



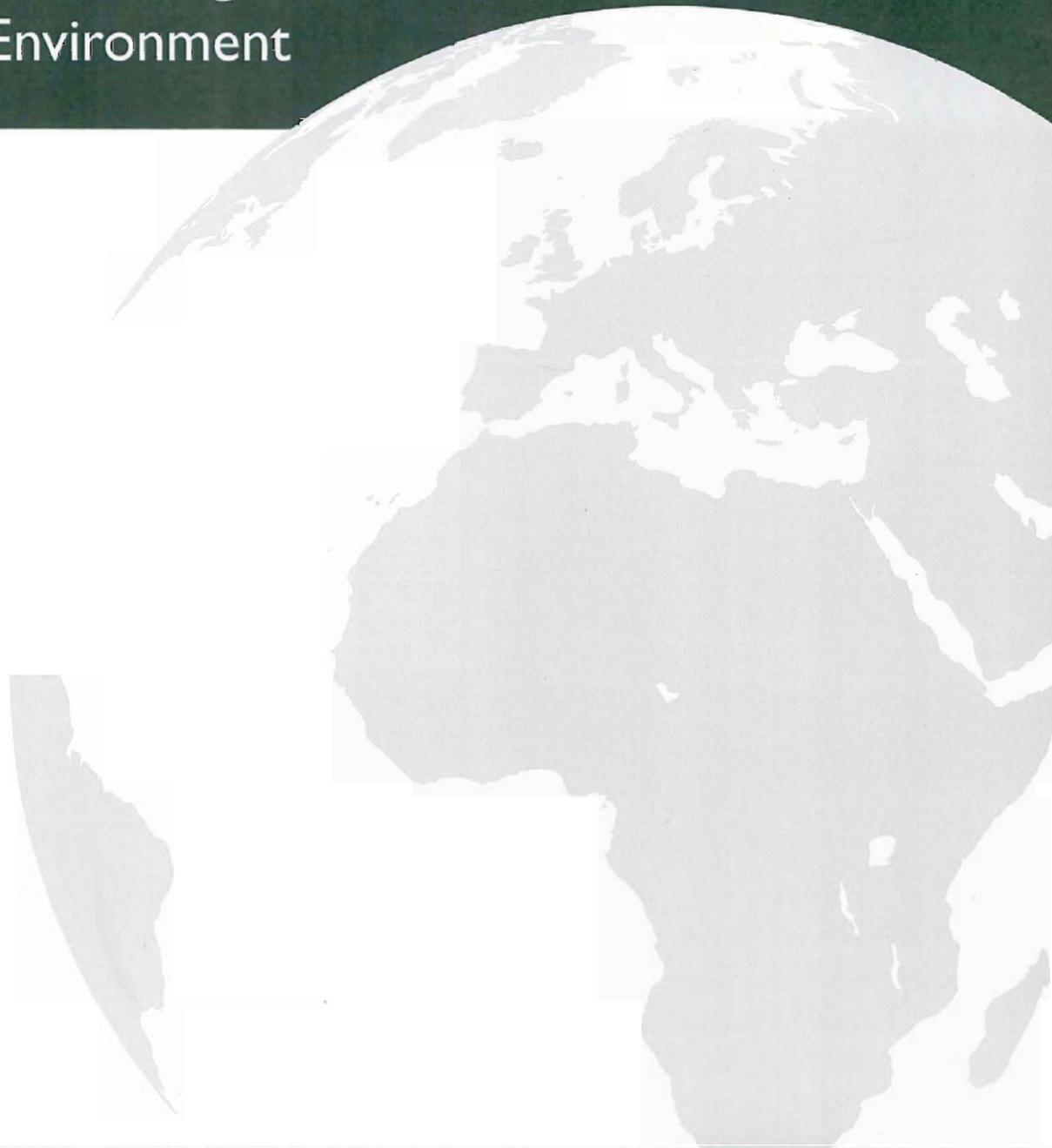
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Briefings on the Agribusiness Enabling Environment





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INTRODUCTION

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.

Briefings on the Agribusiness Enabling Environment is a compilation of briefing materials mirrored by the World Bank Group's *Doing Business* series (www.doingbusiness.com) and adopted by USAID's *Business Climate Legal and Institutional Reform Project* (www.bizclir.com). Divided into four sections (Legal Framework, Implementing Institutions, Supporting Institutions, and Social Dynamics), this document 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.

STARTING AN AGRIBUSINESS

Starting an agricultural business—an agribusiness—can be as simple as clearing an unclaimed plot of land, growing a crop of potatoes, and selling them in a nearby retail market or as complex as investing in a sophisticated manufacturing plant capable of using complex chemical extraction to turn tons of corn into products for consumption or industrial use.

Most agricultural enterprises, even when oriented to production for the market, are managed by individual farmers or households who produce crops on land secured only with traditional tenure rights. They rarely enter into written contracts, have little access to formal credit, insurance, or other means to manage business risks, and rely upon unpaid, family labor in the production process. Similarly, most traders in agricultural products, also agribusinesses, operate through informal networks that collect products from producers, process them minimally (if at all), store commodities for only short periods, and resell them in local or regional markets with little regard for quality standards or packaging.

Those countries that encourage agribusinesses to move beyond informal status—to register within a state-operated registry, acquire licenses, and pay taxes—set the stage for a variety of positive outcomes. When such measures are made available and promoted, agribusinesses are better able to:

- access external financing for start-up investment and growth;
- manage their business risks; and
- expand their access to market opportunities.

It follows that national treasuries are then in a better position to receive the taxes they need to support the country's infrastructure—roads, ports, electrical lines, and other resources that support a vibrant economy. Workers can be protected from abuse and can access health care, pensions, and other social benefits. Basic

necessities will become safer through fair regulation. Important environmental values and ecosystem services can be protected. And those who own or operate such agribusinesses are likely to become more engaged local and national political life.¹

LEGAL FRAMEWORK

As the regulation of agribusiness becomes more complex, it is increasingly important that the legal framework associated with actually starting a business is made as thorough, simple, and equitable as possible. Without special attention to this need, entrepreneurs are less likely to initiate a business, and existing agricultural businesspeople are less likely to voluntarily bring their businesses under the official authority of the framework.

Company law. This governs business organizations and is likely to provide the framework for the legal start-up of medium- to large-scale agribusinesses, including those owned by foreign investors, though even for small agribusinesses a company law will likely provide default provisions:

Company Law sets forth requirements for forming a company, including requirements as to the minimum capital needed for formation and the procedures for registering a company. Company Law also sets forth basic principles or rules of Corporate Governance—that is, the rules that outline the division of roles and responsibilities between company management, boards of directors and supervisory boards, investors or shareholders, employees, and outside stakeholders.²

¹ See USAID and Booz Allen Hamilton (BAH), *Commercial Law and Microeconomic Reform: A Practical Guide to Program Implementation* (March 2007), at 4. This publication, hereafter referred to as "the Guide," can be found at www.bizlawreform.com/CLIRTechPub-r2b.pdf.

² Id. at 7.

Company law also typically defines the conditions upon which the most basic businesses—usually sole proprietorships—exist.

The growth of agribusiness tends to be comparable to the growth of other industry in a developing economy. In the short term, most developing economies are likely to experience the development of a limited number of public company or joint-stock company agribusinesses. The most rapid short- and medium-term growth would be expected to occur among closely held companies, partnerships, or limited liability companies, but actual growth would clearly depend upon the efficacy of regulatory and institutional reform.

Efficacious implementation of a company law crafted to address the special characteristics of agribusinesses enables agribusinesses to grow and prosper. Such company law might include measures to require:

- agribusinesses to delineate their rights and responsibilities with regard to the use of natural resources and to produce or maintain ecosystem services in operations;
- governments to provide access and/or security of tenure over natural resources to companies when outright ownership of such resources is not an option;
- corporate boards to recognize their roles and responsibilities regarding the use and maintenance of the “natural capital” as well as financial capital invested in agribusiness operation; and
- all interested parties to agree on the standards for public health and safety that will apply to agribusinesses’ operations.

Cooperative law. In many economies, the largest group of agribusinesses may be too small to qualify as small- and medium-size enterprises under whatever company law is in place. For these micro- or small-scale enterprises, the first step to acquiring the status of legal agribusiness may be joining a cooperative. A cooperative law, therefore, may be a critical element of the law for the agricultural sector. Further, the

promotion of sound principles of corporate governance provides an essential foundation to the success of cooperative agribusinesses, no matter their size.

Current development practice encourages agricultural cooperatives as sound business strategy for boosting smallholder production and/or marketing. Agribusiness-oriented cooperatives can provide members with collective access to finance; economies of scale in input purchase; information that enables them to better manage individual and collective risks; and greater and more stable access to markets offering higher prices (including export markets).

In many developing countries, the legacy of socialist economic policies of the 1960s to the 1990s laid a poor foundation for the formation of business-oriented agricultural cooperatives. Forced membership, excessive control by state bureaucracies, and government-controlled non-market pricing policies characterized the earlier “cooperatives.” This experience has made today’s agricultural producers and processors wary of joining market-oriented cooperative businesses. Nonetheless, since 1990, significant legislative reform in Europe, Africa, and Asia (though not in Latin America) has resulted in cooperative laws modified to reflect changes in the global business environment.³

To be fully supportive of the evolution of agribusiness, a cooperative law in developing countries should:

- acknowledge a definition of cooperatives as distinct from other forms of business organizations;
- define conditions for *voluntary* membership and member;
- promulgate rules regarding internal and external financing and creditor rights;
- develop rules on officers, directors, and governance (including between individual cooperatives and apex structures, e.g., a cooperative union); and,

3 Henry Hagen, “The Creation of a Supportive Environment in Theory and Practice: Cooperative Law. Is it Necessary, Is it Sufficient for Cooperatives to Prosper?” Draft paper for meeting jointly organized by the Division for Social Policy and Development, UN, and the government of Mongolia, May 2002.

- recognize, support, simplify, and encourage the use of both formal and alternative forms of dispute resolution.

These elements of a cooperative law are similar to those of a company law for corporations and limited liability companies. However, governance of cooperatives is typically provided by cooperative members rather than designated non-members, and shareholder votes are typically unrelated to the level of production of any member. Governance rules for cooperatives must be especially clear given the potential number of individual members in cooperatives, the likely wide range of educational disparities among members (which opens opportunities for corruption and exploitation of some members for the benefit of others), unequal treatment of male and female members, and the potential for government intervention in various aspects of agricultural production, processing, and marketing undertaken by the cooperative. The government may provide additional rules for cooperative function for legitimate reasons (health and food safety, taxation, research) as well as for reasons that are less legitimate (forced surrender of commodities to meet urban consumer needs in times of shortage, excessive taxation).

Agribusiness, for the reasons outlined above, remains a heavily regulated industry in virtually any type of economy. It is critical, therefore, in order to preserve predictability for those who enter the industry or who are in a growth phase, that the legal framework is made as simple and transparent as possible and that the rules are complementary and reconcilable.

It is equally important that laws and administrative rules *related* to the establishment of a business (e.g., those governing the acquisition and use of land, and the acquisition and disposition of animals) are consistent, fair, and transparent.

Competition law. Laws governing abuse of dominant positions in a market, the formation of cartels, and the activity around mergers and

acquisitions can have a powerful effect on the growth of whole sectors, including those relevant to agribusinesses. Many countries single out cooperatives among agricultural producers as being exempt from competition laws' prohibitions against competitor collaboration. To be exempt, these agricultural cooperatives tend to need some formal requirements spelled out in the law, including registration. A critical point for regulators to remember is that the collaboration among farmers could be structured as joint ventures and actually be pro competitive. At a minimum the joint ventures have to share risk and pool capital. These co-ops and joint ventures are important ways in which growers can pool resources to buy or lease equipment, provide storage facilities, and ease transportation and distribution that individually they could not afford. They also put the growers in a better negotiating position vis-à-vis powerful buyers. Importantly, they give growers a pro-competitive means of structuring collaboration that does not result in a net loss to consumers.

IMPLEMENTING INSTITUTIONS

The implementation of a business organization/company law relies upon a number of institutions. These typically include:

- a company registrar to record the establishment of companies and the amendment of corporate documents;
- courts and judges to review and approve licensing and formation;
- government ministries such as ministries of trade or economic development; and
- a national securities commission to protect shareholder rights, undertake enforcement actions, and establish disclosure and reporting guidelines.

Streamlining of business registration procedures is emphasized in many developing countries. The *Doing Business* rankings have documented the enormous variability in four dimensions of business start-up: the number of procedures

that must be completed, the time they take, the costs of required legal and professional services, and the amount of paid-in minimum capital.

Agribusinesses employing 10 or more workers are likely to fall under the jurisdiction of the above institutions in registering as businesses. However, the *Doing Business* approach does not address start-up requirements related to compliance with specific environmental regulations. As these sorts of regulations are likely to be an issue for agribusinesses, it is an area for further inquiry and analysis.

Agricultural cooperatives (as opposed to individual agribusinesses) are likely to come under the authority of more sectoral institutions, or, given the democratic and voluntary characteristics of cooperatives, within the jurisdiction of entities responsible for local government. The process of registration is, therefore, likely to be somewhat different than it is for individual agribusiness.

Even when a cooperative law is well developed and provides for autonomous, member-managed agribusiness cooperatives, governments tend to exercise a degree of oversight over the activities of cooperatives. Generally, it appears that government organizations with sectoral responsibilities offer the most pertinent oversight, e.g., a ministry of agriculture, although several developing country governments have other configurations. In Indonesia, for example, oversight comes from a specialized Ministry of Cooperatives and Small and Medium Enterprises (SMEs); Tanzania dissolved its Ministry of Cooperatives and Community Development, and current responsibility lies with the Ministry of Agriculture, Food, and Cooperatives; and Bangladesh deposits responsibility with a Ministry of Local Government, Regional Development and Cooperatives. Whatever the ministry, there should be the capacity to establish and maintain a registrar of cooperatives.

Often, the operational staff members of implementing institutions are not in complete agreement as to the role of cooperatives in

agribusiness, and practice may not be congruent with policy and law. Given the history of cooperatives as a social rather than economic movement in many European countries and North America, rules and norms governing cooperatives often reflect social and political objectives as much as they address business goals. Recently, some countries have simply included cooperatives as one element of “civil society.” If cooperative agribusiness is to thrive, legal, regulatory, and oversight institutions must pay attention to how cooperative governance is structured to provide adequate business direction, guarantee shareholder value, and establish how disputes between cooperatives’ officials and members (shareholders) are to be resolved.

In addition to those implementing institutions that directly govern the formation and composition of a business, other institutions may have indirect authority over formation. Many countries have established technical assistance services to help agribusinesses navigate the many difficult environmental, licensing, property, and riparian issues that may arise. It is also important, whether or not there may be a “clearinghouse” for government assistance, that the various relevant ministries provide clear, precise, and simple assistance and information.

SUPPORTING INSTITUTIONS

Supporting institutions are those that exist exclusively or otherwise to assist, often as an intermediary between industry and the implementing institutions, people in carrying out their business productively, legally, efficiently, and safely. These institutions include universities, trade associations, research organizations, political advocacy groups, and municipal and regional business centers.

Most support for cooperative formation and operation is provided by the government ministry in charge. However, since a key rationale for forming a cooperative is collective access to



credit, banks, both private and state owned, are often deeply engaged with the agricultural community. Cooperatives often receive training or support from institutions tasked with promoting microfinance or SME development.

