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PACT EAC2

Promoting Agriculture, Climate and Trade Linkages in the East African Community

Briefing Paper

How can Trade Help Agro-Processing Development in East Africa?

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Summary

This briefing paper examines the role of trade policy tools in agro-processing development within the East African Community (EAC). Trade measures can help realise the potential of agro-processing for economic development, enhancing food security and employment creation in the region. Choosing and applying the right mix of trade policy tools requires a thorough analysis of their viability in a particular context, ensuring coherence with other policies, as well as appropriate institutional coordination.

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PROMOTING AGRICULTURE, CLIMATE AND TRADE LINKAGES IN THE EAST AFRICAN COMMUNITY – PHASE 2

The PACT EAC2 project builds capacities of East African stakeholders for climate-aware, trade-driven and food security enhancing agro-processing development in the region. Web: www.cuts-geneva.org/pacteac2

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Background

Agriculture is the mainstay of East African Community (EAC) member countries as an income generator, major source of employment, and key trade commodity. Typically, development of the agricultural sector has been regarded as the first stage of development of an economy, with industrialisation working as a development indicator in later stages of development (Food and Agriculture Organization, 1997). Increasingly however, there is growing recognition of the value inherent to combining the two sectors for expedited growth of the economy by giving rise to agro-processing.

Agro-processing is, according to classifications by the UN International Standard Industrial Classification of All Economic Activities, present in different aspects of the manufacturing sector such as food and beverages, tobacco, textiles and apparel, wood and wood products, paper and paper products, and rubber. Potential for agro-processing development in East Africa lies in the abundance of raw materials in the form of agricultural produce within the region, coupled with the relatively low cost of labour.

A major case for agro-processing is food security, coming about from decreased food waste especially among smallholders, who would be able to increase the shelf life of their commodities (Olaoye, 2014). Secondly, there is more income to be earned from value-added commodities for both the farmer and the economy as a whole. The job creation potential of agro-processing is another benefit, owing to backward linkages to the agricultural sector and coupled with the spillover effects to farm-level production (Olaoye, 2014).

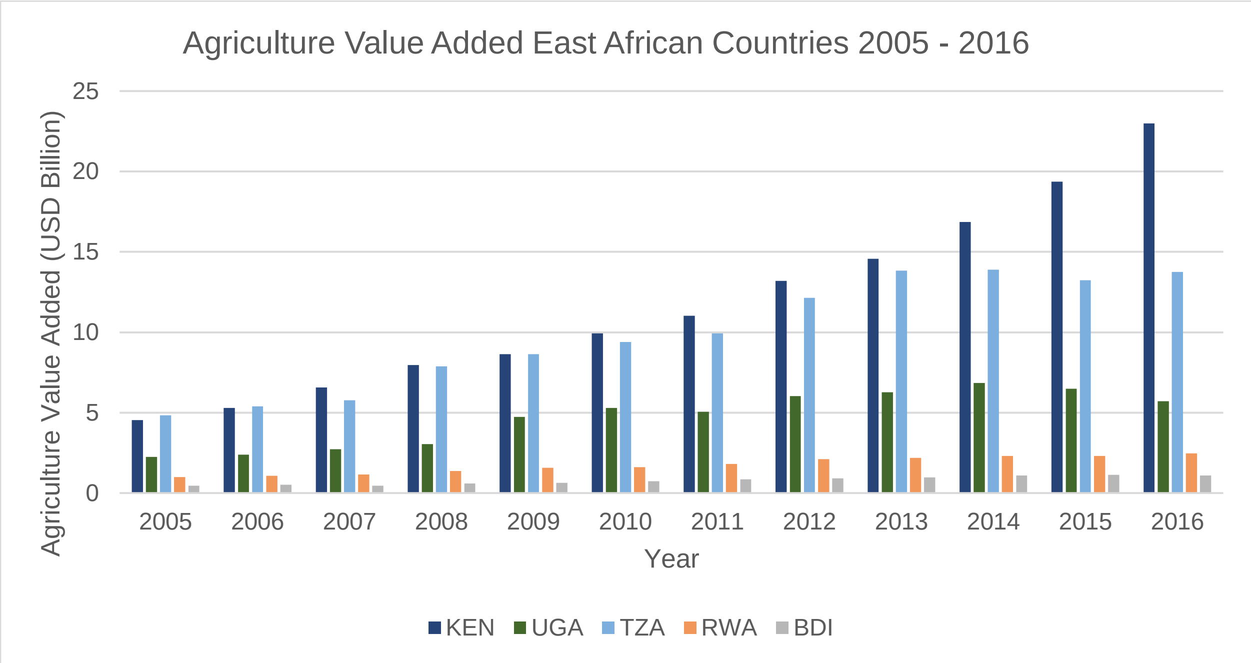
Agro-Processing Development trends in East Africa

