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Briefing on the Agribusiness Enabling Environment

AgCLIR Agribusiness Commercial Legal & Institutional Reform Diagnostic

AgCLIR LESSONS FROM THE FIELD: TRADING ACROSS BORDERS

This publication was produced for review by the United States Agency for International Development (USAID), as part of the Agribusiness Commercial Legal and Institutional Reform (AgCLIR) diagnostic.

The business of agriculture occupies a critical space in most economies. Distinct and special among industries, agriculture is the dominant source of employment for a large share, even a majority, of the population in developing nations.

Accordingly, governments treat the regulation of agriculture and food differently than any other sector. Unlike the output of other sectors, many agricultural products are basic necessities: agriculture provides the food, fiber, fuel, and construction materials necessary to sustain human existence. Governments everywhere assume responsibility for assuring that the distribution of agricultural commodities is great enough and equitable enough to provide a reasonable quality of life for its citizens.

Agriculture and Agribusiness: Trading Across Borders is a briefer that mirrors the analytical framework used by the World Bank Group's "Doing Business" series (www.doingbusiness.com) and adopted by USAID's Commercial Legal and Institutional Reform framework. Divided into four sections (Legal Framework, Implementing Institutions, Supporting Institutions, and Social Dynamics), this briefer highlights the specific issues that must be addressed in local legal, regulatory, and institutional environments if agribusiness is to be economically productive, contribute to environmental sustainability, and assure a safe and reliable food supply.

INTRODUCTION: KEY CONCEPTS

The principle that trade and investment are important for economic growth is widely accepted. By trading with other countries and attracting foreign investment, nations can take advantage of global market forces—competition, human resource development, technology transfer, and innovation generate growth and reduce poverty.

The agribusiness sector encompasses half of the world's labor force and 40 percent of consumer purchases. The public policy issues that it raises impact economic development, trade, nutrition, food safety, the environment, intellectual property, genetics, and other social and economic priorities.

Trade is investigated as an area of the business environment under the Agricultural Commercial Legal and Institutional Reform project (AgCLIR) because of its large and growing importance to economies the world over and to the growing interconnectedness of these economies. The last twenty years have also seen a dramatic increase in the amount of goods and services traded globally. This growth has come from a variety of sources, including increased global income; improvements in technology, logistics, and transportation efficiencies; and the series of trade negotiations following WW II that eventually led to the establishment of the World Trade Organization (WTO) and dramatically lowered tariffs on a reciprocal basis.[1] However, despite rapidly expanding growth in agriculture and food products over this same time period, today the share of developing countries accounts for little more than half the world agricultural trade, and food trade is about the same as it was twenty years ago.[2]

1 Agriculture, however, has traditionally benefited from special arrangements that sheltered it from the full impact of GATT (and now WTO) rules. Even today, in the WTO, trade in agricultural products are covered by a separate agreement that, to a degree, still shelters it from generally applicable rules.

2 "Summary of World Food and Agriculture Statistics," Food and Agriculture Organization of the United Nations, 2005.

There are no shortages of issues that constrain the growth of agribusiness trade. Such issues include product perishability, low margins, lengthy distances to markets, and, "lumpy" cash flow (i.e., cash flow is produced only after months of soil preparation, growing season, harvest, and marketing). Moreover, major global trends in agricultural trade limit the ability of developing country firms to compete with their developed country competitors:

- Many OECD countries subsidize their farmers and provide export subsidies to their agribusiness, keeping world prices down and flooding the market with surplus production.
- Poor national infrastructure makes it more expensive for farmers in a remote area to ship commodities to urban consumers in their own country than for internationally competitive agribusinesses on the other side of the world to ship them to those same urban buyers.
- Technological innovations needed by producers and processors come with a high price tag if they are available at all.
- Tariff escalation (i.e., tariff rates that increase as the amount of additional value added by the producer is increased) forces developing countries to export raw product without reaping the employment and other benefits of adding value locally.
- Non-tariff barriers to trade (especially strict plant and animal health standards that can be used to protect markets in lieu of more obvious tariff barriers) further restrict their ability to penetrate global markets.

