



THE POTENTIAL OF AGRICULTURAL GLOBAL VALUE CHAINS FOR SELECT SUB-SAHARAN AFRICAN COUNTRIES

A FOCUS ON REGULATION AND TRADE WITH ASIA



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EXECUTIVE SUMMARY

Global Value Chains are becoming an ever more central component of modern international trade. Despite a new body of research attempting to map drivers and determinants of Global Value Chains, there still remains a lack of research specifically into the role of regulation in agricultural Global Value Chains that leaves a significant gap in the abilities of countries to formulate appropriate strategies to value chain upgrading.

This report analyzes two sub-Saharan African cases of GVC participation and their limitations and potential in trade with Asia from a regulatory perspective. By focusing on Malawian and Zambian cotton and tobacco value chains an overview of the trade performance of the two commodities is provided using trade in different levels of upgrading of the selected commodities (for instance: unmanufactured cotton, cotton yarn not for retail, cotton yarn for retail). For both countries, cotton and tobacco are important cash crops that constitute a significant portion of agricultural exports. In the two countries a severe lack of upgraded exports and an overarching focus on exports of raw tobacco and cotton has been observed.

The fluctuations and changing levels of trade (for the chosen commodities over the past 10 years) are explained with regards to a series of factors but with a focus on regulation. The role of regulation, specifically the key multilateral and bi-lateral trade agreements along with pertinent national-level regulation is analyzed in light of the observed patterns of upgrading. It is found that much of the rapid expansion of trade of the raw commodities owes to tariff-free trade agreements with China. There are some notable exceptions to the overall lack of upgrading (for instance Chinese investment in Malawi), however it is found that the current regulatory structures are failing to facilitate value-chain upgrading. In fact, the tariff-free agreements have in some cases meant a flooding of the markets with cheaper and higher quality finished goods (within our chosen commodities, clothing) that form a restraint to value-addition, as Zambia and Malawi would struggle to compete.

It is found that the current lack of participation at any level higher than unmanufactured exports forms a significant and unsustainable barrier to development in the two selected countries and that current regulation should be re-formulated in line with a strategy for upgrading. A re-negotiation of such bi-lateral agreements to the benefit of the African nations has been suggested. The wide array of preferential

access agreements in place implies the two countries have enormous potential to export more highly finished products to world markets. The lack of investment into processing and assembly remain a key hindrance. Higher levels of trade, in value-added products can mean higher levels of export income and employment for the cases chosen. The lack of national level regulation is also found to be a limitation to upgrading, specifically with regards to enforcement of contracts and comprehensiveness, which further discourages investors to take the first steps to upgrading (investing in factories).

Finally, the report also presents a framework for future research into the area of regulation in Sub-Saharan African agricultural value chains by laying out the process used to build the case studies including key sources and methods.

ACRONYMS

AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
ATC	Agreement on Textiles and Clothing
AU	African Union
CAD Fund	China-Africa Development Fund
CDB	China Development Bank
CIA	Central Intelligence Agency
COMESA	Common Market for Eastern and Southern Africa
EBA	Everything But Arms Agreement
EPA	Economic Partnership Agreements, between EU and ACP Countries
ERA	Economic Report on Africa
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
FOCAC	Forum on China-Africa Cooperation
GoM	Government of Malawi
GVC	Global Value Chain
ITC	International Trade Centre
LDC	Least Developed Country
MIPA	Malawi Investment Promotion Agency
MCCCI	Malawi Confederation of Chambers of Commerce and Industry
MoFA (PRC)	Ministry of Foreign Affairs of the People's Republic of China
OECD	Organization for Economic Co-operation and Development
RATES	Regional Agricultural Trade Expansion Support Program
RTA	Regional Trade Agreements
SADC	Southern African Development Community
SSA	Sub-Saharan Africa
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organization
USITC	United States International Trade Commission
WB	The World Bank
WIR	World Investment Report
WTO	World Trade Organization

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1. Introduction

There is an ever-increasing body of research seeking to map patterns, drivers and determinants of Global Value Chains (GVCs) globally yet a lack of commodity-specific studies (see for instance: UNCTAD-Eora GVC Database; UNCTAD/WTO Inter-Country-Input-Output model). The current lack of research into the role of *agriculture* in Sub-Saharan African GVCs leaves a gap in the ability of countries to formulate an approach to GVC participation. There is also an identified lack of research into the role of regulatory frameworks affecting African GVCs and even less focus on those links with Asia. In those African countries for which agriculture constitutes a large portion of GDP and employment, the study of integration into GVCs with Asia will yield concrete policy recommendations.

Whilst Africa has not widely participated in GVCs, instead focusing on exports for the world market, the emphasis in the trade and development community is beginning to shift to value-addition and how African countries can start to participate higher up the value chain and therein create value-addition (UNCTAD WIR 2013, 122; ICTSD, 2013). The surge of Chinese investment into African agriculture, for instance, has left a need to re-assess the potential benefits from an African perspective. The challenge for countries, this report seeks to investigate, is to promote integration into agricultural GVCs, to evaluate the country trading profile and build on existing advantages from a regulatory perspective.

This paper posits an inductive case study approach to our analysis of agricultural GVCs in two Sub-Saharan African countries with analysis of the GVC relationship with Asia. By offering an overview of trends first in GVCs globally, then between Africa and Asia and then in agriculture the report moves from broad to specific. We then assess the current performance of two Sub-Saharan African countries' (Zambia and Malawi) participation in, and value-addition from, GVCs with regards to agricultural trade and then with Asian countries with a focus on China as the largest trading partner and other select Asian countries to give a rounded view of agricultural GVCs with Asia. By focusing on the value-addition from key agricultural products (cotton and tobacco) we build a picture of the opportunities for upgrading GVCs with

Asian countries (see further explanation in ‘Methodology’). In order to produce concrete evidence of value-addition we take two comparable cases: Malawi and Zambia and examine the performance of participation in GVCs. The aim is to provide a monetary snapshot and show the non-monetary benefits (such as innovation and R&D upgrades), whilst considering how the countries have/can further ‘upgrade’.

In this report a special emphasis is placed on regulation and especially trade agreements (part of ‘governance’) as a key actor in GVCs. Due to the dynamic nature and multiple influencers on GVCs, regulation is key to facilitating opportunities for governance external to the chain that affects its performance. This aspect of governance includes chain-specific regulation (such as preferential treatment from bi-lateral agreements) as well as general public sector interventions relevant to the development of value-chains (national level regulation). Rules governing preferential bi-lateral trade agreements, or implications of multilateral regulations (WTO) are to be identified from the country case studies.

a. Definition

More than 60 per cent of global trade consists of intermediate goods and services that, at various stages of the production process, are incorporated for final consumption. The internationalization of the production process has led to ‘borderless production’ defined by global chains of production that are global, regional or between two countries. These have become known as global value chains (GVCs) (OECD-WTO joint note 2013, 1-10).

“Global Value Chains” are derived from the concept of a “value chain”. A value chain is the full range of firm’s activities, from the conception of a product to its end use and beyond. It usually includes activities such as design, production, marketing, distribution and support to the final consumer (Porter, 1986; Gereffi et al., 2001). The activities in a value chain can either be undertaken by a single company or divided among several firms. They cover goods as well as services and can be concentrated at one location or spread out over different locations.

As an outcome of globalization, an enabling policy environment and technology advanced the term: “Global Value Chains” that was used to reflect a strong trend

towards the *dispersion of value chain activities across the world*. GVCs also imply a *fragmented production process*, with distribution across the globe. Now different stages of production are more likely to be performed in the location best suited to the activity (De Backer and Miroudot 2012, 9-12). GVCs allow multinational companies to increase efficiency, save costs, and speed up production. GVC participation can lead to income growth, to employment growth and social welfare improvements. Greater participation in GVCs can lead to higher levels of domestic value-added which has a direct impact on GDP and employment whilst building productive capacity through enhanced skills and infrastructure (UNCTAD 2013, 122-126). GVCs are transforming international trade in at least two major ways: first, exports depend more than ever on imports. Intermediary goods used in the midst of production play a more crucial role than ever. Secondly, trade in services is now more essential.

Despite the general consensus that participation in GVCs implies both opportunities and pitfalls for developing countries, a majority of analysts is optimistic about the future of GVCs and the associated impact in promoting economic development, knowledge transfer, job creation, and competitiveness enhancement (Sturgeon and Memedovic 2009, 2-7; Humphrey and Schmitz 2002, 1-6).

2. Methodology

The overarching goal of this report is to assess the performance of two Sub-Saharan African countries in terms of agricultural GVCs participation, and value-addition from trade with a focus on Asian countries. The intended outcome being to highlight concrete areas in which the chosen countries can increase benefits from GVCs by making (better) use of international, bi-lateral, regional and/or national level regulation to stimulate GVC participation. Moreover, to highlight not only the potential benefits but the current losses from regulation that can be adapted.

a. Trends in GVCs

To build a strong picture of current trends in GVCs, the first section of the report provides an overview of GVC: global trends, trends in Africa-Asia trade and trends in agriculture – as showing in Fig. 1. This process of starting from a broad view of GVCs and narrowing down to region and sector specific brings the research to a point at which analysis on a country-specific level with a shared understanding of GVCs can be undertaken.

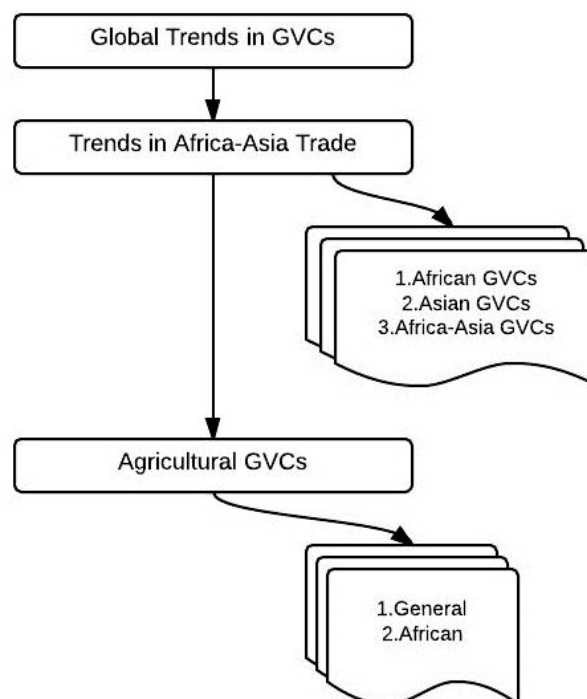


Fig. 1: Trends in GVCs method

b. Case Studies

Two case studies were chosen: Zambia and Malawi. These particular countries were chosen as they are both rapidly growing COMESA countries (Malawi 5.5% projected growth in 2014 and Zambia 7.3% in 2012) yet remain underdeveloped with a need for GVC upgrading (African Economic Outlook, 2013). They have *relatively* similar trade profiles (e.g. cotton, tobacco, tea, coffee, sugar cane, maize) and regulatory participation, whilst both are members of the WTO. Moreover both countries have bi-lateral trade agreements with China, similar multi-lateral agreements and welcome investment whilst deepening trade links. This means the two countries constitute relevant and comparable cases. Moreover both countries have significant latent agricultural potential that remains unfulfilled, whilst both governments maintain a key objective is to tap this potential source of income, growth and jobs.

Yet as value chains generally operate at the commodity level, for any analysis of value chains to yield specific points of upgrading/lagging it is necessary to identify specific commodities to analyze. Two of the largest exports from both countries that are generally at a low point in the value chain but with potential for upgrading are cotton and tobacco – these were chosen as the commodities used for analysis. Different from other agricultural products, such as maize and rice, which generally, constitute both raw material or final product (leaving little room for intermediate GVC upgrading), cotton for instance is often traded as an intermediate product and is possible to be further processed. This pattern makes it a better case in term of GVCs. Otherwise, patterns of value-addition are more difficult to identify (or simply do not exist).

