

# Briefing Paper

## Leveraging Climate, Trade, and Industrial Policies to Upgrade EAC Agro-industries in Regional and Global Value Chains

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### Summary

This briefing paper aims to support implementation of climate change, trade, and industrial policies in the East African Community (EAC) to facilitate effective participation in regional and global agro-value chains. While agro-processing provides great opportunities in this regard, challenges still exist given that the region mainly exports raw and semi-processed agro-products that feed into manufacturing processes in other countries. Upgrading EAC's agro-processing through leveraging the synergies among climate, trade, and industrial policy could improve the region's participation in global value chains.

## Background

The rapid growth of global value chains (GVCs) has become the defining feature of the 21<sup>st</sup> century global trading arena. GVCs break up production processes to allow different countries to carry out various tasks along a value chain in line with their level of specialisation and factor endowment (World Bank, 2017). The GVC revolution, mainly driven by large multinational firms interested in improving efficiency, has led to increased specialisation at both country and firm levels in production processes. As a result, GVCs account for an increasing share of international trade, global income, and employment.

Integration into regional and global value chains holds several benefits for developing countries.

First, GVCs provide developing and least developed countries (LDCs) with new opportunities to partake in global trade in various capacities including supply of raw materials and intermediate goods, product assembly, as well as export hubs for finished products among others (Kowalski, Gonzalez, Ragoussis, & Ugarte, 2015).

Second, GVCs promote export diversification as countries focus on value addition. Today, developing countries are increasingly exporting manufacturing value added due to among other factors, their continued involvement in GVCs.

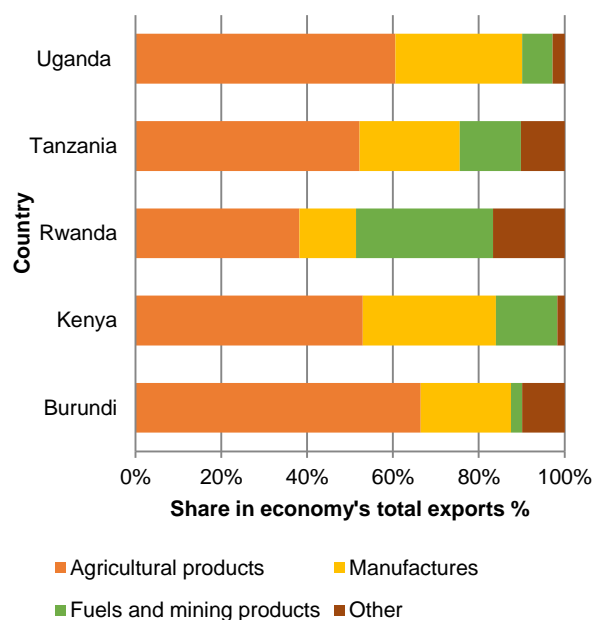
Third, GVCs are a conduit for skills, technology, and knowledge transfer from developed to developing countries (Staritz & Reis, 2013). Such transfers are crucial for industrialisation and socio-economic development. Finally, integration in GVCs may increase foreign direct investment (FDI) inflows or encourage firms to expand their operational capacities, thereby improving job opportunities, reducing poverty, and promoting overall economic growth (Allard, et al., 2016). Given these benefits, the East African Community (EAC) is keen on improving its participation in regional and GVCs in various sectors including agriculture and manufacturing.

## EAC Participation in regional

## and GVCs

Figure 1 shows that agricultural products are the main exports from the EAC, accounting for over 50 per cent of total exports, save for Rwanda (38.2 per cent). As shown in Figure 2, coffee and tea make the bulk of agricultural exports in Burundi, Kenya, Rwanda, and Uganda. Besides this, major agricultural exports include cut flowers for Kenya, maize for Uganda, unmanufactured tobacco and dried leguminous for Tanzania and Uganda, as well as coconuts, Brazil nuts and cashew nuts for Burundi.