THE LEGAL FRAMEWORK

National laws relating to trade in goods and services, customs, intellectual property, sanitary and phyto-sanitary standards and a wide range of other laws relating to investment, distribution, and transportation help to determine the ability of a country to trade both domestically and internationally. For agricultural exporters and agribusinesses seeking to expand participation in global trade, however, two aspects of law and regulation seem particularly important. These deal with trade policy and trade facilitation.

Trade Policy. Trade policy broadly includes any policy that affects international trade and usually refers to tariffs and non-tariff measures concerning trade in goods and services. In terms of trade in agricultural products, there are at least four aspects of trade policy to focus on that affect the degree to which countries can trade in agricultural products:

- Tariffs or regulations should not interfere with access by agriculture and domestic agribusiness to the goods and services they require (including fertilizer, crop protection materials, imported seed and other planting materials, imported cartons, packaging materials, and packaging and processing equipment).
- Investment provisions should facilitate competitive financial systems to ensure low-cost and high-quality access to financial services for agribusinesses.
- Immigration laws should reflect the value of foreign expertise in transferring technology and foreign ideas and should not impede the flow of foreign agricultural experts.
- Trade laws should recognize the role that imported technology can play in fostering innovation in agribusiness, and should not unnecessarily impede such imports.

Competitiveness. Competitiveness is determined at a national and firm level. Trade policies affect competitiveness by influencing the ways firms can act in the market, the degree to which competition is regulated, and the price at which a firm's products can be sold.

- International trade disciplines under the WTO as well as empirical evidence on the degree to which States should be involved in trade suggest that State Trading companies (i.e., the WTO defines as "governmental and non-governmental enterprises, including marketing boards, which deal with goods for export and/or import") should abide by general rules of non-discrimination in selecting trade partners, and that only commercial considerations should guide their decisions on imports and exports.
- Exchange rates should be allowed to adjusted so that agricultural exports are able to compete on the international market while not disadvantaging domestic importers from purchasing equipment from abroad.

Sanitary and Phytosanitary (SPS) Measures. SPS measures can pose enormous barriers to agribusiness and agricultural trade. They are established to reduce significant risks to both humans and the environment, as in the case of international transmission of avian influenza, for instance. If SPS rules are written and interpreted too strictly or on the basis of no scientific evidence, however, they can bring trade to a halt. SPS rules are sometimes used erratically, an indicator that they are a "non-tariff" means of controlling imports. Saudi Arabia, for example, imposes and lifts bans on the export of live animals from East Africa to the Middle East in ways not strictly related to the possibility of diseased animals or meat entering into trade, a breach of WTO rules and an impediment to the growth of trade in live animals. A sound and workable SPS regime relies on good science thoughtfully and fairly administered.

Trade Facilitation. Trade facilitation is the process of simplifying and harmonizing a country's international trade procedures in line with current best practices and globally accepted standards. While such practices benefit all users, they can be most beneficial for agribusiness that often deal in perishable products needing expedited clearances. It is clear that businesses trade less when they face significant transactions costs or time delays. A significant body of empirical evidence helps explain why: each additional day in transit is equivalent to lowering the price of fruits or vegetables by 0.9 percent. In many cases the cost of transit delays even exceed the cost of tariffs. Thus, quick clearance of goods is particularly critical when goods are subject to rapid depreciation as is the case of perishable agriculture commodities.[3]

When good trade facilitation practices are in place, the importer and exporter can reliably predict shipment and delivery times and, even more important, keep border processing costs competitive. Such simple and transparent practices are particularly necessary for the successful integration of the small and medium-sized agribusiness companies (SMEs) into the international arena. When trade facilitation practices are implemented, the players and commodities expand, competitive pricing factors are in play, and the consumer's purchasing power increases. Such reforms also generally improve tax revenues as loopholes for evasion are decreased due to the increased effectiveness of controls based on modern practices such as intelligence-based risk analysis. Trade facilitation should be a national strategy that incorporates all aspects of the trade chain but has customs modernization as a key pillar.