Growing cognizance of gains from agro-processing is highlighted in the increasing value addition to agriculture practiced by East African economies over the past decade. Food products, beverages, textiles and apparel, and tobacco products make for the bulk of agro-processing in East Africa and other developing and emerging industrial economies (UNIDO, 2017). From Figure 1, value addition has experienced a gradual increase between 2005 and 2012 in most East African countries, with Kenya, Uganda and Tanzania manifesting clear growth trajectories in this regard. Although Rwanda and Burundi have experienced lower value addition to agricultural commodities, there is a general upward trend in these economies as well. There are key opportunities for the growth of agro-processing in the region, important to consider as the sector is labour- intensive and would make use of agricultural and labour resources most readily available within EAC countries (Mitullah, 2017).

The Trade and Agro-processing Nexus

For growth, two major options are available to East African countries. First, countries base agro-processing development on local consumption as a means to increase the demand for agro-processed commodities (Dodzin and Vamvakidis, 2009, Shleifer and Vishny, 2011, Gwartney, Lawson and Block, 2006). The second option is trade, which allows access to more market opportunities regionally and internationally for locally-produced commodities.

Figure 1: Agriculture Value Added for East African Countries 2005-2016 (World Bank, 2016)



Source: World Bank Development Indicators

Demand from traditional markets, such as the European Union and the United States of America, for horticulture and other export commodities from the East African region is projected to be stagnating. However, there is growing potential for agro-processed commodities in Sub-Saharan Africa and Asian markets, currently experiencing rapid urbanisation and high growth rates.

Secondly, there are capacity gains to be experienced at the microeconomic level from trade with others in the form of spillover effects, especially where technology and research and development (R&D) are concerned. First, technological advancement within developing economies comes about from participating in the multilateral trading system. With trade, firms in East Africa gain proprietary and firm-specific knowledge and technology in agro-processing from firms in developed economies (Skully and Rakotoarisoa, 2013, Farcasso and Marzetti, 2015). This can be leveraged to improve agro-processing technologies locally, further advanced by increased investment in research and development by these firms in developing economies. R&D, apart from improving technologies for agro-processing and efficiency, also improves the ability of local firms to produce commodities that are already produced by trading partners, based on increased knowledge stocks, gained from trade.

For EAC member countries, agro-processing can be a basis to engage in the production of commodities in which they have a comparative advantage towards export to international markets, allowing for rapid growth where pursued. Increased efficiency in domestic production would also be achieved from this. Secondly, countries whose agro-processing sectors are still lagging behind, such as Rwanda and Burundi (Figure 1), stand to gain skills and knowledge from those like Kenya with more advanced agro-processing sectors.

Trade Policy Tools for Agro-processing Development

Trade policy can provide powerful instruments for promoting agro-processing development, through measures that impact on quantities, prices and direction of agro-industrial trade flows. National, regional and international trade policies can therefore have significant implications for the sector.

At the regional level, trade policy in the EAC has been geared towards harmonization as well as the the elimination of tariffs and non-tariff barriers. Issues of taxation, subsidies, price support measures and tariffs have been considered, and Member States launched the EAC Common Market which seeks to boost regional trade through free flow of goods, labour, services and capital. In this context, a number of trade tools remain available to East African governments to promote agro-processing development.

At the national level, trade and agriculture policies can be complementary in pursuing a number of objectives, such as promoting the growth of exports, increasing government revenues, stabilising commodity prices, increasing the competitiveness of domestic industries, and protecting vulnerable groups. In this regard, Höffken and Dill (2013) identify a number of trade policy tools leveraged by governments, pertaining to import, export and protecting measures.

Import measures

Increasing the demand for domestic commodities holds the potential to bolster local production of agro-processed goods. Import tariffs, quotas and bans on imports are some of the tools used towards achieving this, as they raise the prices or restrict the availability of imported commodities. This leads to higher demand for locally-produced goods.

While higher tariffs on raw commodities can increase domestic prices to the benefit of local farmers, they may reduce affordability for consumers and agro-processors. Hence, such import tariffs may be considered selectively, e.g.as part of a well-thought strategic plan. Tariff escalation has also been used in some countries as tool to ensure that value addition is operated domestically, by imposing progressively higher tariffs to more processed products.

Alternatively, and while import quotas are prohibited by the WTO, governments may consider using tariff rate quotas (TRQs) which set a quota for quantities subject to reduced tariffs, beyond which tariffs increases upto the level of MFN tariffs. This may be useful to control imports of input products for which there is a demand by local industries.

The agro-processing sector can also benefit from import strategies that directly improve conditions for producers. For instance, duty-free imports of selected inputs allow for lower production costs for agro-processors, thereby contributing to more affordable local agro-processed products for consumers.