Support from multilateral organizations and donors is also important in the cooperative sector. The international Committee for the Promotion and Advancement of Cooperatives (COPAC) is a public/private partnership focusing entirely on cooperative law and operations. The UN agencies that are members of COPAC offer a range of advisory and support services for cooperative development in developing countries. The Food and Agriculture Organization (FAO) and the International Labour Organization (ILO) appear to be the most active in this regard.

The United States offers bilateral assistance for cooperative development and operations. The National Cooperative Business Association/ Cooperative League of the USA (NCBA/ CLUSA), the ACDI/VOCA, and many other private voluntary organizations (PVOs) and contractors emphasizing SME development have supported cooperative agribusinesses. USAID's

Development Credit Authority (DCA) works with these organizations and private banking institutions in developing countries to increase agribusiness cooperatives' access to credit.

SOCIAL DYNAMICS

In addition to the legal and institutional foundations necessary to catalyze growth in the agricultural sector, a number of foundational issues unique to agricultural business need to be included in an analysis of the sector. Start-up agribusinesses are first and foremost affected by the geography and topography of a country. But perhaps most important, prevailing political and cultural attitudes towards agriculture shape the role of the state in the agricultural economy. Economic governance issues can be seen as one of the leading causes of poor agricultural performance in an economy: overwhelming state involvement in agribusinesses, provision of private rather than public goods (e.g., fertilizer and seeds rather than roads and canals), and distorted import markets suffering from high costs and low quality resulting from too little competition are a few of the most important indicators of the social dynamics that help determine the eventual success or failure of the agricultural sector in a given economy.

As already noted, many countries have attempted to reduce the time needed to register companies by establishing clearer guidelines for the process and often by establishing "one-stop shops" to help facilitate it. Seven out of the 10 countries the World Bank ranked as leaders in business climate reform in 2006–2007 made progress in the specific area of "starting a business." Overall, this area was found to be the most popular area for reform.⁴

In some countries, foreign direct investors in agribusinesses have also benefited from streamlined start-up procedures and have experienced rapid returns of their investments. The rapid growth of the flower export business in Ethiopia illustrates the kind of response that changes in policy and regulation can engender.⁵

4 See http://www.doingbusiness.org/documents/FullReport/2008/DB08_Full_Report.pdf, at 4.

5 See <http://www.allafrica.com/stories/200705300964.html>.

Cooperative businesses are also experiencing a new wave of growth after a somewhat troubled past. Too often, farmers were forced to join cooperatives if they had an interest in producing a particular crop (e.g., cotton, coffee) or if the government was strongly committed to farmer organization and control. Corruption and incompetence in cooperative management and lack of transparency of commodity pricing (especially when the crop was exported) undermined the concept of cooperatives as agribusinesses.

Newly organized cooperative agribusinesses are attempting to overcome this history.

Organizers are focusing on the principles of the cooperative movement with regard to membership rights and responsibilities. Governments are moving toward positions of support rather than positions of control over democratic, business-oriented cooperatives. Instability of commodity prices on global markets combined with increased competition among agricultural exporters (e.g., cotton, coffee) will continue to challenge cooperative agribusinesses, though. Adequate reporting, shareholder protection, and dispute resolution mechanisms will be vital if agricultural cooperatives are to survive.

DEALING WITH LICENSES

The business of agriculture is typically heavily regulated. Moreover, it is often regulated in a way that requires business owners to actively search out what can seem like, under the best of circumstances, inconsistent and counterintuitive licensing requirements. Operating licenses enable governments to control where, how, and under what circumstances businesses may operate. But the licensing process is generally disaggregated, with different licenses and permits required for specific activities and the authority to issue such licenses and permits delegated to a wide range of administrative units in different locations.

Licensing is a common way to regulate activity in all fields. It permits the authorities to track activity, monitor compliance with rules, and acquire promises that licensees will behave in certain ways. The fees collected permit the licensing bodies to remain self-sufficient.

Examples of the kinds of activities that are typically monitored and regulated through licensing include:

- the initial establishment of an agribusiness so that authorities can influence land use according to policy;
- the establishment of quality standards for both processes and products;
- the limitation of environmental damage by requiring licensing for various emissions (e.g., smoke, water, other effluents) that a business may produce;
- the use of certain chemicals to monitor and limit dangers to the environment as well as the consuming public;
- the services sometimes outsourced by agribusiness (such as pesticide spraying and harvesting); and
- the export and import of product and inputs.

A licensing regime must be efficient, fair, transparent, and predictable or it will impede agribusinesses' ability to contribute to growth. An inefficient licensing regime can lead to wholesale avoidance of protocol and to corruption and cheating.

Bureaucratic impediments to licensing stop or slow business investment and growth and reduce competition. Excessively high license fees can encourage the operation of illegal businesses and/or environmentally damaging pollution.

Agribusinesses of all sizes generally have to deal with licenses or permits at some point, although the importance of the licensing process is typically more important, and more complicated, for larger and more complex agribusinesses. As in any sector, agribusinesses need permits to construct warehouses and stores, access water and electricity, operate transport vehicles, acquire certification of quality standards for their products, or receive certification for their environmental management procedures.¹

Licensing regimes more specific to the agricultural sector are also common, especially because of the important public health and environmental safety issues associated with agriculture. Agricultural traders are sometimes licensed to trade in certain areas or in certain commodities, with the license based upon their demonstrated knowledge of that commodity or market. Distributors of agricultural inputs (e.g., fertilizers, seeds, herbicides, pesticides) often need to be licensed to deal in such products in the interests of assuring public health and quality control. Food processors are required to be licensed—and are closely overseen to make sure terms of licenses are being fulfilled—for

¹ Construction of a warehouse is, in fact, the test case for the *Doing Business* assessment.

reasons of public health or safety. And virtually all other processors are increasingly subject to licenses or permits aimed at reducing harmful environmental effluents.

While small farmers or animal producers may not need to apply formally for licenses to operate, they are, however, subject indirectly to the licensing regimes that affect other players in the supply chain. For example:

- the improved seeds small farmers buy are often produced under license;
- the products they sell either as individuals or as members of a cooperative may need to be quality or safety certified; and
- their access to transport and other utilities and services may also be subject to licensing and permitting procedures.

LEGAL FRAMEWORK

The responsibility for licensing and permitting is generally widely dispersed among various levels of government: state, regional, and local. In the United States, much of the licensing and certification relevant to agricultural production processes, including input supply, is the responsibility of state governments. Processing raw agricultural materials into food or other products and marketing of these materials, however, tend to be the regulatory domain of higher levels of government. In developing countries, where many inputs are imported and exports are controlled, national governments and financing institutions retain control of a greater range of relevant licensing for agribusiness.

Licensing requirements in a number of service areas as well as those licenses having to do with public health and both food and environmental safety could add up and have a major impact on the agribusiness environment. Further, licenses to trade in specific products are sometimes limited to a few exporters to assure quality control for nationally identified exports (e.g., coffee from Ethiopia, Kenya, and Tanzania).

Any discussion of a legal framework must acknowledge the key components of “good” law:

- **clarity**—simple enough so that those regulated by it can easily understand it;
- **fairness**—universally applicable (except in cases in which certain populations are treated differently in order to artificially rectify imbalances; and
- **predictability**—written and applied so that those regulated by the law are able to act with knowledge of the legal outcome.

IMPLEMENTING INSTITUTIONS

For the agricultural sector, there are four categories of national or local government institutions likely to play important roles in issuing business licenses and permits affecting the operation and success of agribusinesses:

- those that license the import and distribution of production input supplies (e.g., seeds, fertilizers, chemicals, equipment);
- those that license services essential to local producers and traders (e.g., veterinary services, transport services, telecommunications services, banking);
- those that license or certify production of food, fiber, or fuel products and production processes (e.g., slaughterhouses or packing plants for meat, dairy processing, other food manufacturing, charcoal or ethanol manufacture); and
- those that set and regulate standards for effluents of processing and manufacturing processes in which agricultural inputs are used (e.g., run-off water containing excess amount of nutrients, disposal of untreated waste in manufacturing plants).

For crop producers, for example, the licensing regimes affecting input supplies are critical. If the procedure for approving new and improved seed varieties is excessively long or burdensome, or if transgenic varieties are not patented or licensed for distribution, farmers may not have access to planting materials that could increase their competitiveness. If licenses for the import and/or distribution of pesticides are not given in a timely way, crops could be lost to locusts or other pests.

Institutions in the agricultural sector are likely to be responsible for most, but not all, of these licenses. Most ministries of agriculture have specialized units for assuring plant and animal health (similar to APHIS in the U.S. Department of Agriculture) and for granting certificates for plant variety protection (PVP) to plant breeders, enabling them to market their new varieties. However, ministries of environment and/or natural resources play a role in setting and regulating environmental standards for agribusinesses that supply inputs, especially herbicides and pesticides, that could have persistent effects on the environment or could result in non-point source pollution in areas away from the production site. Post-Cartagena Protocol controversies on the introduction and management of genetically modified organisms (GMOs) have brought environmental and agricultural ministries into some conflict on that particular issue. Ministries of health play some role in establishing standards for food safety, and some governments, like the United States, have established agencies responsible for licensing on food and drug issues.

SUPPORTING INSTITUTIONS

Among the supporting institutions needed for key support to agribusinesses seeking to acquire legally necessary licenses as well as certifications and permits enabling them to participate in specific markets are:

- laboratories and/or third-party inspectors for food safety certification;
- laboratories for pesticide testing and certification;
- facilities that certify the quality of seed and fertilizer, and provide for spot checking at retail market outlets;
- training institutions that provide information on laws regarding licensing and facilitate agribusinesses' understanding of compliance;
- banks and other financial institutions to provide financial guarantees;

- brokers of various sorts, especially regarding import and export procedures; and
- private sector and industry associations (such as chambers of commerce or more specialized business associations).

The lack of business support services has been noted in many developing countries. Organizations or firms specializing in such services could help to cut through the red tape associated with licensing and certification, thus making the process more transparent and fair. Excessive licensing can result in impenetrable bureaucracy and encourages informal or illegal operation. Thus, the oft-heard demands for less rather than more licensing are understandable, perhaps especially in agribusiness where licensing can spiral out of control.

The involvement of outside analysts and advocates can provide important information and leverage in designing fair and effective licensing regimes. The International Livestock Research Institute (ILRI), for example, demonstrated how excessive licensing laws regarding the milk trade can have adverse effects by encouraging producers and traders to skirt the law and, in the process, provide unsafe products to consumers. Data showed that the government of Kenya's adoption of international standards requiring industrial pasteurization for retail milk was being applied to only 20 percent of milk consumed. Small commercial producers were meeting 80 percent of market demand but encountering serious business problems, including official harassment, as well as providing a product of variable quality and with some health risks. Researchers proposed that training and licensing smallholder milk producers to provide raw milk meeting key hygiene conditions, rather than policing them and punishing them for not meeting the industrial standards, would actually improve milk safety in the country. It was also found that licensing producers and traders using improved milk handling techniques would contribute to a safe food supply.²

2 Overseas Development Institute (ODI) "Bridging the Regulatory Gap for Small-scale Milk Traders." Document Summary, Research and Policy in Development, available at http://www.ilri.org/ilripublication/Uploaded%20Files/200481194330.03BR_ISS_BridgingTheRegulatoryGapForSmallscaleMilkTraders.html

The design of alternative licensing systems, such as that proposed for the Kenyan milk business, is complex and requires considerable research. While it may seem sensible simply to adopt international standards, there may be an economic case for a more locally specific solution. Greater examination of the licensing environment for agribusiness in particular would seem to be warranted in countries where agriculture accounts for a significant share of GDP and exports.

SOCIAL DYNAMICS

No one in the world likes “red tape.” It is a result not of design, but of the type of inefficiency and lack of capacity so often found in developing countries. This creates a vicious

circle: the more difficult the licensing process, the greater the incentives for avoidance and “informal” operation and, ultimately, a breakdown in the government’s ability to address necessary regulatory issues. Further, governmental corruption feeds on its own inability to efficiently regulate. In other words, inefficient government breeds business that avoids official procedures, which in turn creates a market for corruption. As the Kenya example shows, this can have significant negative impacts on public health and safety. In order for growth to be achieved, all components of society need to at least recognize the value of a licensing framework balanced against the legitimate interests of businesses to minimize time spent trying to comply with the law.

EMPLOYING WORKERS

Significant employment in agriculture is seasonal and informal. Employment laws and policies are often misinterpreted as irrelevant in much of the sector; however, for seasonal agricultural labor markets to operate efficiently, workers must have the ability to move among agricultural jobs and/or to pursue non-farm employment or entrepreneurial activities intermittently or simultaneously with their agricultural employment. Given these challenges, and the fact that such large percentages of the adult labor force are engaged in agriculture in many developing countries, employment issues—access to jobs, pay rates, working conditions, provision of health care and housing, migration—are important in virtually all agriculture-dependent developing countries.

Seasonality of employment. Agricultural production is, by its nature, a seasonal business and the peak labor needs of many enterprises are highly correlated; i.e., when one farm needs more labor, all farms need more labor. Three to five months of intensive work in crop production is followed by a one-time harvest—rice, wheat, corn, or cotton—that must be carried out in a relatively short period to maximize output value.

In some countries, or in some ecological zones, it is possible to get another crop or two each year, but in many developing countries the agricultural work demands are highly uneven. Peak seasonal work demands draw-in labor to what are otherwise family farm enterprises; in low seasons, family farm workers migrate elsewhere to find jobs and incomes. Seasonal unemployment or underemployment is, for many, a critical issue.

Ultimately, few countries have employment policies well tailored to the specific needs of the agricultural sector and its highly seasonal labor demands.

Successful farm enterprises are able to manage the seasonality of their businesses by developing, sometimes on a cooperative basis, more capital-intensive and complex farm enterprises

that smooth out their production and income streams. On-farm investments in irrigation facilities permit double- or triple-cropping of staple crops each year or nearly continuous production of tropical flowers, fruits, and vegetables. Diversification of production enterprises, such as poultry and dairy production as well as the growth of annual crops, also tends to occupy labor more fully and generate a steadier stream of income for agribusinesses. Construction of storage facilities can further help to even out the sales over time. While many of these enterprises continue to rely on family labor, most of these commercial agricultural enterprises hire labor either full time or on a seasonal basis. Gradually, capital both substitutes for, and increases the productivity of, labor employed.

Off-farm employment. Other farm owners/operators, while not in a position to address the seasonality of their production outcomes, are able to pursue off-farm entrepreneurial or employment opportunities on a flexible basis—often in a related agribusiness such as trading in crops, operating or working in local processing facilities, making crafts, working in tourism—in order to smooth out their income streams. Where there is ease of entry and exit into small business, this situation can provide the kind of employment appropriate to sustain a more

seasonal agricultural operation. Empirical evidence shows that while off-farm employment can be important as a source of income for very poor rural households, the higher-income farm household operations often are also most successful in pursuing off-farm employment.¹

Migration. Some farm enterprises, however, are so small and unprofitable that, to ensure survival, workers from these household enterprises must rent out their labor to better-off neighbors, even where doing so reduces the productivity of their own agricultural production enterprises. These workers are the most likely to be exploited as they work for others (e.g., low pay, hazardous working conditions). When such workers move cross-border, there is the possibility of even fewer worker protections. In some developing countries, seasonal employment on public works has been provided, sometimes using food for work, to ensure that the truly needy respond to such offers of employment.

