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Interregional trade in agri- & agro-processed produce

REGOVERNING MARKETS

Context

This policy brief forms part of the Recovering Markets study in Southern Africa. It has endeavored to analyse market concentration in the food processing and retail sectors, as well as to predict future dynamics in the sectors which have emerged as a result of the restructuring of the food market and the rapid changes taking place in the structure and governance of local, national and regional agri-food markets and the implications of the changes for small/medium producers in the restructuring of the food industry, together with the implications for policies and programmes within the context of the agri-food market.

Key points

The formation of regional integration groups has allowed trade to become more accessible with trade barriers between respective countries being removed. This integration is further deepened by private sector investment, such as expansion of retailers in the Southern and eastern regions, which also promotes trade. This current expansion of regional retailers continues to raise the standards of business in terms of various requirements such as quality, safety and ethics. Failure of local suppliers to meet any of these standards and regulations may have negative impacts, especially on small agri-businesses, which in the absence of policy intervention, functioning markets and regulatory framework, could fail.

The main drivers of the aforementioned retail growth and expansion within the Southern African Development Community (SADC) are integration, competition and trade liberalisation. Integration has increased the pace at which retailers move and expand across countries thereby increasing the competition with local players. Since those retailers expanding across borders are predominantly large in terms of their size, structure and financial aspects, they tend to dominate the markets and can drive out the smaller, local players. Conversely, due to trade liberalisation some of the domestic trade protection measures that governments use are null and void and this can be detrimental to the local markets. Therefore in the absence of government protection, strong and proactive regulation is needed to maintain fair

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market principles. With that in mind, it is imperative that competition between players within the food chain translates into value creation for consumers. A growing potential concern regarding the regional integration within the agri-business sector is that of diversification from traditional export crops to 'new' higher value crops, especially in the horticultural sub-sector. For instance, vegetables and flowers that are normally air-freighted to export markets can realise a great potential within the landlocked regional countries which will result in a comparative advantage in horticultural production. The production of these 'new' types of fruits in South Africa such as lychees, mangoes and pineapples can be introduced into other Southern African countries. Within the Southern African region, many countries traditionally produce cattle, with beef production in the region having almost doubled between 1961 and 2004. In recent years, poultry and meat production in the Southern African region has gained importance and exhibits a steady overall growth trend, especially in countries like South Africa, Zambia, Zimbabwe, Mozambique and Malawi (Agro Industry, 2008).

There is a definite need for an increase in government support within the agri-sector in terms of integration. Governments are in a position to provide support through strong action against unfair trading practices such as dumping, offering tax breaks and infant industry support to newly established agro-processors. In addition to the introduction of higher tariffs to address subsidised imports, consideration should also be given to exclude certain local agro-processors, which contribute to primary agricultural production and food security, from WTO tariff liberalisation commitments. The agricultural sector has been identified by African governments as one of the priority sectors in the strategy to achieve sustainable development. In addition, Africa's economic performance and poverty reduction are now strongly linked to agricultural production (Stevens, 2003).

National policies have recently been put under pressure to harmonise trade policies with other domestic policies. Competition policies and other regulatory procedures have been implemented, although within the Southern African region, this is happening at a worryingly slow pace.

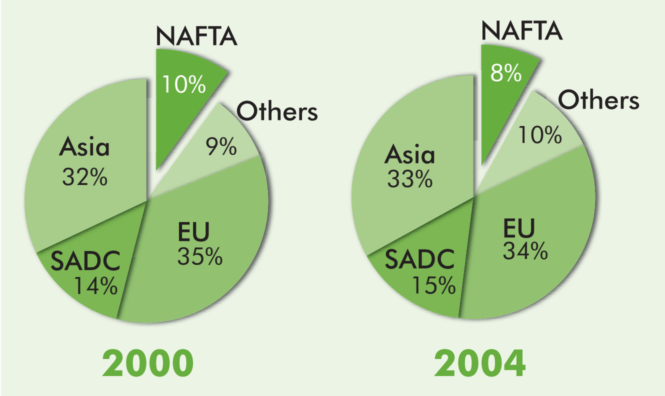
Macro-economic linkages and other institutions must function effectively to ensure that investment by foreign business institutions does not result in the displacement of domestic businesses, but leads to the contribution of poverty eradication and other developmental goals.