The study aims to elaborate a framework that can be replicated for other countries with the findings from our cases. With potentially similar opportunities for GVC upgrading, formulating concrete policy suggestions for a series of countries becomes easier. Creating a replicable framework, taking two relatively homogeneous countries (in terms of commodities traded, level of development, regulatory participation) means that the same general steps to assess regulation in chosen countries can be followed and then analyze the most important factors for each case. The following flow chart (Fig. 2) details the process of building the case studies with further explanation below:

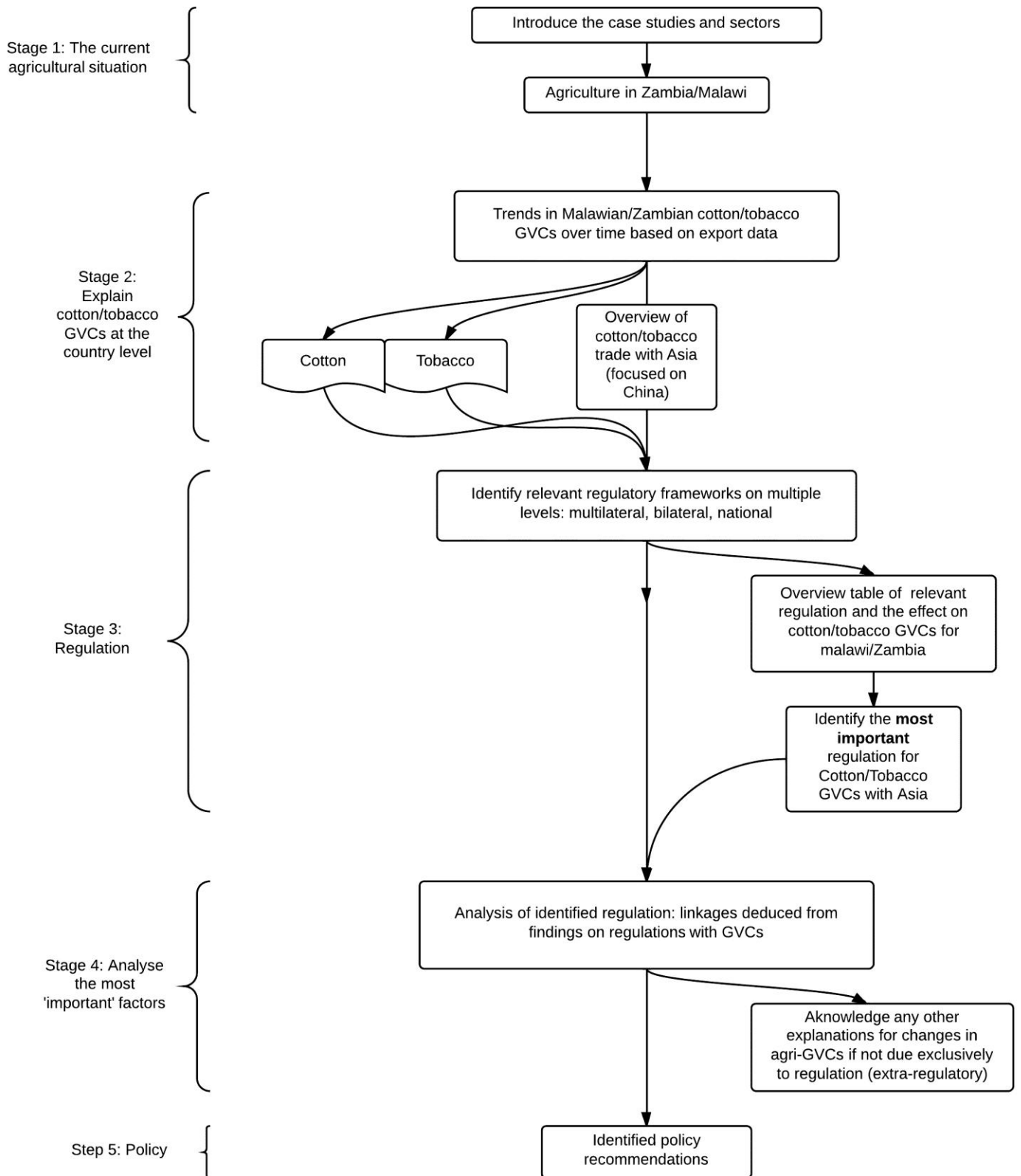


Fig. 2: Case Study Method

Stage 1: Designed to briefly give a snapshot of the current situation in the
Zambian/Malawian agricultural sectors.

Stage 2: Gives a more in depth view of Agricultural GVCs in Malawi and Zambia. By
presenting data on export levels of the two commodities over time, including different
levels of manufacturing we build a picture of current levels of upgrading. Comparing
the levels of the raw, unmanufactured commodity with a more finished level the
levels of upgrading will provide valuable insights. This step is also easily replicable
for further research on other case studies. Then a picture of the performance of cotton
and tobacco and their current performance in the GVC is built.

Stage 3: The applicable regulatory frameworks will be identified in a table format. By
using a table format with multiple levels of regulation: multilateral, bilateral, national
- we can easily identify the relevant regulation for our three key impacted areas.

Stage 4: Thus, having identified the main regulations, *the most important* (defined as
having the largest current and potential effect on GVCs) regulation(s) is/are chosen
and analyzed in terms of value-addition (actual and potential). If there have been any
other important factors affecting value-addition that bias the results these are to be
acknowledged at this stage.

Stage 5: Drawn from the above analysis, implications for policy will have be
identified. These 'recommendations' will not have a standardized (and replicable)
format, as they are country-specific.

c. Framework

As indicated above, the structure of the report – using a case study method - has been chosen in order to make it replicable for other country case studies. In this ‘framework’ section the steps (based on the method described above with elaboration from the actual cases herein) will be defined. To this purpose the specific methods that were used including all relevant data sources, regulatory frameworks, country-specific data and commodity level data will be identified. The intended result is a framework, in flow chart form based on the case study method, that can be used for other countries in order to analyze agricultural GVCs from a regulatory perspective.

3. Trends in GVCs

a. Global Trends in GVCs

GVC are becoming the dominant pattern characterizing world trade, involving all countries and operating at all level of production; around 60 % of today's global trade can be categorized into GVCs (UNCTAD 2013, 122). Despite the fact that GVCs are a global pattern, GVC participation is unevenly distributed across the world. Developed economies are often operating at an advanced stage in GVCs with high levels of value-addition. Amongst developing economies participation patterns are comparable or even accelerating. East and Southeast Asian, and Central American (including Mexico) countries, with an advantage of labor-intensive production and surging technological capacity, are characterized by both foreign value-added trade and domestic value-added trade. By contrast, Africa, West Asia, South America and transition economies, have better performance in domestic value-added trade, due to their abundance in natural resources and specialization in low value-added agriculture. Due to its predominant weight of services exports, which also use relatively fewer foreign inputs, South Asia is distinct from all other regions (UNCTAD 2013, 126–132).

In terms of GVC participation *growth rate*, the global average is 4.5% (UNCTAD 2013, 131). Yet for the LDCs, its participation growth rate per year is higher (9.6%) than that of both the transition economies (8.0%) and developing economies (6.1%). Developed economies have the slowest growth rate in GVC participation, only holding an aggregated rate of growth at 3.7%, whilst this is widely accounted for by developed countries already operating at an advanced stage. This suggests potential for LDCs to rapidly increase participation in GVCs. The question that arises for LDCs: how to best encourage increased participation rates into GDP growth?

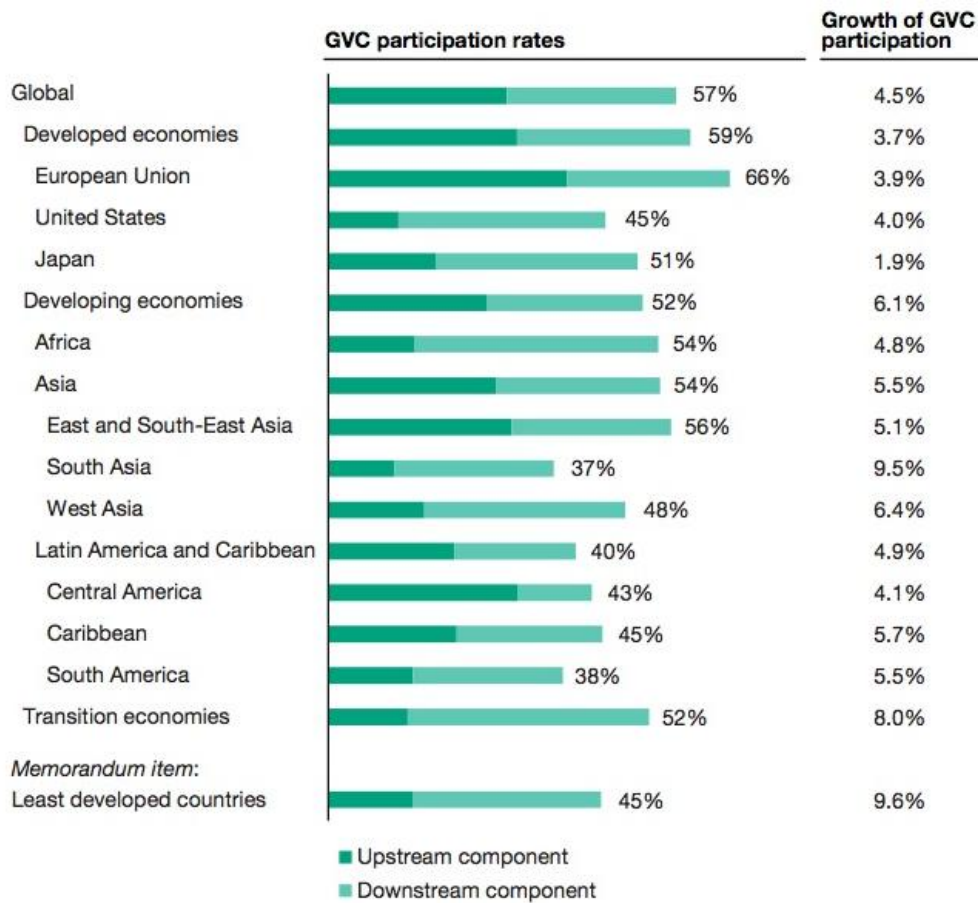


Fig. 3 GVC participation, 2010 and GVC participation growth rates 2005-2010
Source: UNCTAD-Eora GVC Database

To fulfill this goal, an enabling policy environment is necessary. Supporting policy should include: an open and non-discriminatory environment for trade and FDI; a respect for private property rights and intellectual property; further pushing for trade liberalization, and elimination (or at least mitigation) of tariff and non-tariff barriers; a competition fostering mechanism; establishing joint investment promotion mechanisms and institutions etc. (Razeen Sally 2013; OECD, WTO, and UNCTAD 2013, 5, 27).

b. The role of GVCs in Africa- Asia trade

In this section, the trade relationship between Africa and Asia through the lens of GVCs is explored, and divided into three sub-sections: how African countries are performing with regards to GVCs (I.) and Asia (II.) respectively and then how the two continents are now increasingly linked in a world characterized by GVCs (III.).

I. Africa:

Overall, Africa has not successfully integrated itself into the world economy characterized by GVCs, with little share in both the global production network and the world's GVC revenues (OECD, WTO, and UNCTAD 2013, 12). Its value chains are less developed than that of developed economies. As derived from its trade patterns and the structure of Africa's imports and exports, for the past decade (from 2001 to 2011) Africa has been importing over 60% of manufactured goods (with higher value addition) (Mutambara 2013, 284), while mainly exporting (low value-added) natural resources and raw materials (UNECA and AU 2013, 80). This imbalance between exports and imports suggests Africa has not captured the opportunity to add value at home and export; instead it is operating at the bottom of GVCs, as pointed out by Donald Kaberuka (2013).

Broken into different groups based on economic performance, African countries also display polarized patterns of GVC participation and economic growth. On the one hand, South Africa (as member state of G20), has displayed significant economic growth, been centrally involved in primary product-oriented GVCs (Elms et al. 2013) and is currently among the top 25 developing economy exporters (UNCTAD 2013). On the other hand, the remainder of the African countries (particularly the LDCs), are relatively small in economic size, underdeveloped in terms of industrialization, narrow in the varieties of commodity they trade, and are currently participating and "locked" in low-value segments of production (Bhattacharya and Moazzem 2013, 1; UNECA and AU 2013, 79).

Regarding industry and commodities, Africa is heavily concentrating on primary commodities and is weak in industrial sectors (UNECA and AU 2013, 79). There are only a few industries, such as textiles and clothing in which some African countries have (to some extent) successfully incorporated into GVCs (Morris and Barnes 2009). In other conventional industries, like diamonds, coffee, sugar etc., African countries are mainly excluded from value-adding activity.

As a result, African countries are now opting to improve their performance in value-added trade, and endeavoring to move up the value chain. To this end, it is crucial to put the issues of governance, policy and regulations (Arno J. van Niekerk 2013, 9, 10,

19), as well other obstacles impeding GVC integration on the agenda. Particularly, policies should be focusing on structural reform, promoting regional integration under RTAs, securing political stability and embarking on commodity-based industrialization, etc. (OECD, WTO, and UNCTAD 2013, 17; Memedovic and Barnes 2009, 29; UNECA and AU 2013, 95–101)

II. Asia:

When it comes to Asia, Asian countries have been predominately active in GVCs, and have widely benefited from GVCs. Between 1995 and 2009, Asian G20 economies, such as China, India, Japan and Korea, have increasingly strengthened their GVC participation. Successful incorporation into GVCs have benefitted Asian countries by contributing to increased GDP, enhanced productivity, jobs creation and improved social welfare. Specifically, India has become export-competitive by specializing in ICT services whilst 40% of Japanese jobs are sustained by GVCs (OECD, WTO, and UNCTAD 2013, 13).

Yet the GVCs pattern in Asia is uneven. It is more evident in terms of aggrandizing trade volume and relatively low in value addition (such as in China and Vietnam), with little high-tech value addition (except in Japan or the Republic of Korea) (WTO and Ajia Keizai Kenkyūjo (Japan) 2011, 6, 60–68). Moreover, even though most Asian countries take part in GVCs, the distribution of GVCs in Asia is imbalanced, with concentration in mid-tech countries whilst LDCs (i.e. Bangladesh, Cambodia, Laos, Myanmar, and Nepal) remain on the periphery (EIAS 2013, 3–4).

III. Africa- Asia:

Over the last decade, African trade with Asia (as a whole) has been growing at a fast rate, with its overall value and share (of Africa's total trade) almost catching up with that of Europe, which has been Africa's dominant trading partner historically (See Figure below) (Mutambara 2013). The phenomenon of booming trade between Asia and Africa can be observed twofold: on the one hand, Africa's share of manufactured imports (at all levels of manufacturing and technology intensity) from Asia has been on a continuous rise; on the other hand, Asia is providing a grand market for Africa's exports. Gradually, with the help of facilitating policy, this South-South economic linkage has boomed and the volume traded is catching up with the conventionally

predominant one between Africa and Europe. It is also anticipated that Africa-Asia trade will experience sustained growth.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Africa's total trade	277.1	284.4	346.99	441.7	549.8	671.7	805.0	1038.4	772.0	951.0	1096.1
Africa's total trade with Asia	57.6 (20.79)	63.1 (22.19)	77.7 (22.39)	107.6 (24.36)	138.1 (25.12)	181.0 (26.95)	231.5 (28.75)	303.7 (29.25)	230.6 (29.87)	307.9 (32.37)	375.9 (34.30)
		[9.56]	[23.12]	[38.44]	[28.39]	[31.05]	[27.88]	[31.22]	[-24.1]	[33.54]	[22.10]
Africa's trade with Europe	141.6 (51.09)	145.0 (50.98)	172.2 (49.61)	206.5 (46.76)	244.9 (44.55)	281.1 (41.85)	326.5 (40.56)	419.1 (40.36)	320.0 (41.45)	364.6 (38.34)	419.4 (38.27)
		[2.44]	[18.72]	[19.94]	[18.61]	[14.78]	[16.13]	[28.37]	[-23.6]	[13.94]	[15.03]
Africa's total trade with USA	35.0 (12.63)	31.7 (11.14)	41.1 (11.85)	58.3 (13.21)	81.5 (14.83)	100.8 (15.01)	109.0 (13.54)	134.0 (12.91)	78.8 (10.20)	120.0 (11.77)	125.6 (11.46)
		[-9.48]	[29.78]	[41.85]	[39.77]	[23.65]	[8.10]	[23.00]	[-41.2]	[42.13]	[12.16]
Intra-Africa trade	23.7 (8.55)	26.5 (9.32)	33.8 (9.74)	37.6 (8.51)	46.1 (8.38)	70.7 (10.5)	76.2 (9.47)	106.4 (10.2)	98.9 (12.8)	115.9 (12.2)	110.1 (10.0)
		[11.7]	[27.4]	[11.3]	[22.7]	[53.2]	[7.8]	[39.6]	[-7.1]	[17.3]	[-5.0]

Fig 4. Africa's total trade with various regions compared (US\$bn)
Source: ITC database: trademap.org

Asia is becoming an ever more significant source for manufactured goods for Africa. In some sectors (e.g. labor-intensive, resource-based manufactured etc.), Asia has already replaced Europe as major source of imports for Africa. Two leading import commodities from Asia are cotton fabrics, as well as machinery and transport equipment (Yoshino 2008). Even in sectors requiring more technological capacity (with more value-addition), Asia's participation has been on a continuous rise and the gap between Asia and Europe is declining (Mutambara 2013).