Permanent employment. Non-farm agribusinesses that purchase and store raw product and transform or process it for sale throughout the year are critical for managing the seasonality of agricultural production, as they bridge the gap between the periodic flood of raw product into the market and the continuous, daily needs of consumers. In low-income developing countries, agricultural trading operations and storage and processing facilities are likely to be less sophisticated and less capable of market stabilization than in higher-income developing countries. They are likely to be an important source of employment for significant numbers of people, although relatively few efforts have been made to quantify this employment as a share of the total agricultural labor force.

Most developing countries, however, envision an expanding share of agricultural employment going into the visible “value added” agribusiness segment of the economy—processing of raw commodities into diverse food, feed, and fiber products for local consumption and

export, expansion of market outlets, and the like. Growth of such value-adding jobs depends, *inter alia*, on:

- local consumers’ purchasing power and demand for more highly processed products;
- export markets’ willingness to buy processed or semi-processed products rather than raw materials that can be refined for diverse consumer tastes and market standards;
- the quality of the local labor force; and
- the availability of capital and technology for the local production facilities.

Agribusiness firms that process commodities year-round compete for labor with other manufacturing and service firms of comparable size and are likely to be subject to the same labor costs, labor force rigidities, and firing costs as other firms.

Gender. Finally, in many agribusinesses, there is a tendency to allocate specific jobs to women and others to men. Gender disparities are an important aspect of agricultural employment, as pay, treatment, and working conditions are not equal.

LEGAL FRAMEWORK

Business environment assessments most frequently focus on medium- to large-scale enterprises located in urban and peri-urban areas. Several areas of legislation and regulation, however, are likely to be relevant to even small-scale agribusinesses.

Basic workers’ rights are broadly agreed to include freedom of association, the right to organize, collective bargaining, abolition of forced labor and slavery, and equality of opportunity and treatment.² Workers’ rights have been an important issue in the negotiation of international trade agreements; therefore, many developing countries have, in principle, recognized these in their own labor law. Discussions, however, in many international forums have often gone beyond basic rights to focus on

¹ Andre Coppenstadr looked at this phenomenon in Egypt, for example, in “Household Income Structure and Determinants in Rural Egypt” (January 2006), available at <ftp://ftp.fao.org/docrep/fao/008/af840e/af840e00.pdf>, and Thomas Reardon et al. considered household income diversification into rural non-farm activities from a broader perspective in “Household Income Diversification into Rural Nonfarm Activities,” in *Transforming the Rural Nonfarm Economy* (Steven Haggblade et al. eds) (Baltimore: Johns Hopkins University Press, 2006), available at www.aem.cornell.edu/faculty_sites/cbb2/Papers/IFPRIbookchapter2006Final.pdf

² See, e.g., FAO-ILO-IUF “Agricultural workers and their contribution to sustainable development and agriculture” (October 2005), available at <http://www.ilo.int/public/english/dialogue/actrav/new/061005.pdf>

other labor standards and regulations as well. The sensitivities of consumers in developed countries to working conditions in developing countries have also been raised through the concerted action of human rights non-governmental organizations.

Agribusinesses that engage in global trade are typically aware of the impact that workers' conditions have on their markets. Stories of chocolate produced from cocoa harvested by child labor and forced or "slave" labor, for example, were immediately perceived as a major threat to the multibillion-dollar chocolate market. Large companies such as Mars and Hershey took action quickly to assure that all participants in the cocoa supply chain realized the importance of such labor practices on their long-term economic interests. Supplier countries such as Ghana have followed up with actions intended to lead to enforcement of child labor laws and to eliminate the worst forms of child labor.³ With civil war ongoing in Cote d'Ivoire (an important cocoa-producing country), however, it is not clear that commitments to improve labor law and practice are being implemented everywhere.⁴

Workers' rights are also part of the broader global movement toward "fair trade" standards. As agribusinesses in developing countries seek access to global markets, such business and trading standards achieve the same relevance as local laws regarding workers' rights. The Kenya Flower Council and the Zambian Export Growers' Association, for example, have drafted industry codes that have "well developed social sections covering labor rights, working conditions, and issues such as worker housing."⁵

Minimum wage laws are an important element of labor law in most countries but apply only to workers in the formal economy (generally urban, medium to large-scale). Non-wage labor costs (retirement fund, sickness, maternity, injury, etc.) are generally also associated with employment only in this sector. Most agribusinesses, which tend toward the informal

micro size, are unlikely to be covered by minimum wage regulations.

There are, however, a number of agribusinesses that are neither urban nor exceptionally large but are likely to be organized on a scale large enough to come under minimum wage law as well as laws requiring employer payments for non-wage labor benefits:

- plantation agriculture (e.g., tea, palm oil, timber);
- capital-intensive horticultural production (e.g., roses, other greenhouse crops); and
- agri- or eco-tourism operations that involve management of wildlife and forest or coastal land.

Migration law and related labor regulations (e.g., work permits, visas) have an important impact on the ability of commercial farms to hire labor on a seasonal basis and of farm workers (whether hired or self-employed) to move about in search of employment. Laws or regulations that prohibit or constrain internal migration within large countries often reflect a fear of excessive urban growth. Laws that restrict migrant workers from entering the country reflect an unwillingness of countries to risk such workers overstaying (as undocumented workers) and competing for jobs with citizens who are unemployed. Both sets of laws create inefficiencies in the labor market and affect wages and overall employment.

Laws pertaining to the health and safety of working conditions generally, and specifically to agriculture and agribusiness, are often related to the availability and use of pesticides and herbicides. The National Ag Law Center Web site provides a number of excellent examples of the laws and regulations needed to improve worker safety.⁶ Health and sanitary standards also lie behind laws governing the production and processing of horticultural products, especially those moving into international trade. The U.S. Department of Agriculture's HACCP (Hazard Analysis and Critical Control

3 See, e.g. http://www.worldcocoa-foundation.org/about/documents/ROwusu-Amankwah_laborupdate.pdf.

4 Whether adequate progress has been made in other countries is still being debated. Global Exchange says no. See Global Exchange, "The News on Chocolate is Bittersweet: No Progress on Child Labor but Fair Trade Chocolate in on the Rise" (June 2005), available at www.globalexchange.org/campaigns/fair-trade/cocoa/chocolatereport05.pdf.

5 Anne Tallontire and Peter Greenhaigh "Establishing CSR Drivers in Agribusiness: Final Report for Foreign Investment Advisory Service, International Finance Corporation, and World Bank," *Natural Resources Institute* (August 2005), at 11.

6 See <http://www.nationalaglawcenter.org/bibliography/results/?id=58>.

Point) approach has been adopted both legally and voluntarily around the world.

There are other approaches to addressing health and worker safety as well. The government of China has pointed to its approval of genetically modified cotton varieties as a mechanism for improving health and safety of agricultural workers.⁷ The Chinese experience has driven a search for transgenic solutions for other agricultural commodities that are now subjected to excessive spraying for pests and pose a danger to both workers and consumers.⁸ Both China and India have had to develop new legal and regulatory frameworks to permit research on genetically modified crops. These cases illustrate, however, the breadth and variety of legal paths that may accomplish the same worker-related outcome.

IMPLEMENTING INSTITUTIONS

Ministries of trade and industry and/or commerce are likely to have principal jurisdiction over agribusinesses that are covered under the company and cooperative laws. Ministries of labor or social welfare are, however, more generally responsible for the articulation of labor policy and workers' rights and protections, and managing the nuts and bolts of the system. In some cases, separate agencies manage state-required pension contributions and social security or pension payments. And, as in the Ghana cocoa case, countries may establish special agencies or programs to address particular labor issues, e.g., eliminating the worst forms of child labor.

Ministries of agriculture and/or environment and, to a lesser extent, ministries of health, are likely to be involved in issues of agricultural worker safety, especially regarding the use of pesticides and herbicides. Agricultural extension services, both public and private, are key to training in safe use of these chemicals to protect workers' health. International labor standards are, of course, the focus of the

International Labour Organization (ILO). The ILO has little capacity to enforce any particular standards but plays an important role in clarifying countries' labor issues in the course of international negotiations.

Implementing institutions have to balance their core role as regulators and providers of public service with the need of businesses to operate on a profit-maximization basis. Generally speaking, where governments recognize that documentary and procedural requirements in hiring and firing workers should be minimized, growth in the agriculture sector has been strongest. Where governments have been able to do this, they have relied, at a minimum, on three of the following points:

- Feedback is collected from the private sector early and often and taken into consideration in the drafting and enforcing of regulations relating to the employment of agricultural workers.
- Government agencies cooperate and coordinate on an inter-agency basis in order to minimize the procedural burdens associated with the hiring and firing of agricultural workers.
- Documentary and procedural requirements are enforced in a consistent and transparent manner.

SUPPORTING INSTITUTIONS

Better conditions for workers are generally supported by the community of international non-governmental organizations and the media, especially when a globally traded crop is involved. Third-party certification of working conditions is an important feature of "fair trade" and "sustainable" ratings. The positive pressure that such external actors bring to improving workers' conditions is counterbalanced, though, by the forces of competition. These exert downward pressure on wages and the provision of social protections for workers.

7 Jikun Huang et al., "Bt Cotton Benefits, Costs, and Impacts in China," *AgBioForum* 10(3) (Chinese Academy of Sciences; Rutgers University; University of California, Davis 2007).

8 See <http://www.cimbaa.org/downloads/11877a.pdf>, which includes a story of AVRDC and ICAR collaboration regarding research on transgenic vegetables to reduce pesticide use in India.

Local institutions that must function well to support workers' employability, productivity, health, and security include:

Financial institutions. Insurance and investment firms provide worker services, either directly or through employers, that help to reduce workers' injuries, protect pensions, and safeguard income streams in the event of crisis. Availability of credit for entrepreneurial activities in the off-season for agriculture enables workers whose primary employment is in agriculture to sustain income flows throughout the year.

Land administration. Land development, the granting of private land tenure, and public investments that increase the productivity of labor also contribute to improving the status of workers in agribusiness, especially where markets operate efficiently and rising productivity translates into rising incomes.

Educational institutions and training programs are critical for improving worker skills, safety, productivity, and, ultimately, wages. Educational institutions also facilitate the movement of some workers out of independent, small-scale agribusiness and into larger-scale agribusiness or other economic areas altogether. This enables remaining agribusinesses to expand and, potentially, to become more efficient. Donors and non-governmental organizations are likely to be important sources of support for such interventions.

SOCIAL DYNAMICS

The World Bank's *Doing Business* section on Employing Workers emphasizes formal, permanent employment. Countries rank better in terms of *Doing Business* if the business owners have more flexibility and less regulation. The presumption is that workers benefit through increased employment opportunities when this is the case.

An analysis of the elements of labor law and regulation that most affect workers in the seasonal and competitive agribusiness sector should include analysis of workers' rights to bargain for fair treatment in terms of wages and working hours, rights to protection on health and safety issues, and their ability to self-initiate change in employment. Such an analysis should also look at the willingness of villages and customary organizations to make accommodations to incorporate migrant and temporary workers.

So long as employment is hard to find, and incomes are low, agricultural employees or potential employees are less apt to organize and press for changes in laws and regulations that may affect them, e.g., controls on toxic pesticides and herbicides. Cooperatives can help in this regard. As discussed above, foreign buyers of products are also important in increasing pressure on governments to provide adequate, but not excessive, protection of labor.

REGISTERING PROPERTY

Three kinds of property are important in the agribusiness sector:

- real property (land or buildings);
- movable property (personal property such as equipment, inventory, or motor vehicles); and
- intangible property (a future harvest or intellectual property rights such as those embodied in a new seed variety).

Real property. Land is the real property asset most closely associated with crop and animal production. Stable ownership of land provides the rights to exclusively use and enjoy the property and the right to transfer all or part of such ownership rights through sale, gift, exchange, or inheritance. According to most analysts, clear property rights to farm land is the most essential factor in providing the incentives necessary for owners to invest their labor, capital, and management expertise in amounts adequate to maintain and improve its productivity.

For off-farm agribusinesses, buildings are critical real property. These include warehouses, processing plants, and offices. In principle, such real property ownership involves the issuance of a title, the registration of the title in some independently managed operation, and perhaps insurance against fraud or abuse. Registration of land in rural areas may be slightly more complex than in urban areas, but the advent of the global positioning system (GPS) has greatly simplified the surveying work involved.

In much of the developing world, however, and especially in Africa, agricultural producers do not own the land they cultivate or use for grazing or acquiring other agricultural products (shea nuts or wood for charcoal, for example). They are, rather, granted tenure rights with differing levels of security guaranteed by either the community through traditional means or the state through various approaches to usufruct, leasing, or certification. While such tenure rights are often felt to provide adequate

security, their non-heritability (especially by women) and the fact that they cannot serve as collateral for credit do not let them serve as a fundamental building block for social stability and economic activity.

Further, in some countries, multiple systems of land ownership persist. Some farmers and animal producers are able to secure ownership rights through modern titling systems while other farmers occupy land marginalized under insecure tenure conditions. Herding of animals on communal pastures can be threatened by encroachment of farmers for purposes of annual cropping. When such multiple tenure systems can no longer be sustained (as in Zimbabwe and Darfur), conflicts can result, with devastating impacts on the prospects for economic growth.

Natural resources held as community property—forests, lakes, ponds, grazing lands, and wildlife areas—serve as an additional real property asset for many participants in the agribusiness sector. Even where major conflicts of interest do not arise, equity of access and tenure security are common issues. Such community property is often legally set aside for communal use and management, but encroachment and destructive use reduce the value of the asset to both users and the nation as a whole. Stronger legal frameworks for sustainable use of such community property are needed if these are to continue to contribute economically.

Movable property (e.g., equipment, inventory, motor vehicles) can also serve as collateral



for credit and the basis for secured transactions. Secured transactions pertain to the laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability, and simplicity in creating and enforcing security interests in assets. For many participants in the off-farm agricultural marketing chain, movable property in the form of inventory is the most important asset. Warehouse space and transport services can be rented or leased as necessary, but unless credit can be secured against movable property, many agribusinesses specializing in trade can find

themselves in a cash crunch. In some developing countries, however, banking law does not permit the use of movable property as collateral and does not provide a legal basis for its use as the basis for secured transactions. Traders have thus developed a reputation for exploiting producers by taking products against a promise of later payment—forcing producers to bear greater risks.

Donors have supported efforts to increase the use of stored crops (inventory) as the basis for borrowing. The history of community cereal banks (often associated with cooperatives or village associations) is fairly checkered, however, and they are not used widely as originally envisioned as the basis for managing commercial risks. More recently, attempts to develop more formal commercially oriented systems of warehouse receipts as the basis for expanding agricultural credit and offering farmers mechanisms for smoothing income and mitigating price risks have met with some success. A further extension of the warehouse receipt concept has been the development of commodity exchanges in which futures contracts or options to buy/sell can be negotiated. For most developing countries, these are still concepts that need considerable investment of time, money, and effort to become reality.

Intangible property (e.g., future harvests, intellectual property) is thought to be undervalued as an asset held by the agricultural sector in many developing countries. The pledging of crops in the field in exchange for cash advances is a well-known mechanism that can help farm enterprises cope with the seasonality of the agricultural cycle. When it works well, everyone wins—the buyer secures a planned volume of supply and the seller smooths out her income stream. Often, however, this process is associated with horrific tales of exploitation by the creditor—implicit double-digit interest rates, under-valuing of the production due to alleged poor quality, and other abuses. There are also, of course, stories of producers accepting

advance payments (or credit advanced in the form of production inputs such as seed, fertilizer, and pesticides) against set purchase prices through verbal contracts and then renege on these contracts at harvest time.

