Value-added chains and agricultural trade

Advocates of free trade anticipate benefits from globalization for developing countries. However, an export-led agricultural growth strategy does not necessarily generate positive impacts. This article reviews the conditions under which new opportunities deriving from agricultural trade liberalization may be utilized to advance development.

Photo: Wilcke

Dr Helmut Albert
Helmut.Albert@gtz.de
Dr Andreas Springer-Heinze
Andreas.Springer-Heinze@gtz.de
Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH
Eschborn, Germany

With trade liberalization and globalization food chains are changing dramatically all over the world. Farmers in developing countries are increasingly challenged to compete in markets that are much more demanding in terms of quality and food safety, more concentrated and integrated, and much more open to international competition. Global value chains that link agricultural production of developing countries with global markets are especially promising in terms of broad-based und sustainable economic growth, employment creation and poverty reduction. However, historical evidence clearly indicates that there is no automatism leading to this outcome. The potential development benefit from integration into global value chains is affected by global trade rules and agreements and by the way in which the integration into value chains takes place.

Struggling for trade fairness

The development potential of export-oriented agriculture is determined by the structure and conditions of trade. The protectionist agricultural policies of many rich countries, especially in the US and Europe, are creating unfair competition for developing countries. The size of these distortions is immense. In 2000, the producer subsidy equivalent of these policies in the OECD countries was US$ 330 billion – equal to Africa's entire annual GDP. As a consequence, commodity prices on the world market are kept artificially low depriving producers in the South of important economic development opportunities. At the same time, tariff escalation on a number of commodities prevents exporting countries from overcoming their traditional dependency on unprocessed standard commodities the value of which has been following a secular trend downwards.

Unless agricultural policies in the North continue to bring down subsidies for their production and export, and trade policies open the way to higher value imports, agricultural exports from developing countries will remain critically limited. Nevertheless, commercial farmers in developing countries already benefit from diversification into higher value foods and processed agricultural products (e.g. fruits, vegetables, fish, exotic products etc.) that are less affected by unfair trade policies. In addition, the ongoing trade negotiations are about to generate new commercial opportunities for producers in the South.

The rising competitive challenge

These new opportunities will only turn into economic and social gains, if economic policy succeeds in removing the constraints that hamper export growth. Independent of the trade barriers, an array of obstacles such as inadequate technology, poor infrastructure and communication, red tape, corruption, and other supply side constraints are to a large extent responsible for the poor performance of some developing economies in world markets. Getting beyond a merely extractive type of export economy based on low value commodities requires and enhances the competitiveness of rural producers and enterprises. They will only benefit from trade liberalization, if they can compete in the global as well as in regional markets. We need to understand competitiveness as a multi-facetted phenomenon: not only the entrepreneurial capacity at the micro level determines the commercial success.

An important aspect of competitiveness is the organization of value-added chains. In order to gain or maintain access to international food markets, producers need to exactly comply with market demand. The competition for quality, price and the delivery of the right volumes at the right time calls for an increasingly sophisticated management of technology, quality

Impact of standards on exports of high-value agro-food products

The overall setting for food safety and agricultural health requirements in trade is becoming increasingly complex and fast changing as standards are promulgated in multiple scopes at both public and private level. At the public level two agreements regulating the standard setting process have been adopted in the WTO to ensure that no unnecessary obstacles to trade are created: The Agreement on Sanitary and Phytosanitary Measures (SPS) and the Agreement on Technical Barriers to Trade (TBT). Although standards set by private industry are not mandatory, some have become de facto standards, since they are required when producers want to compete in international markets. Observance of voluntary standards is increasingly becoming a precondition for establishing long-term supplier-customer relations. In contrast to the mandatory legal standards they are not challengeable under WTO regulations.