With regards to African exports, Asia has become its second major export destination since 2008, with exports largely of primary products (i.e. Fuels, Ores and Metals). According to Yoshino (2008), approximately 47% of Africa's exports to Asia are from oil and natural gas exports; agricultural raw products and non-oil mineral and metal products are also major product groups, representing another 39% of Africa's exports to Asia. Within agricultural raw products, cotton, timber, fruits and nuts, crustaceans and mollusks are the major agricultural products exported. This trade pattern is largely driven by increasing demand in Asia for natural resources and other primary commodities coming from growing industrial sectors and rising purchasing power (Yoshino 2008). Additionally, Asia is also the chief destination of African manufactured products with high skill and technology intensity.

Shifting from an aggregated continental level down to country level, one would not be surprised to discover that currently China and India are now the most prominent business partners of Africa among all Asian countries (Mutambara 2013; Yoshino 2008). For China and India, they have high demand on both imported energy resources rather than other commodities. Except for the current leadership of China and India, Japan and South Korea previously used to be the most important market for Africa's exports in the early 1990s (Yoshino 2008, 1). Other Asian developing countries (particularly ASEAN ones) are also significant players in Africa-Asian trade. For instance, Africa's exports to these five ASEAN countries (Indonesia, Malaysia, Philippines, Singapore, and Thailand) together have expanded by 65% from US\$ 2.3 billion in 2001 to US\$39 billion in 2005. Different from the case of China and India, the demand of ASEAN countries is more concentrated on imported food (e.g. Coffee) (Yoshino 2008).

The impact of trade between Africa and Asia is two-fold. On the one hand, as suggested by Yoshino (2008) and Broadman (2007), it is complementary: since Africa is rich in natural resource endowments and Asia is abundant in labor resources and more advanced in technology, there is a natural exchange of products (manufactured goods and primary products) in which each party has a comparative advantage. There has also been evidence showing positive shifts in complementarities between Africa and China and India. Given the difference between factor endowment, Africa is working as a large supplier of raw materials, while developing Asian countries are supplying manufactured products to African countries (Yoshino 2008, 5). On the other hand, highly competitive Asia is hindering the less-competitive Africa from moving up the value chain through exporting Africa's local natural resource back home for further processing in Asia, as well as through exporting cheaper and more highly processed goods to Africa.

From the perspective of GVCs, trade between Asia and Africa is surging, yet endowed with relatively low value-addition from Africa's side. To facilitate the economic linkage and to add value in Africa, it is necessary to establish a more enabling policy environment to attract Asian FDI to Africa and to encourage learning effects and technological spillovers (Mutambara 2013, 295).

c. Agriculture

According to the OECD attempts at mapping GVCs (De Backer and Miroudot 2012, 9), agriculture and food product value chains are relatively long: starting with agricultural inputs, to cultivation, processing, manufacturing and eventually retailing. The agro-food value chains is composed of farmers (producing raw material for next stage processing), processors and manufactures (adding value to intermediary goods), and retailers (as the final stages). Traditionally, the agro-food value chains is completely located in one domestic location. Yet in the context of globalization, agro-food value chains are becoming increasingly international and structured around global value chains led by global food processors and retailers (Memedovic and Barnes 2009, 3–8).

In terms of value addition and economic growth, agricultural products are contributing much less than manufactured commodities. UNCTAD (2013) has pointed out that in 2009, the primary sector (i.e. agriculture and other natural resource utilizing sector) only accounted for 11% of global value added trade, among which agriculture itself only makes up less than 10 %. Moreover, agro-food value chains are the most vulnerable to tariff and non-tariff protectionism, while agriculture remains the most protected sector in both developed and developing countries (Memedovic and Barnes 2009, 24). There is a relatively slower nominal tariff liberalization in agriculture (than in the case of manufactured goods) (OECD, WTO, and UNCTAD 2013, 13). Developed and developing countries are in favor of protecting local farmers against imports by adopting tariff, quota restrictions and a plethora of non-tariff barrier tools. Hence, it requires more effort at the regulation level (i.e. trade agreements and standard setting) to further liberalize agricultural trade and facilitate agro-food value chains (Memedovic and Barnes 2009, 24–29).

Agriculture is the backbone of most African countries as they are generating a large portion of their revenue from that sector. However, most African countries are only specialized in basic farming and exporting primary agricultural products (Draper and Lawrence 2013). Revenue is gained solely from exporting raw material rather than from adding value. In other words, they are marginalized in terms of agro-food GVCs, and are currently competitively trapped – selling low-skill, low-value products and services, with little chance to increase value-added share in global trade. The trade

liberalization movement has contributed to the verge situation of African agriculture, through devastating African local industrial capacity with cheaper and high-quality goods flooding into the local market (Arno J. van Niekerk 2013, 2; Asche 2011, 5). It becomes even worse when African agricultural products face fierce competition from those locally subsidized products in the destination, or meet quota restraint over agricultural goods.

4. Case Study I: Zambia

a. Agriculture in Zambia

Before getting to the analysis at the product level, a brief introduction to agriculture in Zambia is useful. Agriculture and agro-processing are important to the Zambian economy, representing more than 40 percent of gross domestic product (GDP) and contributing about 12 percent of national export earnings. Agriculture employs some 67 percent of the labor force and supplies raw materials to agricultural industries, which account for some 84 percent of internal manufacturing value-added in the country (although very limited value-addition) (WB 2009, 2-10). With regards to employment, two-thirds of the workforce are engaged in agriculture with levels higher in rural areas (CUTS International 2011, 218-220). Agriculture therefore constitutes an important source of employment and income for Zambia. The recent growth in agricultural exports reflects the government's commitment to increasing investment, upgrading regulation and building trade agreements. These trends can be observed in the following chart.



Fig. 5 Source: FAOSTAT Agricultural Trade Domain, 2013 (total exports per year of the 20 top agricultural products)

Zambia has enormous latent agricultural potential. The country has long been reliant on copper exports but has been focusing on nontraditional exports (all exports except

basic metals) for the last decade and increasingly under the current administration. Government policies and reforms to open the agricultural sector to direct foreign investment, eliminate foreign exchange controls, and simplify tax and tariff policies have been significant in stimulating export growth. These rapidly expanding exports are boosting incomes in rural Zambia. This export growth has however been widely bereft of coupling with investment in production and manufacturing in an effort to increase value-add. (see: USAID, 2010)

Cotton and Tobacco Value Chains

The following chart details a standard agricultural value chain (on the industry level) that gives a general picture of the chain for cotton and tobacco. The arrows connecting input supply to all other stages denote input supply is a cross-cutting function that *can* (but this is almost non-existent in the case of Zambia) affect all stages of the process. The link from farm production to the processing simply denotes the possibility of a farmer to supply the product directly to a factory. As will be extrapolated in the following sections, cotton and tobacco value chains in Zambia essentially halt at the farm production stage of the chain and the vast majority of the unprocessed product is then transferred straight to be exported be it raw cotton or tobacco. As can be the case with GVCs, inputs can also come from abroad at any stage of the chain with the goal of manufacturing a more finished good. This is widely not the case in in Zambia, as is clear from Fig. 5 & 7 that there is a lack of upgrading of the two selected products even *within* the country.

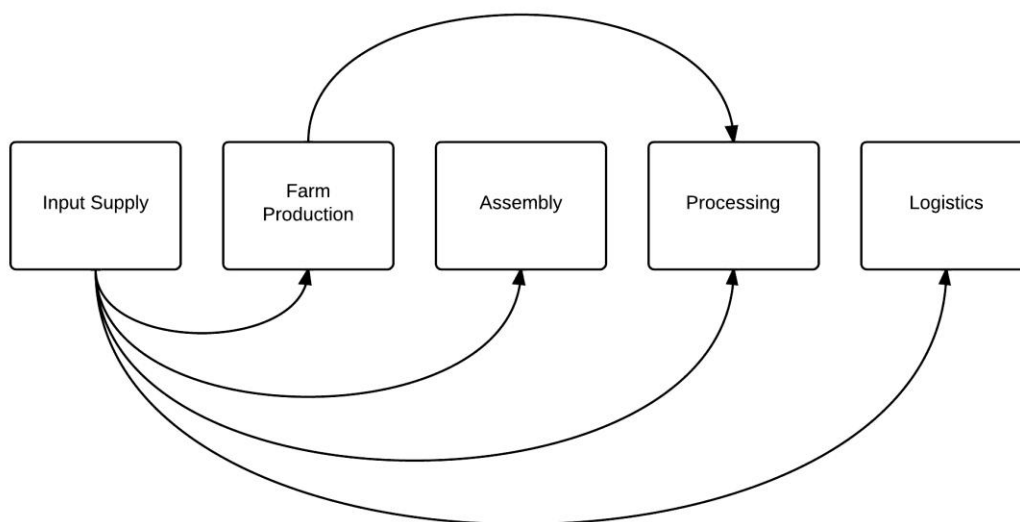


Fig. 5. Source: WB, Value Chains in Zambian Agriculture, 2009

b. Cotton

Cotton in Zambia is produced almost entirely by smallholder farmers and contributes about 20 percent to agricultural GDP and employment.

“In 2005, every third smallholder household in Zambia sold seed cotton (“seed cotton” refers to the harvested cotton bolls that have not yet been ginned to separate the cotton lint from the seeds). (WB 2009, 19-20).”

All smallholders producing cotton are linked to the cotton value chain under ‘outgrower’ arrangements. These ‘outgrower’ schemes are structured as follows:

A private company provides farmers with:

- Inputs (seeds, chemicals etc.)
- Technical support
- Marketing services, plus picking and packaging material
- Transport logistics

The farmers provides:

- The output (seed cotton)

Zambia is almost entirely an exporter of *raw* cotton with the main export destinations being South Africa, Mauritius and East Asia (Zambia Development Agency 2011, 7). The graph below, details the levels of cotton exports over the period 2003-2012 with three levels of manufacturing of cotton. The lowest level of manufacture is the raw cotton: ‘cotton, not carded or combed’, followed by ‘cotton yarn (not sewing thread) 85% or more cotton’, and the slightly more highly manufactured ‘cotton yarn (not sewing thread) put up for retail sale’. As is clear from the graph and analysis below, the level of upgrading of Zambian cotton is extremely low from 2003-2009 and non-existent thereafter.

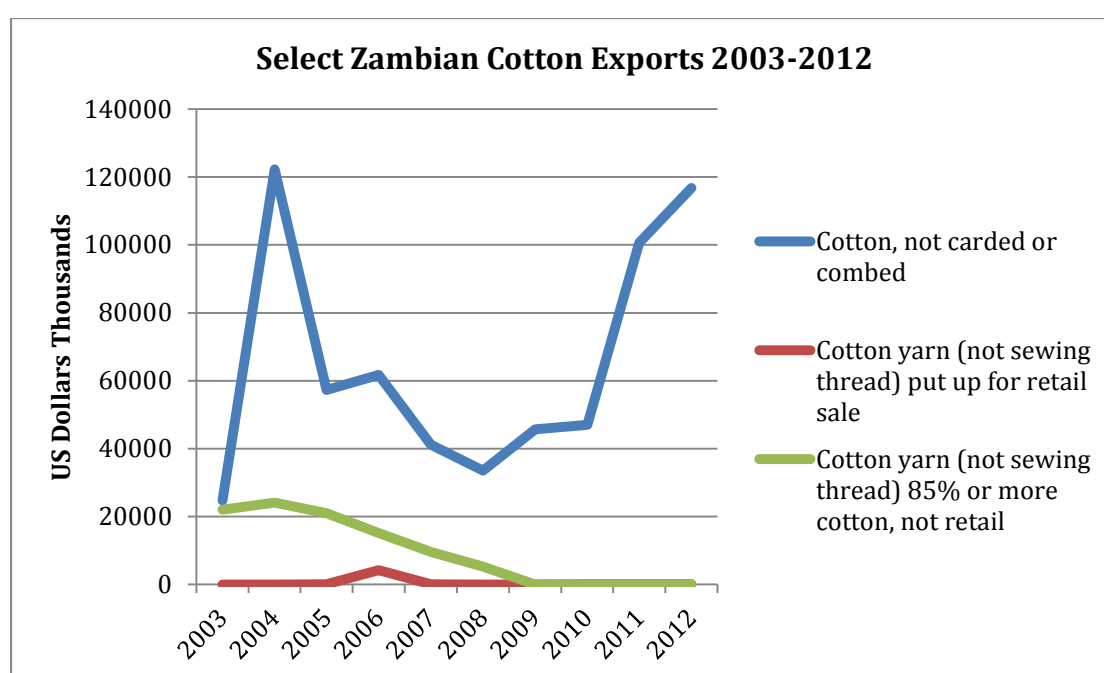


Fig. 6. Source: ITC Calculations based on Export Board of Zambia, Central Statistics Office since January 2012; UN COMTRADE statistics until January 2012.

