FOREIGN INVESTMENT IN AGRICULTURE AND HIGH COMMODITY PRICES: A CONTRIBUTION TO UNDERSTANDING MERCOSUR’S PRESENT CHALLENGE

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The aim of this article is to analyse the main incentives for foreign investment in agriculture in the four original Southern Common Market (MERCOSUR) countries. This study constitutes a contribution to the debate about the effects of the present high agricultural commodity prices. Although there is substantial scholarly research on trade patterns, dependency and Dutch Disease, there is a much less understanding of the connection between commodity prices and foreign investment. The goal of this article is to provide some starting points to understand this dynamic. This paper argues that the incentives of domestic and international actors are aligned to investing more capital into commodity farming activities. Particularly, in this scenario of high prices. In this sense, it submits that there are limited probabilities that foreigners will get involved in food processing or distributing activities, except for projects seeking to serve the regional market or very specific sectors. In addition, although the MERCOSUR governments may have an interest in curbing a potential excess in commodity farming (to prevent dependency or a Dutch Disease), the paper explains why the interaction of private and public incentives shifts government attitudes to self-indulgence.

INTRODUCTION

The agricultural commodity boom shapes the economic scenario in the four original MERCOSUR countries. The high prices of soya, corn and other export commodities have affected the pattern and value of their international trade. These countries show an increasing specialization in agricultural commodities, most of which are exported outside Latin America. In addition, as a result of such high prices, they have been enjoying consistent trade account surpluses in recent years (Gayá & Michalczewsky, 2011, pp. 42-47). However, this scenario of alleged bonanza may become a short-term trap. This international trade pattern might eventually lead to dependency or to the Dutch Disease phenomenon (Gallagher, 2010, pp. 5-6; Kosacoff & Campanario, 2007, p. 17). In brief, these countries may undergo an appreciation of their currency and a subsequent loss of competitiveness of their high-value exports. This would only exacerbate...
their dependency on commodity exports. As in the past, many commentators expect commodity prices to return to lower levels. This would put immediate pressure on the exporting countries’ external balances (Kosacoff & Campanario, 2007, p. 17).

Although there is substantial scholarly research on trade patterns, dependency and Dutch Disease, the connection between commodity prices and foreign investment is much less understood. The aim of this article is to provide some starting points to help understand these dynamics. The arguments exposed here are built upon the eclectic paradigm of foreign investment and multinational corporation activity, which in its most recent form, requires focusing on international business, political economy and institutions (Dunning & Lundan, 2008, pp. 116-144; Boddewyn, 1988, pp. 342-346; Gilpin, 2001, pp. 278-304). Business strategy, state incentives and market structure are essential elements to conduct an adequate analysis of the links between the agricultural sector and foreign investment. All other things being equal, the evidence suggests that a rise in agricultural prices will mainly attract to MERCOSUR resource-seeking foreign investments (FAO, 2011; Piñeiro & Villarreal, 2012). This means that most foreign capital flows into agriculture are ultimately aimed at exporting commodities or speculating with prices. In my view, the incentives of domestic and international actors are intended to promote the investment of more capital in commodity farming activities, particularly in this scenario of high prices. In line with this, foreigners are very unlikely to devote themselves to processing or distributing activities, unless these projects seek to serve the regional market or very specific sectors. Moreover, although the MERCOSUR governments may have an interest in curbing a potential excess in commodity farming (to prevent dependency or the Dutch Disease), this paper will explain why the interaction of private and public incentives leads governments to adopt attitudes of self-indulgence.

**Domestic Agricultural Sector**

Argentina, Brazil, Paraguay and Uruguay show, to different extents, high levels of agricultural land concentration (FAO, 2011). Two groups share the control of the land. First, the traditional elites of landowners who have historically controlled very large establishments in many regions of MERCOSUR. Although these elites had more power in the past, they are still important economic and political players. Exporting sectors in developing countries have considerable leverage over the political sphere. Their strength lies in the fact that they control essential resources of the economy, and also in their close ties with foreign players, normally from more powerful countries (Shadlen, 2008, p. 14). In fact, no MERCOSUR country has passed any serious rural reform, and, arguably, the power of the agricultural elite has increased during the present commodity boom.