Over the millennia, farmers and herders have domesticated wild crops and animals, gradually developing their capacity to produce greater volumes of the products that humans want by carefully selecting specimens with the desirable characteristics and breeding them for greater productivity. Similarly, over the millennia, rural people have conserved many wild plants and animals as they have identified them as having beneficial uses as food, medicine, and fiber. The intellectual effort involved in both breeding and biodiversity conservation and management is now recognized as having an enormous value for current and future generations. The issue of rewarding past efforts has been a major point of negotiation in international treaties and conventions and remains largely unresolved.

Local populations, for example, are beginning to recognize their right to the economic benefits that can accrue when extracts from wild plants they have carefully conserved are used in a major cancer-treating drug. Pharmaceutical companies, on the other hand, see that their intellectual contributions of identifying and manufacturing (and often synthesizing) the extract are the critical ones and are less willing to share the economic benefit in ways perceived as fair.

Similarly, agricultural seed companies have grown increasingly skilled at extracting genetic information from the crops and animals (phenotypes) that were carefully selected by farmers and herders over the years. When new varieties are developed on the basis of this information, how should the original developers of this intellectual property or their heirs be fairly recompensed?

LEGAL FRAMEWORK

A considerable body of research exists that details the benefits of clear property rights. The

foundation upon which agricultural enterprises grow is, of course, the real property that is used to grow crops or raise livestock. Clear legal recognition of movable and intangible rights is particularly important for access to finance and certain government-related services.

Field experience also suggests a handful of other lessons learned to allow a country to reach its agricultural potential. These lessons include:

- a legal and regulatory framework fosters active and non-discriminatory markets for assets used in agriculture;
- no statutory limits are applicable to the amount of agricultural land that can be exploited, or the uses for which the land may be placed;
- no statutory restrictions are applicable with regard to irrigated land that limit its accumulation or availability of use;
- preferential land allocation based on tribe, ethnicity, gender, political affiliation, or national origin is discouraged; and
- a clearly defined correlation exists between land rights and the water rights that accompany it.

Real property. The first legal barrier to agribusinesses' land ownership in many developing countries is generally constitutional: private ownership of land is prohibited for policy or ideological reasons. As a practical matter, however, even where the state legally owns all land, some legal means are generally established for users to gain access to land for productive purposes, with varying degrees of tenure security. The transformation of law mandating use rights and informal tenure into law providing ownership rights is, for many, a first step toward improving incentives to invest in and manage land with more economic efficiency.¹

Laws regarding land titling and certification, registration, insurance, and procedures for transfer through sale or lease form the foundation of a workable real property regime. A cadastral system of land registration and mapping provides the necessary informational infrastructure for a

¹ See, e.g., Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, (New York: Random House, 2003). In this book, de Soto argues that property not endowed with formal ownership rights is "dead capital."

land administration system that provides security of tenure and supports lands markets, taxation, and the delivery of land-related services that underpin sustainable development.²

Not everyone defines the legal and regulatory requirements associated with the establishment and maintenance of cadastres in the same way. However, it is obvious that in countries just beginning the process, some prioritization of more economically critical areas is necessary, and the choice of technology used should reflect local capabilities and information needs. Ian Williamson of the University of Melbourne is more specific as to the need for adaptation of cadastral systems; he succinctly summarized his views in a keynote address at a seminar on Modern Cadastres and Cadastral Innovation sponsored by Commission 7, International Federation of Surveyors, at the Technical University of Delft, The Netherlands, May 16, 1995:

Important lessons learnt from investigating land issues and establishing and maintaining cadastral systems over the past decade, include:

- *efficiency ultimately requires formal recognition of individual land rights and the establishment of cadastral systems, where population densities cause land to be scarce, as farming becomes more commercialized, as farming technologies improve, and due to the emergence of land markets.*
- *the design of cadastral systems must be appropriate, systematic, sustainable and sensitive to the culture, needs, resources and level of development of individual countries. They should be designed for the needs of the land holders, not a central government bureaucracy. They should also be decentralised to the local or village level. They should be designed as processes associated with adjudicating, transferring and sub-dividing land rights, not stand alone entities such as land registries*

or cadastral surveying and mapping systems. Unfortunately many donors and policy makers have preconceived notions of the ideal cadastral system which sometimes results in the establishment of inappropriate systems.

- *the necessity and importance of an appropriate base map for the cadastral system which can also be used for many other purposes. It is essential that the base map is made freely available. However the cadastral system must be designed with the land registers having equal importance to the cadastral map. Simply the registers and the map can be considered “two sides of a coin” and as such cannot be separated and should be treated as one system.*
- *cadastral systems must be kept up-to-date otherwise there is little justification for their establishment.*
- *the appropriate use of new and enabling technologies to support the establishment and maintenance of cadastral systems, noting that while the use of computers, for example, may speed up some activities, such as the creation and maintenance of cadastral indexes, it may also slow down others, such as the creation of a base map if there is a desire to have the map fully computerized as part of a geographic information system, unless the country has an established information technology environment within government, has well trained professional staff to operate the systems and has access to local hardware and software maintenance, and system expertise. It must be remembered that effective and efficient land markets based on modern cadastral systems do not require computerized cadastral maps. The justification for computerized cadastral maps comes from the multi-purpose use of those maps.*

2 See the presentation by Jude Wallace of the University of Melbourne at <http://www.sabt.gov.ir/Attachment/GnrDocuments/App/99062500003190.pdf>.

- *cadastral systems should be designed with a national focus, but should be sufficiently flexible to accommodate both urban and rural requirements.*
- *cadastral systems are not ends in themselves and are a tool designed to support a variety of purposes which usually includes the operation of efficient and effective land markets.*³

Clarifying property rights to communally held properties is similar to that of determining and allocating rights to individually held real property—but those ownership rights are more complex to manage over time. The challenge with communally held real property is in establishing collective governance mechanisms that foster sustainable use, provide sanctions for violations of use rights, and ensure transparency and equity for all community members. Expansion of crop cultivation into forest or grazing lands often pits individual landowners (or individual claimants) against the collective rights of communities seeking to use the property in a less-intensive way.

Secured transactions and movable property. Laws and regulations pertaining to movable property of importance to agribusinesses are most unique when it comes to inventory. Many developing countries have incomplete systems of grades and standards for agricultural products. Without these, there is no basis for operating markets or secured transactions in which personal inspection is not involved. Commodity exchanges and warehouse receipt systems offer great promise for increased efficiency in the trade of agricultural products but can only work when grades and standards are known and accepted.

Intangible property. The practice of selling or buying intangible property such as “future harvests” is reasonably well established in some developing countries. Buyers offer a set price, often combined with a cash advance against that price, in an effort to acquire inventories

at harvest. Buyers risk the inability of the producer to deliver the anticipated volumes at the expected times; sellers absorb the price risk. Even where the practice is established in developing countries, however, typically there are few mechanisms for registering such purchases/sales, making contract enforcement problematic, especially for buyers.

Contract farming, in which the legal force of the contract binding producer and buyer is clearer and more enforceable, has been growing as the development of vertically integrated agricultural value-chains has grown. The growth of supermarkets in the developing world, and the expansion of international value-chains for perishable commodities (e.g., raspberries, cucumbers), have raised attention to contract farming. Strengthening of the legal and regulatory frameworks is likely to strengthen buyers’ rights first, but attention should as well be paid to treatment of sellers (i.e., agricultural producers and processors).

The development of commodity futures markets, in which the financial risks of both buyers and sellers are more broadly shared with a wider range of actors, has been suggested as a way of further stabilizing agricultural markets. Few developing countries currently operate commodity exchanges capable of handling futures contracts for locally or regionally traded commodities, but there is potential for expansion to futures in existing exchanges for commodities such as coffee, cocoa, palm oil, etc.

The understanding of valuation, use, and management of intellectual property as an intangible property of critical importance to agriculture and agribusiness is evolving rapidly around the world. Still, international agreements such as the International Treaty on Plant Genetic Resources and the Convention on Biodiversity have not been universally accepted. The development of transgenic seeds for some crops (generally called GMOs or genetically modified organisms) has elicited highly negative reactions from many European non-governmental

³ See <http://eprints.unimelb.edu.au/archive/00001306/01/Appropcadsystems.htm>.

organizations, as well as some European governments, on the grounds that they involve unfair exploitation of small farmers by multinational agribusinesses and that they are potentially harmful to the environment. Most developing country governments have begun to develop laws and regulations regarding ownership of the genetic intellectual property in their agricultural sectors but few have complete and/or enforceable regimes in place.⁴

IMPLEMENTING INSTITUTIONS

Real property. Most developing countries set land policy at a national level but allocate the task of land registration and administration to local institutions. Where national policy does not permit private ownership of real property, lower levels of government and the stakeholding public tend to set up informal—not legally sanctioned—systems. Some of these systems actually seem to work (for example, people construct buildings, undertake agricultural production, and connect to available infrastructure). However, as Hernando de Soto concluded, they are likely to result in less than optimal development, economically, politically, as well as socially.⁵ It is then a small wonder that significant attention has been paid to reforming real property systems, including through agrarian reform.

Palmer and McLaughlin noted, however, that “as countries foster market-oriented democracies, the institutions of property are being reappraised...the state’s role is not to mandate ownership but to assist in managing the social record of ownership.”⁶ According to their analysis, government institutions need to be responsible for certain aspects, but private sector services are likely to be necessary as well. The institutional infrastructure encompasses those services that:

- define a person’s property rights and enable that person to defend his/her claims against others or to re-allocate those claims through inheritance. Offices

of land administration, land cadastre, or property or land registries are likely to be complemented by judicial organizations that can resolve ownership disputes and perhaps by private companies that make a business of registering titles to assure owners of their rights. Survey firms help to establish boundaries with technical accuracy and provide the basic maps.

- preserve and make available accurate public records on ownership and boundaries—again, a land or property registry.
- increase the certainty that investments in the property are recognized—the tax authorities perform evaluations, not only increasing government’s revenue but defining new values for the property.
- establish systems to ensure that land goes to its highest and best use—by providing laws regarding sale, lease, and other transfer mechanisms.
- provide effective services and utility to support development of land and private investment in ministries of public works and ministries of transport.
- plan, manage, and enforce environmental and other regulations important to all citizens—i.e., ministry of environment or environmental protection agency.⁷

Unfortunately, developing country institutional track records in transforming real property systems is uneven. Traditional systems often maintain their validity at the local level, in spite of legislative or administrative changes from the top down. Not only does this limit the effectiveness of real property law innovations in fostering greater investment (and perhaps greater equity, often a great motivator for legal reform), but it also reduces the security of tenure among those in the traditional system and raises the potential for corruption.

Movable property. Institutions for implementing legal and regulatory changes with regard to movable property in the agribusiness sector include:

⁴ Gregory Jaffe, *Regulating Transgenic Crops: A Comparative Analysis of Different Regulatory Processes* (Spring, 2004).

⁵ Hernando de Soto, *supra* note 16.

⁶ David Palmer and John McLaughlin, *Integrated Land Administration: Institutional and Technical Challenges* (Centre for Property Studies, University of New Brunswick 1996), available at <http://www.gisqatar.org.qa/conf97/links/f2.html>

⁷ *Id.*

- vehicle registries;
- judicial agencies capable of enforcing surrender of movable property in settlement of disputes (e.g., capability to repossess and dispose of movable property); and
- public and private organizations involved in establishing and managing warehouse receipt systems or commodity exchanges.

Intangible property. National institutions charged with establishing and regulating intangible property include government institutions that provide market oversight (ministries of commerce or trade, ministries of justice, and/or commercial courts) as well as institutions that establish intellectual property rights, such as patent offices. Privately owned and managed commodity exchanges are generally under the jurisdiction of a public organization charged with oversight on securities.

SUPPORTING INSTITUTIONS

International organizations such as the World Bank and other donors have provided significant amounts of technology (e.g., surveying systems, registry systems) and technical assistance to launch reforms of real property law. Nonetheless, many agrarian reform programs have foundered before realizing the projected benefits. The support of local civil society and grassroots political interests has been shown to be a critical element of the reform package.

Supporting institutions critical to the success of a successful property system include, notaries, courts, non-governmental organizations (NGOs), banks, leasing companies, insurers, providers of credit information, local universities, and the legal profession responsible for dealing with property disputes and registration.

Banks and other financial institutions might be expected to be strong supporters of legal and regulatory reforms regarding property, as property is the underpinning of the concept of collateral in lending. However, support from financial institutions for reform of laws on real

property has been weak in many developing countries. It is hypothesized that banks remain reluctant to lend to agriculture on the basis of real estate collateral, partly in recognition that confiscation of real property for non-repayment of loans, for example, could be a socially unacceptable action.

A real estate sector capable of brokering sales and leases of real property is critical to building efficient markets in real property once the legal framework is clear. Title search firms, mortgage insurance companies, and notaries or other agents who verify transactions are all key elements of this real estate system.

Support for movable title registration systems may include vehicle dealers, vehicle inspection services, commodity warehousing systems, and other transport and storage firms.

Institutions established to enhance and protect intellectual property rights relevant to agriculture range from the World Intellectual Property Organization (WIPO) to national institutions tasked with patenting innovations, protecting the rights of musicians or providing plant variety protection to local institutions claiming ownership of knowledge associated with preservation of wild plants and animals or with selective breeding of domesticated plants and animals over the centuries. Specialized organizations, such as the African Agricultural Technology Fund, have been established to help national researchers gain access to intellectual property that would otherwise not be available to developing countries.

SOCIAL DYNAMICS

Real property. In addition to the increasing recognition of the importance of property rights to economic growth, population growth in the developing world is perhaps the single most important factor driving revision of laws and regulations governing land ownership and tenure. In rural areas, farms have been divided among children for generations, resulting in farm sizes too small to succeed as

viable commercial enterprises. Populations have encroached onto communally held lands, reducing the sustainability of all agricultural enterprises as watersheds have been destroyed, wind erosion has increased, and firewood for energy is no longer readily available. Additionally, rural workers have migrated to urban areas and have established themselves in unhealthy and unsafe shanty towns, drawing further attention to real property issues.

Widows seeking fairer rules on real property titling have become a vocal in Africa. Traditional systems establishing access to land have provided satisfactory tenure to most male farmers, but women farmers still find themselves in highly vulnerable positions when their marital relationship ends by death or divorce. Even though many developing countries are moving toward certification or titling systems (some of which simply provide greater security of tenure rather than the ability to buy or sell real property), gender equity is often not assured.

Countries with scarce rural land are under greater pressure to reconsider rules regarding the transfer of real property. Some permit land consolidation that would increase the economic viability of farm units, but few seem to be responding to the pressure in a proactive way. A number of reasons are apparent: fear that land sellers will become unemployed urban dwellers; fear that the politically powerful will acquire real property rights in rural areas but not use them fully for productive purposes; and concern that a potential upset to precarious ethnic balances will result.

Intellectual property. Private companies interested in introducing new technologies for agricultural production and processing

have identified laws and regulations regarding intellectual property as critical. Research and development organizations are searching for greater clarity on laws and regulations regarding intellectual property. Groups such as the African Agricultural Technology Fund (AATF) are helping to articulate and facilitate resolution of this demand.

A number of NGOs, both local and international, are on the other side of the agricultural intellectual property rights issue. Many seek to stop the use of transgenic varieties of seeds (GMOs) for cultural, political, or environmental reasons. There are active advocacy movements regarding “farmers’ rights to save seed” that effectively counter the interests of multinational seed companies to sell improved seeds (e.g., hybrids, transgenics) that must be purchased anew each year because they cannot be propagated by the farmer.

