TRADE-LED AGRICULTURAL DIVERSIFICATION

Frequently Asked Questions

The questions and answers below are aimed at clarifying various aspects of a recent study of trade and agricultural challenges and opportunities in Central American and the Dominican Republic. The study is titled, *Optimizing the Economic Growth and Poverty Reduction Benefits of CAFTA DR.*[1]

Question: How will trade-led agricultural diversification affect small farmers?

Answer: Increased producer incomes and rural wages, as well as increased growth in farm and off-farm jobs, will only occur through a process of market-linked (trade-driven) enterprise diversification. Such enterprise diversification will occur to the extent that one or more of the following processes advances in the rural sector: (1) increasing productivity and/or adding value to the basic grains sub-sector; (2) shifting from basic traditional grains to other food products (e.g., root crops); (3) adding value to traditional crops (e.g., coffee and cacao); and (4) expanding product lines across diverse agro-climatic growing conditions. Each scenario is illustrated below.

1. Increasing productivity and/or adding value to the basic grains sub-sector

Within the CAFTA-DR countries, as well as LAC countries generally, small-scale producers place first priority on meeting family food requirements. In this situation, the first step toward enterprise diversification generally entails increasing the productivity of arable land for food crops. For example, farmers should begin to use higher productivity maize varieties, so that the portion of land previously allocated to support family food needs can be reduced and more land can be allocated to more highly remunerative activities (e.g., agro-forestry, livestock and dairy, fruits, vegetables, etc.). Programs in Honduras (*Plan Maiz)* and Nicaragua (*Programa Productivo Alimentario Hambre O*) have the potential to respond to this basic need, but do not appear to be structured to facilitate these shifts. While many producers are able to increase production and could increase their incomes temporarily as a result of the currently higher prices, basic grains hold little potential along the value chain to increase employment and incomes at the levels now required. At the same time, farmers benefiting from increased incomes as a result of the higher prices are afforded a cash cushion they could use to invest in higher value crops that will be more profitable than basic grains, especially as tariffs on cheaper imports from the United States decline.

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[1] Optimizing the Economic Growth and Poverty Reduction Benefits of CAFTA DR - Volumes I & II, 2008. David D. Bathrick. This study was initiated by Carana Corporation under USAID-funded LAC Trade 3, and completed by Chemonics International under the USAID-funded LAC Equitable Growth Best Practices Task Order.

Also, there is growing demand for some traditional products. For example, the increasingly popular Nicaraguan red bean is observing record sales to regional markets, Mexico and ethnic markets in the United States. The case of red beans illustrates a market opportunity that offers greater potential for increased jobs and incomes along the supply chain that adds value though product sorting, selection, packaging (in attractive bags), and shipping. Other product lines should be explored to include value-added local processing for expanding national, regional and ethnic markets in North America.

2. Shifting from basic traditional grains to other traditional food products (e.g., root crops)

Under the terms of the treaty (CAFTA-DR), tariffs on basic traditional grains (rice, sorghum, beans, yellow corn, and wheat) will be reduced in the future. This means that, over time, many of these crops, employing current seed varieties and technologies, will not be competitive in the face of products imported at a lower cost. There are, however, some exceptions that each country will have to carefully analyze. For example, in the Dominican Republic and El Salvador, rice could be competitive if productivity (i.e., yields) increases by 20 percent. At the same time, higher commodity prices for cereal commodities have forced household dietary shifts. This has resulted in a notable expansion of less expensive root crops, such as expanded production of yucca in Nicaragua and increased intra-regional trade. Other countries may also have opportunities for expanded production and marketing of root crops and for some feed grains for vertically integrated meat products.

3. Adding value to traditional crops (e.g., coffee and cacao)

In past years, exports of coffee and cacao were in a long-term decline due to shifts in market demand and considerable production increases outside the LAC region. However, more recently, market-based crop diversification to higher quality varieties have stimulated major gains. For example regarding coffee, Guatemala placed national priority on product differentiation and improved production practices and post-harvest handling in order to meet market demand of importers and roasters in the specialty coffee business for higher quality coffees. Currently, 80 percent of its coffee is now positioned in the high-end market fetching around 50 percent higher producer prices. Regarding cacao, the Dominican Republic has positioned itself very favorably in the organic cacao market, while also employing much-valued farm-level product fermentation processes. This new value chain for cacao not only generates expanded employment opportunities for farm families but also notably improved prices, thereby increasing the incentive of producers’ children to look to staying in agriculture (“on the farm”) for their future livelihoods.