The application of food safety and agricultural health standards by governments and the private sector can significantly affect international trade. These standards can impede trade, especially for developing countries, through explicit bans on imports of particular products or through the high cost of compliance with stringent standards, which can diminish competitiveness. For example, the value of world agro-food trade affected by official product rejections at the import level is estimated at US$ 3.8 billion in 2000-2001. High-value food exporters in developing countries frequently claim that they face more rigorous controls than the domestic suppliers in certain industrial countries. The estimated value of developing country agro-food border rejections is US$ 1.8 billion.

In certain circumstances the new landscape of proliferating and increasingly stringent food safety and agricultural health standards can be a basis for the competitive repositioning and enhanced export performance of developing countries. Key to this is the ability of developing countries to upgrade capacity and make necessary adjustments in the structure and operation of their supply chains. For example: The European Union's hygiene requirements for fish and fishery products have had profound effects on the Nile perch sector in Kenya. Whereas the export supply chain had developed with a sole focus on EU markets, today most exporters have diversified their export base and have major markets in Australia, Japan and the United States. Compliance with EU requirements helped Kenyan exporters to access and maintain these markets.

and marketing logistics – in short, the establishment of value-added chains. Similar trends can be observed in domestic food retailing as supermarkets take an ever greater share of the food market rationalizing their supplies. Not only individual enterprises compete but entire supply chains and economic clusters. Moreover, at the macro level, there is a need to implement a set of public policies and investments in developing countries creating a favourable business environment. Promoting competitiveness includes investment in rural infrastructure and in technologies needed for higher value and perishable foods, and often further liberalization of the agro-industrial sector. Public services and legal arrangements need to facilitate key steps such as quality certification, export logistics and customs clearance.

The new tasks of public policy require a fundamental shift in thinking as many public agencies are still geared towards the dominant role that the state used to play in agricultural commodity markets in the past.

Pitfalls of chain governance

Private business necessarily plays an important role in the higher value market chains. Global value chains in the agro-food sector are frequently dominated by big import or retail companies or by agro-industry. While the co-operation with lead firms often is the only chance of winning market access, chain integration may easily get in conflict with social and ecological goals. Increasing exports does not necessarily lead to poverty reduction and agribusiness investments entail risks. An important determinant of poverty alleviating effects is the governance of value chains. The structure of chains and the distribution of market power affect the distribution of risk and gains across chain partners. The suppliers of agricultural produce typically remain in a weaker position and may be squeezed. In turn, risk aversion, the failure to honour supply contracts and a lacking understanding of business realities prevents producers from taking new opportunities. At the least, the lack of trust will ensue higher transaction costs and a mentality of pursuing short-term gains that are both detrimental to building sustainable economic structures.

Although it is difficult for outsiders to influence business arrangements in detail, a lot can be done to build trust and improve the entrepreneurial culture. Business fora, public-private partnerships and the public support to private investments help to shape the process of economic

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development. By setting and enforcing standards and by enhancing consumer awareness, governments and international agencies can not only prevent the exploitation of farm workers, child labour or ecologically destructive production technology but contribute to creating long-term economic perspectives and interests.

Making export growth pro-poor

Even if the conditions of world market integration are acceptable, only a minority of small-scale farmers will be able to achieve and maintain a competitive position in agribusiness. Besides the issues of chain governance, we face a growing problem of economic exclusion, especially of farmers in marginal rural areas. Therefore, it is important to note that the development of export-oriented agriculture needs to pursue various pathways towards poverty alleviation. Provided the export growth involves transformation activities that add value in the exporting economy, spillover can generate pro-poor effects. Besides the employment generated in additional stages of value addition that remain in the country of origin, a greater value added will also translate into demand for new types of services and inputs. Selecting a promising export product for promotion requires screening the potential growth-poverty reduction linkages.

Perspectives for International Cooperation

The increasing openness of world markets for agricultural products, the rising quality demands of consumers throughout the world, more stringent regulatory requirements, and growing integration and professionalization of food trade contains risks and, at the same time, opportunities for rural producers in developing countries. Their economic position can be significantly improved, above all through

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more local value added, diversification into higher-value products, quality management, and assured market ties, which, taken together, require stronger vertical networking.