**Figure 1: Share of main export product category by country in 2015**



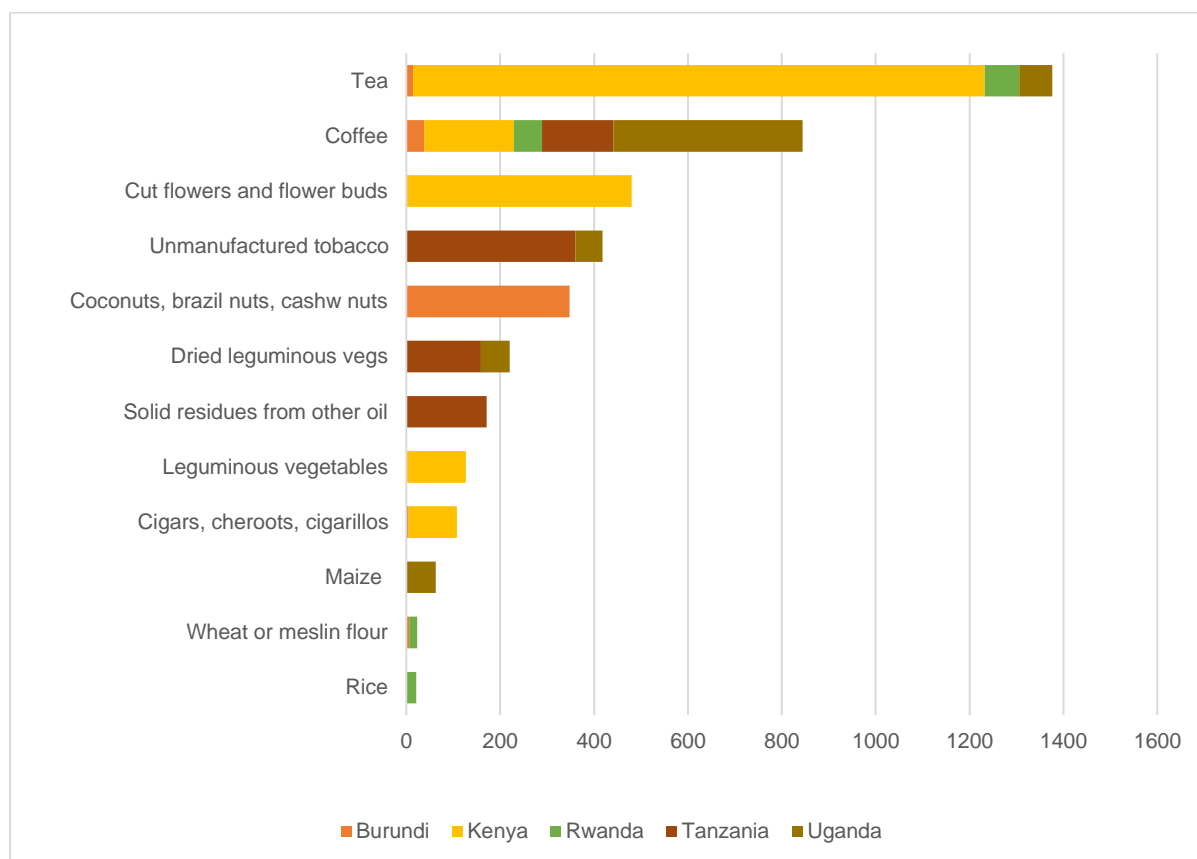
Source: UN COMTRADE

The EAC is involved in the aforementioned agricultural value chains at a lower level at both regional and global level. This is because most agricultural products from the EAC are exported as either raw or semi-processed products that feed into manufacturing or processing activities in other countries. However, this interpretation should be considered in the context that some agricultural products such as fruits and vegetables and cut flowers might not require heavy processing since

their consumption as fresh produce is highly preferred by consumers in export markets.

Agro-processing contributes nearly 80 per cent of total manufacturing value added in the EAC with food processing accounting for nearly 40 per cent of the value added by agro-industries (EAC-Kilimo Trust, 2012). However, much of the installed capacity for food processing is for primary processing only, with only 28 per cent of agricultural produce in the region being processed for local and export market. This calls for upgrading EAC's position in regional and GVCs to enhance its participation in international trade.

**Figure 2: Key Agricultural Export Products by Country in 2015 (USD Millions)**



Source: UN COMTRADE

## The Needed Upgrading

EAC's agro-processing sector should embark on

process, product, functional, and channel upgrading in order to move to higher and more profitable levels in regional and GVCs.

## Process Upgrading

Process upgrading involves improving efficiency in production through better organisation of production activities or deploying better technology in production (UNIDO-GIZ, 2016). Improving efficiency is important to agro-processors to the extent that it can lead to substantial reduction in production costs and increase output in response to competition. Currently, high production cost limits the ability of EAC agro-processors in sectors such as textile and food processing to compete with their counterparts from China, India, and Brazil in export markets; hence, the need for process upgrading.

## Product Upgrading

Product upgrading entails enhancing the quality of a given product to increase value for consumers, and is necessitated by the ever-changing consumer preferences regarding product quality. Only competitive agro-processors can survive in advanced export markets such as the European Union (EU) and the United States (US) where consumers are increasingly demanding for agro-products that meet specific health, safety, social, and environmental standards (Allard, et al., 2016). Thus, continued participation in regional and GVC is contingent on the ability of local agro-processors to meet product standards set by lead firms such as supermarkets in the EU or consumer preferences. Nonetheless, meeting product quality standards and consumer tastes and preferences is still a challenge to most East African agro-processors, especially Micro, Small and Medium-sized Enterprises (MSMEs) that face financial, skill, and technological constraints.

## Functional Upgrading

Functional upgrading requires agro-processors to take-up new higher value-addition functions in their value chains (UNIDO-GIZ, 2016). It essentially involves taking up more activities along a particular value chain. Functional upgrading is important to the extent that it can increase the share of value retained by EAC agro-processors in regional and global value chains, while enhancing income-

earning opportunities. To this end, EAC agro-processors need to upgrade from being suppliers of raw materials and semi-processed goods to higher value addition activities including processing a wide range of finished products, product design, marketing, and distribution.

