

Enabling environments for competitive agro-industries

Agro-industries can be an engine for growth for developing nations and their promotion is high on the agenda of donors, development planners, governments and international organizations. Fostering competitive agro-industries requires that a conducive business climate, or “enabling environment” be in place. Indeed, competitiveness at the national or sector level is increasingly seen to be contingent upon enabling environments. Under this vision, the development of competitive agro-industries requires that enabling environments be created, often through reform processes that can be triggered by, so-called, “business climate assessments”. Although several frameworks for these assessments exist, the current approaches were not designed for the evaluation of business climates for sector-specific agro-industrial enterprises. To bridge this gap, key constituting elements of enabling environments for agro-industries have been identified by FAO in a series of cross-country appraisals. Reform processes in developing countries can be analyzed with reference to two key dimensions, namely the level of risk (and uncertainty) agro-industries face when conducting business and the capacity of the state in shaping the environment for business. For effective reform to emerge, an appreciation of the role public policy-makers can play in sustaining competitiveness is needed. Moreover, many of the elements required to create an enabling environment for agro-industries are outside the usual mandate of ministries of agriculture. Advocacy of organized stakeholders thus becomes essential to ensure that the proper branches of the public sector become engaged in the reform processes.

INTRODUCTION

In the most recent decades, developing nations have focused predominantly on economic prescriptions for “getting markets right” by adjusting macroeconomic policy, privatizing state-owned enterprises, or opening domestic markets to international trade in agricultural commodities and currencies. Consequently, a large part of economic development policy has centered on creating an enabling environment¹ for competitiveness, one that would attract capital to invest in both general market-based solutions and specific firm strategies. Herein we take competitiveness to mean “the degree to which, under open market conditions, a country can produce goods and services that meet the test of foreign competition, while simultaneously maintaining and expanding domestic real income” (OECD 1992, 237). An important aspect of the concept of competitive advantage lies in the efforts of many organizations to provide measures of an enabling economic environment to promote investments and foster competitiveness.

Efforts by public policy-makers to measure competitiveness, enhance enabling environments, and comprehend the rapidity of change in domestic and global economies have given rise to three fundamental questions, which are addressed in the next sections of this paper.

BUSINESS CLIMATE ASSESSMENTS

How well do measures of business climate by international organizations and research institutions relate to the competitiveness of agrarian economies?

The assessment of business climate (or enabling environment) dates back to the late 1970s, when the World Economic Forum

started publishing the *Global Competitiveness Report*, with the assessment and ranking of economic competitiveness for 16 European and North American countries. The level of interest in these climate assessments grew considerably from then on as increased globalization created demand for methods of providing signals to investors interested in foreign direct investment (FDI). In addition to this main use, business climate assessments have also been seen as a way of inspiring reform, a direct result of the ranking system used in these analyses. In most cases, focus is placed on those economies whose rankings have improved substantially from one year to another, through special mention in case studies or reform awards. Recommendations on reform procedures generally accompany climate assessments. Box 1 shows a summary of competitiveness and investment climate indices that have been developed over the last three decades and their limitations in assessing agro-industry competitiveness.

Distinguishing Agro-industries from other Economic Activities and Sectors

An analysis of business environment assessments has revealed some cross-cutting features of the existing methods. First, the business climate is generally described at national level to focus on macro determinants of investment attractiveness. As a result, the effect of local variations in access to (or application and enforcement of) the national determinants is not captured. The local business environment, however, is the relevant environment in which the business operates and is therefore the environment of interest for the assessment exercise. Only one of the known assessment indices comes close to addressing this limitation.

¹ An “enabling environment” is the set of policies, institutions, support services and other conditions that together create the general business setting where enterprises can be started and thrive.