The promotion of agricultural trade and value-added chains adopts a sectoral perspective and thus complements spatial approaches such as the promotion of local and regional economic development. According to A. Stamm (DIE, 2004) the implementation of the value-chain approach in development cooperation has to consider the following aspects:

- First of all, the value chain approach, as a heuristic device, can make clear that measures to promote economic development and employment have chances of success only if they systematically take into account the structural embeddedness of each economic activity, in other words, the question of forward and backward linkages, including the competition and dominance structures.
- As a rule, it is not promising to undertake small and medium enterprise (SME) promotion that bypasses the respective relevant lead firms. There is less and less room to expand markets for SMEs by forming these firms to be active «solitary actors» in international markets. Rather, a relationship to the integrating firm of the value chain must be established. In the ideal case, these can be integrated into economic development and employment promotion measures as PPP (public private partnership) partners.
- The «value chain readiness» of firms in developing countries is strengthened and their upgrading possibilities increased, if they can access specific, knowledge-based inputs where they are. Thus, corresponding institutions for training, applied research, standardization, measurement, quality control, etc. must be strengthened.
- In the framework of policy advice, development cooperation can support the governments of developing countries in drawing up local policies that work toward the targeted acquisition of linkage-relevant direct investments and a systematic improvement in the competitiveness of local SMEs.

Development impacts of value chains are also dependent on the income distribution within the chains. Building up information systems that are also accessible to weaker links of the chain can help reduce information asymmetries and thus contribute to greater retention of income in developing countries.

The Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) has developed a service package called «Promoting Agricultural Trade / Promoting Value Chains» that is designed to integrate the rural population into national and international markets. By extending the scope for adding value in rural areas, the aim is to open up escape routes out of poverty. Taking the economic development potentials of the production sector into account, the package helps achieve maximum employment and income effects.

The service package addresses public-sector institutions actively engaged in agricultural sector development and private clients seeking investment opportunities. This support for the development of trade and export capability adds a new dimension to the old slogan «Trade not Aid».

An example: fresh vegetables chain

Twenty years ago, small exporters in Kenya would normally buy green beans in local wholesale markets or directly from smallholders, pack them in boxes or sacks and send them to importers in the United Kingdom, who would sell them through national wholesale markets. They would then be bought by a variety of retailers (large and small). Since then, the business has been completely transformed, notes John Humphrey of the Institute of Development Studies, University of Sussex.

- Fresh vegetables are now mainly sold through large supermarkets. Five supermarket chains account for over 70 percent of all fresh food retail sales in the UK.
- Cash-rich but time-poor consumers buy products that are easy-to-use – ready-trimmed, washed and mixed with other ingredients. These products are much more likely to be wrapped in trays or cellophane packs than presented loose.
- Product freshness and shelf life have been enhanced by speedier passage through the supply chain. Levels of quality, continuity of supply and consistency of quality across the whole year have become the objectives.
- Food safety requirements and standards are much stricter, particularly with regard to pesticides and minimum residue levels fixed by the European Union.
- Traceability now goes from the supermarket shelf to a grower's field (literally). Suppliers are monitored and regularly audited. Specialized logistics systems are used to transport fresh vegetables from Kenya to supermarket shelves in the UK within 48 hours. Processing and packaging takes place almost entirely in Kenya with mostly imported materials.
- Seed companies, exporters, importers and retailers work together to develop new product promotions, new varieties and increased growing seasons.

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None of the new requirements for the value chain could have been obtained through continued reliance on independent smallholders and wholesale markets. Now a few large exporters dominate the industry. They are linked in exclusive relationships to UK importers, and the import business is consolidating rapidly. Thus the emphasis has switched from finding new markets to improving the efficiency of imported materials.