Introduction

The objectives of the Southern African region have changed from those stipulated at its' inception in 1980. Today the dominating issues are human development, food security, infrastructure development, environmental and social welfare (SADC Secretariat, 2005). Most of the prioritised issues are linked to agriculture as it is encompassing most of the current issues, especially trade related ones. Today SADC is one of the drivers of the new market structures as regional integration intensifies.

Trade is always the first step towards further integration, and is therefore key in achieving SADC integration goals. The implementation of the SADC Trade Protocol in 2000 was meant to facilitate trade in the region and encourage further convergence towards greater and deeper integration. This was to be achieved through the phasing out of tariffs and other non-tariff barriers. The implementation of the protocol is expected to be complete in 2008 when 85% of regional trade should be duty-free. The Southern African Customs Union (SACU) area, comprising of South Africa, Botswana, Lesotho, Namibia and Swaziland, has begun phasing out tariff barriers faster

Figure 1: Share of SADC imports by origin in 2000 and 2004



than the rest of the SADC members. By the end of 2006, more than 95% of all tariffs against SADC goods were zero rated. The percentage of agricultural goods entering the SACU area duty-free is 99%.

So far, the reduction in tariffs has induced a small increase in intra-SADC imports relative to other sources of imports. Figure 1 shows the shares of imports from various regions coming into SADC for the year 2000 and 2004. In between the two periods, the share of intra-SADC imports increased by a mere one percent from 14% to 15%. From the four selected regions, none had significant change in import shares.

Between the years 2000 and 2004, SADC's total imports increased from US$38.36 to US$ 63.10 billion. The top half of the past five years SADC has slowly increased openness[1] as it approaches global activities at both trade and macro-economic levels. Figure 2 shows an upward trend in the trade systems both regionally and globally. The index shows that, relative to earlier periods, the SADC is engaging more and more with the world today and therefore in general other businesses are bound to follow.

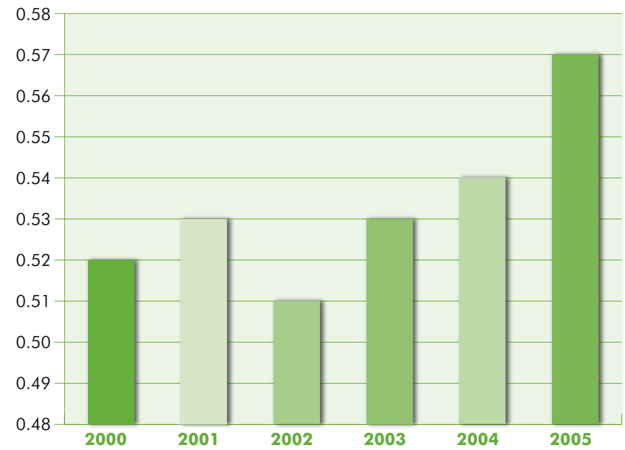
Table 1 shows that agricultural imports increased from US$ 3.01 billion to US$ 4.67 billion, maintaining about the same share. The bottom half of the table shows a high intensity of intra-SADC trade in agricultural products. Share of agriculture in intra-SADC is twice that of total trade.