With regards to ‘cotton, not carded or combed’ (the raw product) it can be observed from the trend that the period 2003-2005 experiences a significant boom in exports and then a sudden decrease caused primarily by a reduction in domestic producer prices induced by a sharp increase in the value of the Zambian Kwacha and a shift in government support to corn growing over cotton. This decline continued through 2006-2008 to the point at which imports began to come in from neighbors such as Malawi to sustain demand (US Trade Commission 2009, 73-75). This is followed by a sharp increase in exports in 2011-2012 triggered by an increase in world cotton prices (Agritrade 2013, 2-7).

Figure 5 profiles three levels of manufacturing of cotton with the most highly manufactured being ‘cotton yarn (not sewing thread) put up for retail sale’ whilst ‘cotton yarn (not sewing thread) 85% or more cotton’ is the most basic level of manufacturing above the raw material. Both of these levels of manufacturing are very basic with little value-addition and are a long way from the highest level of cotton manufacturing ‘clothing’. The declining pattern observed in ‘cotton yarn (not sewing thread) 85% or more cotton’ from 2003-2008 to zero in 2009 shows the last remnants of Zambia’s dying textile and garment sector which in the 1980s enjoyed high tariff protection and government subsidies and a significant boom leading to growth in jobs and GDP. The entrance of high quality, cheap Asian and especially Chinese manufactured textiles and apparel has meant Zambian producers were forced out of the market (Dinh 2013, 2-3; WB Trade Policy Review Zambia 2009, 61). For example, by 2012 Zambia’s imports of ‘Woven cotton fabrics less than 85% cotton, mixed with manmade fibers’ (clothing) from China constituted 75.52% of total imports of that category of cotton (International Trade Centre Trade Map: Zambia-China 2012). This phenomenon has been accelerated by the signing of a bi-lateral tariff free trade agreement between China and Zambia (see ‘bi-lateral agreements’ table below). The graph highlights the decline to zero of the last of those cotton-based industries with higher levels of value addition (higher up the manufacturing scale) over the period 2003-2012.

Cotton trade with Asia – focus on China

The below graph details the exports of ‘cotton, not carded or combed’ (the most raw, unmanufactured form of cotton) from Zambia to select Asian trading partners, whilst there are zero exports of any form of upgraded cotton to the selected Asian countries (the major Asian destinations of Zambian cotton exports). As can be observed the largest proportion of Zambian cotton exports to Asia are to China, accounting for more than 50 per cent of total Zambian exports of ‘cotton, not carded or combed’ in 2012. The increases from 2010 onward to all of the Asian trading partners reflect a push from the new Zambian government to promote agricultural exports through increased investment. These investments are, however, mostly increasing quantities of exports rather than upgrading (see graph below). Zero upgrading of the cotton value chain from the Zambian perspective with these key Asian trading partners can be observed. The potential for upgrading with the export destination of Asia are therefore

minimal as will be explained further in the section ‘opportunities for tobacco upgrading based on regulation and trade agreements’.

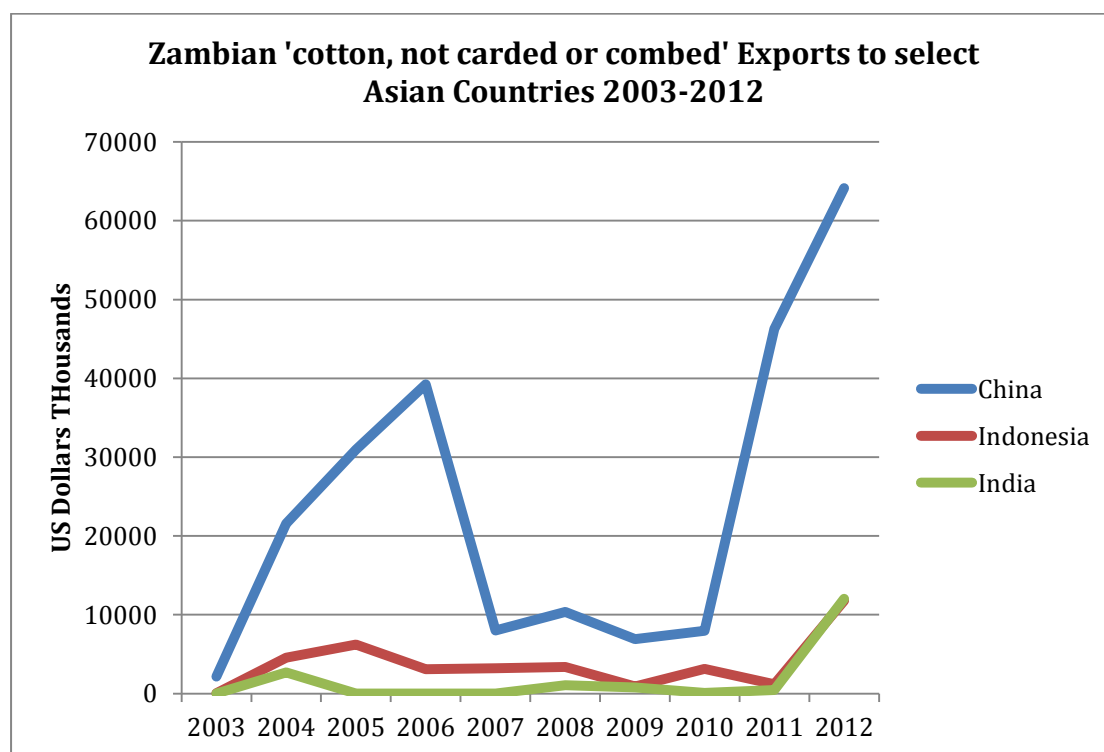


Fig. 7. Source: ITC Calculations UN COMTRADE statistics until January 2012.

c. Tobacco

Zambia has a strong history of tobacco production and exportation. Following a dip in production during the late 80’s and early 90’s a significant production and promotion effort has led to a revival of the tobacco industry into the 2000’s. Tobacco is an attractive cash crop as it is 7.5 times more profitable per hectare than maize and 14 times more profitable than cotton (Zambia Development Agency 2011, 7-8). With tobacco now constituting the second largest smallholder crop after cotton (WB 2009, 19). These recent trends can be observed in the following chart:

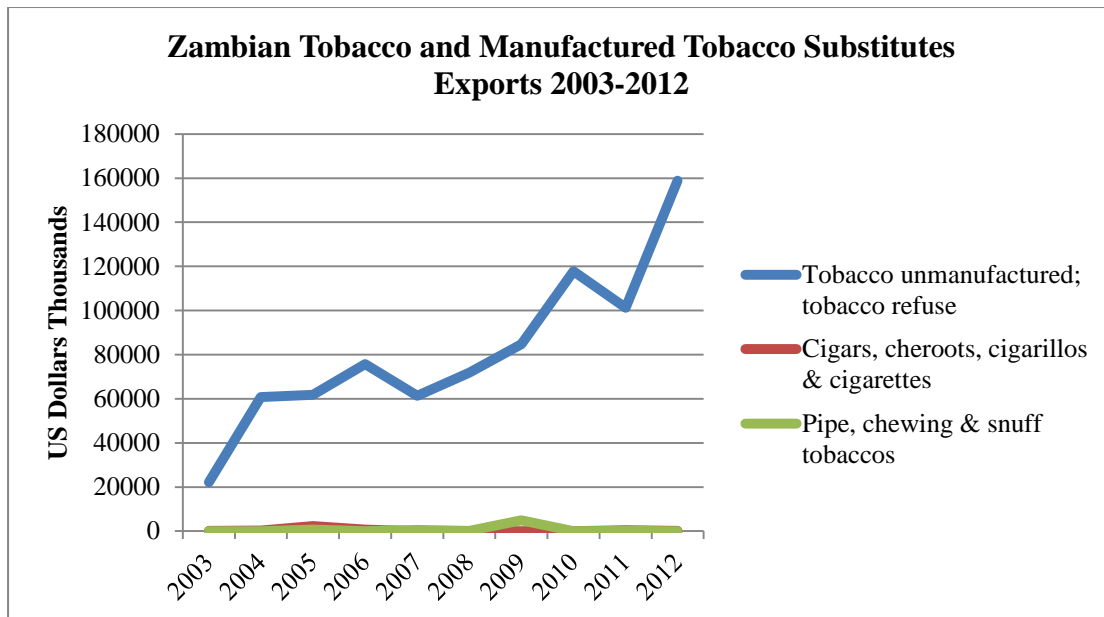


Fig. 8. Source: ITC Calculations based on Export Board of Zambia, Central Statistics Office since January 2012; UN COMTRADE statistics until January 2012.

As observed in the chart, production and export of Zambian ‘tobacco unmanufactured; tobacco refuse’ has soared over the period 2003-2012 mainly due to heavy investment in the sector leading to higher productivity (Zambia Development Agency 2011, 7). However as can be observed from the ‘cigars, cheroots, cigarillos & cigarettes’ and ‘Pipe, chewing & snuff tobaccos’ trends that exports are almost entirely the unprocessed raw product. With no processing infrastructure (operational factories) in the country there is little capacity to move up the tobacco value chain. There remains significant latent potential in the industry to expand production and exports due to a favorable climate, soil, water and labour yet a lack of capacity for upgrading.

Tobacco Trade with Asia – focus on China

China and Japan constitute the largest destinations in Asia for Zambian raw tobacco with Chinese demand rapidly increasing from zero in 2004 to nearly 1/3 of all Zambian raw tobacco exports in 2012. This sharp increase is widely due to the tariff-free bi-lateral China-Zambia agreement (see bi-lateral agreements table below) whilst the demand from China exceeds current supply and therefore exports are predicted to almost double from 35 million kilograms in 2013 to 60 million kilograms in 2018 (Tobacco Board of Zambia, 2013). In comparison to larger producers of tobacco in the COMESA region such as Malawi (exported approximately US\$ Thousands 35,000 to China with total tobacco exports of over US\$ Thousands 600,000) exports of Zambian tobacco to China are significant and constitute such a large portion of overall tobacco exports that the relationship is key. China is now the third largest trading partner of Zambia, yet the major export good remains metals whilst tobacco is exported only as an unmanufactured product (Bank of Zambia 2011, 3-4).

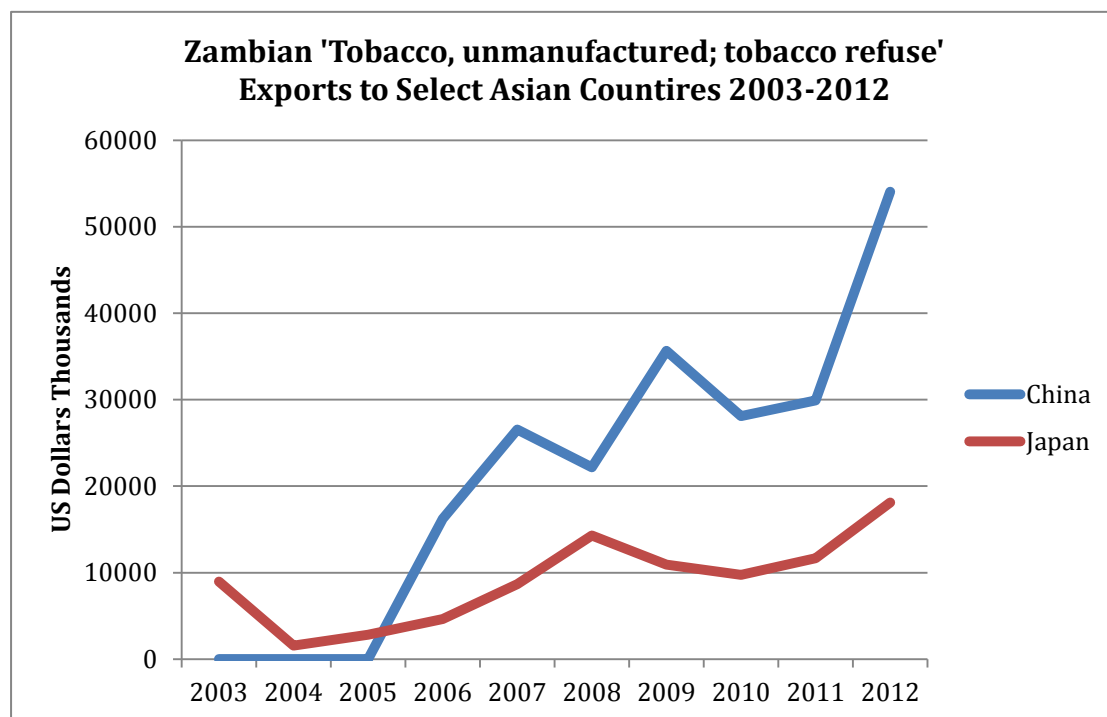


Fig. 9. Source: ITC Calculations UN COMTRADE statistics until January 2012.

d. Regulation/Agreements

Affecting Tobacco and Cotton in Zambia

The following section provides an overview of the multilateral, bi-lateral and national level regulations and agreements impacting Zambian cotton and tobacco value-chains.

They are named, briefly outlined and the key impacts on tobacco and cotton are highlighted with further analysis in the ‘recommendations’ section.