3 Hummels, David et al. "Calculating Tariff Equivalents for Time in Trade." USAID, 2007.

IMPLEMENTING INSTITUTIONS

Trade Policy. Trade policy that promotes economic growth requires strong institutions capable of setting long term objectives that cut across economic interests of any individual sector in society. As such, responsibility for international trade law, regulation, and administration is broadly dispersed within any government ranging from Ministries of Trade and Industry to Agriculture, Health, and Transport. A high degree of policy coordination and continuous, structured engagement between such government agencies as well as between government and other key stakeholders (namely, private sector and civil society interests) is paramount to the overall success and sustainability of trade policies.

Policy analysis, policy coordination, and negotiation capabilities are three of the most critical functions of institutions responsible for implementing trade policy.

- **Policy Analysis.** Policymakers need accurate and timely analysis on the implications of agricultural trade policy. Global price trends in regionally important tradables, tariff and non-tariff barrier trends, and policy issues affecting trade in agricultural products include regulation of movement of people, investment, and industrial policy. Each of these must be clearly understood and presented to policymakers.
- **Policy Coordination.** Trade policy requires substantial policy coordination to ensure that policies accurately reflect the best business and civil interests of the country.
- **Negotiation Capabilities.** Trade policy is increasingly dealt with at international negotiation tables of the WTO and regional or bilateral bodies. The Doha round is one of many examples of the sensitivity surrounding trade in agricultural products.

Trade Facilitation. Prudent and effective international trade facilitation includes the provision of high-quality government services, predictable and consistent government procedures and regulations, overall transparency of the system, as well as the building and maintenance of an anticorruption environment for business. Governments increasingly recognize that capable and responsible government operations are a prerequisite for development.

Modern customs operations strive to end unnecessary and unproductive trade barriers and constraints by applying modern techniques and technologies, and by improving the quality of necessary controls in a manner that reflects factors consistent with recognized international standards.

Customs Enforcement and Protection Services. A modern customs service has to strive for transparency, predictability, and fairness in its dealings with the international trade community. For a truly facilitative environment, the laws and regulations governing the import and export of materials and goods must provide the following:

- An adequate and coherent authority structure for the essential trade-related institutions;
- Clearly stated regulations and procedures that form a basis for an adequate balance between facilitation and necessary controls essential for public health and welfare;
- The means to legally employ modern risk management techniques utilizing selective inspections and post-release audits to accomplish their respective missions;
- A productive environment of cooperation and procedural coherence with the other government agencies with border control responsibilities; and
- A cooperative and consultative atmosphere of dialog among government agencies, the international trade community, and the national legislature to accomplish goals and eliminate roadblocks.

Sanitary and Phyto Sanitary (SPS) Measures. The perishable nature of agricultural goods and the fact that they are frequently used for human and animal consumption, make agricultural-related products highly regulated. Testing and certification services are the core competencies of agencies responsible for managing SPS risks. SPS measures tend to be the responsibility of the Ministries of Food and Agriculture, under groups with an expertise in plant protection and, regulatory and veterinary services. There are four functional areas that tend to make up such an office:

- Plant quarantine
- Pesticides management
- Seed inspection and certification division
- Plant disease and pest management

International Agreements. An important part of maintaining a system of SPS standards involves observing and becoming signatory to international standards concerning foodstuff. To bring the local laws into line with international best practices, governments need to amend laws in order to include Codex standards and International Plant Protection Convention (IPPC) standards. This needs to be supplemented by the construction of physical infrastructure that includes, among other things, labs and, testing facilities, to ensure the soundness of the agricultural products for human, plant and animal health.

SUPPORTING INSTITUTIONS

The health of a trade environment depends just as much on non-governmental actors as it does on governmental actors. Nationally, a number of types of organizations provide trade services that facilitate trade across borders: trade associations, transporters, freight forwarders, insurance providers, and marketing agents each play essential roles in the movement of goods within and across national boundaries.