Second, in the last ten years, a new agribusiness sector has emerged together with the soya and corn booms. This sector is financially sophisticated and does not necessarily rely on land ownership. Its influence on the commodity markets is very important and is characterized by its ability to attract and channel domestic and international funds to gain control over large areas of land (sometimes through contract farming) for the production of export commodities. For this reason, the ownership structure of these agricultural investment funds is rather opaque, hiding domestic, regional and foreign investors (Piñeiro & Villarreal, 2012, pp. 4-14; FAO, 2011, pp. 14-17; 86-87). As a key player in the exports field, the political influence of this sector is also relevant.

Overall, these actors can be viewed as having little or no interest in any policy intended to upgrade to food processing and distribution. In fact, such an attempt might put their export business at risk. On the contrary, they show an open support for free trade and policies oriented to assuring and opening new markets for their commodities (Shadlen, 2008, p. 2). Reasonably, any rise in agricultural commodity prices strengthens the bargaining power of these actors. In addition, higher prices mean further incentives to concentrate more land and improve large-scale techniques. As a result of their international connections, it can be said that foreign actors play a key role in these initiatives. Thus, local groups develop an interest in flexible regulations to attract foreign capital (Colombres, 2011; Ávila, 2011). The influence of this domestic-foreign coalition

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**The Actors’ Incentives**

The reasoning here draws from the private and public incentives at the domestic and international level. In this context, state-owned firms qualify as private actors when they pursue profits, and as public actors when their goal is to guarantee food supply at the domestic level.
has recently become evident in the four original MERCOSUR countries. In Argentina, these groups united forces to block an increase in export tariffs. In Paraguay, groups of large landowners, many of whom are foreigners, have managed to gain control over more land, displacing indigenous populations. In Uruguay, the agricultural establishment has blocked several initiatives to restrict land acquisition by foreigners. Finally, in Brazil, the agricultural lobby is gaining more and more power in Congress, where its representatives are promoting a law to repeal the limitations to foreign land ownership.

**The Domestic Public Sector**

In the 1990s, Argentina, Brazil, Paraguay and Uruguay implemented free trade reforms, thus dismantling the system in place protecting some domestic industries and concentrating back on their traditional exports, i.e. agricultural commodities (Bonnal et al., 2003, pp. 5-8). These neo-liberal projects failed to different extents, and the political sectors that had promoted these measures lost the elections taking place in the 2000s. Paradoxically, the center-left administrations that took office in these countries have been favored by an unprecedented increase in the price of such agricultural commodities. As a result, these governments have enjoyed trade account surpluses, which are being spent in infrastructure and social projects. In addition, in the context of the global crisis, the original MERCOSUR countries continue to benefit from relatively sound macroeconomic positions. In this way, except for the recent episode in Paraguay, the other three administrations have been either re-elected or the governing party has prevailed in the following elections.

Regardless of the actual destination of the funds, which is beyond the scope of this paper, these administrations have little incentive to put the source of these trade surpluses at risk. Despite the political discourse against foreign dependency, the present governments may be falling into some self-indulgence (Kosacoff & Campanario, 2007, p. 17; Moreno, 2012). First, this attitude is consistent with the short-term nature of political incentives. Many of the present social and infrastructure policies depend, although to a different extent according to each MERCOSUR member country, on agricultural exports. Second, any attempt to upgrade the commodity model threatens the existing economic bonanza. On the one hand, the domestic agricultural sector would resist these reforms. On the other, the international scenario poses obstacles to a shift to higher-value food activities (see The International Private Sector and The International Public Sector below).

In this regard, the MERCOSUR countries tend to limit their international demands for the free trade of their agricultural commodities (The China Post, 2011; Laens & Terra, 2006, p. 1). This behavior is consistent with their real possibilities in a multilevel scenario, where they need to negotiate with their domestic agricultural sector, multinational corporations and other states (Putnam, 1988; Strange, 1992). The MERCOSUR countries are more likely to get a tariff reduction on wheat or cotton than the dismantlement of the tariff escalation structure. Therefore, during a commodity boom, the most profitable exporting opportunities are most likely to open up in highly demanded commodities, as it presently occurs with soya and corn. For all these reasons, the MERCOSUR governments are not expected to take serious measures to curb the exacerbation of commodity farming. As elaborated further on, the only exception to this general attitude could be the imposition of limitations on foreign land acquisition.

