic and social growth in rural areas. Investments in agriculture can take many forms, such as money lending or equity participation, with a higher or lower level of control over the financed activity. Agricultural investment is typically directed toward financing land acquisition and facilities development, the purchase of equipment, livestock and machinery, and input and crop financing. It may also rely on contractual relationships in which a farmer or firm produces to the specifications of a transnational corporation, which reflects the contract farming pattern.

A number of institutions and intermediaries may operate on local rural financial markets, such as commercial banks who are investing, like other institutional investors, in the emerging market agricultural sector and have been able to mobilise larger amounts of capital than in the past. For commercial investors on the international marketplace such as private equity funds and international investment banks, investments in agriculture have become increasingly attractive in view of the recent increase in prices for agricultural commodities. One particular form of investment which will be discussed during this session concerns acquisitions or long term leases by foreign investors.

## **3. – Ensuring responsible investment in agriculture**

From the rural communities' perspective, the transformation of agriculture toward commercially-oriented activities entails opportunities, but also risks. It is generally recognised that the farming community encompasses very different realities. To ensure responsible investment, large categories of agricultural producers in developing countries would require targeted strategies and actions to support and accompany the process toward new production methods and patterns, to ensure that they are not deprived of their legitimate rights, that they receive the expected and fair economic and social benefits, that any disruption caused to their livelihood is mitigated or adequately compensated.

Two recently adopted instruments have special relevance in this context: the Voluntary guidelines on the responsible governance of tenure of land, fisheries and forests in the context of national food security, and the Principles for Responsible Investment in Agriculture and Food Systems, adopted respectively in 2012 and 2014 under the auspices of the Committee on World Food Security (CFS). They provide important guidance in this regard. Many other actors including business associations have adhered to a variety of voluntary principles and documents promoting the recognition and enforcement of rights of farmers and rural populations in the context of agricultural investments.

# **B - PROMOTING A CONDUCTIVE LEGAL FRAMEWORK FOR SUSTAINABLE AGRICULTURAL INVESTMENTS**

## **1. – The role of private law rules**

Enabling factors for domestic or foreign investments in agricultural production include many aspects. In addition to a number of fundamental economic conditions, public policy orientations and the regulatory and institutional environment play a major role, for example regarding investment regulation, competition rules, tax policies, labor and social protection, public entities efficiency, the global administration of justice, etc.

An enabling and secure environment requires adequate private law rules in the various areas of property law, commercial money lending, secured transactions, capital markets, contract law, company law, and dispute resolution among others. Obsolete or inefficient laws may discourage

agricultural production or deprive commercial investors as well as farmers or agricultural enterprises of the legal certainty and predictability needed for their investment. They may also pose obstacles to marketing of agricultural products or limit access to credit needed for modernisation or expansion of agricultural production.

While promoting economically profitable agricultural activities, the legal rules must also comply with overarching human rights principles and promote fair transactions, thereby ensuring sustainability for all actors in the long term. While trade liberalisation has boosted private initiative and open competition in world markets, certain activities require more regulation than others to correct market distortions and negative social impacts. Agriculture is certainly one key area where potentially high economic returns can create major social and policy concerns.

## **2. – Promoting legal certainty and rights enforcement**

A telling example of the difference that efficient legal rules can make in supporting investment regards access to credit. One main reason for the high cost of capital for agriculture investment, which is a typical obstacle for farmers seeking credit, is legal risk. Risk is generally associated with the debtor's ability to provide adequate collateral and other performance guarantees to the lender, and the ease with which the creditor may enforce its rights. While small farmers as the typically weaker party in the bargain may require special protection, commercially operating farmers may actually wish to be able to tap effectively commercial lending and capital markets funding mechanisms. Adequate secured transactions laws and effective enforcement procedures – in particular through workable alternatives to court litigation such as mediation or arbitration – may therefore play an important role in facilitating access to credit.

Other telling examples are given by the topics of this morning's session and will be discussed at length during the ensuing discussions. One topic concerns tenure rights and their recognition. Clarifying and streamlining land titling, acquisition and registration of property rights facilitates investment as the land can serve as collateral for funding, thereby diminishing risk for the investor and lowering the cost of debt or equity capital for investment. Similarly, it is important to provide for secure tenure rights where farmers live on land under customary forms of tenure and lack formal title, so that those farmers are able to produce without fear of losing the land and being able to obtain investment.