4. Expanding product lines across diverse agro-climatic conditions

The country success stories highlight diverse examples ranging from melons, green peppers, oriental herbs, and tilapia in Honduras to numerous agro-processed foods that small-scale enterprises in El Salvador are now producing to meet market taste preferences. In many cases, a major constraint has been obtaining a sufficient amount of high quality produce to fill shipping containers, which in turn reduces costs and increases local profits. Reviews of Guatemala’s competitiveness indicate export market opportunities for 27 product lines for fresh and packaged fruits and agro-industrial food processing sub-sectors.

There is also growing international demand for organic products. Further, in this era of increased petroleum-based products and the need to expand employment opportunities, organic product lines that require intensive crop management practices can be more highly profitable because of reduced input prices and the higher price that organic products command in the market place. The Dominican Republic is expanding in organic cacao, coffee, bananas and mango production, which, at the production level, require two to three times more labor than do basic grain crops. The country reviews and the Chilean experiences demonstrate that increased production, processing and export of organic products generate increased demand for off-farm labor, thereby raising rural incomes.

Question: Does diversification only mean exports to the U.S.?

Answer: Trade does not mean only exports to the U.S., but rather opportunities for local, regional and North American markets. Numerous examples, particularly for fruits and vegetables, demonstrate that national production opportunities have not been effectively pursued. Guatemalan producers have gained market shares in El Salvador, Honduras, and Nicaragua, suggesting that there is great potential for increasing production in most of the countries, if this potential is properly nurtured. Regarding regional trade, El Salvador has advanced in numerous processed food and beverage product lines that utilize products increasingly provided by farmers in Honduras and Nicaragua. Nicaragua's expanding meat product lines are outselling Mexican producers, as they are now increasingly supplying regional supermarkets to include Walmart. This creates new opportunities as a platform for supplying the U.S. market with specialty meat cuts demanded by a growing market for *Latino* consumers. Annually, the Dominican Republic is exporting $200 million of food crops to Haiti.

Question: What is the benefit of working with medium and small-scale farmers on agricultural diversification, versus larger-scale farmers that may already be more commercially oriented?

Answer:

1. Medium- to small-scale farmers, who comprise about half of the rural population and a significant percent of the rural poor, are a key political support group in developing countries. Ensuring the continued political support of this group will require stimulating economic growth and poverty reduction in the rural areas, this also being vital to slow or reverse negative trends on food insecurity, illegal migration, drug and people trafficking, gangs and violence, and environmental degradation, while providing positive demonstrations that open democracies and free trade can deliver on their promise.

2. Stimulating economic growth and poverty reduction in the rural areas depends on increasing farm incomes and household expenditures so as to create greater local demand for labor-intensive, non-tradable goods and services. The key to increasing farmer incomes and household expenditures is to more effectively link rural-based producers (farms and firms) with markets (local, regional, and export) that are seeking to buy higher-value crops and value-added products.

Rural-based farms and firms who can produce for and compete/trade in these markets will earn higher incomes than they currently earn from their traditional crops (e.g., basic grains)—and this increased income will be spent, within the rural sector, on rural-produced non-tradables (e.g., housing, services, etc.), thereby further stimulating local demand, job creation, and income growth.

Question: Can governments and donors expect a relatively near-term pay off from working directly on agricultural diversification with small-medium sized farmers, or do other factors and issues have to be addressed at the same time?

Answer:

1. While this rural-based agricultural diversification process needs to be almost entirely market-linked (trade-driven) in order to be sustainable, the ability of small-scale firms and businesses to compete and succeed (make a profit) will require that countries make a substantial investment in public goods, as follows:
    a. Infrastructure – e.g., rural roads and electrification will play a key role in motivating and facilitating private investment in rural areas, thereby leading to market-oriented agricultural and non-tradable production having a greater impact on economic growth and poverty reduction.
    b. Policy – e.g., ongoing national-level policy reviews to constantly search for policy bottlenecks and find ways to break them.
    c. Credit - e.g., a national (but private sector-based) system of rural finance to mobilize deposits and make loans to small commercial farms and firms.
    d. Research/Extension - e.g., research stations, staffed by technically competent scientists and practitioners that develop/disseminate technical advances, with the technology agenda developed in close consultation with the private sector.
    e. Ensuring a favorable "doing business" environment to foster a competitive marketplace and to attract private investment in all aspects of the value chain, from input supply and distribution, to processing, to sourcing products from small farmers to marketing to domestic and export markets.

2. A major, large-scale success likely will require long, concentrated government and donor support, complemented by public-private partnerships and support for advanced degree training, to ensure adequate levels of support and coordination of technical assistance, training, and upgrading of infrastructure (physical and institutional).