## Channels Upgrading

Channel upgrading requires agro-processors to enter new regional or international markets with the existing products (Kowalski, Gonzalez, Ragoussis, & Ugarte, 2015). In the EAC, channel upgrading is necessitated by the perennial challenges facing agro-industries such as price fluctuations, changes in consumer preferences, and implementation of restrictive trade measures in export markets. Channel upgrading mitigates these risks and challenges by providing alternative markets to sell agro-products as trade opportunities wane in traditional markets.

## The Role of Climate, Trade, and Industrial Policies

### Climate Change Policy

Implementing the four types of upgrading discussed in the foregoing section requires coherence among climate, trade, and industrial policies in the EAC. Climate change is a key constrain to product upgrading to the extent that it limits agricultural production. For instance, adverse climatic conditions such as extreme temperatures may affect the quality of agricultural raw materials that ultimately determine the quality of agro-products.

Further, limited local production of raw materials due to climate change curtails process upgrading by reinforcing reliance on imports of raw materials that may be more expensive (EAC, Climate Change Policy ). Climate change also affects development

and access to infrastructure such as roads, ports, and electricity that are necessary for agro-processing. A climate change policy that provides adequate strategies for mitigating and adapting to climate change can help in value chain upgrading. For instance, adoption of climate-smart agriculture (CSA) can ensure access to cheap and high quality raw materials for production of high quality agro-products. Further, it may facilitate channel upgrading by facilitating access to markets for green products. The EAC has already developed a climate change policy. National climate change related policies should be aligned to the EAC climate change policy and implemented effectively to facilitate upgrading of agro-processing value chains.

## Trade Policy

Regional and GVCs often involve multiple border crossings of raw materials, intermediate goods, and final goods. Thus, existence of tariffs and non-tariff barriers can significantly amplify trade costs and diminish competitiveness in the context of regional and global value chains (Allard, et al., 2016). Within the EAC, great progress has been made in eliminating tariff barriers through the EAC Common Market Protocol. Nonetheless, persistent and new non-tariff barriers continue to affect free flow of raw materials, intermediate goods, and final goods. A case in point is the 2017 trade standoff between Kenya and Tanzania that restricted free flow of products such as maize, wheat, and milk across their borders. At the international level, EAC countries are yet to agree on and enforce key trade pacts such as the EAC-EU Economic Partnership Agreement to ensure free market access to countries such as the EU, especially for Kenya that is considered a developing country.

## Industrial Policy

Effective participation in regional and global value chains requires agro-processors to focus on increased value addition. Improving value addition requires increased investment in skills development, research and development, improved access to technology, and intellectual property protection. Achieving these requirements remains a herculean

task in most EAC countries. Further, business environment should be enhanced through interventions that address infrastructural constraints, facilitate FDI inflow, increase access to finance, and strengthen key institutions such as regulators. According to the Ease of Doing Business report 2017, Rwanda has performed best in improving the business environment in the EAC. Rwanda is leading in the ranking at position 56, followed by Kenya at 92 globally. Uganda, Tanzania, and Burundi are at position 115, 132, and 157 respectively. Thus, implementation of an effective industrial policy that addresses the competitiveness challenges facing agro-processors is expected to facilitate process, product, and functional upgrading. While the EAC has a regional industrial policy in place, harmonization of national industrial development related policies is still needed.

## Way Forward

Agro-processing holds great potential for the EAC to integrate and reap the benefits of regional and global value chains. Although EAC countries are already participating in regional and GVCs in various capacities, several challenges abound. These include low value addition, negative effects of climate change on agro-processing, conflicting policy measures at national level that translates into non-tariff barriers to trade, limited access to technology, and high cost of production among others. Thus, it is important that EAC agro-processors focus on process, product, functional, and channel upgrading to enhance their participation in regional and GVCs.

Implementing the required upgrading in EAC's agro-value chains can be achieved through leveraging the synergies among climate, trade, and industrial policies. Given that these policies have already been or are being adopted, the focus should be on their effective implementation. In this regard, the following measures should be considered:

- 1 Implementation of national and regional climate change policies should focus on equipping actors in agro-value chains with adequate knowledge, skills, technology, and financial resources to mitigate and

adapt to climate change.

- ② National and regional trade policies should be harmonised to avoid conflicting policy objectives that oftentimes create barriers to trade and increase the cost of production. Further, improved coordination of implementation of these policies should be ensured by the national and regional implementing agencies.
- ③ Implementation of industrial policy should focus on addressing the business environment challenges such as infrastructural constraints to reduce the cost of production.
- ④ Political will in implementation of climate, trade, and industrial policy should be enhanced. This should be reflected in improved budgetary allocations and commitment to implement the measures outlined in these policies.
- ⑤ A framework should be developed for periodic review of climate, trade, and industrial policies to take into account emerging issues, as well as, ensure effective involvement of all stakeholders in implementation.

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