Multilateral Agreements:

Name	Outline	Outcome for Zambian cotton/tobacco GVCs
WTO <ul style="list-style-type: none"> - Agreement on Textiles and Clothing - Multi-Fibre Arrangement 	The drafted Doha Round aims at further trade liberalization	Less protectionism in agriculture and some safeguards to protect agriculture in LDCs (including Zambia). The Multi-Fibre Arrangement widely protected the textile and clothing industries of developed countries, particularly in the European Union and the USA
COMESA	Free trade area with access to nineteen southern, central and north African States	With South Africa as key trading partner, maintenance of low tariffs are important to the export market and can form a significant market for future exports of manufactured cotton or tobacco
SADC	Southern African regional trade body, Africa-wide free trade under the 'African Free Trade Zone'	
EBA	Duty free and quota free exports to the EU (yet with stringent rules of origin)	Grants LDCs preferential access to EU markets (including Zambia). Minimal exports of cotton and tobacco from Zambia to Europe
AGOA	Duty free and quota free exports to the USA	Zero exports of cotton and tobacco from Zambia to the USA

Sources: WTO 2013, http://www.wto.org/english/tratop_e/texti_e/textintro_e.htm; ITC Trade Competitiveness Map, <http://legacy.intracen.org/marketanalysis/TradeCompetitivenessMap.aspx>.

Bi-lateral agreements:

Name	Outline	Outcome for Zambian cotton/tobacco GVCs
Zambia-China	Chinese trade facilitation, privileged access of Chinese companies, Access of Chinese exports to Zambia, Chinese investment in infrastructure, culture. Tariff-free imports and exports for both China and Zambia.	Perverse relationship – Allows China tariff free access to Zambian raw exports of cotton for the Chinese textile industry. In turn, cheap and high quality textiles and clothing products have free access to the Zambian market and therefore undercut any attempts of Zambian textiles competing on price. Tariff free access to the tobacco market.
Zambia-Japan (2012)	Japanese investment in infrastructure and agriculture.	Investment in improving productivity and business education of smallholders such as diversification of crops. This scheme has the potential to improve smallholder farmer incomes and technical assistance to the manufacturing sector.
Zambia-Canada (2012)	Designed to pave the way for future Canadian investment into Zambia	Potential only.

Sources: Forum on China-Africa Cooperation (<http://www.focac.org/eng/>); Foreign Affairs, Trade and Development Canada (<http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/zambia-zambie.aspx>); Japan International Cooperation Agency (<http://www.zm.emb-japan.go.jp/en/press/2012.07.12.C.A.P.pdf>).

National Level regulation:

Name	Outline	Outcome for Zambian cotton/tobacco GVCs
Cotton Act (2005)	Regulate the production, processing and marketing of cotton	Focused on coordinating regulation for smallholders rather than potential for upgrading.
Tobacco Act (since 1964)	Promotion, control and regulation of the production, marketing and packing of tobacco. The promotion and control of exports of tobacco from and imports of tobacco to Zambia	Focused on regulating the industry as it stands rather than promoting upgrading. Serious deficiencies in formulation of rules and regulations coupled with weak enforcement.
National Vision 2030	Goals: reaching middle-income status; significantly reducing hunger and poverty; and fostering a competitive and outwardly oriented economy. Through investment in economic infrastructure and human resources development.	Minimal. The biggest share of the agriculture budget finances the provision of subsidized fertilizers and buying of maize from farmers, while spending on research and extension services is inadequate. This is not consistent with the goal of improving productivity and promoting diversification of agriculture.

Sources: WB Trade Policy Review Zambia 2009, 52-55; Tschirley & Kabwe 2010, 10-16.

e. Implications and Recommendations

Opportunities for cotton upgrading

As is clear from table 2, Zambia has in place a plethora of preferential multi-lateral trade agreements. Such agreements have had a significant impact on the global textile and clothing industry whilst a significant regulatory development was the 2005 phase out of the Multi-Fibre Arrangement. The system widely protected the textile and clothing industries of developed countries, particularly in the European Union and the USA. As is evident from the above graph, the apparent reduction in protectionism from the cessation of the Multi-Fibre Arrangement has in fact had a negative effect on the prospects of upgrading Zambia's cotton industry. The abolition of the Multi-Fibre agreement has meant the Zambian textile industry faces intense international competition and is therefore in an untenable position to compete with the likes of China and other South East Asian producers such as Vietnam (as is documented above in Fig 5, the end of exports of slightly more manufactured cotton). The necessary gains in productivity to compete internationally are sizeable and many years off at this stage of the value-chain.

The multi-lateral agreements have significant potential (as almost all upgrading of the Zambian cotton industry at this stage is potential) for the cotton industry yet in the short-run and purely in terms of value-addition, the most important is the maintenance of the free trade agreements within Africa and especially South Africa as a significant trading partner (through COMESA and SADC). Zambian exports of 'cotton not carded or combed' to South Africa totaled 'US Dollars thousands 59,574' in 2012 (ITC bilateral trade map between Zambia and South Africa, 2013). Zambia does have the potential to expand its production of niche textile (cotton based) products for the domestic and regional market. Zambia indeed has a history of exporting niche textiles to South Africa before the collapse of the industry in the late 1990s and early 2000s. As Zambia is at such a low point in the value-addition chain, focusing on promoting those industries in which it can have a natural advantage can form the beginnings of value-addition (USITC 2009, 4-70; Dinh 2013, 45-52). Not only in niche textiles but upgrading the spinning industry and exporting of yarn and fabric (the more intermediate cotton products) has the potential as an avenue towards upgrading (UNIDO 2009, 104-109). A 2009 UNIDO report into the feasibility of a cotton-

spinning mill in African countries identified Zambia as one of only 4 African and of 2 Sub-Saharan African countries (the other was Tanzania) in which a spinning mill would be financially feasible if certain infrastructure and technology investments are made available.

As touched upon in the 'bi-lateral agreements' table, the Zambia-China agreement not only offers little prospects for Zambian upgrading its exports to China but in fact limits its very potential to upgrade. China's public objective of moving up the value chain means there is a need for cheap imports of raw materials for processing in China. This agreement promotes trade expansion of raw materials from Zambia to China rather than more highly manufactured products. Moreover the free access of Chinese goods to the Zambian market has produced an influx of finished goods; Chinese textiles that are cheaper and of higher quality than Zambia can produce – therein 'crowding out' the market (Mwanawina 2008, 14-18). In line with the above opportunities in expanding the niche textiles market, Zambia could re-negotiate bilateral agreements in the context of joint and subcontracting arrangements, with the aim of increasing skills transfer and fostering capacity building in the local textiles industry (Chileshe 2010, 9-13). Rather than a one-way flow of finished goods from China to Zambia, the private sector could endeavor to make better use of the zero-tariff opportunity to export to China as an avenue for value-added goods to be exported.

Finally, deficiencies in regulation of the cotton industry at the national level brought about a lack of efficiency and a barrier to investment and therefore, upgrading. The government's key piece of legislation on cotton trade, The Cotton Act and the associated department suffer from a lack of resources for implementation and therefore does not provide for effective contract enforcement. For investment in the industry to be feasible and less of a 'risk' for operating firms, a more transparent and competitive trading environment is necessary (WB 2009, 43-47). The effect of broken contracts on the recovery of investment into the cotton sector and therefore the financial viability of an upgraded value-chain can, and regularly does, leave investing firms with large outstanding loans and no mechanism with which to recover the input investment (WB 2009, 29-31). Therefore, strengthening the national regulatory environment, especially with regards to contract enforcement, would create new

incentives for investment into the value-chain. Whilst Zambia has done much since 1993 to foster private sector investment, the above recommendation is aligned with the Zambian Development Agency goal of further increasing investment (UNCTAD Investment Policy Review: Zambia, 45-58).

Opportunities for tobacco upgrading

Value-addition is critical for the Zambian tobacco industry as the current policy of rapid and rather unbridled expansion of production of raw tobacco is unsustainable in the long term due to over-reliance on the current boom in market demand from a small number of countries (China and Japan notably in Asia). At the national level, a key barrier to upgrading the tobacco industry to the stage of manufacturing remains the lack of regulation in multiple areas but especially with regards to contract enforcement (WB 2009, 43-47). As with cotton regulation, deficient tobacco regulation forms a significant barrier to investment whilst contract enforcement issues deter investments in value-added tobacco processing. Zambian cotton and tobacco value-chains are very similar in structure and this particular regulatory issue impacts both. As a concrete example, Zambia Leaf (tobacco company) has pulled out of tobacco production in the Eastern Province citing poor credit recovery as the reason (WB 2009, 30-31). The rhetoric of the government to encourage investment from China and Japan (the two key buyers of Zambian tobacco) in processing plants inside Zambia is not matched with policy change (Zambia Ministry of Commerce, Trade and Industry, 2013). For firms to consider large investments into tobacco processing, a system of contract regulations and (equally importantly) *enforcement* has to be in place. This means contracts are to have specified penalties for breaking an agreement, clear explanations of the roles of and benefits for the farmers, firm and government bodies and standardization of those contracts between farmers, trade bodies and firms.

The current size of Zambia's tobacco industry *is* a restraint to upgrading in comparison to neighboring markets in Zimbabwe and Malawi that form a more immediate option for tobacco processing. *However* a transition to value-added exports should not be delayed for that reason. Furthermore, the current level of demand from China means an ever-increasing export income coupled with job creation in tobacco is impossible for a government to ignore. Yet these increases in production to satisfy demand from China can be coupled with investments in upgrading. This implies a re-

negotiation of bi-lateral agreements to include not only financial investment but also skill transfer from China into the Zambian tobacco manufacturing industry to begin the long-term transition to value-added exports.

5. Case Study II: Malawi

Malawi is a landlocked country in southern central Africa, as well as one of the LDCs, recognized by the United Nations. Malawi's economy heavily depends on substantial inflows of economic assistance from the IMF, the World Bank, and individual donor nations (CIA 2013).

Agriculture in Malawi

Agriculture is the backbone of Malawi's economy and exports. For the last decade, Agriculture contributes one-third of GDP (Reserve Bank of Malawi 2013) and 80% of export revenue (WTO Database 2013). About 84% of the population live in rural regions and are employed in the agriculture sector, with an annual growth rate of agricultural workers of 2.57% (CountrySTAT 2013). Malawi's major export crops are tobacco, sugar, tea, and cotton. Due to its agricultural tradition, Malawi has a large agricultural sector with an embedded comparative advantage vis-à-vis the non-agricultural sector. During the last decade, total Malawian agricultural exports have been continuously increasing until 2010, when a sudden decline began.

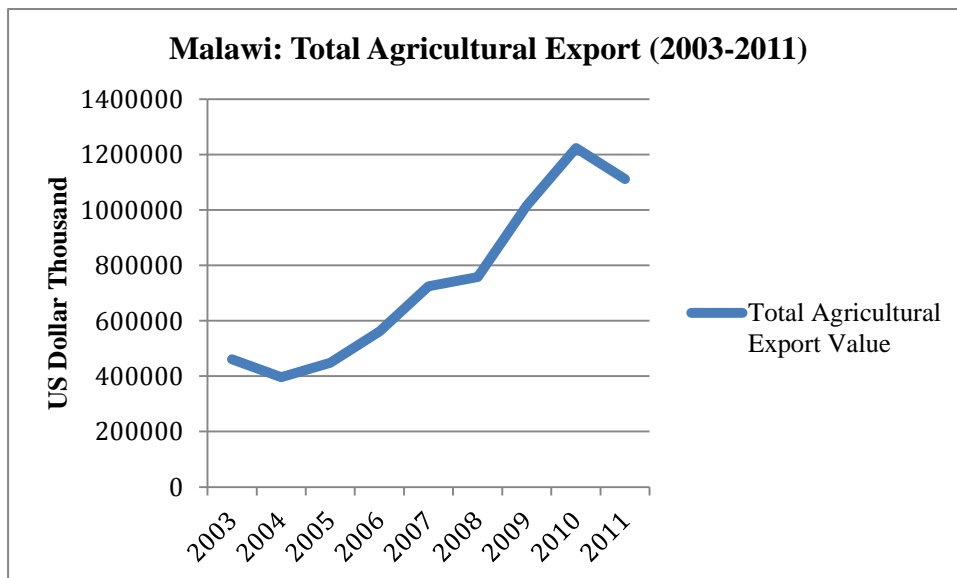


Fig. 10: (total exports per year of the 20 top agricultural products)
Source: FAOSTAT Agricultural Trade Domain, 2013

Tobacco and Cotton Value Chains:

As one of the world's leading exporters of tobacco, Malawi's economy is heavily dependent on the performance of tobacco. Tobacco accounts for 53 percent of its exports (CIA 2013) and more than 50 percent of its export revenue (Zant 2012, 8). Meanwhile, the composition of its export suggests that cotton has been increasing its share in the past 20 years, hence will potentially grow into another important export commodity.

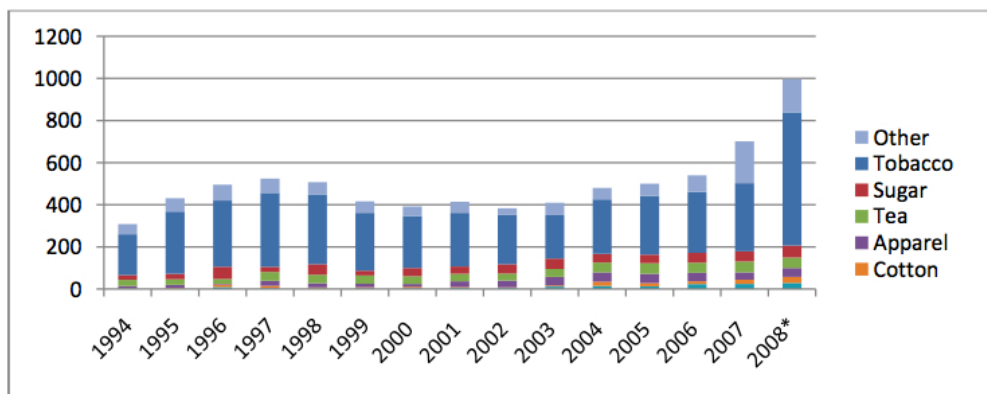


Fig. 11 Composition of Malawi's agricultural export commodities by value (US Dollar Thousands)
Source: (Tchale and Keyser 2010, 4)

In terms of GVCs, both tobacco and cotton are concentrated at the stages of cultivation and manufacturing. On the one hand, smallholders dominate the cultivation process of agricultural crops. Due to a lack of capacity to invest in or to improve the infrastructure, they are unable to significantly enhance the quality of products (i.e. tobacco leaf and cotton). On the other hand, there is little sign of upgrading with regards to manufacturing stage. Malawi does not have its own cigarette industry, while the cotton-processing and textile industry has been shrinking since the early 1990s (Zant 2012, 3).

a. Tobacco

Currently, there is relatively little value-addition in tobacco production for the last decade (See Figure below). There is a steady increase in total tobacco exports, yet exports are completely composed of unmanufactured tobacco. In other words, the country's tobacco industry is resting at the bottom of the Global Tobacco Value Chain, by only participating in cultivation and exporting raw material to global mega-companies, including Phillip Morris International (PMI), Japan Tobacco International (JTI) British American Tobacco (BAT), Phillip Morris USA, Imperial, and RJ Reynolds (Moyer-Lee and Prowse 2012, 12).