Private Sector. The private sector plays an important role in influencing trade policies that affect the costs and ease of trading across borders. Often traders and the associations they form the most vocal advocates or impediments to trade policy reform. Importers and exporters, while often the same individuals, may have separate interests. For instance, exporters prefer a weaker currency so as to make their goods more competitive internationally, while importers prefer a stronger currency to enable the purchase of relatively cheaper inputs. Of increasing importance to trade in agricultural products are third-party certification services (fair trade, organic, etc.) that help to assure grades and standards underpinning a trade have been met.

Customs Clearance Agents. Customs clearance agents are the essential link between customs and the importer/exporters. They should be knowledgeable of tariff and valuation principles, and customs procedures and policies, and should be able to facilitate the clearance of goods on behalf of their clients. When this sector is efficient in rendering a high quality of service, transaction costs and delays are minimized.

About AgCLIR:

AgCLIR, or the Agribusiness Commercial Legal & Institutional Reform diagnostic is a unique tool for agribusiness enabling environment analysis that identifies the root causes of an inefficient or underperforming agricultural sector. AgCLIR is a sector-specific adaptation of the United States Agency for International Development (USAID) CLIR approach, which aims to improve the business enabling environments through sound analysis and strategic interventions. This series, Briefings on the Agribusiness Enabling Environment is intended to shed light on some of the most important, and least understood, components at the intersection of agribusiness and commercial law and institutional reform. All issues are available at http://egateg.usaidallnet.gov/EAT

Marketing Information. Buyers and sellers of agricultural products need timely, unbiased price and market information to assist in the most efficient marketing and distribution of agricultural products, particularly agricultural commodities. Services such as the Agricultural Marketing Services (AMS) of the United States Department of Agriculture or non-governmental services run by industry associations or donors such as USAID's MISTOWA Project (www.mistowa.org) provide useful information on prices, quality, volume, location, and other relevant market data. Most important, this information should be timely (e.g., AMS distributes its data within hours of collection) and easily accessible (e.g., AMS distributes the data via the Internet, hard-copy reports, telephone recordings, and relevant news outlets).

Information and communications technology service providers facilitate the timeliness of trade transactions as well as expand the range of possible buyers or sellers. Reliable, ubiquitous, and affordable phone and Internet services are critical to reducing trade information asymmetries, improving returns, and avoiding physical losses of product. Internationally, the International Trade Centre in Geneva and the Food and Agriculture Organization in Rome play key roles in providing information and technical assistance to developing countries on agricultural trade issues.

SOCIAL DYNAMICS

Trade is consistently a topic of intense debate in developing and developed countries. Changes in trade policy have distributional impacts that affect groups unevenly; there are winners and losers from changes in trade policy that make reform difficult, despite the potential for aggregate improvements in social welfare. Trade facilitation reforms, while less far reaching than trade policy reform, are full of entrenched interests and obstacles to reform. The reduction or elimination of corrupt trade practices goes beyond a competent legal framework. Governments and stakeholders in the trading system must address fundamental issues of incentives, transparency, and professionalism to lower instances of illegal behavior. Strengthening trading systems' capacity to deal with SPS issues is no longer an option; without rigorous plant and animal health control measures products will not be tradable on global markets.

Trading across borders tends to be complex and costly, especially so for traders of agricultural products. There is no shortage of pent-up demand for reform in most developing countries. Fruit processors will run diesel generators all day to avoid costly interruptions on the grid. Small-scale farmers will pay more than 100 percent interest on loans just to get access to credit. Transporters expect quick depreciation of their vehicles due to poor roads. The issues are many.

Governments and donors have to balance the often-competing demands of food security, economic growth, and natural resource management in handling trade flows. Empirical research over the last twenty years has made it increasingly clear that trade can cause growth, reduce food insecurity, and have neutral environmental impacts. Yet achieving this textbook result in countries where capacity to generate sufficient supplies of goods and services is low is a challenge to say the least. Governments and donors need to focus on providing public goods that facilitate trade in agricultural products while setting incentives so that people act in their and the public's best interest.

The supply of reforms tends to lag behind demand, however. The rural, cyclical nature of agriculture and the dispersed populations of poor, vulnerable people make agriculture policy reform a particular challenge. Given the strongly rural dimensions of poverty across the globe, resolving to prioritize policy constraints for businesses in the agriculture trade has never been more important.

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