Table 1: Total and Intra-SADC demand of agricultural goods 2000 - 2004 (US$ Million)

Year	2000	2001	2002	2003	2004
SADC Imports	38,356.98	36,666.53	38,538.10	49,188.19	63,098.51
Agricultural imports	3,012.23	2,861.46	3,318.02	4,110.35	4,668.69
Share of Agric in Total intra-SADC	**8%**	**8%**	**9%**	**8%**	**7%**
SADC Imports	6,666.07	6,762.05	6,989.45	8,941.33	9,038.76
SADC Agric Imports	1,178.76	1,164.27	1,310.69	1,620.36	1,392.12
Share of SADC Agric	**18%**	**17%**	**19%**	**18%**	**15%**

Source: SADC Trade Database

Figure 2: SADC Trade openness from 2000 to 2005



Source: SADC Trade Database and authors' calculations

In the past five years SADC has slowly increased openness[1] as it approaches global activities at both trade and macro-economic levels. Figure 2 shows an upward trend in the trade systems both regionally and globally. The index shows that, relative to earlier periods, the SADC is engaging more and more with the world today and therefore in general other businesses are bound to follow.

It is a further indication (at trade level) that a greater variety of products is being traded and/or similar products with higher unit values. The outcome arising from this increasing expansion of trade worldwide includes a significant decline in prices of domestic goods due to the efficiency and competitiveness of foreign involvement. When developments from other parts of the world filter through domestic markets

1 Openness is an index showing a share of total trade in GDP. The higher the index implies that the respective country is increasing its integration into the world.





like this, it may be an indication that the region or country is integrating into a more globally defined economy.

Potential drivers

Although regional integration appears to be happening at a slower pace than previously expected, it is still considered to be one of the important drivers of trade in terms of agricultural commodities. One of the key goals of the New Economic Partnership for African Development (NEPAD) in fighting poverty on the continent has been to allow for a greater movement of food-based products across borders free of any trade barriers. Thus the regional blocs can be considered to be key role players of the integration process. There is a need for proper co-ordination between regional and continental projects that feed through to domestic policies without causing confusion.

Most of the current trade within Southern Africa is highly influenced by South African exports to the region. This implies that these commodities are following those of other businesses that have already been established within the region such as mining and other related services. There is anecdotal evidence that a number of South African businesses in the region, especially those involving food chains, source most of their supplies and other necessary inputs from their origin being South Africa. This is especially evident in the mining industry where the South African firms throughout the region import the majority of their equipment from South Africa (Hartzenberg & Mathe, 2005).

Another potential driver to be considered is that of the current migration taking place from rural to urbanised areas. This urbanisation movement has, and still is contributing hugely towards the increases in the demand for goods within these urban areas. Increase in demand for value added goods has led to an increase in domestic production and created the potential for even further increases in the future. If the domestic production capacity is overcome by the demand, then imports will be seen to escalate.

Regional integration has the potential to become an even greater force with the removal of all non-tariff trade barriers. To date, there has been limited progress made in terms of the lowering or complete eradication of these barriers and this has impacted negatively on other trade gains that have been made thus far, such as the rules of origin and technical barriers. The expansion of retailers in the region has been encouraged by the ability to source from the country of origin with very few barriers in place. This would help reduce adjustment costs such as sourcing new suppliers. Furthermore, it adds towards welfare gains as it has the potential to create more trade between regional members.

At political level, agricultural development is driven through the Comprehensive African Agriculture Development Programme (CAADP) which is a NEPAD subset (NEPAD Secretariat, 2006). CAADP aims to drive economic growth of 6% per annum and increase public investment to a 10% share of budget in order to attain some of the Millennium Development Goals (MDGs). The key focus and emphasis is given to small scale farmers and women with the objective of integrating them into the main market and improving their market access. There are further commitments such as infrastructure development, a free flow of staple foods across borders, the facilitation of access to inputs (seed, fertilisers, etc) and ensuring the provision of an investor-friendly environment within Africa. For these to happen, political leadership that is committed to private sector initiatives is required.

Trade impacts of supermarkets

Links with the parent company

The trend where businesses follow the leaders in the region has been established in the mining, banking and insurance sectors. The expansion of the South African banking arena into the rest of the region was mainly due to the need to follow the mining business as they utilise the same service providers. This has encouraged growth in the retail sector and multinational businesses, promoting further expansion in the region. This pattern extends further to trade links, which in turn enhances efficiency (Weatherspoon et al, 2003). Therefore, these businesses facilitate South African exports, which explain a positive trade balance with Southern Africa. The presence of South African manufacturing and retail business is indicated in Table 2, and in all eleven countries there is a representation.