Given the current situation, an upgraded tobacco industry with higher yields, better quality, and growing revenue would be highly valuable to all national stakeholders, including buyers, local farmers and government. Yet the anti-competition nature of the concentrated cigarette manufacturing industry remains a barrier impeding local investors' attempts to initiate cigarette production in Malawi (Chirwa 2011, ix). Specifically, they lack financial and technological resources to start the business, as well as the research and development capacity to sustain the business in the long run.

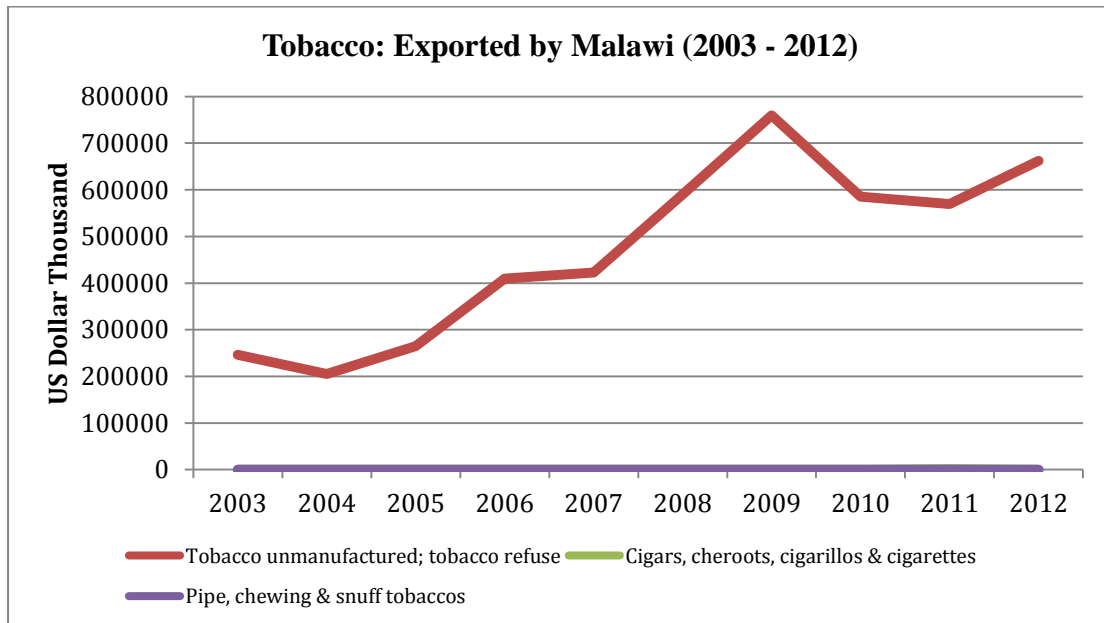


Fig. 12
Sources: ITC calculations based on National Statistical Office (NSO) of Malawi statistics, since January 2012.

Tobacco trade with Asia- with a focus on China

Among Malawi's major Asian trading partners, China is found to have replaced the ASEAN block to become the largest buyer of Malawi's tobacco exports currently. Hence this section will solely focus on Malawi-China tobacco trade.

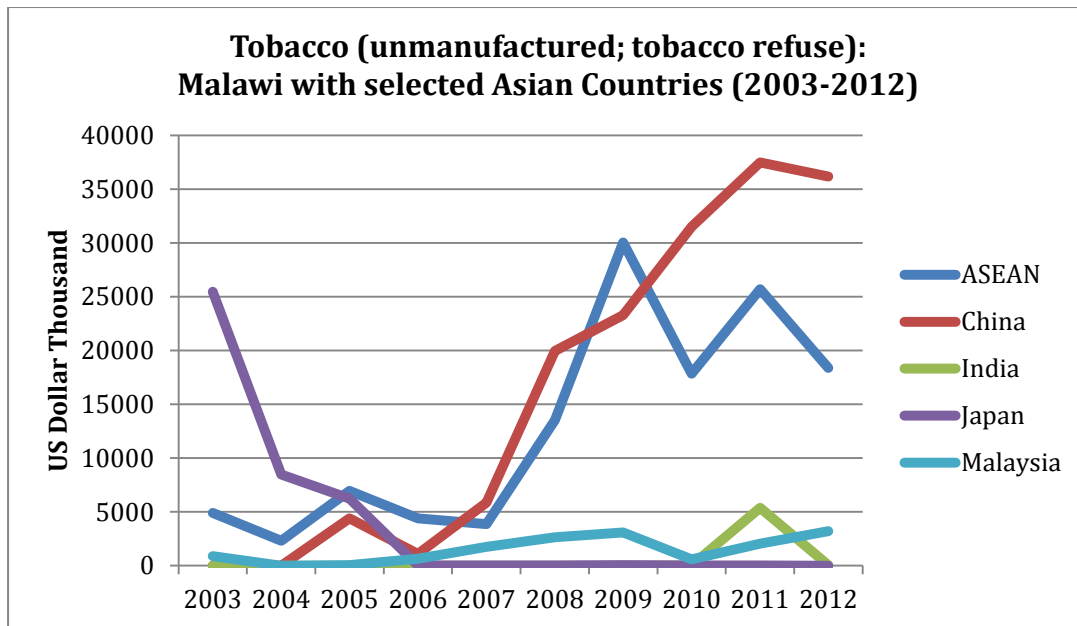


Fig. 13 Sources: ITC calculations based on National Statistical Office (NSO) of Malawi statistics, since January 2012.

Among the tobacco trade between China and Malawi, there is no value-addition taking place. Even though one can observe that Malawi's tobacco exports to China have been sharply increasing in value since 2008, these exports are solely comprised of unmanufactured tobacco. In addition, the scale of tobacco trade is not likely to increase because Malawi mainly produces Burley, which does not meet the demand of Flue-cured tobacco (FCV) from China (Zant 2012, 11–12). The current trade is mainly sustained by one bilateral scheme by which Malawi is contracted to sell 5 million kgs of FCV to China (Moyer-Lee and Prowse 2012, 12). Nevertheless, since China is reported to have started investing in Tobacco-processing companies in Malawi since 2008 (Latham 2008), it might be possible that positive GVCs upgrading take place in the future, yet not for sure.

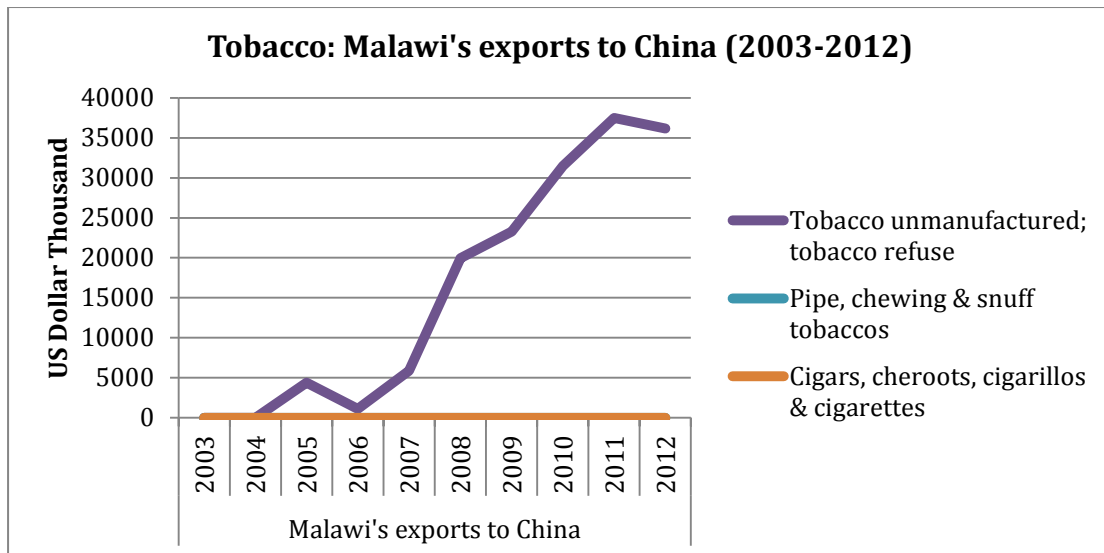


Fig. 14. Sources: ITC calculations based on National Statistical Office (NSO) of Malawi statistics since January, 2012. ITC calculations based on UN COMTRADE statistics until January, 2012.

b. Cotton

Traditionally, Cotton has been an important cash crop for Malawi. Since the 1980s, there was a two-decade decline, yet a revival of the cotton and textile industry is currently taking place (RATES 2003, 4).

Cotton production in Malawi is focused on two stages: cultivation and manufacturing. Similar to tobacco, cotton cultivation is dominated by smallholders. Ginneries are responsible for the primary stage of separating seed cotton into lint and cottonseed. Then it has been reported that over 95% of the cotton lint (semi-processed) is exported to other countries for spinning, while Malawi's cotton industry only processes the remaining 5% and largely works on transforming cottonseed into oil for domestic consumers, with animal feed as a by-product. However, Malawi does not lack the capacity or infrastructure to undertake further processing, as Malawi has owned half of the major ginneries (for example at Iponga, Toleza and Woget) (MCI and Vale 2011, 24) as well as one large textiles company: Davis Whitehead and Sons (Limbe 2010, 4).

As shown in the figure, Malawi has been increasing its cotton exports. From 2003 to 2012, the total volume of exported cotton has tripled. Yet, the exports are volatile and much smaller than for tobacco. One distinctive pattern is that the composition of products has been diversified since 2010, when "carded or combed" cotton started to be exported. Meanwhile, the share of unmanufactured cotton (i.e. Cotton, not carded

or combed) is still predominant. Overall, there is only minor evidence of GVCs upgrading in Malawi's cotton business.

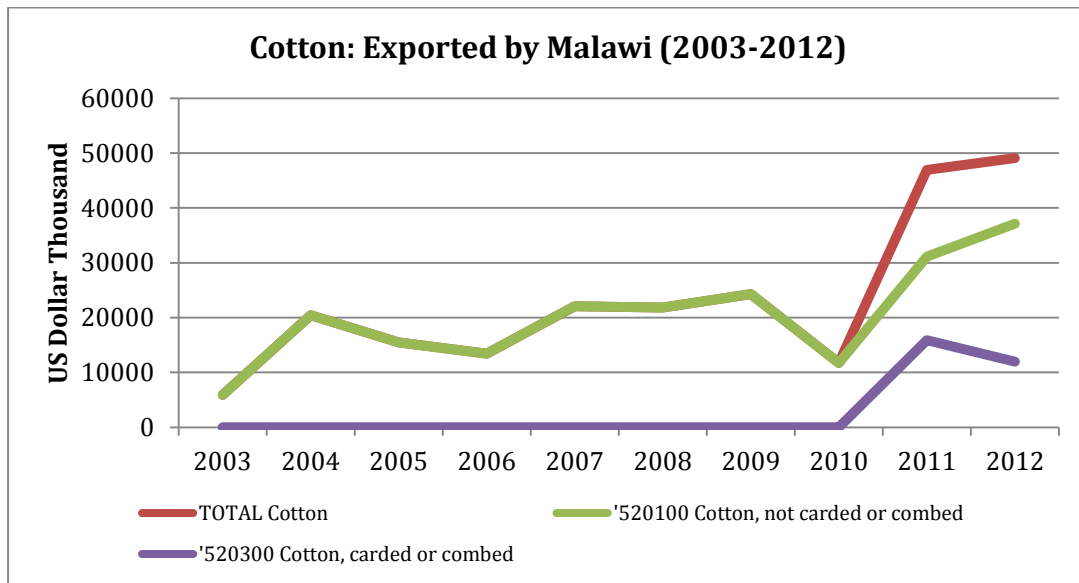


Fig. 15
Sources: ITC calculations based on National Statistical Office (NSO) of Malawi statistics, since January, 2012

Cotton trade with Asia- with a focus on China

Among Malawi's major Asian trading partners, China is found to be the largest receiver of Malawi's unmanufactured cotton exports. Hence this section will solely focus on Malawi-China cotton trade, as a representation of Malawi-Asia cotton trade.