Box 1: Competitiveness assessment frameworks and their limitations

Index and year established (source and coverage)	Key strengths	Limitations in assessing agro-industry competitiveness
1979: World Economic Forum's Global Competitiveness Report 125–131 countries	Holistic—considers policies, factor endowments, and institutions Adjusted for each country's level of economic development	Does not inform policy at industry or sectoral level Fails to capture value chain components
1988: UNCTAD's Inward FDI Performance Index 141 countries	Uses three-year periods to offset annual fluctuations in the data Captures influence of all factors other than market size	Does not inform policy at industry or sectoral level Neglects domestic investment, hence key components of agro-industries
1995: World Bank's Investment Climate Surveys 50 countries	Adapted to country context and sector priorities Data covers business perceptions	Small sample sizes limit global comparisons Places emphasis on foreign investment
2001: UNCTAD's Investment Compass	Focuses on both availability and quality of infrastructure Land tenure central to the analysis Considers objectives of investors and policy makers	Does not inform policy at industry or sectoral level Fails to capture value chain components
2003: World Bank's Ease of Doing Business Index 178 countries	Highly comprehensive—covers major business considerations from inception to folding of operations Provides an excellent assessment of regulatory framework Allows inter-country comparisons	Disregards broader business environment, e.g., macroeconomic fundamentals Biased in favor of formal establishments Is not sector specific
2004: World Economic Forum's Business Competitive Index 121 countries	Examines firm-level efficiency	Intensive data requirements
2004: World Economic Forum's Global Competitive Index 131 countries	Holistic—considers policies, factor endowments, and institutions Adjusted for each country's level of economic development	Does not inform policy at industry or sectoral level Fails to capture value chain components
2006: OECD's Policy Frameworks for Investment	Provides a policy evaluation criterion Directly targets policy-makers Highlights key areas for private-sector-led growth enabling proactive policies	Focused on foreign investment Is not sector specific

Likewise, for industries with unique characteristics, the value chain characteristics become as important as, if not more important than, broad national factors in determining competitiveness. To the extent that the industry is global, nation-specific descriptions of competitiveness are less important than, say, local value chain coordination and the extent to which these value chains are integrated into the global value chain. In this case, stimulating supply response, strengthening supporting markets, and strengthening market demand become critical in creating and sustaining competitiveness.

In the agribusiness sector, “climate” issues such as condition of downstream markets, proximity to markets, compliance with sanitary and phytosanitary standards, the presence of subsidies in local and foreign markets, prevailing food security policies, rural infrastructure, farm land ownership structures, and geographic and climatic conditions, can substantially influence profitability. Proximity to input and output markets, for example, is especially important for the agribusiness industry, given the higher level of perishability and bulkiness of commodities and, at times, products. In emerging markets, quality of infrastructure such as road networks is important for the same

reasons, particularly for the effect on accessibility of farming enterprises that are both input suppliers and consumers of products from the agroprocessing industry. Regarding property rights, emphasis is required on state property leasing rights, or the reform of state ownership of assets and institutions (land, biotechnology organizations, agricultural marketing agencies, etc.) which are important when considering downstream industry efficiency for agroprocessing industries.

THE NATURE OF ENABLING ENVIRONMENTS FOR AGRO-INDUSTRIES

If current measures are inadequate, what are the essential factors underlying agro-industry competitiveness in developing countries?

One of the most fundamental issues government must address in formulating policies in a global economy is to define its own role in fostering economic progress. The role of the state, at its most basic level, calls for the provision of laws that define property rights, enforce contracts, and resolve disputes. In this sense, without state action, markets

could not exist. Governments can play an even larger role by investing in infrastructure that contributes to the efficient functioning of markets. In Figure 1, a hierarchy of enabling needs that government can consider in addressing its role in advancing economic progress is identified. The ten enablers were derived from the proceedings of a number of FAO regional workshops on “Comparative Appraisals of Enabling Environment”, conducted in 2007. The proposed hierarchy divides state actions into three levels of activities that characterize and assess enabling environments for agro-industrial enterprises. At the base of the pyramid, the state must provide *essential enablers* that will make possible the function of markets and enterprises. In this category items such as rule of law (e.g. contract enforcement, property rights), provision of infrastructure, and a conducive trade policy are placed. So-called *important enablers* are second-order activities that the state can and often does provide, such as finance, transportation, and information. Finally, *useful enablers* are defined as sufficient but not necessary conditions to include grades and standards, linking small farmers to formal markets, and business development services.

REFORMING ENABLING ENVIRONMENTS

How can we reform the public process, in the context of radical change, to creatively enact policies to improve the relative competitiveness of agro-industries in emerging markets?