Table 2: South African Selected Manufacturing and Retail Presence in SADC, 2003

Sector	Retail			Manufacturing			
Company	Metro Cash & Carry	Shoprite	Steers Holdings	Illovo Sugar	SABMiller	Nampak	Tongaat Hullett
Angola		✓	✓		✓	✓	
Botswana	✓	✓	✓		✓	✓	
Lesotho		✓	✓		✓	✓	
Malawi	✓	✓	✓	✓	✓	✓	
Mauritius		✓	✓	✓		✓	
Mozambique		✓	✓	✓	✓	✓	✓
Namibia		✓	✓			✓	
Swaziland		✓	✓	✓		✓	✓
Tanzania		✓	✓	✓	✓	✓	
Zambia		✓	✓		✓	✓	
Zimbabwe	✓	✓	✓		✓	✓	✓

Source: Kalaba, 2006

The entrepreneurial initiative of South African retail firms is something that drives trade beyond the incentives of trade liberalisation. After being isolated from the international and regional activities, some South African firms adopted an outward orientation and sought opportunities in the markets where they have a comparative and competitive advantage. South Africa's relatively matured manufacturing sector as well as the well-developed infrastructure system is among the factors contributing to this comparative advantage, relative to the Southern African region. Concomitant with NEPAD, the African Union and other continental initiatives, South Africa is able to exploit opportunities better than their international counterparts.

In general, the main supermarkets in the urban areas source mostly from large agri-businesses. In countries where a foreign supermarket dominates, the effect may have conflicting results on suppliers. Firstly, there is the effect of competition which is introduced by the regional suppliers. In terms of SADC, the dominant retailer is likely to be South African. The domestic suppliers are then forced to raise the competitive bar in order to stay in business. If they can manage, the consumers will undoubtedly benefit from increased competition and thus lower prices, better value, and an overall higher standard and quality of product.

In terms of foreign direct investment (FDI), South Africa dominates the Southern African region with a substantial fraction of overall FDI. South Africa also hosts the greatest number of foreign subsidiaries across a broad range of economic sectors. Their capacity to act as a magnet for FDI in the region, particularly in the context of growing regional economic integration, is an important feature of investment flows. South Africa is the largest market in Southern Africa and is thus pivotal for regional production and trade.

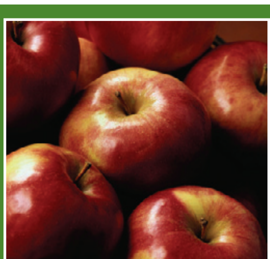
Alternatively, the consequences will be devastating for the domestic suppliers if they fail to keep up with the level of competition. Bankruptcy may be the outcome in some cases, which will affect the local farmers with further negative implications in the fight against poverty. The small farmers are usually left out due to their inability to meet the required volumes, safety standards and quality, as well as other requirements by large supermarkets. On their own, small farmers will generally struggle to adjust to the changing environment and meet the requirements of food systems. This also becomes a challenge for governments as small farmers play such an important role in rural livelihoods although they also stand a chance to gain through a broader fiscal base from new developments in markets.

Diversity in consumer preferences

The preferences of consumers are different in each country and the diversity of these consumers, across many countries, is even more evident. Therefore, there is no doubt that any retail business expanding outside their borders will be faced with even more challenges. The presence of South African brands is widespread in the SACU area due to the advanced economic integration of the trade bloc. As a result, the presence of these South African retailers is more profound within SACU than other Southern African countries. Brand management and aggressive promotion has increased awareness and ensured that regional consumers accept South African goods.

Trade policy issues

Economic integration in eastern Africa has taken another step by moving closer to a customs union. Common Markets of Southern and Eastern Africa (COMESA) has


recently confirmed such intention for 2008, while Southern Africa will become a free trade area (FTA) in 2008 and customs union in 2010 (SADC Secretariat, 2005). The main feature of a customs union is the common external tariff among members and free movement of factors of production between members. This implies that the trade policies of member countries should be harmonised, and eventually there will only be a single trade policy. When all these are accomplished, they will provide additional incentives for businesses to expand even further.