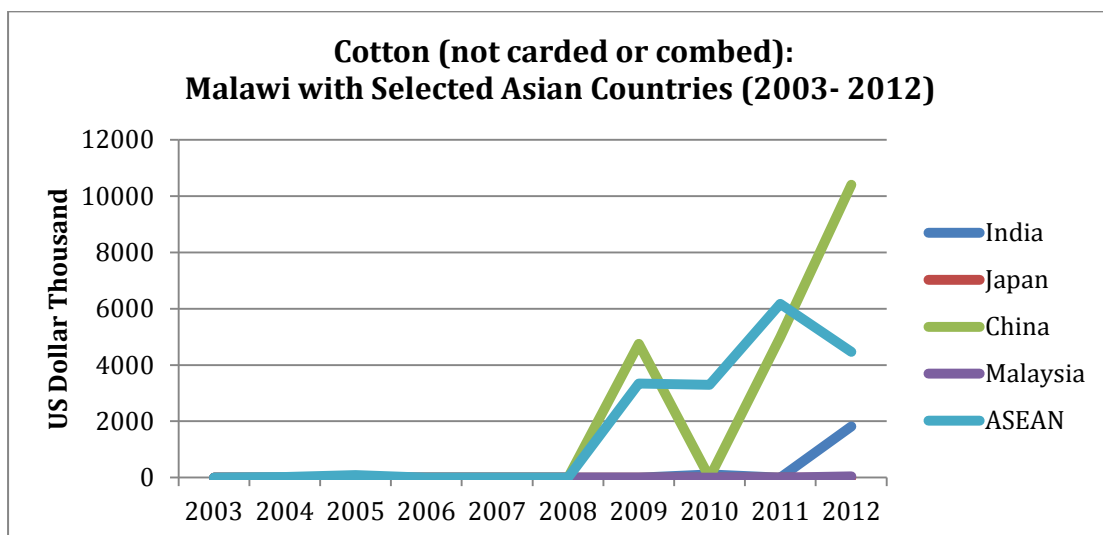


Fig. 16. Sources: ITC calculations based on National Statistical Office (NSO) of Malawi statistics since January, 2012. ITC calculations based on UN COMTRADE statistics until January, 2012.

Regarding Malawi's cotton trade with China, there is minor pattern of GVC

upgrading. On the one hand, there is a huge increase in trade value since 2009; and in 2010, in aligning with its overall cotton trade pattern, Malawi started to export more processed (carded or combed) cotton to China. On the other hand, China has actively responded to GoM's request by investing in its cotton processing industries in Malawi, starting the business of the Malawi Cotton Company (China), and building cotton mills (Magombo 2011; Xinhua 2012).

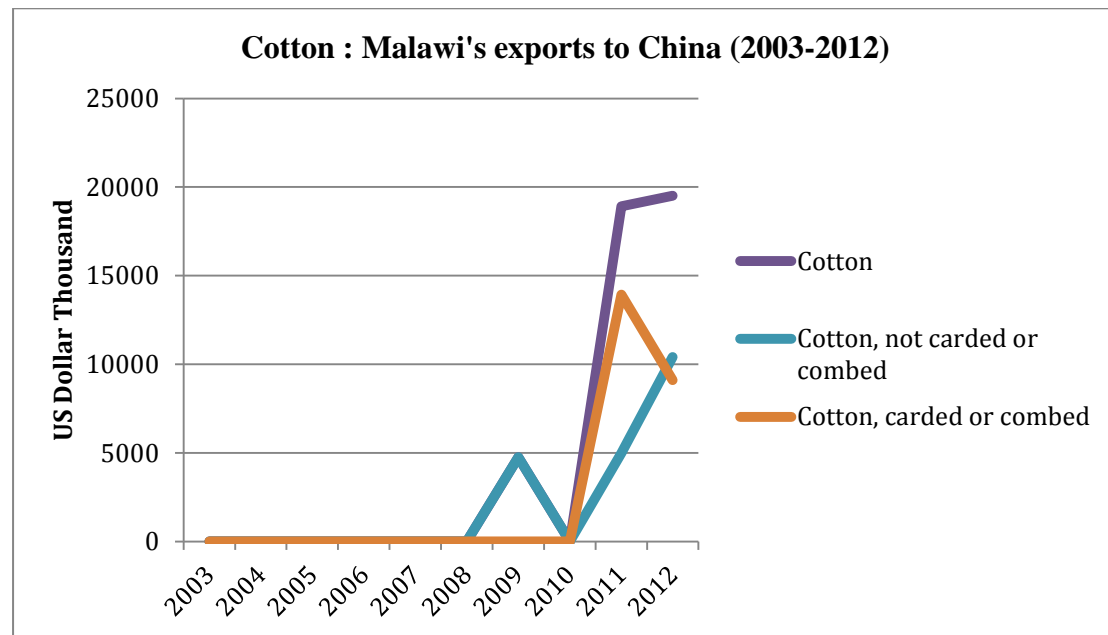


Fig. 17 Sources: ITC calculations based on National Statistical Office (NSO) of Malawi statistics since January, 2012. ITC calculations based on UN COMTRADE statistics until January, 2012.

Overall, there is little value-chain upgrading in terms of tobacco and cotton trade between China and Malawi. Even though there is an increase in trade volume, a diversification of the portfolio and an introduction of more processed products (only observed slightly in Cotton), is marginal and far from sustained.

The reasons behind these GVC patterns between China and Malawi are complicated. Some are contextual, including the climate-sensitivity of tobacco and cotton as agricultural crops (Malawi Today 2012a), domestic political turbulence in 2010 and 2011, the declining trend in international prices (Limbe 2010, 6), instability of the local currency (Nyasa Times 2013), as well as domestic farmers' protest against tobacco auctions (AfDB/OECD 2007, 333; Malawi Today 2012b). Apart from the above, this report is more focused on closely exploring the role taken by regulatory framework, on which level (i.e. multilateral, bilateral or national) and to what extent, with the help of tables below.

This regulation-based analysis suggests that, in the particular case of Malawi-China, the minimal value addition is mostly caused by regulation on a bilateral level, which is aligned with the fact that Malawi officially established a diplomatic relationship with China in 2007 (MoFA (PRC) 2011). This bilateral agreement claims to promote trade, investment and technical support from China to Malawi. In reality, Chinese promises have translated into action: an investment of over \$25 million (K3.5 billion) to establish Malawi Cotton Company under the framework of China-Africa Cotton Development which is devoted to cotton processing (China-Africa Cotton Malawi Limited 2010; RNW 2009), provision of training service to Malawian farmers from Chinese side (CCTV 2012), the introduction of China's mature technologies in cotton breeding, planting, field management and processing to Malawi's cotton plantation bases under the framework of China-Africa cotton project (CDB 2012). Apart from ongoing projects, Malawi is also anticipated to benefit from preferential market access to China (with 1.3 billion population) and become exposed to the opportunities that come with participating in formal and informal dialogues with Chinese investors (i.e. CAD Fund, FOCAC). Yet most Chinese investment is focused in the cotton industry, rather than tobacco.

On the domestic level, GoM has recently passed the national Cotton Bill, emphasizing the importance of enhancing value-addition and broadening the export base, which is aimed at further GVC upgrading in the future (Sichali and Nyasa Times 2013). In addition, regarding this particular case of China- Malawi trade, other multilateral or national regulations have not contributed to any value- addition. Their impact will be discussed in the next section.

c. Regulation/Agreements affecting tobacco and cotton in Malawi

Multilateral Regulation

Name	Outline	Outcome
WTO <ul style="list-style-type: none"> • ATC 	The drafted Doha Round aims at further trade liberalization <ul style="list-style-type: none"> • Eligible for non-reciprocal tariff preferences offered by various WTO Members, including Australia, Canada, the EU, Japan, New Zealand, Norway, Switzerland, Turkey, and the United States. 	Less protectionism in agriculture and some safeguards to protect agriculture in LDCs (including Malawi).
COMESA (2008)	Free trade area with access to nineteen southern, central and north African States	With South Africa as key trading partner, maintenance of low tariffs. Yet less important for tobacco, since it is exported less to Southern African countries.
SADC	Southern African regional trade body, Africa-wide free trade under the ‘African Free Trade Zone’	
EPA (In substitution of previous Cotonou Trade Agreement)	Help create right conditions for trade and investment for both parties of EU and ACP. <ul style="list-style-type: none"> • Less strict rules of origin. • Grant tariff-free access for tobacco exported to all European member states. • More legal certainty than EBA granted 	Positive and Important: <ul style="list-style-type: none"> • Promotes local productivity and capacity building in ACP countries (including Malawi) and grant with preferential access to EU markets. • Less strict rules of origin, making it easier for ACP countries (including Malawi) to export products with third-country inputs (i.e. processed products.) • Provides certain safeguard for agriculture in

		ACP countries.
EBA	Duty free and quota free exports to the EU (yet with stringent rules of origin)	Positive impact <ul style="list-style-type: none"> • Grants LDCs (including Malawi) preferential access to EU market, especially apparel (i.e. processed cotton.)
AGOA	Tariffs on tobacco are selectively applied and different types of tobacco are allowed to enter the US market tariff-free.	Grants certain products from African countries preferential access to US markets

Sources: Malawi Confederation of Chambers of Commerce and Industry (<http://www.mccci.org/>), Trade policy section of European Union (http://ec.europa.eu/trade/index_en.htm), Trade Policy Review of Malawi (http://www.wto.org/english/tratop_e/tpr_e/tp331_e.htm)

Bilateral Regulation

Region	Name	Outline	Outcome
Intra-Africa	Malawi-South Africa Bilateral Trade Agreement (2007)	Non-reciprocal. The Agreement providing Malawi with duty-free status for its commodities as long as they meet the 25 percent local value added, while South Africa receives only MFN treatment. (It also compasses the investment sector.)	Positive in terms of regional trade, as it promotes value-addition.
	Malawi-Zimbabwe Bilateral Trade Agreement (1995)	A reciprocal trade agreement, with 25 percent domestic value added requirements.	Positive in terms of regional trade, as it promotes value-addition.
	Malawi-Mozambique Bilateral Trade Agreement (2005)	It provides for duty-free trade between the two countries, with only a limited number of excluded products.	Positive in terms of regional trade, as it promotes value-addition.
With Asia	Malawi-Malaysia Bilateral Trade Agreement		Positive as Malaysia is a competitive source of imports of machinery, tools and equipment for light manufacturing (i.e. cotton processing) and farming (of cotton and tobacco).
	Malawi-China Bilateral Agreement (on trade, investment, and technical cooperation)	<p>From 1 July 2010, Malawi is eligible for tariff preferences in China covering some 4,800 products, according to the authorities.</p> <ul style="list-style-type: none"> • This agreement offers Duty Free Quarter Free (DFQF) to LDCs (including Malawi). • Goods from LDCs countries are accorded duty-free and quota-free access to the Chinese market, whereas goods from China to LDCs countries attract normal duties so as to avoid dumping. 	<p>Positive Impact.</p> <p>It grants Malawi with preferential access to huge market in China.</p> <p>It also includes technical and investment cooperation, which is more likely to trigger value-addition.</p>
	Malawi-India Bilateral Trade Agreement (since	This agreement offers Duty Free Tariff Preference (DFTP) to 49 LDCs (including Malawi).	Minimal Impact, as it only focuses on tariff, without any specific support for value-

	2009)	<ul style="list-style-type: none"> tariff reduction in five equal cuts over five year period, 85% market duty free, 9% on preferential duty access and sensitive products constituting 6% . 	addition.
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Source: Malawi Confederation of Chambers of Commerce and Industry (<http://www.mccci.org/>)

National Level Regulation

Name		Outline	Outcome
Investment Promotion Act of 1991	Export Processing Zones Act of 1995	<p>Establish the agency of Malawi Investment Promotion Agency (MIPA), granting MIPA with the mandate to “promote, attract, encourage, facilitate and support local and foreign investment in Malawi.”</p> <p>Through MIPA, investors can access general incentives and export incentives, including Export Processing Zones (EPZs). (MCCCI 2013)</p> <ul style="list-style-type: none"> • Malawi maintains an export-licensing regime, covering both unmanufactured tobacco and cotton. • Few restrictions on foreign investment. 	<p>Mixed impact:</p> <p>Positive as it is working to incentive investment and specifically targeting at export process.</p> <p>Negative as both trade of unmanufactured tobacco and cotton are restrained.</p>
The Competition and Fair Trading Act (CFTA) of 1998		Creation of the Competition Commission, so as to encourage competition in the economy	Positive but minimal impact, as it is does not directly deal with value addition.
Tobacco	Tobacco Act	Responsible for tobacco uprooting/ registration/ tax etc.	Minimal impact. More focused on regulation instead of promoting upgrading in value chain.
	Control of Tobacco Auction Floors Act	<p>Establishing the Tobacco Control Commission (TCC) to administer the whole tobacco industry.</p> <ul style="list-style-type: none"> • Defining the duty of TCC, building an auction-central trading scheme, as well as corresponding procedures of registration, marketing, licensing. 	<p>Minimal positive impact on upgrading due to its focusing on regulation and control.</p> <p>Some negative impact in terms of the wholly state-owned tobacco trading scheme, a lack of openness to global market and lack of competition.</p>
Cotton	Cotton Bill (2012)	It is aimed to help improve quality and quantity of cotton produced in Malawi, enhance value addition, facilitate compliance with international market standard and diversify production of	<p>Recently enacted, its outcome has not yet been observed.</p> <p>Yet, its focusing on enhancing value addition</p>

		<p>cash crops.</p> <ul style="list-style-type: none"> • Establishing the Cotton Council, supporting research, monitoring product standard, developing new varieties of cotton, regulating market/ licensing/ warehousing, regulating ginning licenses, imposing restrictions on sales/ export/ purchase etc. 	<p>can be beneficial.</p>
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Source: Malawi Legal Information Institute (<http://www.malawilii.org/>), Malawi Consulate Zambia (<http://www.malawiconsulate.co.za/index.php/invest-in-malawi>), Parliament of Malawi (<http://www.parliament.gov.mw/docs.php?mode=bills>)

d. Implications and Recommendations

Despite the current poor performance, there are plentiful opportunities and sufficient potential for Malawi to upgrade cotton and tobacco GVCs by taking advantage of the regulatory framework.

On the one hand, Malawi already has a well-equipped regulatory framework at the multi-lateral, bi-lateral and national level, which it could better utilize. Thanks to multilateral and bilateral agreements (within WTO, with US, EU, China, India, etc.), most Malawian exports have enjoyed preferential market access (usually characterized by zero tariffs and relatively loose rules of origin requirements) to most large markets in the world. The framework of COMESA, SADC and bilateral agreements also support regional trade with neighboring countries such as South Africa, Mozambique and so on. However, Malawi has not yet taken full advantage of these benefits as it mainly export raw materials, with scarce value addition. Furthermore, some of the multi and bi-lateral agreements cover investment and technical assistance, which Malawi has rarely addressed.