As widely discussed, “economic reform” is the process by which emerging economies are transformed from state-led to market-driven principles with the goal of advancing economic prosperity. This view puts the government as the primary driver of the reform process with measures that, in sequence, include privatization, tax reform, fiscal discipline, trade liberalization, deregulation of economic activities, price liberalization, decontrol of interest and exchange rates, elimination of state subsidies, and enforcement of intellectual property rights. Because of the rapidity of globalization, however, a more parallel reform process can be observed; one in which state and private sector act in concert to create an enabling environment.

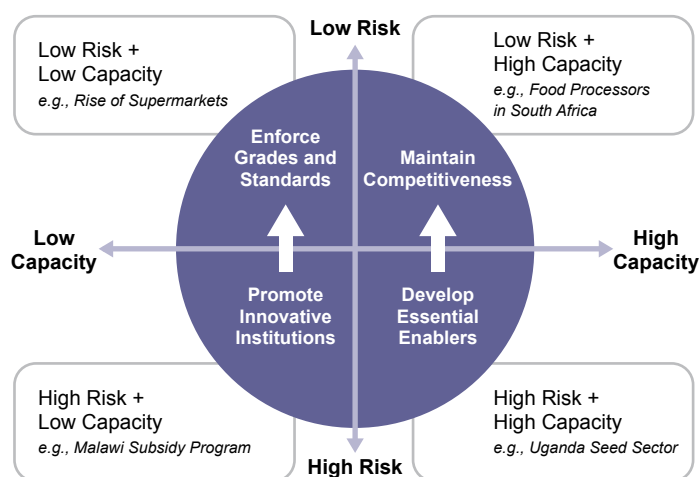


Figure 2.
A framework for enabling environment reforms in developing countries

The proposed model for analyzing the agrifood sector reform process in developing countries is dependent on two key variables, risk (the level of risk and uncertainty agribusinesses face when conducting business) and capacity (the capability of the state in shaping the environment for business) (Figure 2).

Identification of those elements for policy-makers to put in place is complicated by an underlying feature of the globalization process: the rapidity of change occurring within and across national economies. The globalization process has the potential to benefit emerging economies. This process has fused the theoretical stages of economic development and raised the premium on the traditional, sequential approach which calls for the state to first create an enabling environment, which should then be followed by private-sector investments. What has become abundantly clear is that institutions matter. The reliance on markets in achieving policy goals requires developing nations to invest in institutions and services that will allow markets to function well in a global economy.

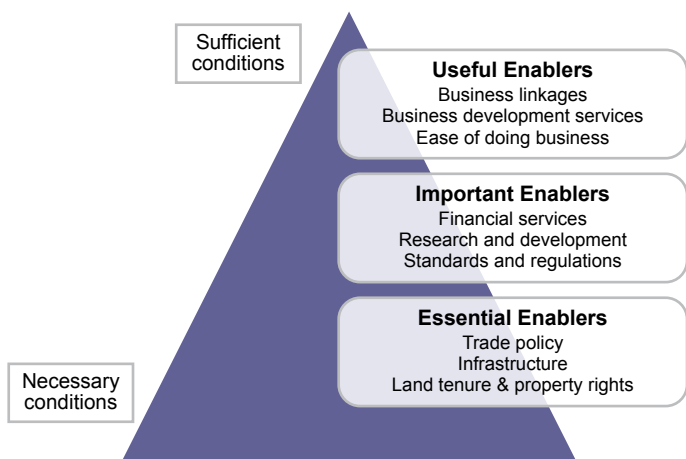


Figure 1.
Hierarchy of enabling needs for agro-industry competitiveness

Box 2: Seed Industry Reform in Uganda

Uganda has made important strides toward economic growth and poverty reduction since the late 1980s. In the 1990s annual GDP growth climbed steadily to 6.9 percent from a 3 percent per annum growth rate in the 1980s. This impressive growth appears to be linked to the set of economic policies that advanced structural adjustments within the economy. The Government liberalization of the foreign exchange rate was a significant economic reform that provided incentives to major sectors of the economy: agriculture, industry, trade, and tourism. In line with overall policy, the Government fully liberalized the seed industry in the early 1990s, and privatized it in 1993. By 2005, six new private seed companies had entered the market. The regional harmonization of seed laws and regulations for East African countries (Kenya, Tanzania, and Uganda) has opened national borders for regional seed trade. For private seed companies, the harmonization will present new opportunities via the expansion of markets, a factor that can also lead to increased competition and to the creation of incentives to further modernization and improved efficiency.