Other NGOs seek to protect agricultural resources from external bio-prospectors, arguing that local traditional knowledge and the act of conserving wild plants have clearly established intellectual property rights that should be recognized and rewarded.

Still others seek to preserve local agribusinesses against the exploitation of external, large-scale investors (such as those in mining and timber harvesting). National governments seeking greater export and tax revenues often grant concessions without sufficient recognition of local users’ rights (whether individual or communal). This may amount to the exercise of “eminent domain,” regarding both real property and intangible property (e.g., the intellectual property value of preserved plants and animals).

GETTING CREDIT

Virtually all modern businesses rely upon credit: for operations, to bridge the gap between production of products and payment for them; for investment, as buildings and capital equipment are generally multiples of annual revenues; and to cover swings in supply and demand conditions. Farmers in developing countries often point to the lack of credit as the greatest barrier to increasing production and the profitability of agricultural enterprises.

The ability of entrepreneurs to borrow money at reasonable interest rates and for appropriate durations depends on a number of factors that collectively affect the risks associated with lending. These include a mix of policies, laws, and regulations; property rights; processes and standards for loan approval; the quality of registration systems; and enforcement mechanisms. In jurisdictions where these and other factors do not work to protect lenders (or borrowers), the risk of default is typically high, and this risk is reflected in the increased cost and, in many cases, decreased availability of credit. Further, certain types of borrowers are perceived as raising additional risks due to their limited capital, entrepreneurial history, or precarious social situation such as depending on rain for each crop cycle. As a result, agribusinesses and other less secure groups typically face significant obstacles in securing credit.

Many of the issues highlighting the special risks for providers of agricultural credit have already been mentioned elsewhere in this briefer series:

- seasonality of production—this leads to “lumpiness” in credit needs and repayments;
- high correlation of risks experienced by borrowers in a geographic area—drought, pests, and floods have widely shared impacts;
- producers’ inability to use real or movable property as collateral; and
- difficulties in enforcing contracts for which the subject matter is intangible property.

The fact that many enterprises are family operations (and essential for the family’s survival) raises social issues that are not encountered in lending to other small or medium-scale enterprises. Lenders have proved reluctant to seize agribusinesses’ assets—even when legally allowed to do so—when it is clear that total impoverishment would result.

Agricultural production enterprises that are more diverse—i.e., include the production of several products and services—might seem better candidates for credit. Diversity of production could mitigate some of the risks associated with seasonality or the price risks associated with a large number of producers bringing the same product to market at the same time each year. Nonetheless, the complexity of diversified operations makes evaluation of their credit-worthiness more difficult. The developed world has, in fact, moved in the opposite direction—toward more specialization and on a larger scale. Government underwriting of some of the risk through credit subsidies has been an important factor in making this possible.

Producers who join cooperatives gain a significant edge in accessing credit. Lenders’ costs are reduced—the transaction costs of dealing with one cooperative are far lower than the costs of dealing with hundreds of individual producers. Lenders’ risks are reduced to the extent that co-op membership is voluntary and members accept a level of mutual responsibility for loan repayment. Lenders’ risks are reduced even further where services that enable cooperatives



to succeed as business enterprises (e.g., training, information, technology) are provided by donors or government entities.

The possibility of expanding the microfinance model to an increasing array of agribusinesses, especially small and family-owned/-operated businesses, has been explored in some countries. Microfinance institutions are cautious about explicitly expanding their business in the agricultural sector because of two risks noted at the outset: the seasonality of borrowing and payback for most agricultural production enterprises, and the high level of correlated risk among borrowers as adverse conditions due to weather, pests, or diseases affect many borrowers at the same time.

Trade financing for agricultural products can be secured by contracts for sale or against inventory as collateral. This requires significant organization and formalization of markets, especially regarding grades and standards of products traded. Many—and, in some cases, the majority of—agricultural traders on domestic markets are said to personally finance their business operations. Agribusinesses that engage in international trade, however, are generally forced to seek trade financing to manage cash flow between the time of shipping and payment.

Agribusinesses that deal in the import and distribution of production inputs and process raw agricultural materials into value-added products face credit conditions similar to those of other processing or manufacturing industries. Lenders' risks can be assessed using standard business evaluation tools. For this reason, "supplier credit," that is, credit provided to producers by input dealers and/or agricultural processing companies, is a major source of credit in many developing countries. Contract law is an essential underpinning for such credit, since the ownership of intangible property (a yet-to-be-realized harvest) serves as security for such agricultural credit.

LEGAL FRAMEWORK

The legal framework for getting credit or accessing financial services is comprised of a variety of laws. These laws, when well designed, enable lenders to reduce costs and manage their risks more effectively. This helps potential borrowers gain access to beneficial financial services, namely, credit, savings, and a guarantee for products by establishing their creditworthiness and managing institutional risk that can limit access to financial services, even to "creditworthy" firms or individuals.

A **real property law** and a **secured transactions law** provide the basic legal framework for agribusinesses registered under the company law to access bank credit and for lenders to seek recourse in the event of an

agribusiness' default. Collateral, in the form of real or movable property, is provided by the borrower to the lender. With this method, the lender is able to seize and liquidate assets if the borrower defaults.

Collateral lending lowers the risk of non-payment because the borrower will normally pay off the loan instead of losing the property used as collateral. If the borrower does default, then the value of the collateral helps to pay off the debt, further reducing the overall risk of non-payment. Finally, enforcement provisions of a well-crafted collateral law allow secured lenders to seize and sell the movable property rapidly and more efficiently than would be possible through a longer lawsuit. This reduces the costs of collection. As an added benefit, collateral lending reduces conflicts over rights in property by establishing priorities and eliminating unnecessary legal claims. It reduces attempted fraud by borrowers because the lender's interest in the property follows the property—if the borrower fraudulently sells the collateral and hides the proceeds, the lender can still seize the property from the new buyer. Consequently, the system lowers the overall risk of loss through fraud for the banking community.

Well-structured collateral lending systems also expand the scope of property that can be used as collateral, and thus expand access to credit. Any property right that can be identified, used, defended, and transferred by the owner can be used as collateral. In modern systems, this ranges from tangible property like vehicles to intangible property such as accounts receivables or future crops. Livestock and inventory can also serve as collateral, even though the individual items may change over time.

In many countries agribusinesses are unable to claim ownership to real property, thus limiting their ability to borrow on the basis of collateral in the formal banking sector. This accounts for the popularity of supplier or buyer credit provided against a pledge of intangible property, i.e., the crop to be harvested, and for

cooperative borrowing, in which members guarantee each others' ability to pay. This method, however, demands a reasonably sophisticated foundation for secured transactions. As Douglas Pearce concluded in a study done for a USAID-sponsored conference on rural finance:

Product-market credit is not a substitute for financial markets. Financial service providers offer more transparent credit than do most buyers and suppliers, can offer loans to a larger number of clients due to having more appropriate systems and procedures, and can also offer a more diverse range of financial services. Yet in order to overcome the risk, operating cost, and information constraints that have limited their involvement in agricultural lending to date, financial service providers may need to establish linkages with suppliers and buyers, either directly or through intermediaries.¹

The European Bank for Reconstruction and Development (EBRD) Agribusiness Operations Policy reflects this kind of thinking: “the Bank has concentrated its efforts down-stream of agricultural production, mostly in agro-processing, marketing and distribution...Direct commercial financing to primary agriculture has proved to be more difficult due to higher risks prevailing in the sector.”²

The legal and regulatory structures governing the operation of credit registries, both public and private, help to ensure that lenders have adequate and correct information about borrowers' creditworthiness—whether “upstream” in the primary production business (or input supply business) or “downstream” in the marketing and processing of the product. Academic research shows, however, that public credit registries affect borrowers' behavior as well.³ Credit registries have been growing in many developing countries, but are still considered to be weak.

A bankruptcy law, which should allow agribusinesses that “have a chance at viability, the

- 1 Douglas Pearce, “Buyer and Supplier Credit to Farmers: Do Donors Have a Role to Play?” *Rural Finance Innovation Case Study, Paving the Way Forward for Rural Finance: An International Conference on Best Practices* (Washington, D.C. 2002–2003), at 16.
- 2 See www.ebrd.com/about/policies/sector/agri.htm.
- 3 See, e.g., Martin Brown and Christian Zehnder, *Credit Registries, Relationship Banking and Loan Repayment* (April 8, 2005), available at http://www.philadelphiafed.org/econ/conf/consumer-creditanpayments/Brown_Zehnder.pdf.

opportunity to extend, reduce, or wipe out debt and protect themselves from pursuit by creditors,” complements the laws that provide for the extension of credit in the first place.⁴ The core issue is the extent to which the interests of secured creditors are met in the course of the bankruptcy and how these creditors are able to seize and sell collateral to resolve debt.

A factor complicating agribusiness lending is government intervention in the provision of credit to agribusiness, as well as in the commodity markets essential to a borrower’s ability to establishing an agribusiness’ viability. The establishment of state-owned agricultural development banks in developing countries has resulted—or has been intended to result—in a steady flow of credit to the agricultural sector. Too often, however, these banks have failed by responding too readily to uneconomic but politically supported agribusiness proposals, being insufficiently sophisticated in risk management, and finding themselves with inadequate capital to meet the needs of even a small share of potential borrowers’ needs. However, the very existence of a state-owned agricultural development bank tends to steer other banks away from agricultural lending, especially to commercial farms and cooperatives, and has actually contributed to shrinking the amount of capital available to agribusiness borrowers.

Special laws and regulations for microfinance also have a bearing on credit availability for the informal agricultural sector. Start-up microfinance institutions typically try to establish portfolios with lending to different sectors and few, if any, specialize only in agricultural lending because of the higher risk. However, for small agribusinesses seeking to assure stability through off-season off-farm employment/entrepreneurism, microfinance could be an important factor in business growth. Microfinance institutions frequently allow group guarantees or “social collateral” to maintain loan security in lieu of more traditional individuals’ collateral to secure a given loan.

IMPLEMENTING INSTITUTIONS

The range of implementing institutions pertaining to getting credit tracks the vast range of laws affecting this area.

Financial institutions of all sizes are critical to agribusiness credit, either directly or indirectly, through, for example, the provision of trade financing or supplier credit to businesses that then lend to agribusinesses. All such financial institutions are subject to the oversight of national central banks and/or other banking supervision structures. These may affect the level of competition in the banking industry, rates and fees charged for various kinds of loans, and the ability of banks to tap global capital.

Some financial institutions have access to guarantees offered by international donors that help them manage risks inherent in agriculture and agribusiness. These include the International Finance Corporation (IFC), USAID’s Development Credit Authority (DCA), and the Overseas Private Investment Corporation (OPIC). Credit insurance is available to borrowers through other mechanisms as well, although at a higher cost and with less technical assistance.

As already noted, many developing countries continue to support state-owned development banks and agricultural development banks that operate without using strictly financial criteria. Such banks may offer agribusiness preferential access to credit in order to stimulate investment in particular sectors or geographic areas. The presence of such an institution, however, may create a non-competitive playing field for agricultural credit and drive private financial institutions away from the very agribusinesses the state, as a matter of policy, wishes to favor.

Some NGOs continue to use privately raised wealth or donor funding to manage revolving loan funds that provide credit to small agricultural enterprises. Revolving loan funds are often established outside of the regular financial market, charge low interest rates,

⁴ See, the BizCLIR website, available at <http://bizclir.com/>

and generally decapitalize over time.⁵ It is not known what share of agribusiness credit comes from these sources.

Judicial institutions are essential to settling disputes between borrowers and lenders and are responsible for ensuring that judgments, once entered, are enforced. In some cases, special commercial courts have been established to ensure that judges are capable and that business cases can be speedily settled. In other cases, alternative dispute resolution mechanisms have been established to settle cases.

SUPPORTING INSTITUTIONS

Registries for property (real and movable) are needed so that lending institutions build confidence in their access to collateral in the event of default. Most such registries are in the public sector.

Credit rating agencies, both public and private, provide important information on borrowers for all financial institutions, thus lowering lending risks.

Information and communications technology (ICT) is becoming increasingly important to the credit sector. Both lenders and borrowers are finding that ICT is an essential tool for business. The explosive growth of cellular telephony has made an important contribution to the operation of rural credit systems. The Consultative Group to Assist the Poor (CGAP) noted that “transformational branchless banking”—the use of ICT and non-bank retail channels to reduce costs of delivering services to clients beyond the reach of traditional banking—is growing rapidly. It is now not considered a “banking activity” under domestic regulation, but its presence in so many rural markets is challenging governments to seek “how to formulate proportionate regulatory policy that gives space for innovation and permits branchless banking to scale up safely.”⁶

Statutory marketing boards, also known as statutory marketing authorities or control boards, are the most common types of state-trading enterprise (STE) in the agricultural sector and play a role in making credit available to producing agribusinesses. Such boards may have any or all of the following objectives: domestic price stabilization, market regulation, and control and promotion of exports. They are usually producer-controlled, state-sanctioned monopolies with exclusive authority for a wide range of market interventions, such as regulating and purchasing domestic output, setting consumer and producer prices, controlling domestic distribution, and conducting foreign trade.⁷ STEs often provide credit in the form of production inputs. Repayments are deducted from payments for delivered crops at the end of the marketing season. This works well as both the STE and producer increase the security and volume of their production. The downside risk is that STE accounting is not transparent and the true costs of the credit are not known to the borrower.

Many private firms, often agribusiness firms that process or market an export commodity, also provide supplier credit to smaller agribusinesses, generally through contracts against commodity delivery (known as contract farming). “Side-selling,” where the producer sells all or part of the harvest to another buyer, thereby avoiding loan repayment, is a common issue with such arrangements; if credit access and market outlets are limited and contract enforcement is possible, this practice can be controlled.

SOCIAL DYNAMICS

Increased access to affordable credit is much more than a matter of good laws and proper procedures. Underlying assumptions, expectations, and vested interests, among other issues, influence the social dynamic in which finance reform takes place. Factors include supply and demand for finance and for reform, conflicting norms, transition in governmental roles, and differing conceptual definitions of the problem. Many of

5 A short paper by the Economic Research Service (ERS) at the U.S. Department of Agriculture entitled “Are Revolving Loan Funds a Better Way to Finance Rural Development?” (USDA/ERS Agriculture Information Bulletin No. 724-05, October 1996) provides a concise review of the pros and cons of revolving loan funds in the United States. Many of the observations are likely applicable to NGO- or project-managed revolving loan funds in developing countries as well.

6 CGAP Focus Note No. 43 (January 2008), available at <http://cgap.org/p/site/c/template.rc/1.9.2583/>.

7 See <http://www.fao.org/DOCREP/005/Y3733E/y3733e07.htm>.

these have implications for design, implementation, and prioritization of reform efforts.

It is a given that agricultural/agribusiness debtors would like to see lower interest rates and easier terms. Agriculture is a highly competitive business. Since no policymaker can envision a future without a stable and secure food supply, however, governments are often willing to provide both subsidized credit and loan guarantees—as well as insurance against the possibility of default when bad weather occurs or global prices drop—to large segments of the agribusiness community.

History in much of the developing world indicates that erratic interventions on the parts of donors or governments in the agricultural credit markets have inhibited stable growth in the availability of and agribusinesses' access to credit. Periodic forgiveness of agricultural debt for political reasons, for example, makes it more

difficult to maintain credit discipline and keeps private lenders out of the business. Donors' intermittent provision of agricultural inputs on a grant basis leads to producers questioning the need to repay loans for those same inputs.

