EG Technical Briefings
Volume VI No. 1, March 2009

Achieving Greater Trade-Led Agricultural Diversification (T-LAD)

Introduction – Many developing countries face the challenge of enhancing the contribution of their agricultural sectors to economic growth and poverty reduction. In a globalized economy, higher-income markets for fresh and processed agricultural products offer a pathway to development, if governments and the private sector will make the right policy choices, institutional reforms, and investments. But governments and private sectors sometimes are slow to do so.

A recent USAID-funded study examines the challenges to diversifying agriculture in the Latin American and Caribbean countries—Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic—that are signatories to the Dominican Republic-Central America-United States Free Trade Agreement (or CAFTA-DR, as it is commonly known).[1] The study, *Optimizing the Economic Growth and Poverty-Reduction Benefits of CAFTA-DR: Accelerating Trade-Led Agricultural Diversification*,[2] authored by David Bathrick, finds that industrial growth in the CAFTA-DR region under the predecessor Caribbean Basin Initiative (CBI)[3] did not generate enough jobs nor increased wages, while the number of low wage workers in agriculture—primarily producing lower-value basic grains—has grown significantly. The study points out serious structural issues that developing countries need to consider if they are to succeed in unleashing the potential of their agricultural and rural sectors to act as an engine for trade-led economic growth and poverty reduction. To confront these major issues, the study provides a policy and strategic framework to stimulate new thinking about the reforms needed to respond to globalization's opportunities and challenges.

Study Findings and Policy Implications – CAFTA-DR, a permanent two-way free trade agreement replacing CBI (which was a one-way preferences arrangement conditional on an expiration date determined by the U.S. Congress), represents a new phase in advancing trade-led economic growth. As the CAFTA-DR countries work to implement the treaty, they share an overarching concern: how to achieve the structural reforms needed to enhance the capacity of the agricultural sector to diversify into higher-value crops and value-added products that generate increased jobs and incomes, hence economic growth, poverty reduction, and food security. To diversify their agricultural and rural sectors, the CAFTA-DR countries face a number of significant impediments:

Under CBI, the region made limited market gains: Although the CBI has provided potentially lucrative access to the U.S. market, CAFTA-DR countries have not adequately diversified their agricultural and rural sectors to tap into this market by developing more remunerative, competitive, and trade-linked enterprises. While the region did see significant increases in exports of nontraditional agricultural and other products–as well as in GDP–during the 1990s, growth rates since then have declined. In part, the CAFTA-DR countries experienced a diminished hold on the U.S. market for apparel assembly, fruits, and vegetables as a result of increased global competition and not sustaining a focus on product competitiveness.

The influence of protectionism continues: Despite varying degrees of macroeconomic reform and trade liberalization, all of the CAFTA-DR country economies continue to be constrained by protectionist policies for

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numerous producers (e.g., subsidized credit to basic grains farmers) and numerous distortions (e.g., public agencies involved in production input supply and food markets).

Support to the agricultural sector has been weakened: As countries adopted fiscal restraint as part of IMF structural adjustments, they favored reduced spending over increased taxes. This resulted in a decline in public-sector funding for agricultural development, while donor funding was also declining. Thus no "retooling" support was provided to producers and enterprises interested in responding to unprecedented market opportunities.

Countries' agro-industries are insufficiently competitive: In all countries reviewed, the broad agroindustry sector—both primary agricultural production and agroindustrial processing—is becoming an important economic base. However, despite the market opportunities available, the CAFTA-DR countries have low levels of productivity and competitiveness. This condition will likely continue under CAFTA-DR unless the enabling environment is improved through regulatory reform and new investments in infrastructure, support institutions, and human capital. A particular concern is the weak sanitary and phytosanitary systems.

Small and medium-sized producers are not contributing: These producers lack access to finance and technology, as well as timely market information and "know-how" that would enable them to enhance land and labor productivity and become significant suppliers of both higher quality and new food products to market agents who have the capacity to serve the export and processed-food markets.

These impediments define a rural-based productive sector ill-prepared to compete under CAFTA-DR or in the global economy. Additional attention is needed by government to address policy issues, as well as to promote the public and private sector investments needed to improve competitiveness.

Alternative Approaches – Over the past 30 years, two models of agricultural and rural development have influenced the development strategies of governments: One, the *trade-led model*, has tended to stimulate economic progress, while the other, the *protectionist model*, has tended to perpetuate poverty and dependence.