**The International Private Sector**

The private sector cannot be considered monolithically, as its actors have different short- and long-term incentives. For this reason, the international private sector should be broken down into multinational businesses and international speculators. First, in relation to the multinational food sector, the evidence shows that most global food firms come from and have stronger ties with developed countries, although there are competitive global commodity companies from developing countries as well (UNCTAD, 2009, p. 124). In MERCOSUR, the only truly global food firm is JBS (meat and poultry), while Brazil Foods has only a regional presence (IMAP, 2010, Annex A). The size of these firms cannot be compared to large global corporations such as Nestlē or Kraft. These conglomerates control most of the global food production chain (farming, processing and distribution). In addition, supermarkets from developed nations are gaining authority and control over the food chain. Overall, this control means that the MERCOSUR businesses need to integrate into the global chain, and this generally occurs at the farming stages (UNCTAD, 2009, p. 107). In this structure, multinational firms and supermarkets have the incentive to secure their supply
of commodities in the most convenient location. These actors may follow strategies of direct investment or other forms of involvement, such as joint ventures or long-term supply contracts, but in most cases their objective is to farm or acquire commodities that will be exported for processing and distribution in a different location. Additionally, these foreign firms make investments aimed at capturing the local markets (market-seeking investment) and, depending on their size, the MERCOSUR countries are potentially good locations for these undertakings.

Second, the increasing prices of agricultural commodities and land attract international speculators, whose investment plans aim at making short-term gains. In a global economy in crisis, where it is difficult to find good business opportunities, it is reasonable that speculators should try to invest in agricultural land when food prices show an upward trend. In addition, these actors are unlikely to invest in any form of medium-term activity. In fact, speculators want to maintain as much freedom as possible to relocate their funds quickly. For this reason, they will exert pressure to reduce state regulation to a minimum.

Finally, due to their increasing influence in the commodity and food industry, the role and incentives of biotechnology firms are worth mentioning. In general, these large multinational corporations, such as Monsanto and Nidera, develop products to improve large-scale commodity farming. In this way, there is a natural alliance between large landowners, agribusiness groups, and biotechnology firms. Although these actors battle one another on some concrete issues, such as property rights, policies regarding genetically modified organisms are a paradigmatic example of their concurrent interests. Overall, biotechnology firms have a concurrent interest with traditional landowners and agribusiness groups in supporting “La República Unida de la Soja” (Newell, 2009, pp. 56-57).

The International Public Sector

Historically, states have shown an interest in controlling the foreign natural resources required to supply their processing sector and cover their food supply needs. In addition, they have evidenced an incentive to promote processing and distribution activities domestically. Thus, from the perspective of the farming country, the behavior of foreign governments could be divided into two broad categories. The first one involves the establishment of barriers to imports of semi-final and final goods (e.g. pork or soya oil) with the purpose of promoting processing activities domestically (i.e. cattle feeding and oil production). Mainly, these barriers are tariff escalation and phytosanitary regulations. The first mechanism encourages the foreign producer (or subsidiary) to export the commodity, and the local firm to import and elaborate the product locally. As opposed to a flat tariff, which would have more neutral effects, an escalating tariff rises as the value added to the product increases. This promotes an international division of labor between farming and processing countries (Tabb, 2008, p. 7). See below examples from the tariff structures for soya of the European Union and China.

<table>
<thead>
<tr>
<th>Tariff Structure for Soya of the European Union and China</th>
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<tr>
<td><strong>MFN Tariff (ad valorem %)</strong></td>
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<tr>
<td>Soya beans</td>
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<tr>
<td>Soya bean oil, crude</td>
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<tr>
<td>Soya bean oil, other than crude</td>
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<tr>
<td>Oil-cake &amp; other solid residues from soya beans</td>
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**Notes:** <sup>a</sup> In the case of the EU, there are two different tariffs rates, depending on whether the product is “for technical or industrial uses”. <sup>b</sup> The same observation applies (see note above).