Largely because of the microfinance experience, however, there is greater appreciation of the need for financial institutions serving rural areas and micro and small agribusinesses to put viable, sustainable financing models into place. Women borrowers, especially those who have built up a credit track record with microfinance, are now a particular client group seeking to move up the credit scale. They are, in some cases, looking for greater access to agribusiness credit. Laws or rules that require husbands to co-sign or for “heads of households only” to be considered to be eligible for cooperative members are not helpful in expanding women-led agribusinesses' access to credit.

PROTECTING INVESTORS

Agricultural enterprises have a number of options for raising capital to pay for their inputs, equipment, and other costs of growing a business, most of which are appropriate instead of—or in addition to—seeking a loan from a bank or other lender. Of course, each option carries not only the promise of economic gain, but also the risk of loss. The more that investors feel that they are protected against loss—particularly the kind that can be prevented through better information, more thorough scrutiny of an enterprise’s financial history, and faster access to prompt and fair dispute resolution—the greater the possibility that they will invest.

First, at the grassroots level, individual farmers with relatively few resources may pool their capital as **cooperatives**, or, as referred to in many countries, “farmer-based organizations” or “associations.” In general, cooperatives are businesses owned and controlled by the farmers who use their services. *Supply cooperatives* supply their members with inputs for agricultural production, including seeds, fertilizers, fuel, and machinery services. *Marketing cooperatives* are established by farmers to undertake transformation, packaging, distribution, and marketing of farm products (both crop and livestock). Farmers may also rely on *credit cooperatives* as a source of financing for both working capital and long-term investments. Cooperatives can play an important role in rural communities, where they encourage democratic decision-making processes, leadership development, and education.¹

Second, agricultural enterprises—whether they are independent local producers or outsiders who aspire to develop business opportunities in the sector—can seek capital, whether in the form of money, equipment, or other valuable contributions, from **private investors**, including individuals, firms, and outlets of “venture capital.” There are many examples of successful investments in agriculture throughout the developing world, and they exhibit certain key traits that provide lessons to others. These

include the investors’ willingness to invest for the long term, rather than to require immediate dividends; the use, in certain contexts, of a “nucleus” farm model that contributes to greater quality control on out-grower farms; creative use of public-private partnerships, including seed agencies, international manufacturers, farmers cooperatives, and others; a well-functioning legal system; a commitment to international standards in corporate governance, bookkeeping, and other business practices; and careful understanding and development of markets. However, due to the high degree of risk in agriculture—often compounded by poor seed, irrigation, transportation, infrastructure, and land rights—the availability of capital investments in agricultural enterprises may be low. Encouragement of investment in agriculture requires a multifaceted effort to reduce or control such risk.

Third, larger or especially ambitious enterprises may seek capital by offering shares to the public through a national **stock exchange**. Although public trading of stocks (also called “securities”) usually appeals to larger, existing enterprises that seek to build capital (as opposed to most small and medium-size enterprises (SMEs)), public ownership should not be overlooked as a future destination for growing agricultural enterprises that are fundamentally strong and

¹ United States Department of Agriculture, *Agriculture Cooperatives in the 21st Century* (November 2002), at v.

have demonstrated the potential to do even better. There is a range of public ownership models throughout the world. In some less-developed countries, particularly those engaged or recently engaged in conflict, there is no stock exchange at all. In several transitioning economies, a stock exchange has been established in recent years, often as a mechanism to privatize formerly state-owned enterprises or to otherwise attract foreign investment. In still others, such as India, Indonesia, Kenya, and a number of Latin American countries, there are dynamic, thriving stock exchanges that have been in place for many years.

Under typical cooperative, company, investment, and securities laws, investors are provided with a number of important rights. *Doing Business* distinguishes three dimensions of investor protection: transparency of the company's transactions, particularly those directly aimed to enrich company directors; liability for self-dealing of directors—specifically, the means by which they can reduce the value of the company rather than increasing it; and the ability of shareholders to sue officers and directors for misconduct. As in any area of the law, protections of rights are only as strong as the institutions that support them. Key institutions include local, regional, and national cooperative societies; investment agencies; securities regulators; courts and other legal institutions; and such ministries as agriculture and commerce or trade. Vibrant systems of professional services and associations, higher education, and media are also critical components of a healthy investment environment.

LEGAL FRAMEWORK

Access to laws and information. The demands of the global economy require a paradigm shift in many developing countries—one that welcomes and responds to the search for law and information, rather than mistrusts or dispels it—and in recent years this has been realized and acted upon to varying degrees. In

short, there is more demand now than ever for current, verifiable, detailed, and thorough information about all aspects of economic activity, including opportunities in agriculture. In general, governments and private companies must provide ample access to laws and information; accurate statistics, including those pertaining to agricultural production and trade; reliable profiles of existing companies; credit information; court records; financial profiles of public officials; accurate media and academic analysis; and so forth. Without prompt and meaningful access to information, potential investors and traders are likely to search elsewhere for their business opportunities. Moreover, as a matter of practice, where governments and private companies endeavor to place their laws and other information online, they must also have a plan for keeping that information updated and current.

The law of cooperatives. Unfortunately, in many developing countries, the history of cooperatives is one that discourages confidence in the model as a promising investment opportunity for small producers. In many African countries in particular, cooperatives were initially established to serve colonial powers, and, by the mid-twentieth century, strict government controls over cooperatives broke down the confidence and trust of their members. The law of cooperatives in many developing countries now tends to be outdated or has essentially been abandoned as a structure for new agricultural enterprises: farmers instead often choose to join forces as formal companies or non-government organizations. Farmers working cooperatively also often remain informally organized, thereby forgoing the many benefits of entry into the formal economy.

A modern cooperative law that conforms to international best practices—particularly with respect to governance and management of the cooperative—is desirable but not essential for service and marketing cooperatives to be established and to function as they should. Nor is the existence of a cooperative law, in

itself, sufficient for cooperatives to prosper.² Agricultural cooperatives can function where there is a sound law of contract and a viable system of dispute resolution, as well as a healthy respect for the rule of law. Most important, cooperatives require an atmosphere of trust, bolstered by formal tools of accountability.

Company law and corporate governance. Sound company law, which typically establishes the rules of corporate governance, is critical for post-conflict and transitioning economies that seek growth through expansion of their agricultural enterprises. Sound company law and practices protect investors—and encourage new investment—by establishing clear rules for the stewardship of enterprises and providing enforceable standards to protect shareholder rights and access to information. They can also bolster the country's reputation as being investor-friendly. As stated in the introduction to South Africa's corporate governance code, "If there is a lack of good corporate governance in a market, capital will leave that market with the click of a mouse."

Corporate governance is meant to foster efficient decisions that benefit a company's investors while discouraging insiders, such as majority shareholders and managers, from expropriating the assets of the firm or acting contrary to the interests of shareholders. Under most new company laws, duties of care and loyalty on the part of company directors are often firmly established, with rights of shareholder redress clearly delineated. A sound law further establishes clear shareholder rights in decision-making processes, along with the ability of investors to propose changes in operations. Protections for smaller investors from possible unfair treatment by larger shareholders, and rules enabling investors to sell or transfer their shares, are also needed. Countries seeking to bolster their commitment to corporate governance should not only update their company laws to conform with well-established international best practice, but also support and

promote private codes of conduct within the business community and individual sectors.

Company law and corporate governance is an area in which international best practices are well established and outside guidance and insight is freely available. One easily accessible benchmark is the Principles of Corporate Governance long established by the Organization for Economic Cooperation and Development (OECD). Decision-makers who attempt to defend deviations in their laws from these international standards rarely have the proverbial "leg to stand on"; ultimately, they do their country a disservice if they seek to avoid protections that favor transparency and accountability and discourage management secrecy or malfeasance.

Investment law. Most potential investors—both foreign and domestic—look first to a country's general economic opportunity and evidence of respect for the rule of law. For agricultural enterprises, potential investors also look especially at trade-related systems—specifically, the time it takes to transport raw or processed goods to market, often across international borders. They also look at the environment for licensing, including licensing for seed, fertilizer, and food-processing, as well as food safety regulations and enforcement. Thus, the existence of a stand-alone investment law is not critical. Nonetheless, many countries find that an independent law spelling out investor protections and incentives is one way that they can build confidence in their respective business environments.

A sound investment law typically provides for convertibility and foreign repatriation of profits, loan service payments, royalties, and similar items; for prohibition of nationalization or expropriation of investments without fair and prompt compensation; and for dispute settlement by arbitration. Investment laws also typically set forth incentives for investment in certain enterprises or sectors, including tax holidays and other benefits.

2 Henry Hagen, *The Creation of a Supportive Environment in Theory and Practice: Cooperative Law. Is it Necessary; Is It Sufficient for Cooperatives to Prosper?* (June 2002).

Furthermore, investment laws often provide for the creation of an investment agency dedicated to smoothing the way for both domestic and foreign investment into a country's various sectors of opportunity. A best practice that has evolved is the creation of a "one-stop shop" for investment—that is, an agency that helps investors obtain necessary permits, authorizations, approvals, registrations, consents, licenses, and any other matter required by law. In addition, investment agencies are often charged with connecting potential investors with local opportunities through promotion of key sectors, maintenance of statistics, and general information-sharing. Experience shows, however, that even in countries where agriculture employs more people than all other sectors combined, agriculture can be underserved by investment agencies, which often favor sectors with less perceived risk, such as construction, tourism, or trade.

Moreover, there is a surprising degree of resistance in some countries to the creation and implementation of a "one-stop shop." Particularly where there is a high level of state corruption, such agencies can be perceived as closing down opportunities for officials in other bureaus to collect the "informal fees" to which they historically have considered themselves entitled.

Securities law. Countries that seek to support the raising of capital through public ownership do so according to securities laws, which typically allow for the creation of one or more stock exchanges and, in turn, provide for their regulation and oversight. Where there is a stock market, there should also be clearly defined rules of corporate governance of publicly traded enterprises, whether through the securities law or a stand-alone code of conduct. To that end, securities laws tend to "overlay" or supplement company laws in the area of corporate governance. The institutions charged with oversight of stock exchanges—often known as "securities and exchange commissions"—must be properly funded and their staff adequately trained,

or the potential of public ownership will not be realized. Shareholders too must be informed of their rights and responsibilities, while judges and other key decision-makers must be trained to understand and enforce the law.

Special economic zones. Many developing countries have established laws that create "special economic zones" or "free zones" that aim to encourage investment, particularly where the goods produced are bound for international markets. These zones can be especially beneficial to agricultural enterprises because they combine many different government functions and services into a single geographic area. These include not only food health and safety inspections, export licensing, and customs administration, but also such key resources as electricity, water, cold storage, and access to ports. Laws supporting special economic zones also may provide tax incentives and exceptions from certain labor laws. Where special economic zones are run properly, they diminish various risks of investment, especially in agricultural enterprises.

IMPLEMENTING INSTITUTIONS

The rights afforded by law are only as strong as the institutions that support them. The core set of institutions charged with protecting the rights of investors in agricultural enterprises generally includes the following: the Ministry of Agriculture and other key economic ministries; private cooperatives and the agency charged with overseeing them; the company registrar; the investment promotion agency; the securities and exchange commission; and the courts and other dispute resolution agencies.

Ministry of Agriculture and other key economic ministries. In many countries, the Ministry of Agriculture is a large, far-flung organization that is engaged in a vast number of activities aimed at supporting agriculture, including extension services, livestock control, seed development, regulation of fertilizer, food health and safety, and many others. Too often,

the ministry is viewed as a bureaucracy that presents more roadblocks than benefits. When run properly, however, it can make a tremendous impact on the way that investors view opportunities in agriculture. The better a country's seed, fertilizer, and farmer know-how, the better the product and the less risk presented to potential investors. Other ministries, such as those overseeing trade, commerce, and infrastructure, should also view their mission as that of supporting opportunities for private enterprise, rather than obstructing efficient access to markets.

Cooperatives. The cooperative model holds enormous potential for domestic agricultural enterprises, but it also can be enormously challenging to implement. Specific roadblocks often include low rates of literacy and capacity among farmers; insufficient levels of trust among members of a cooperative; inconsistent treatment of agricultural contracts among members; and overall ambivalence about the role of cooperatives, based on local culture or history. Investors in cooperatives—that is, small producers who are members of cooperatives—often are not especially well protected, given the typically unpredictable and informal operations of most rural cooperatives.

Standards of corporate governance should apply not only to enterprises organized under traditional company laws, but also to enterprises organized as cooperatives. A workshop in 2007 sponsored by the United Kingdom's Department for International Development (DFID) and others on "Corporate Governance and Cooperatives" found that:

[G]overnance problems that plague cooperatives also account for their poor reputation and neglect by policymakers and the wider public. Among the most salient governance problems...are those of confusion on the role and mission of the cooperative, the entrenchment of power elites, conflicts between the principles of profitability and the social objectives of

the cooperative, opacity in decision making, weak oversight and control mechanisms, and lack of clear rules on how to adapt strategic objectives to changes in the market environment, particularly those stemming from a global economy.³

Thus, public agencies charged with overseeing cooperatives typically have their work cut out for them. The support they receive from government and donors, however, tends to be surprisingly minimal.

Company registrar. A commitment to abide by standards of corporate governance, thereby lessening risk to investors, begins with an enterprise's registration with the company registrar. This agency, which is often the first major point-of-contact for all enterprises seeking to do business in the formal sector, has the ability to influence corporate governance from the inception of an enterprise. Namely, the strongest company registrars provide access to information about the obligations of governance and may even work with local chambers of commerce and other entities in promoting awareness of this key issue.

Investment promotion agency. A well-run investment promotion agency serves as a "gateway" for domestic and foreign investment and joint ventures and, as noted earlier, is most effective when acting as a "one-stop shop" for investors. There is little excuse for the website of an investment agency to be inactive or out-of-date—maintenance of a thorough web presence, which includes relevant laws, statistics, and sectoral information, is a straightforward and inexpensive way for countries to present their opportunities to the outside world. As also noted, however, the agricultural sector is often overlooked by investment agencies, which may perceive greater potential payoff from other types of investments. Agricultural organizations, cooperatives, and even the Ministry of Agriculture should work with the investment promotion agency to understand and promote opportunities in agricultural investment.

3 DFID/CIPE, *Global Corporate Governance Forum, Corporate Governance and Cooperatives: Peer Review Workshop*, London (February 8, 2007).

Securities and exchange commission. The establishment of a stock exchange requires the resources and knowledge to support robust enforcement of securities law. Where potential investors perceive that the securities and exchange commission is monitoring the statements of publicly traded companies and acting when there is evidence of malfeasance, they are more likely to invest in the stock market (which almost always includes several agricultural enterprises, including breweries, dairies, horticulture firms, and other major food processors and traders). If enforcement and accountability is lacking—as evidenced by poor maintenance of statistics, company statements, and other key information, not to mention financial losses—investors will seek to place their money elsewhere.

Courts and other venues of dispute resolution. Modern company law gives courts and alternative dispute resolution agencies a significant role in protecting and enforcing the principles of corporate governance and in resolving disputes that arise between economic actors. Given this role, it is very important that judges, arbitrators, and other key decision-makers understand their responsibilities and receive adequate training in the law of contracts, company law, and corporate governance. The following factors often contribute to a positive environment for dispute resolution, which, in turn, reduces perceived risk on the part of investors:

- The creation of a well-resourced commercial court or commercial section of the regular courts, and, equally important, access to these courts in agricultural areas;
- The growth of alternative dispute resolution (ADR) mechanisms, including both arbitration and mediation, particularly those that allow for fast resolution of disputes involving highly perishable agricultural goods;
- A well-established community of valuation and accounting professionals; and
- A strong legal community, for which continuing education in commercial law is of high quality and is readily available.