The ***trade-led model*** was used most successfully in Chile, where a broad network of agribusinesses—including agricultural producers and providers of related value-added processing/services—became a major driver of economic growth. Successful implementation of the model requires a national commitment to strengthen policies and support services to encourage investment in market-oriented agri-businesses that link markets to producers of differentiated traditional exports (e.g., high-value coffee) and/or higher-value, resource-based activities (e.g., nontraditional fruits/vegetables, aquaculture, seafood, certified forestry), many entailing processing industries using advanced technologies. Over a sustained period Chile dramatically reoriented its agricultural sector toward export-led growth by reducing tariffs and strengthening the enabling environment (e.g., infrastructure, market promotion, research and development, financing, and human capacity), including efforts to reach small-scale producers. The model contributed to increased rural jobs and incomes and a notable decline in rural poverty.

A clear example of the ***protectionist model*** is southern Mexico under the North American Free Trade Agreement (NAFTA). While facilitating nontraditional exports in the north, Mexico did little in the south to advance enterprise diversification within the large traditional agricultural sector dominated by small-scale basic grain producers. Under NAFTA, few of these producers would be competitive as tariffs for these sensitive crops decline. By the end of the transition period, Mexico had done little to develop basic support services to reduce risks and facilitate investments that would help small-scale producers diversify. Instead the government's cash payments to such producers provided little incentive to diversify production to take advantage of markets opened by NAFTA. Thus, farmers did not diversify and rural poverty levels were not reduced.

Conclusion – The trade-led model as illustrated by Chile includes several important aspects. These include: a long term commitment to open markets and reductions in economic distortions and subsidies; serious and sustained public and private investments in education and technology; development of strong institutions; and recognition of the need to focus on consumer demand for high quality, value-added products. However, neither the benefits of the trade-led model nor an understanding of the ingredients for its success have been fully and broadly appreciated by the CAFTA-DR countries. In general, while most of the CAFTA-DR countries have tried to emulate the Chilean's approach to market development (e.g. growing the right varieties of fruits and vegetables for the export market), few if any of the countries have incorporated the full extent of the Chilean model into any sort of national commitment and plan for trade-led agricultural diversification. Several countries (e.g. Costa Rica, El Salvador and the Dominican Republic) have had stronger economic growth and export performance than others. Some have also developed strong competitive positions in selected products (e.g. Guatemala in snow pea, Costa Rica in organic coffee, and El Salvador in value-added processing). However, this should not be interpreted as suggesting that these countries are truly implementing a robust trade-led model. All of the countries must begin to more effectively address a broad range of constraints to trade-led agricultural diversification if they are going to be more successful in tapping agriculture's potential for trade-driven economic growth and value-added job and income generation.

In short, to capitalize on the treaty's potential to drive economic growth and reduce poverty, the CAFTA-DR countries need to rally stakeholders—government ministries, the private sector, universities, civil society, and donors—into a coalition committed to boosting trade-led agricultural diversification (T-LAD). As evidenced by Chile's experience, a national commitment transcending changes in political administrations is vital to improving the enabling environment and stimulating private investment.

The T-LAD report is accessible at: http://www2.cepal.org.mx/agricola/, http://www.ruta.org**,** or send an email to**:** kbyrnes@usaid.gov**.**

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[1] The Central American countries signed CAFTA on 5/28/04, with the Dominican Republic signing on 8/5/04. The U.S. brought the treaty into force for El Salvador on 3/1/06, with the other countries entering as follows: Honduras and Nicaragua (4/1/06), Guatemala (7/01/06), the Dominican Republic (3/1/07), and Costa Rica (1/1/09).

[2] The T-LAD study reports -- Executive Summary, Vol. 1: Cross-Cutting Analysis, Vol. 2: Country Reviews, and Frequently Asked Questions – are available at: http://www2.cepal.org.mx/agricola/, http://www.ruta.org**,** or send an email to**:** kbyrnes@usaid.gov.

[3] The trade program known as the Caribbean Basin Initiative (CBI) is intended to facilitate the economic development and export diversification of the economies of the Caribbean Basin countries of Central America and the Caribbean. Initially launched in 1983 through the Caribbean Basin Economic Recovery Act (CBERA), and substantially expanded in 2000 through the U.S.-Caribbean Basin Trade Partnership Act (CBTPA), the CBI currently provides beneficiary countries with duty-free access to the U.S. market for most goods. CBTPA entered into force on October 1, 2000 and continues in effect until September 30, 2010 or the date, if sooner, on which the FTAA or another free trade agreement as described in legislation enters into force between the United States and a CBTPA beneficiary country. There are currently 18 countries that benefit from the CBI program and, therefore, may potentially benefit from CBTPA. These countries are: Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Netherlands Antilles, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago. For more information on the CBI, see the USTR web site at:

http://www.ustr.gov/Trade_Development/Preference_Programs/CBI/Section_Index.html