CONCLUSIONS

In recent decades, agrifood markets have experienced rapid change. This dynamic environment has raised the premium on traditional policy approaches to the sector, where “getting agriculture moving” is now being replaced with “making markets work” to sustain economic progress. Previously, ministers of agriculture were myopically focused on increasing on-farm productivity without paying attention to the enabling environment required for the competitiveness of the sector. A “one size fits all” strategy would be inappropriate to advance a reform agenda for the agrifood industries of developing economies. For effective reform to emerge, an appreciation of the role public policy-makers can play in sustaining competitiveness is advocated.

Creative public policy in this dynamic global economy seeks to sustain efficient and equitable outcomes for the agrifood sector that call for government to develop essential enablers, promote innovative institutions, advance facilitative policies, and maintain competitiveness. We recognize that although the agrifood sector is unique, it must exist in a wider national economy. Therefore, the list of specific policy measures that are here considered as essential, important, and useful to the agro-industry of developing countries must be integrated as part of the wider national macroeconomic policy framework.

Establishing the “rules of the game” in the form of property rights, especially in the case of deeds for physical and intellectual property, is a critical aspect of an enabling environment for agro-industries. Contract enforcement is included as an essential enabler. Given the rise of contract farming, vertical coordination and supply chain management by large food companies, efficiency and equity in the sector are undermined without strong laws to ensure that contractual obligations are fulfilled by all partners involved in the transactions. In principle disadvantaged, small farmers engaged in contract farming can become efficient actors in a supply chain if the legal apparatus that governs contracts made with large agro-industries is adequately enacted and enforced. Likewise, under a proper legal frame, companies that offer contracts can be assured of the delivery of goods and services contracted. Enforcement of contracts used by agro-industries is, however, part and parcel of “the rule of law” established by any nation. Therefore ministries of agriculture must expand such legal remedies to a wider set of rural transactions.

Rural areas within emerging economies are often confronted with highly risky environments and weak public institutions. Under such circumstances, segments of the economy can exhibit market failure in the face of state failure. The private sector does not develop an appetite for investing in such environments, and the state lacks capacity to improve this environment such that inward investments could be made. The promotion of innovative institutions is critical to enhancing the bargaining power of farmers. The position of farmers in the market needs strengthening in most countries. Investment in farmers’ associations can reduce transaction costs, enhance farmers’ bargaining position, allow economies of scale and thereby stimulate on-farm production.

In closing, it should be recognized that many of the elements required to create an enabling environment for agro-industries are outside the usual mandate of ministries of agriculture, which are the typical interface with agrifood sector stakeholders. Advocacy of organized stakeholders, possibly through their inter-professional associations, becomes thus essential to ensure that the proper branches of the public sector become engaged in the reform processes. A case can be made for the role of international organizations to facilitate public sector engagement by assessments and rankings of agro-based business climates.

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Useful Web sites

- The World Bank Doing Business Survey:
www.doingbusiness.org
- OECD’s Policy Framework for Investment:
www.oecd.org/daf/investment/pfi
- The World Economic Forum Global Competitiveness Report:
www.gcr.weforum.org
- Agribusiness and Agro-industries at FAO:
www.fao.org/ag/ags/index_en.html
- Agro-industries work at UNIDO:
www.unido.org/doc/5070

Credits

Authors: Ralph Christy, Edward Mabaya, Norbert Wilson, Emelly Mutambatsere, Nomathemba Mhlanga²

Support Group: Carlos A. da Silva, Alexandra Röttger, Eva Galvez (FAO, Rural Infrastructure and Agro-Industries Division)

² Christy, Mabaya and Mhlanga - Applied Economics and Management, Cornell University, Ithaca, NY; Wilson - Department of Agricultural Economics, Auburn University, Auburn, AL; Mutambatsere - African Development Bank, Tunis, Tunisia