**Source:** Based on data from Market Access Map, INTRACEN.

In a scenario of rising food prices, this international division of labor would shift available capital to MERCOSUR only with the purpose of increasing farming activities. On the contrary, the capital interested in food processing and distribution would flow to firms and countries that control and pursue these activities. This would include the MERCOSUR countries only for the purpose of serving these markets. Second, phytosanitary standards may constitute another reason to prefer processing activities to be carried out domestically. Although the WTO implemented a specific agreement related to food standards (SPS Agreement), this mechanism has not brought enough certainty to producers in developing countries (Das, 2008, pp. 1016-1017). Obstacles range from long administrative proceedings to changes introduced for
pseudo-protectionist purposes (Alonso Díaz, 2009, p. 182). In this way, processing agricultural commodities for export to foreign markets is a risky business.

With regard to the second category, governments have a very reasonable interest in guaranteeing food supply, a rationale that is particularly relevant in food importing countries, such as Japan, South Korea and the Arab nations. Although many of these countries began to buy agricultural land or secure their food supply before the 2008 crisis, the scarcity experienced during such period sparked an intense wave of state-driven acquisitions (Piñeiro & Villarreal, 2012; FAO, 2011). This attitude ran parallel to the export ban applied by some farming countries (e.g. Brazil banned rice exports in 2008). It may be argued that a scenario of increasing prices anticipates potential supply shocks, and importing countries would reasonably perceive this as a signal to take adequate measures. Thus far, their strategies have been to acquire land or enter into supply agreements directly or through state-owned firms. In both cases, they are aimed at farming agricultural commodities with a view to exporting them back to their respective home country. These investments would have limited or no interest in undertaking processing activities in the host country.

**HIGH COMMODITY PRICES AND FOREIGN INVESTMENTS IN AGRICULTURE**

The objective of domestic agricultural sectors and the incentives of private and public international actors indicate that any increase in the price of agricultural commodities would attract more capital to farming activities. This, in turn, would lead to an expansion of the arable surface and a shift to export commodities. The argument is valid for both domestic and foreign capital. However, the interest of foreign actors in commodity farming tends to be more homogenous, due to their general set of incentives. Conversely, some domestic players may have opposing views on rising concentration and dependency issues. Increasing inflows of foreign capital, for instance, would have an effect on the exchange rate of the local currency, increasing the chances of the Dutch Disease phenomenon. Therefore, it is reasonable to expect a struggle between different private actors and the public sector regarding foreign investment in agriculture and commodity exports. On the one hand, the agribusiness lobby will favor the expansion of large-scale agriculture, the attraction of foreign capital, and keeping regulations to a minimum. On the other hand, other economic sectors, particularly the manufacturing and processing sectors, would advocate measures to maintain their international competitiveness.

Arguably, the importance of agricultural exports would increase the power of the agribusiness lobby, and domestic governments would remain skeptical about disturbing a good economic situation that is greatly instrumental to many of their immediate political goals. Although the influence of agricultural commodity prices in the good performance of the region is open to debate, the relevance of this factor cannot be disregarded. For Argentina, Paraguay and Uruguay, it is a main source of foreign currency. This does not mean that domestic private and public sectors will not struggle for the distribution of this “extra” benefit; Argentina is a good example of this tension. However, in spite of the voices advocating an upgrade to food processing activities (Ordóñez et al., 2004; Cincunegui, 2010), a scenario of high agricultural commodity prices in MERCOSUR constitutes, in my view, a difficult context for implementing private or public strategies to promote such food processing activities. Foreign investment flows would continue pushing to fund farming activities, unless they are subject to restrictions or limitations. And if direct investments were restricted, other forms of involvement would emerge unless governments modify the incentives currently in force.