On the other hand, contract farming, which is generally recognised as a potentially beneficial alternative to equity investment, needs to be supported by adequate rules. Such rules include ensuring stable and balanced contractual relationships between producers and contractors during the life of the contract, protecting parties against abusive practices by clearly delineating the rights of both the producer and the contractor, and encouraging effective dispute resolution mechanisms to offer redress and to deter against contract breach.

## **C – THE CONTRIBUTION THAT PRIVATE LAW-FORMULATING ORGANISATIONS CAN MAKE IN SETTING LEGAL STANDARDS FOR GOOD PRACTICES AND FAIR RELATIONSHIPS**

The discussions to follow during this session will focus on specific instruments prepared by international organisations. I shall limit myself to just a few more remarks, discussing first the key players and second the types of instruments they use.

### **1. – The players**

Supranational organisations are key actors in the preparation of global private law rules. Certain organisations with sectorial competence or pursuing regional economic integration, as well as international financial organisations, have prepared legal instruments in furtherance of their specific objectives. In addition, a large number of organisations and supranational forums provide policy advice, which are relevant to private law issues and perspectives.

Agricultural and food security-related matters are part of the agenda of a number of organisations, but two United Nations agencies have a leading role in the area, the Food and Agriculture Organization of the United Nations (FAO) and the International Fund for Agricultural Development. In addition the Committee on World Food Security (CFS) to which I have referred earlier, serves as

a forum in the United Nations system for review and follow-up on policies concerning world food security and access to food.

For harmonisation and unification of private law, there are three main international organisations, including the International Institute for the Unification of Private Law (UNIDROIT), the Hague Conference on Private International Law, and the United Nations Commission on International Trade Law (UNCITRAL). Under a substantive law or conflicts of law approach, they have developed instruments in a large variety of civil, commercial and procedural matters. UNIDROIT, for example, has prepared landmark instruments in the areas of general contract law, secured financing, capital markets, transnational civil procedure, cultural property protection, to mention just a few.

## **2. - Setting legal standards for good practices and fair relationships**

These organisations formulate a wide range of instruments to achieve their objectives. Beside the traditional multilateral treaty instrument, which is submitted to formal ratifications by States, legal standard setting organisations have developed many forms of instruments which intend to offer a model or guidelines. Such instruments may be intended for legislators, economic actors, or a larger amount of stakeholders. Although not binding, soft law rules draw their legitimacy both from the authority of sponsoring organisations, whose technical expertise, political neutrality and transparent working methods involving the participation of stakeholders, are the basis for instruments.

Soft law rules permit espousal of best solutions rather than to reflect generally accepted solutions as a minimum common denominator. Because of their non-binding character, this “innovative” approach is likely to find less obstacles in reaching a higher consensus in the preparation stage, and permits promotion of advanced concepts supported by the sponsoring organisations as part of their policy objectives.

Soft law rules may have a large number of applications. To mention just a few, they find a useful application in the context of domestic law reform and the modernisation of certain aspects of domestic legal systems. They also allow for an adaptation to the particular situation of recipient countries, including local culture, economy and institutions. Soft law generally provides a benchmark against which parties can assess their practices. They may have a gap-filling role with default rules considered by public and private enforcers and they generally contribute to the body of authoritative documents likely to shape effectively future practices.

.....

Agriculture universally has a history that is characterised by an apparently unsurmountable dependence on “localism”. This, however, is no longer the case. Sustainable development, social justice, and the empowerment of the weakest sections of rural populations cannot occur at the necessary pace until and unless a context is created favouring a constant flow of adequate investments in equitable terms towards agriculture. In turn, adequate investments on equitable terms will not realistically move towards agriculture unless the unavoidable diversities reflecting agricultural localism are somewhat counterbalanced by a minimum uniform or harmonised legal framework.

The preparation of the Legal Guide on Contract Farming is the successful outcome of a partnership between UNIDROIT, FAO and IFAD. As the world is becoming ever more global, it is also more complex and requires a high level of technical expertise, as well as political sensitivity. Many organisations are involved in field operations and project management, in developing project financing, in policy design and regulatory advice. While all actors should join forces and build cooperation, intergovernmental organisations have a special responsibility in this regard. The international community agenda has set common objectives, which require sharing experiences and building synergies to engage in coherent actions and to maximise resources and benefits.

.....