SUPPORTING INSTITUTIONS

The health of an investment environment can be gauged to a significant degree by the availability and quality of information and professional services in a given community. Among the key supporting actors that reduce risk to investors are the institutions listed below.

Professional services and associations.

Investors in agricultural enterprises—particularly well-resourced foreign investors—will seek access to a strong cadre of professional services, including lawyers, accountants, valuation professionals, and others. Lawyers and law firms should be able to provide services that help investors meet their needs for more market information, for understanding and taking advantage of investment incentives, for assuming their regulatory obligations, and for handling international transactions.

Many professions, however, including law, banking, accounting, and others, lack broad-based expertise in the area of agriculture specifically. Thus, perceived investment risks may be cited as reason for not going forward with loans, investments, or enterprise growth plans, even though, as summarized by one agricultural economist in Ghana, “risks of agriculture can be over-exaggerated” and, particularly among people who understand the sector, “they can be managed and minimized.” Law schools in developing countries often teach very few courses—other than land law—that speak directly to concerns of the agricultural sector. Similarly, bankers often lack training in special products or risk-minimizing tools pertaining to agriculture.

Associations of businesses and professions can have an important impact on the quality of an investment environment. Chambers of commerce or other business associations can play a watchdog role over information promulgated by the government and, through regular publications, keep investors apprised of industry developments against which they may benchmark individual firms.

Universities. Investors in agricultural enterprises can be well served by educational institutions, including those that train food scientists, agronomists, and other specialties, such as commercial entrepreneurs. In the area of agricultural production, universities can work directly with farmers, accessing them for internship opportunities and for exchanging experiences and expertise.

Media. Newspapers, radio, and TV stations can serve as a powerful influence on the quality of an investment environment because they have a direct impact on the quality of information available in an economy. In many developing countries, however, even where the media is permitted to deliver the news freely and without censorship, the quality of reporting on business news generally, and on agricultural matters in particular, is not considered especially strong.

Media can also be used to assist farmers in better understanding the use of their inputs and in maximizing productivity. For example, short radio and television ads may be used by investors to explain in local languages how farmers can best cope with weather and other conditions.

SOCIAL DYNAMICS

There are many social, political, and cultural issues that influence the extent to which a society feels obliged to protect private investments in

agricultural enterprises. These issues often relate very closely to local context; accordingly, development professionals must strive to understand and integrate these considerations. For example, as noted, the twentieth-century history of cooperatives may have a strong bearing on whether that model can serve as a positive mechanism for investment in the short term. Similarly, current political winds may influence a country's hospitality to foreign investors. The relative education of a populace, the availability of English as a second language, and access to professional services for investors may further impact the extent to which a private investment or investment in a stock market will be successful.

All investors should be aware that, to realize meaningful returns, investment in agriculture takes time. Those who succeed in agriculture—and the institutions that support them—exhibit clear awareness that time is a critical input, without which high productivity and consistent access to markets cannot be achieved. A country's search for investors must underscore the fact that investment in agriculture is not for the impatient, but that the government will support those who make the long-term commitment, through healthy and honest institutions, tax holidays and other incentives, and institutional preparedness when the time for trading or exporting arrives.

PAYING TAXES

The fairness and efficiency of a tax system has significant impact on whether entrepreneurs (particularly smaller and micro enterprises) and individual citizens choose to join the formal sector. If they believe that the tax system is fair and that the state will use their tax revenues wisely, they are more likely to participate. A state with a larger tax base can typically pursue more growth-oriented priorities, including expenditures on public goods such as education, health, and infrastructure, all key to the success of the agribusiness sector. Moreover, when more individuals and businesses participate in the tax system, the state can reduce the amount of the payments it seeks from each taxpayer.

The tax system also helps to determine the incentives agricultural producers face. Historically, agricultural products were taxed at relatively high rates when compared to other products in the same economy—leading to distortions in the market that had the perverse effect of discouraging agricultural investment where it was needed most.

Agribusinesses that could also be described as manufacturing firms (e.g., those producing bio-fuels, flour, fertilizer) are likely to be subject to corporate taxes (e.g., turnover taxes, taxes on profits) similar to those paid by any other manufacturing firm. Depending on the defining laws, cooperatives functioning as agribusinesses often retain a “non-profit” character. As such, they may not be subject to standard corporate taxes.

An analysis of the 2004 *Doing Business* data indicated that higher corporate tax rates discourage investment, are positively associated with the size of the informal economy, and are inversely correlated with growth.¹ Agriculture-based economies, especially in Africa, tend to have poor scores.

To understand the full impact of taxation on the small and micro enterprises dominant in the agricultural sector, it is important to assess how taxes are levied on specific commodities (and producers or traders of those commodities).

To understand the relative rates of taxation (or subsidy) on agriculture and non-agriculture, an analysis of the terms of trade is useful.

Taxes on the majority of agricultural enterprises are of two types:

- *explicit or direct* taxes on land, outputs, inputs, and sales; and
- *implicit or indirect* taxes on or subsidies to the non-agricultural sector that change the terms of trade for agriculture.

Direct taxes. Direct taxes on land (property taxes) are a key element of agricultural taxation in developed countries but are relatively less important in the developing world, in large part because of limitations on private ownership of property. Some countries (e.g., Vietnam) have circumvented the ownership issue by levying taxes on use. However, collection of taxes on rural real estate is relatively difficult and costly in administrative terms.

By comparison, market-based taxes or trade taxes on sales of agricultural products are relatively easy to collect, especially when the commodity is imported or exported. Private trading agencies and state trading enterprises provide centralized tax collection points and offer lower administrative costs. This relative ease of collection has encouraged governments to place

¹ Simeon Djankov et al., “The Effect of Corporate Taxes on Investment and Entrepreneurship,” available at <http://www.doingbusiness.org/features/Research-Corporate-Taxes.aspx>.

greater reliance on market-based taxes for a limited range of commodities.

Raw or minimally processed agricultural commodities exported into regional or global markets have traditionally been the most significant source of agriculture-based revenue for the exporting country. Generally, licenses to export are limited in scope and number, and national revenues can be collected in a cost-efficient way as the products must pass through ports or airports where they are weighed and valued and a clear paper trail is created. However, high rates of taxation on agricultural exports have been shown to pose strong disincentives to production and/or increased incentive to ship commodities through neighboring countries with less onerous export taxation regimes.²

Under the Uruguay Round of international trade negotiations and the ongoing debates within the World Trade Organization (WTO) on the Agreement on Agriculture, as well as within the regional trading negotiations that have led to the creation of regional trading blocs, developing countries have come under some pressure to rethink these policies. Many countries have brought export tariff rates down and now allow tariff-free export within a trading bloc of neighboring commodities. Some countries, such as Ghana, have recently lowered export tax rates on processed agricultural commodities to provide an incentive to foreign companies to invest and to domestic companies to add greater value-added (and create jobs) in-country.

Import tariffs on inputs (e.g., fertilizer, seeds, machinery) are another explicit tax on agribusiness. In the interests of encouraging upgrades to agricultural technologies, though, many developing countries keep these tariffs low.³

Indirect taxes. While international trade talks have led to reduced direct taxes in many cases, several analysts have pointed to the implicit or indirect taxes imposed on agriculture as important, negative impacts on agribusinesses:

The indirect tax on agriculture, through overvalued currencies and industrial protection, was nearly three times the direct tax on the sector [in 1982]...With reforms in the 1980s and 1990s to restore macroeconomic balance, improve resource allocation, and regain growth in many of the poorest countries, both direct and indirect taxes were reduced. The reform of overvalued currencies, which taxed agricultural exports (usually exported at the official rate of exchange) and subsidized food imports, is reflected in the huge reduction in the parallel market premiums for foreign currency in developing countries.⁴

LEGAL FRAMEWORK

Tax codes and regulations are fundamental in every country. They provide the information needed to assess the incidence and burden of explicit taxes on agribusinesses: property, production or marketed surplus, sales, or inputs. When analyzing the impact of taxes on agribusinesses, it is important to consider a broad range of taxes, fees, and contributions likely to impact firms operating in agricultural sectors, including:

- tariffs on agricultural products;
- water charges for irrigated production, processing, and manufacture;
- waste collection taxes;
- any environmental mitigation fees that might be levied; and
- vehicle and road taxes.

Information on import tariffs for specific categories of goods is also useful in assessing the extent of discrimination against agribusiness in favor of other kinds of industrial or sectoral growth. Customs regulations (valuation, reporting) are likely to be of some importance in computing the actual amount of taxes paid on either imports or exports.

Regarding implicit taxes, the rules governing management of exchange rates are likely to be found in financial sector and trade policies and in the administrative mandates of organizations (e.g., central banks, treasuries, or ministries

2 A World Bank brief, "The Plundering of Agriculture in LDCs" summarizes these. See www.worldbank.org/html/dec/Publications/Briefs/DB3.html.

3 If a private business is doing the importing, however, that firm will be subject to corporate taxes and is likely to pass some of that burden along to input buyers.

4 World Bank, *World Development Report 2008* (2007), at 98, available at http://siteresources.worldbank.org/INTVDR2008/Resources/WDR_00_book.pdf.



of finance) that play some role in determining exchange rates. Taxes at local, regional, and national levels often amount to a burden that renders agricultural commodities uncompetitive in global and regional markets; implicit taxes are frequently missed in any analysis, yet they affect the competitiveness of products just the same.

Full accounting for subsidies to other sectors that might disadvantage agribusinesses is complex, although these sectors can play a role in establishing the terms of trade between agriculture and non-agriculture. Subsidies may take the form of reduced tariffs on imports, tax holidays, or other kinds of tax forgiveness. Such measures are likely to be embodied in specific “infant industry” rules and regulations, pricing for public goods and services, and the provision of preferential credit terms.

IMPLEMENTING INSTITUTIONS

Ministries of finance, industry, customs, and trade, as well as central banks/treasuries, are likely to be responsible for setting policy, administering tax collection, and reporting. Many countries delegate authority for collecting certain taxes (e.g., property tax, school tax, road tax) to local administrative units. In some cases,

the authority extends from levying to collection and use; in other cases, local administrations simply collect taxes on behalf of national revenue units. Corruption at the local level may be disguised as quasi-legal fees and imposts: ad hoc market fees, establishment of roadblocks, fines for contravention of various rules. Reportedly, these have significant impacts in some areas.

State trading enterprises (STEs) often fall under independent jurisdiction. Where exports are involved, the STEs may play an important role in the administration of marketing or export taxes.

SUPPORTING INSTITUTIONS

Tax accountants and lawyers can provide advisory services to agribusinesses seeking to comply with tax legislation but facing a complex and perhaps contradictory set of rules. Brokers in the transport and warehousing sectors provide services that facilitate the verification and payment of export and import taxes and fees.

Most agribusiness cooperatives are tax exempt as non-profits, but the products they deal in may be subject to taxation. Further, cooperatives are not immune to the impacts of implicit taxes, local fees, and corruption. Many donors and a growing number of domestic non-governmental organizations support cooperatives in developing countries. Many are likely to be prepared to provide accounting, training, and/or advisory services if needed.

SOCIAL DYNAMICS

Agribusiness and cooperative associations have been vocal regarding tax reforms in some countries. In the 1990s, organizations of private Kenyan horticultural exporters, for example, successfully negotiated the removal of an export cess on their products as they argued they were getting no service for the fee. It has been difficult, however, for governments to resist the temptation to impose new fees. In 2001, the government again proposed an export fee, this time to fund the parastatal Horticultural Crops

Development Authority.⁵ The private associations again objected.

Often, however, producers have simply responded to the disincentives posed by excessive taxation by changing production patterns or, where possible, by marketing products through alternative routes. Relatively high taxes on cocoa exports in Ghana in the 1980s, for example, led to cross-border smuggling and increased exports out of Cote d'Ivoire. Ghana

learned its lesson and has, since 2000, adopted a more pro-business attitude.

The cumulative effects of taxation, however, are often not clear to the agribusinesses themselves. Governments intending to stimulate agribusiness should undertake studies of potential problems in the area of taxation. The government's short-term needs for revenue may compromise long-term investment and increasing productivity over time.

5 Mary Magdalene Opondo, "Trade Policy in the Cut Flower Industry in Kenya," n.d., available at <http://www.gapresearch.org/governance/HORTI.pdf>.

TRADING ACROSS BORDERS

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 Climate 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

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

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.

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.

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,

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

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.

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.

ENFORCING CONTRACTS

Contracts are legally recognized and enforceable agreements between two or more parties for the exchange of goods or services for something of value in return—"consideration." Consideration is typically money or other assets but can consist of almost anything, even a promise not to do something. The more informal an agricultural enterprise, the more likely contracts will be unwritten (oral) and/or enforced by social and community norms and processes. Nonetheless, even the simplest informal agribusiness, by its nature, necessarily involves a contract (agreement). The larger scale and more formal an agribusiness, the more likely contracts will be written by lawyers or specialized contract managers, international in scale, and enforced by both local and international law. The range of possible forms of agreement between these two extremes is broad.

A maxim in the globalizing world is that the ability to enter into contracts without face-to-face contact facilitates more widely dispersed trading patterns and market efficiency, but also requires sophisticated systems for informed, calculated allocation of risk that do not usually exist in settings where oral agreements between merchants are the norm.

Contracts are important to agribusinesses for key purposes: securing labor and other inputs; selling products, especially across borders where other business laws may apply; and managing business processes over time (for example, "forward" contracts that commit buyers to purchase crops still to be produced).

Technology agreements associated with the purchase of transgenic seeds are a specialized form of contract, committing the purchaser to their use in only one season. The provision of supplier credit in the form of in-kind production inputs is another form of contract; the recipient of the input contracts to deliver a specific amount of product at some time in the future. Leasing arrangements (e.g., rental of land, equipment) also fall into the area of contracting, and typically require a specialized legal regime.

Established grades and standards for defined products and services are fundamental to the contracting process in the agricultural sector. When a contract is made to deliver "Number 2 hard red wheat" with a specific degree of moisture content, all parties have to agree on exactly what that product is and have a way of verifying it at time of shipment and/or delivery. The lack of such standards is a key barrier to effective use of contracts and agricultural market development in many developing countries. Technical barriers to producers' abilities to meet such standards reliably compound the problem.

Non-performance on contracts is normally subject to penalties that should be understood by both parties entering into the contract. In some cases, e.g., for late delivery, for lower quality, these penalties are written into the contract itself. When contracts are poorly written or are established verbally, there is great scope for disagreement between the parties as to the quality or timeliness of the contract's fulfillment. Adjudication and other dispute resolution services are thus integral to the maintenance of a system of contracting. In fact, it is the efficiency of the judicial system in resolving commercial disputes that forms the

core of the World Bank Group's *Doing Business* analysis of enforcing contracts.

For local contracts, traditional courts or mediators might be sufficient to resolve disputes between contracting parties. For more complex contracts, formal legal entities following codes of civil procedure or other court regulations are likely to be involved, though the dispute may be resolved through private or semi-private sector arbitration/mediation structures that comply with mandatory legal provisions. Small claims may be easily reimbursed, but non-performance on international contracts, e.g., the export of raspberries from Guatemala to a Whole Foods in Florida, may be significantly more complex.