However, contrary to the description of the domestic public behavior above, it could be argued that the governments of the four original MERCOSUR countries have considered implementing -and Argentina and Brazil have already implemented- limitations to land acquisition by foreigners. This position contradicts the self-indulgence argument stated before, proving that domestic public efforts are made to curb increasing concentration and dependency on agricultural commodities. This argument is dealt with in the next section, although some reservations are put forward as to the real rationale behind the recently adopted restrictions. In any case, these efforts are not enough to prevent other forms of foreign involvement in commodity farming.
restrictions on the foreign acquisition of agricultural land

In 2010 and 2011, respectively, Brazil and Argentina imposed some restrictions on the foreign acquisition of agricultural land (Perrone, 2012). During this period, the Uruguayan government tried to pass a law introducing such limitations, but the initiative was blocked in Congress. In Paraguay, the issue has been on the agenda, but no serious attempt was made to establish some restrictions. The adoption of these measures confirms the perception that higher agricultural commodity prices attract foreign investment to farming activities, although it may cast some doubt on the previous discussion regarding domestic public incentives. What is clear, although it may require some explanation, is that states cannot be treated as a black box with a single clear-cut interest. In this context, my argument is that we should not expect domestic public sectors to pose any serious obstacle to the present large-scale agricultural model (including foreign involvement). As far as the restrictions on foreign land ownership are concerned, there are two reasons to support this claim.

First, the measures implemented in both Brazil and Argentina were not aimed at curbing concentration and dependency. The main justification for them is the national sovereignty issue (FAO, 2011, p. 32). In Brazil, the debate about whether Brazilian corporations under foreign control should be comprised by the limitations established by a law of 1971 related to sovereignty and national interest issues (Parecer CGU/AGU number 01/2008-RVJ). The government never mentioned the excessive concentration on export commodities or the increasing dependency as the justifications for reintroducing these limitations. In this way, the political debate concentrated on sovereignty issues rather than on curtailing the development of agribusiness (Hage et al., 2012). Something similar occurred in Argentina, where neither the government nor the opposition sectors referred to the negative sides of an excessive reliance on export commodities (FAO, 2011, p. 29). In both countries, the political debate concentrated on how much land foreign individuals and corporations had acquired (Perrone, 2012). On the one hand, it is possible to see a connection between foreign acquisitions and the exacerbation of a commodity-dependent economy. On the other hand, however, these restrictions seem to be directed at foreign control and not at curbing the excesses of the present agricultural model.

Second, restrictions only target the foreign acquisition of land, disregarding the large range of other possibilities open to foreign actors to participate in commodity farming activities. Although this could be identified as a weakness of these limitations rather than as a signal of self-indulgence, several Argentine provincial governments have entered into large-scope agreements with other countries or foreign state-owned companies (Río Negro, Chaco). These are explicit government decisions that commit vast areas of land to farming export commodities, such as soya, for long periods of time (Piñeiro & Villarreal, 2012, pp. 6-7).

Conversely, the opposition to the restrictions on foreign land ownership confirms the incentives of the domestic agricultural sector. In the four countries, these groups have taken a position against these limitations (Perrone, 2012). And in Paraguay and Uruguay, foreign investors have played an important role in blocking these attempts. Many of the foreign actors involved are in fact agribusiness groups from Argentina and Brazil, which manage regional and international funds. Finally, the Brazilian National Congress has recently started to debate, upon the request of agribusiness representatives, a possible repeal to the restrictions to acquire agricultural land applicable to Brazilian corporations under foreign control (Macedo, 2012).

Conclusion

This article aims at analyzing the behavior of foreign investment in agriculture in the four original MERCOSUR countries. This study purports to be a contribution to the debate about the effects of the high agricultural commodity prices. The possibility of attaining sustainable development through export commodities remains open to debate. This article does not take a particular position on this issue. However, the analysis presented here may help continue reflecting on this question, and if the answer were positive, even help design the best policies to attain sustainable development through agricultural commodity exports. The evidence suggests that, in a scenario of high prices, most foreign investment flows into agriculture would lead to a greater concentration of large-scale commodity farming. It has been argued that this is consistent with the incentives of international and domestic actors. As long as these incentives
remain in place, substantial foreign involvement is not to be expected in food production and distributing activities. The only exceptions are market-seeking or specific sector investment opportunities. In the short run, nothing indicates a change in this trend. Thus, foreign investment inflows may increase dependency levels and the risk of Dutch Disease contagion. On the one hand, government actors may have an interest in curbing these excesses, but on the other hand, incentives show that the MERCOSUR governments are not willing to pass any relevant measure in this regard. Indeed, an analysis of the recent restrictions on foreign land acquisitions has confirmed that these policies are not intended to tackle these concerns.

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