If these goals are achieved, there will be a boost for net food importers in the region as this will provide additional ammunition in the fight against poverty. In the Southern African region, the poorer majority are predominantly rural and therefore agriculture has the potential to play a significant role in poverty reduction and fundamental growth. A stronger link between trade and local agricultural needs to be formed to give incentives to farmers and private traders. Therefore farm incomes may, as a result of resource allocation, go a long way in relieving poverty throughout the rural economy. Agriculture, apart from the mining sector, is also an important source of national income for most of the member states.

Deeper integration forces members to assess domestic policies because as the process gathers momentum, countries tend to adopt common policies or at least align themselves in some way with them. Therefore countries are obliged to review and monitor policy performances against the set targets. Sectors that play important roles in the economy (like agriculture in Southern Africa) are likely to be prioritised in these reviews.

Paradigm shift in policy

The integration momentum has meant that trade policies are not developed independently of other sector policies. The presence of multi-national corporations and retailers, warrants the linking of trade policies and competition-related issues. Because firms establish themselves through import penetration, the nature and the intensity of competition is known to change quite considerably. Trade policies continue to prioritise the promotion and maintenance of market shares (of their goods) in foreign markets, but an even further pursuit of gaining ground in the region and other markets is observed. Conversely, competition-based policies aim to accommodate and regulate the domestic environment relating to both domestic and foreign goods within the markets. Approaches differ from one country to another. For example, competition policy in Zambia aims to encourage innovation and ensure fair distribution of income as well as to reduce unemployment. South Africa's competition policy considers job losses that result from mergers and acquisitions, the promotion of small and medium enterprises and the empowerment of the previously disadvantaged.

Only four countries in the Southern African region (South Africa, Zambia, Zimbabwe and Tanzania) have competition policies that are a serious concern (Hartzenberg & Mathe, 2005). In Tanzania it is called Fair Trade Practices Act, but nevertheless it still regulates competition-related matters. In the case of Namibia, the Competition Act has been enacted, but has yet to be implemented. Swaziland and Botswana are in the process of drafting the legislation. The 2002 SACU agreement requires that each member have a competition policy, which will be linked to industrial development. Lack of capacity in the competition area is a serious challenge to the region and unfair practices will result in drawbacks on some of the region's gains. It is hoped that deeper integration in the region will make sure that competition related issues are given priority and the formation of competition policies be prioritised.

The role of research

There is strong empirical evidence linking research and development (R&D) with improvements in income and livelihood in the developing areas. Agricultural R&D therefore contributes to the enhancement of agricultural productivity, output and quality. There are further benefits such as improvements in the sustainable use of natural resources, lowering of food prices for consumers and the accumulation of physical and human capital among poor households. Such improvements play an important role in uplifting livelihoods of small scale, resource poor, farmers and households.





To sustain a process of technological change and growth, regional R&D needs to be increased considerably. In the SADC region it is mostly considered government investments, with the private sector's contribution remaining highly insignificant (DFID, 2005). R&D can be applied to the challenges of poverty reduction and agricultural development. Therefore it is vital that both the private and public sector's work collaborates in addressing these challenges.

Linkages

Due to the growth in retail chains, and in the absence of policy interventions, small scale farmers will be pushed aside or left to serve the informal market alone. Thus, for them to have a role in the economy, there is a definite need for various linkages between the formal and informal markets. In which case, there will be some spillages from and multipliers of wages, employment and transfer of skills which will benefit marginalised groups and contribute towards the fight against poverty. Small farmers are an important link with rural dwellers', their livelihoods, the whole agricultural sector and the rest of the economy. This is one of the powerful ways in which agriculture generates growth and reduces poverty. However, the first step is to ensure that the links between the informal and formal markets are strengthened. By increasing intraregional trade in agricultural commodities, these linkages will strengthen, especially if one considers an improved transformation and value addition of these commodities. The promotion necessary to create industry linkages and promote increased investments is highly necessary, but to achieve this, countries need to move away from a national to a regional approach that emphasises industry linkages and value addition through regional value chains and joint cross border investments (Miti, 2003).