Domestically, the GoM has also established a comprehensive (institutional) regulatory framework for attracting investment, promoting competition and boosting trade, including MIPA, Tobacco Act, Cotton Bill, CFTA. The challenge GoM is facing therefore lies beyond the regulatory framework. Instead, the GoM should concentrate on how to translate existing regulations into real outcomes. This means working to facilitate value-addition by building infrastructure and adapting existing regulations. It is necessary for the GoM to reform and improve its investment environment, to improve the notorious bureaucratic procedure, and to strengthen transparency in business regulations (KPMG 2012, 6; World Bank Group 2013b; World Bank Group 2013c).

On the other hand, it is crucial for the GoM to recognize the fact that not all multi-lateral agreements it has signed can facilitate upgrading, while some are actually impeding Malawi from climbing up the value chain. Most multi-lateral agreements promote trade liberalization, which is not compatible with Malawi's capacity and current situation (Said 2011). As an LDC, Malawi (and local producers) would be at extreme disadvantage when competing with cheaper goods imported, which impede

development of the local infant industry. Concretely, the rapid trade liberalization process in the mid-1980s required by the WTO was one major reason for the collapse of Malawi's manufacturing industry and levels of unemployment (Chigaru 2006, 1,3). EPA, as a reciprocal trade succession of non-reciprocal Cotonou Partnership Agreement, is more beneficial to EU producers rather than Malawian. Under the framework of EPA, the EU will be able to export cheaper goods to Malawi, whereas Malawian producers do not have the competitiveness to compete with EU goods nor to export to the EU market. This imbalanced trade will eventually harm local producers and hinder Malawi's attempts to add value before exporting (Griffith 2007, 32). Moreover, the EU subsidizes its own farmers to export and imposes non-tariff barriers such as SPS (Sanitary and Phytosanitary Measures) to prevent Malawi and others from exporting more agricultural goods. In the long term, both the WTO and EPA is reinforcing the "lock in" scenario whereby Malawi exports cheap low-cost agricultural commodities and imports high-value goods (Griffith 2007, 32).

Moreover, almost none of those multi-lateral trade agreements are addressing the more important issues of capacity building, infrastructure improving and technical assistance, all of which Malawian farmers are in urgent need of. Concerning regional trade agreements, both COMESA and SADC are controversial in terms of redistributing the benefits of regional economic integration and reinforcing regional competition (Douillet and Pauw 2012, 2).

Opportunities for Tobacco upgrading

On the multilateral level, tobacco trading is neither stringently constrained nor facilitated by existing regulations. Yet, Malawi's tobacco business is more influenced by another multilateral document of the WHO Framework Convention on Tobacco Control (FCTC), to which Malawi is not a signatory party. The global implementation of FCTC and the Protocol to Eliminate Illicit Trade in Tobacco Products has been decreasing the global demand for tobacco, thus hurting Malawi indirectly (Chirwa 2011, 8). This global demand decline implied the importance for Malawi to diversify its export portfolio, and to decrease its economic dependency on tobacco.

On the bilateral level, Malawi could upgrade its tobacco sector by further collaborating with existing partners or seeking new opportunities. For instance,

Malawi could seek cooperation with China and request technical assistance to improve local soil quality to grow cotton and tobacco. As the largest cigarette producing country and committed to help Malawi develop, China would be able to offer technical support for Malawi to initiate a domestic cigarette-manufacturing industry. On the other hand, GoM may seek trading opportunities with other trade partners, like Japan. With Japan Tobacco International (JTI) operating as the Malawi's second largest destination of tobacco export (Moyer-Lee and Prowse 2012, 12), a bilateral trade agreement with Japan will potentially enlarge trade volume, and serve as a safeguard of revenue in today's extremely volatile tobacco industry.

Concerning national level regulation, Malawi should update its tobacco legislation and unsatisfactory auction system. The existing Tobacco Act and Tobacco Control Auction Floor Act are both outdated in content, and mainly about controlling domestic tobacco cultivation and trading by licensing and bureaucratic administration. It would be useful for GoM to update pertaining documents and integrating the idea of value addition, so as to guide practice.

Opportunities for cotton upgrading

On the multilateral level, in contrast with relatively liberalized tobacco, there are more restraints set on cotton, textiles and apparel products. Even as a LDC, Malawi is not enjoying completely free market access for textile products. It is often regulated by the Rules of Origin that processed goods (of cotton) must contain a certain proportion of domestic contribution.

Moving to the regional level, due to similar specialization in cash crop cultivation, Malawi does not have a comparative advantage in cotton with neighboring countries of Zambia, Mozambique etc. However, it could be strategic for Malawi to shift its focus to textile manufacturing or cottonseed processing, based on current production of cotton, textiles and garments, as well as an existing but not fully utilized manufacturing capacity (Limbe 2010, 4,9). As long as it is within the Rules of Origin, Malawi could import raw materials from neighboring regions, process them domestically, and exporting manufactured goods. This strategy could mitigate the pressure from regional competition, revive local textile industry and mutually benefit its neighboring countries (e.g. Zambia, Mozambique), which are larger cotton producers. This strategy would allow Malawi to make use of both regional trade

agreements (i.e. SADC and COMESA) and bilateral agreements. This strategy is also likely to be promising considering China's current standing, investment and assistance, as mentioned earlier.

6. Framework

The following framework documents the steps that were taken in order to arrive at the results of the case studies above. It follows the outlined approach in the methodology closely yet provides extra details of the process including the key sources used at each stage. This process, which is designed to provide the foundations for the development of case studies needs not to be followed absolutely precisely, as the name ‘framework’ suggests.. There is significant room to bring in additional sources (as occurred in the case studies above) as supplemental information (for example, key academic papers, on-the-ground studies, further databases). The final recommendations detail the findings of the researchers through the process of following the steps and are therefore not tied to any specific reference. This framework is also intended to be a first point of reference that is flexible to future change in agricultural GVC research. To fully utilize the framework section one must also look at the original two case studies above to see in detail how they progressed, yet without it should still form a ‘frame’.

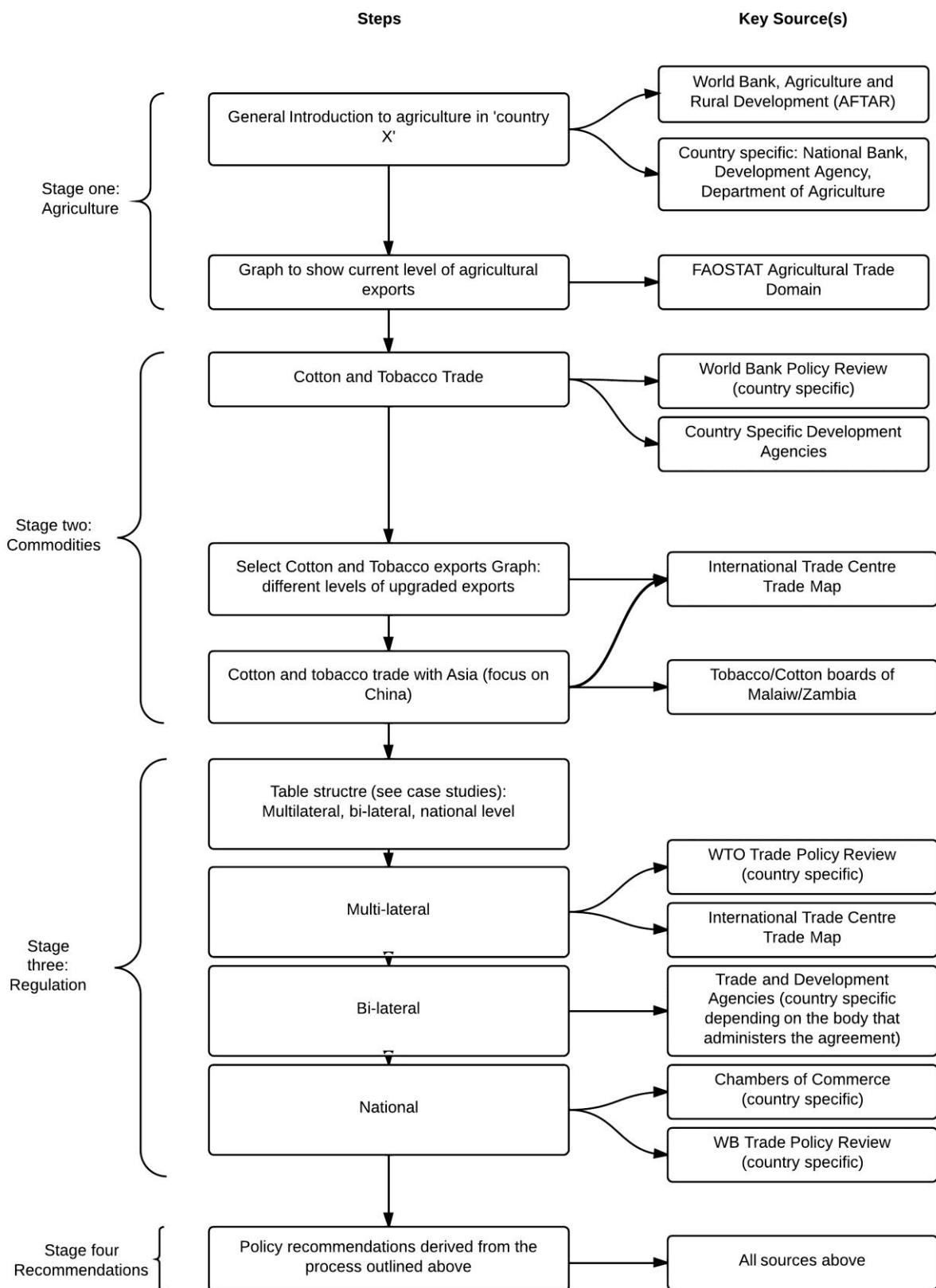


Fig. 18 Framework
 For hyperlinks to key sources see: 'framework' section of bibliography (excluding country specific sources)

7. Concluding Remarks

This study has provided the foundations of research into the specific field of global agricultural value chains between select Sub-Saharan African Countries and Asia with a focus on regulation how it can be leveraged more effectively from the African perspective.

It has been identified that global GVCs are constituent feature of 21st century trade. However countries at lower levels of economic development are making less use of, and enjoying fewer benefits from, participation in GVCs. African countries in particular have struggled to upgrade beyond the level of raw agricultural products whilst Asian countries in comparison have benefitted from specializing in certain, more highly manufactured, goods and enabling them to move up the value chain.

The case studies presented in this report have highlighted two Sub-Saharan African countries both with a high level of reliance on agricultural exports that have a need for upgrading but have thus far achieved only an increase of quantity of exports. In both countries for cotton and tobacco, only the raw product is being exported (to any significant degree).

Both countries have been experiencing rapid growth in trade with Asian and a surge of exports over the past 10 years, owing in no small part to the bi-lateral, tariff-free trade agreements put in place within that period. In terms of regulation on the multi-lateral, bi-lateral and national level the regulations on cotton and tobacco trade are relatively similar for both cases and both countries have the potential to make better use of such regulations. In fact the tariff-free nature of agreements with China (especially) have produced a negative effect on the ability of the countries to upgrade due to a flooding of the markets with Chinese products (especially textiles and clothes). A re-negotiation of such agreements to the benefit of the African nations has been suggested (included further investment from China/Asia in upgrading production). Yet, for Malawi at least, there appears to be the first green shoots of upgrading with the assistance of Chinese investment in upgrading production. Both countries enjoy significant benefits from a plethora of preferential multi-lateral agreements yet are currently not making optimal use of them. Further trade of higher value-added goods would mean a significant boost to GDP whilst enjoying tariff-free

access to many of the world's largest markets. National level regulation presents a further barrier to upgrading due to deficiencies in enforcement and comprehensiveness, further prohibiting opportunities for investors to take the first steps to upgrading (for instance, investing in factories). This is matched by a need for government pro-activeness in updating regulation and delivering on promises of investments coupled with shifts in focus towards value-added trade. A possible shift of focus towards new trading partners in Asia whilst building on local partnerships such as SADC and COMESA has been posited as a potential avenue for further, more beneficial agreements.

Another goal of this report was to provide a framework for future research into the same area but using different case studies. This has been achieved through the description of a step-by-step procedure with reference to key sources of information from which to draw. The report provides thus intends to be the stepping-stone to deeper research into the issue of regulation in agricultural GVCs Africa-Asia.

GLOSSARY OF TERMS

Developed countries: the member countries of the OECD (other than Chile, Mexico, the Republic of Korea and Turkey), plus the new European Union member countries which are not OECD members (Bulgaria, Cyprus, Latvia, Lithuania, Malta and Romania), plus Andorra, Bermuda, Liechtenstein, Monaco and San Marino.

Developing economies: in general all economies not specified above. For statistical purposes, the data for China do not include those for Hong Kong Special Administrative Region (Hong Kong SAR), Macao Special Administrative Region (Macao SAR) and Taiwan Province of China.

Raw/unmanufactured good: *Not manufactured good.*

Regulation: *The action or process of being regulated.* The use of the word regulation herein applies to multilateral and bi-lateral trade agreements and national level regulation affecting trade.

Transition economies: South-East Europe, the Commonwealth of Independent States and Georgia.

Upgrading: *The acquisition of functional capabilities.* See Fig. 4 ‘Agricultural Value Chain’, moving production from left to right on the chart constitutes an upgrade at each stage.

Value addition (Value-addition): *An enhancement to a good/service that increases the product value.*

8. Bibliography

Hyperlinks to ‘key sources’ from ‘Framework’ section (excluding country specific sources)

World Bank Agriculture and Rural Development (AFTAR)	http://data.worldbank.org/topic/agriculture-and-rural-development
FAOSTAT Agricultural Trade Domain	http://faostat.fao.org/
International Trade Centre Trade Map	http://www.trademap.org/

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