Work on the evolution of supermarkets as key players in the food business in both developing and developed countries has highlighted the importance of contracting in agribusiness. Small agricultural enterprises and cooperatives need training and technical assistance to enable them to move from local, verbal contracting processes to the kinds of contracts that underpin the global horticulture business, for example. Penalties for non-compliance with sanitary-phytosanitary standards (SPS) can be severe. Rejection of an entire shipment of green onions for SPS reasons at a U.S. port of entry may mean the loss of an entire season's work and significant capital investment, a critical blow for an exporting cooperative.

Timing is often crucial as well. In the example of a rejected shipment for contract non-compliance, getting the right kind of third-party inspection and setting in motion the process for legal redress must be done within hours of notification of non-compliance. While a shipment of steel can sit in a warehouse without damage for weeks, the green onions must be reinspected almost immediately. This not only requires that the sellers have contract representation on the spot but also places a premium on communications facilities. In these cases, contract management can incur considerable costs.

LEGAL FRAMEWORK

Statutes and regulations regarding contract formation and performance are a standard part of the commercial law in most countries. The *Doing Business* assessment process, therefore, does not rate the law itself, but the efficiency of the judicial process in resolving a commercial dispute over a contract.

It is often a country's constitution that establishes the court system and its jurisdictions. In countries following the civil law tradition, various codes address specific aspects of dispute resolution. In common law jurisdictions, there is a greater reliance on case law. Contract laws are supplemented with laws regarding reliance on information, capacity, and bargaining positions. "For example, the integrity of contractual exchange relies on fraud law to punish those who have positively misled their contracting partners into a contractual relationship and to deter others from doing so in the future."¹

Carefully drafted law with regard to agricultural products and services and the ability of a variety of institutions, not just the courts, are required for the satisfactory resolution of contract disputes, especially when time is of the essence.

Three legal components are particularly critical to agribusiness.

Provisions regarding grades and standards. Mechanisms to establish such grades and standards and to inspect products for their compliance with these standards are critical for developing country agriculture. Increasingly, such grades and standards, e.g., for sustainably harvested sawn wood or "fair trade" coffee, are so complex that third-party inspectors are required as part of the contracting process.

Provisions on expeditiousness of the adjudication process. For many agricultural products, a drawn-out court process is not satisfactory. Mechanisms to establish evidence regarding the contract in dispute and preserve it for legal proceedings must reflect the fact that many agricultural products are highly susceptible

¹ USAID and Booz Allen Hamilton (BAH), *Commercial Law & Microeconomic Reform: A Practical Guide to Program Implementation* (March 2007), at 92. This publication can be found at www.bizlawreform.com/CLIRTechPub-r2b.pdf.

to spoilage, contamination, or loss in a very short period of time. Attaching a shipment of “sustainably harvested wood” is more feasible than attaching a container load of “contaminated raspberries.”

Provisions on transgenics. This will be particularly important as Bt cotton and Bt soy production expands in the developing world. While seeds from first generation Bt cotton can be planted for a second year, contracts with seed suppliers prohibit such planting.

IMPLEMENTING INSTITUTIONS

While the negotiation, drafting, and performance of an agreement may be a rather private affair between two or more parties, the resolution of disputes arising out of agreements typically requires more institutional involvement. Resolution of disputes without some kind of fair and predictable institutional intervention is undesirable and usually against public policy. Whether the intervention comes from a public sector institution or from a private/semi-private institution is a different matter.

The mechanisms for enforcement of contracts originate both in the public sector and in civil society. In fact, both contracting (agreeing) and the enforcement of such agreements are rooted in the customs and traditions of a social unit. More complex systems and structures for enforcement developed as the distances (both geographic and relational) between traders became larger. When distances were small (between blood relatives or townspeople only), the traditional systems were typically some variation of arbitration or mediation.² As the public sector became more deeply involved at the policy level, and the contracting relationships became more tenuous and complex, official judicial systems were adapted to provide law-based resolutions. Much more recently, because of the drawbacks to adjudication,³ arbitration and mediation have found new popularity.

Judicial institutions (i.e., lawyers, courts, court-appointed bailiffs/repossessors) are critical as the default institutions for contract disputes as well as for enforcement of awards given in disputes resolved outside the court system. As the *Doing Business* analysis points out, countries that provide better and faster services in enforcing contracts are those that have established specialized commercial courts and have systems that do not involve excessive costs.

Traditional dispute resolution systems are often sufficient for resolving local contract issues—performance on a labor contract, payment for a good or service. These are typically in the nature of arbitration or mediation and can be quite formalized, but are usually simplistic to the point that they can only accommodate limited types of disputes and only parties from the same town or region.

More complex transactions do not necessarily require increased formality (indeed, arbitration is typically less formal than adjudication) but do need a dispute resolution system in which the arbitrators/mediators understand the issues and parties not from the same area can still feel they are being treated fairly.

Alternative dispute resolution can also involve third-party inspection or certification and provide more timely and satisfactory conclusions to some contract disputes. A number of relevant “third parties” exist for key agricultural commodities, e.g., the Forest Stewardship Council.

SUPPORTING INSTITUTIONS

Though trade/business/professional associations may be blossoming in a growth-oriented economy, and there may be significant interest in the possibilities for alternative dispute resolution (ADR), often virtually nothing will have been done to develop it. This seeming ambivalence may be the result of public sector inertia, a paucity of lawyers trained in ADR, or the lack of organizations that provide assistance in the area.

² For the purposes of this brief, arbitration may be defined as a dispute resolution mechanism that exists outside the official judicial system and offers binding resolution of a dispute based on applicable or chosen laws/rules. Mediation refers to resolution that is attempted through non-binding third-party facilitation. Various combinations of the two mechanisms may also be available.

³ Advantages to an alternative dispute resolution mechanism include, among others, that it can be quicker and less expensive than litigation, that it can be kept confidential, that arbitral centers may be specialized in complex matters, and that arbitral awards are often enforceable abroad, where the losing party may have assets.

ADR should be, and often is, one of the highest priorities for the development community.

Trade associations and chambers of commerce often have interests in establishing ADR mechanisms: they provide a service to the membership, income and prestige to the association, and allow the association to have input in the way specific disputes are handled.

Many contract forms are standard, specifying such things as the grades and standards expected, the timing of receipts and payments, and terms of delivery. Identifying the grades and standards, however, can require considerable work, especially when regional markets involving contracting for future delivery are being developed for the first time and there is little homogeneity in the way people produce and trade. Serious consultation with academic analysts, research institutes capable of analyzing quality, and market actors is required to come up with a system that works across a region.

SOCIAL DYNAMICS

Contract specialists (who are sometimes lawyers) can help agribusinesses reduce their risks of contract non-compliance. Knowledge of the culture(s) within which the contract is being negotiated can help to reduce surprises and the risk of non-compliance and dispute. This includes knowledge of the trade usages/business customs in effect in the place in which the contract is to be performed.

Given the importance of supplier credit for financing commercial agriculture, remedies for contract non-compliance (i.e., side-selling) in this area have been of some concern to the supplier industries—seed companies, fertilizer companies, and processors (milk, textiles, etc.). Government extension services and NGOs providing farmer organization and education services have been helpful in sensitizing farmers to

their responsibilities regarding contractual obligations and performance.⁴

There are some who feel that contract terms offered by buyers to cooperatives and their member-farmers have been extortionate and have relied upon farmers' not understanding exactly what the expected grades and standards are or having the capacity to certify that they are being delivered. If this is the case, attention also needs to be paid to protecting farmers from having to accept non-competitive terms due to actual or perceived quality deficiencies. Donor-funded projects promoting agricultural exports and "aid for trade" have directed some attention to this issue, making sure that expected grades/standards as well as delivery terms are well understood and fair.⁵

It is, by now, well established that a business climate is made more effective, productive, and efficient if commercial ADR, especially arbitration, is promoted, facilitated, and made available to businesspeople. There are a number of reasons for this, some of them perhaps a bit surprising unless commercial ADR is thought of as a *structure* that underlays the entire *process* of business—from negotiating a deal to drafting an agreement to performing the obligations to resolving disputes if necessary and to maintaining a long-term, multi-agreement relationship between the parties. Through the provision, promotion, and facilitation of a *system* of arbitration, a culture of contract and allocation of risk—in other words, *educated contracting*—can be developed.

The notion of ADR as an after-the-breach method for referring disputes to an organization outside an inefficient judicial system is only the tip of the iceberg. The true value of an ADR system is in its ability, if it is structured properly, to provoke the careful preparation of agreements so disputes are never suffered, and if they are, the burden is minimal.

4 Heifer International, for example, has worked with Kenyan dairy producers and cooperatives on honoring contracts with a buyer. Land O'Lakes is working more broadly with the dairy industry in East Africa to strengthen fair competition. And RATES, among others, has analyzed the issue of side-selling in Zambia. See http://www.cottonafrica.com/downloads/Zambia_Cotton_VCA.pdf.

5 See www.pfid.msu.edu.

CLOSING A BUSINESS

A farmer deciding, after two rejected shipments, that the risks of producing green onions for the global market are too great and that the production of sweet potatoes for the local market would be better is effectively "closing the business" of green onion cultivation and starting another. The losses from the green onion business have already been absorbed by the household enterprise and sweet potato planting materials can be readily acquired. Such easy entry and exit characterize many agricultural enterprises in the developing world. Few legal barriers exist to prevent closure of one business and start-up of a new one.

As agribusinesses grow in scale and increase their levels of capitalization, however, entry and exit become more complicated. Significant amounts of credit, substantial investments in fixed assets, and contracts with employees need to be taken into account. Then, the option of bankruptcy becomes highly relevant to the process of closing one business and starting another. Bankruptcy law provides a "pre-determined set of rules concerned with the legal definition of insolvency, the liquidation of reorganization of the insolvent business, and the allocation of the financial consequences between stakeholders...This allows for efficient reallocation of the debtor's resources, which itself leads to greater public confidence in the security of their investments."¹

Governments often bear some responsibility for the closure of agribusinesses in developing countries. There are two kinds of situations in the agribusiness sector that seem to engage governments and to prevent the use of normal bankruptcy procedures:

- Where the company in question holds a monopoly position (or is part of a small oligopoly) and failure would jeopardize consumers' or producers' interests; and
- Where the company in question has been grossly negligent and has raised issues of public and/or environmental health.

For various reasons, some developing country governments have awarded monopolies or quasi-monopolies to specific agribusinesses or have allowed limited numbers of firms in a particular area, thus creating oligopolies. In some cases, they are considered to be state trading enterprises or parastatal firms. In other cases, they are privately owned and managed but operating under special conditions. Fertilizer importers are a common example of this type of firm. State-run dairy industries or grain mills are another. Although in principle these firms are to operate along commercial lines and be profitable, in practice many of them have become insolvent. Rather than risk that there will be no fertilizer imports, however, governments intervene directly to prevent bankruptcy and the closing of the business.

The second situation could arise when a firm's action has created a liability of such public importance that special work-out procedures are required. Companies importing day-old chicks known to be infected with avian influenza, for example, could be prevented from simply closing when the fact of infection became known. The public health liability incurred would require government assessment of damages as part of the bankruptcy proceedings.

The liquidation or restructuring of an agricultural cooperative may present a special case of bankruptcy. Where the cooperative has been

¹ USAID and Booz Allen Hamilton (BAH), *Commercial Law & Microeconomic Reform: A Practical Guide to Program Implementation* (March 2007). This publication can be found at www.bizlawreform.com/CLIRTechPub-r2b.pdf.

constituted as a legal entity and has sound corporate governance, closing it may be relatively straightforward. It will be important to ensure that processes that assure a fair and equitable outcome for all shareholders are established and followed.

LEGAL FRAMEWORK

Bankruptcy law is relatively straightforward. Bankruptcy law generally provides two options for firms facing insolvency: liquidation or rehabilitation. Either option can be entered into voluntarily by the company owners (the debtors) or initiated by creditors (shareholders). It establishes the priority of creditors' interests, as well as other types of expenses or debts. It shares certain fundamental necessities with other commercial laws, such as the ability to execute judgments, the need for competently administered registries for real and movable property, and the existence of sound implementing and supporting institutions such as courts, administrators, and valuation professionals.

USAID recommends that, rather than incorporating procedures to address insolvency issues in civil or commercial codes, countries enact a single bankruptcy law to cover all enterprises or corporate entities other than financial institutions and insurance companies. The law should cover the following: commencement of process; creditors' involvement and treatment; the role of the court; corporate reorganization; corporate liquidation; and criminal provisions.

As noted above, to take into account specific situations in the agricultural sector, some attention to managing or remedying public health or environmental liabilities and to maintaining operation during a period of reorganization due to the essential nature of the product or service provided may be necessary.

Further, given the continued existence of many parastatal entities in the agricultural sector, some consideration directed to addressing the insolvency and reorganization of this category of entities in particular is warranted.

IMPLEMENTING INSTITUTIONS

Judicial institutions, financial institutions (creditors), and specialized organizations and consultants dealing with business work-out and reorganization play roles in implementing the process of closing or reorganizing a business under rules governing bankruptcies.

In addition, bankruptcies may involve a special insolvency agency rather than a court. At the company level, the appointment of administrators or trustees and liquidators is common. The administrators or trustees are designated to handle either the rehabilitation or the liquidation of the enterprise and are accountable to the court or agency with jurisdiction over insolvency cases. The disposition of the property and distribution of the assets may be designated to another individual or entity, known as the liquidator.

SUPPORTING INSTITUTIONS

Court officers, such as bailiffs, and lawyers are an essential part of the judicial processes involved in bankruptcy. Professional associations are also useful for addressing the needs of bankruptcy constituencies and promoting the effectiveness of the bankruptcy system as a whole.

Because of the strong public interest in food and agriculture, extension services provide education and information that can help agribusinesses understand and initiate bankruptcy proceedings as needed.

Business advisors or consultants can provide the company and its appointed administrators with the advice needed to determine whether liquidation or reorganization is the best way to close the business. While international business consulting firms (such as McKinsey and Company and Bain Consultants) are sought for their advice in some cases, non-governmental organizations such as ACDI/VOCA, CNFA, and Technoserve are available to provide advisory services to smaller agribusinesses in many developing countries.

SOCIAL DYNAMICS

Financial institutions wishing to expand agribusiness lending portfolios are perhaps most aware of the need for bankruptcy law and regulation as it underlies their abilities to recover assets in lieu of credit repayment.

The failure of state trading enterprises, parastatal production units, or state-managed “cooperative” apex organizations has probably had a larger impact on the majority of agricultural enterprises, however. Governments have often intervened to forestall an orderly process of liquidation or reorganization of such entities in the interests of consumers, corrupt but well-connected political figures, or an inability

to agree on the appropriate state role regarding the function in question (Kenya Cooperative Creameries, and the Ethiopian cotton industry, for example).

Keeping publicly owned but failing agribusinesses going takes a toll on taxpayers and establishes a climate of uncertainty that keeps new businesses from taking over the functions of the failed enterprises. Reorganization as private companies seems to be the bankruptcy remedy most often proposed by donors, but unilateral liquidation on the part of the government seems to be more effective (e.g., the Uganda Coffee Cooperative, the National Food Authority of Tanzania).

ABOUT AgCLIR:

AgCLIR is a unique agribusiness enabling environment diagnostic that provides a comprehensive method to diagnose the root causes and inefficiencies of an underperforming agricultural sector. AgCLIR is one of a series of sector specific diagnostics produced under the USAID BizCLIR project. BizCLIR, or the Business Climate Legal & Institutional Reform Project, is a multi-year initiative of the United States Agency for International Development (USAID) with the goal of improving 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 www.bizclir.com.

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