Policy actions by governments in the region to better integrate the formal and informal agri-marketing channels can lead to a significant increase in competition, a provision of greater access to the range of less expensive food products preferred by low-income consumers, and an improvement in terms of production incentives for small-scale farmers capable of growing a surplus especially in terms of maize (Takavarasha & Jayne, 2004).

Expansion of South African retailers

The fact that the region is a net importer of food products has made it possible for South African companies to venture into the region in addition to the advantages they have in terms of production and manufacturing capacity, infrastructure and technological advancements. These demands and market opportunities are very important drivers of growth of South African investment throughout the region.

Another factor driving the South African expansion is the availability of resources. Most countries are exporters of raw commodities such as tea, coffee, cotton and tobacco. This provides reasonably inexpensive inputs in some of the manufacturing and local industries. Relative to South Africa, most of these countries have lower labour costs. This is also an area where recipient countries benefit in terms of the jobs that are created by these developments.

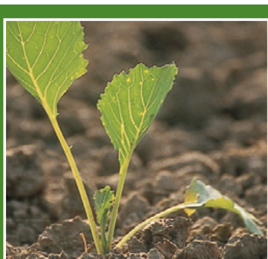
Global developments

It is expected that by 2025, the world population will be 8 billion more people than in 2000. This is projected to increase cereal demand from 2.2 billion to 3 billion ton (DFID, 2005). This translates to an annual increase of 30 million ton based on an increase in population alone. The growing demand for grain-fed livestock in many a developing country, will also be a contributing factor to this demand. Livestock demand for maize is estimated to outstrip production presenting further opportunities and challenges. Regional differences in demand and supply will persist and therefore the SADC region will also have to be prepared for such changes.

Further challenges and way forward

Infrastructure in the region must be improved since poor infrastructure contributes towards the high costs of doing business. Lack of, or inadequate, infrastructure remains one of the most fundamentally constraining factors, and therefore reduces competitiveness of the region as a whole. The most relevant factors include that of transport which affects the distribution of goods directly keeping the small scale farmers and other entrepreneurs out of the mainstream.





The next level relates to policy development and co-ordination. Given that the firms that are likely to expand beyond their borders are usually large and capital intensive, they may drive some of the local firms out of business. The domestic policies should therefore be strengthened to make sure their activities do not negate any other objectives such as reducing unemployment, equitable distribution or fighting poverty.

Therefore, regional and national policies should aim to stabilise and foster an active and productive agricultural industry. This action is critical in ensuring that viable farms are retained. Furthermore, they should look to facilitate investments in agricultural infrastructure, support, maintenance and in the expansion of the business of farming. At the same time, these policies must be identifying and facilitating the creation of new markets and helping farmers access and survive in the dynamic and changing marketplace.

The lack of intra-SADC trade is seen as a major constraint to regional economic development and should be addressed. A large demand for agricultural products exists in the region and there is nothing which prevents domestic producers from satisfying this demand. Furthermore, policy interventions that aim to reduce transaction costs in agriculture, such as investment in infrastructure, must be considered. SADC should develop a coherent trade policy that considers each country's trade and development needs. This is why competition policy is such a crucial and fundamental part of development and integration. SADC has not yet reached the stage of co-ordinating policies of members, and it will be helpful if progress can be made in this regard.

Interventions that create awareness and encourage compliance of small scale farmers with international quality, safety and ethical standards must be considered. This will help comply with domestic and regional requirements. To achieve this, regional governments need to support the agri-business world and further improve on policies, regulations and institutional environments in order to strengthen markets and private sector initiatives. The long term objective should be to create an emergence of both regional and global competitors.

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