Export measures

Export measures can also be used as trade tools for agro-processing development. These may include export restrictions imposed on certain agricultural products, leading to a local surplus of raw commodities available to domestic agro-processors (Höffken & Dill, 2013).

For instance, export taxes can contribute to both agro-processing development and food security. By discouraging exports, they can lead to more products available locally at lower prices for consumers and agro-processors. However, such lower prices could affect poor farmers' income, who may have less incentive to produce thereby reducing food security in rural areas. Importantly, and although not expressely prohibited under WTO rules, export taxes are prohibited under current version of the EU-EAC Economic Partnership Agreement (EPA).

In the past, governments could use export quotas and bans to limit the maximum amount of permitted exports of a certain product. However, such export restrictions are prohibited under WTO rules except as a temporary response to "critical shortages of foodstuffs or other products essential to the exporting…". For instance, export quotas were used by several countries during the 2007 food price crisis. Alternative trade tools also exist, such as issuing export licenses under certain conditions, although these have sometimes been criticised for lacking transparency and favouring corruption.

Before 2015, many developed countries also used export subsidies to promote the international competitiveness of their domestic agro-industries, often outcompeting producers in the developing world. However, WTO members in Nairobi decided to eliminate agricultural export subsidies, with a deadline of 2018 and 2030 for developing and least developed countries respectively. As an exception, the decision allows developing countries to use export subsidies for transport and marketing until 2023.

The same Nairobi decision of 2015 prohibits the use of governmental export credits, which offered cheap credit rates to foreign buyers as a way to promote exports of given commodities. While these credits - sometimes used to counter restrictive lending by private banks – benefitted producers and exporters, they could also affect domestic consumers and processors through reducing product availability and rising prices.

Finally, export processing zones (EPZ) have been effectively used to promote the development of non-traditional export sectors such as textiles and clothing. These special economic zones are granted a different trade regime than the rest of the country, e.g. lower import tariffs and reduced bureaucracy for products directly processed within the EPZ and re-exported. This allows for promoting national export industries and investment into them, without further opening the domestic market to foreign competition. However, such export promotion policies mainly benefit the firms involved in the EPZ, whereas more comprehensive value chain promotion policies may be better suited to develop agro-processing across the counry.

Protecting measures

Besides import and export measures, governments can leverage a number of trade protection tools in order to promote the development of their domestic agro-industries,

Such protecting measures include anti-dumping tariffs and countervailing duties, whose main effect is to shield domestic producers from foreign imports deemed as unfair priced due to sale at below the cost of production or subsidies in the exporting country, respectively. In the area of agriculture, such protections can help secure domestic agricultural production, farmer income and better food security in rural areas. However, reduced foreign competition can also lead to higher domestic prices for consumers and agro-processors for their inputs.

The use of anti-dumping and countervailing duties are regulated under WTO Agreements, which require the provision of sufficient scientific proof of dumping or subsidisation to justify their application. As a result, applying such measures is often a challenge for Least Developed Countries (LDCs) who often lack the technical and humen capacity to undertake rigorous anti-dumping investigations.

Alternatively, the application of safeguards is subject to less strict WTO requirements. Safeguard measures such as import quotas or higher tariffs may be applied by governments temporarily in case of import surges or sudden price drops, and can therefore be effective in supporting food security.

Conclusion and Recommendations

Agro-processing development is a key priority in EAC countries, as suggest the value addition trajectories of their agricultural sectors. This is a move in the right direction, given the potential benefits of agro-processing for food security and employment creation in the region. While a number of trade policy tools can help governments promote agro-processing development, choosing and applying them requires a thorough analysis of their viability in the country's particular context. In this regard, the following recommendations can be made:

❶ *Ensuring coherence.* Trade policy interventions in agro-processing development should take into account the overall development strategy and ensure they remain coherent with agricultural, industrial and environmental policy among others. This not only requires appropriate institutional coordination and cooperation, but also the involvement of other stakeholders from these sectors in both planning and implementation.

❷ *Finding the right mix.* In line with the government's strategy for promoting agro-processing, the choice of trade policy tools should strike the right balance between liberalisation, promotion and protection. This choice should be informed by appropriate strategic planning and situation analysis beforehand, and be regularly re-evaluated through timely reviews.

❸ *Strengthening domestic trade institutions*. For shared benefits from trade policy tools, it is important to reduce the risks associated with institutional inefficiencies and corruption through enhanced transparency and appropriate reforms. In particular, tools such as export licensing have been associated with such risks.

❹ *Exploring alternate development tools*. As useful as trade measures can be in the short term, they may not always be the most appropriate long-term solutions to major developmental challenges, e.g. industrialisation, employment and food security. Other measures need to be put in place to support agro-processing development, such as credit facilities to provide affordable finance to farmers and agro-processors.

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