Trade and rural development
Opportunities and challenges for the rural poor
Local farmers sell vegetables at the Sunday market in Meo Vac, Viet Nam. Nearly 85 per cent of the local population is assisted by IFAD projects.

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Overview

IFAD’s objective is to contribute to accelerating and deepening the global process of reducing rural poverty and food insecurity. The Fund has an important role to play in achieving the Millennium Development Goals: directly, and catalytically, through sharing insights with other development partners as to who the rural poor are, how they become or remain poor, and how they may be enabled to overcome their poverty. There are many different groups of rural poor, with very different livelihood situations: smallholders, herders, fisherfolk, landless agricultural labourers, indigenous groups and, cutting across all of these, poor rural women.

The varying situations of these people involve specific challenges, and IFAD is heavily engaged in developing different types of responses to each such challenge. However, a number of common elements are increasingly entering the environment of all groups of poor people – although they may be experienced differently. One of these elements is the organization and evolution of markets. Virtually all poor rural people rely on markets to access goods essential for their human, social and material development. In most cases, reducing such people’s poverty will require better linkages between small-scale poor producers and a variety of official and other local institutions, civil society and market actors, including medium- and larger-scale private-sector entities.
The influence that markets and trade can have in reducing poverty was recognized both in the Millennium Development Goals and in the Monterrey Consensus, and the relation between rural poverty in developing countries and international markets was at the centre of the Doha Development Agenda. International markets for agricultural products are directly and indirectly important for a very large number of the world’s 900 million rural people living in poverty. The reduction of agricultural protectionism and subsidies, particularly in developed countries, would help many of the rural poor obtain better prices for their products and strengthen their basis for long-term livelihood change and improvement.

How much the rural poor may benefit from the changes envisaged in international trade regulations depends upon both the macroeconomic policies of national governments in the developing world and the extent to which those governments provide the institutional, policy and material framework foundations for a positive response from different groups of rural poor. To benefit from trade opportunities, the rural poor need access to capital, relevant technology, land, water, infrastructure and opportunities for organization. Without these, the direct benefits of changes in trade regulations may be modest in terms of rural poverty reduction.

Increasingly, the issue of markets and the poor must be seen in terms of the consequences of globalization rather than of changes in trade regulation alone. The global economy is changing in such a way as to increase the influence of non-local markets—but also to challenge the viability and profitability of existing relations with them among the rural poor. The rural poor need assistance to successfully meet these challenges. In order for that to happen poor rural producers, governments and donors will need to appreciate and develop answers to some fundamental questions, including: how to reduce small farmers’ dependence on traditional exports to developed country markets; how to diversify into higher-value products; how to enter the value-added chain—everything from improving processing and quality control to addressing tariff escalation issues; how to forge mutually beneficial relations with the larger-scale private sector; and, how much to focus on developed country markets—as opposed, for example, to focusing on regional, national and local markets in the developing countries themselves.

These questions have become critical at the beginning of the twenty-first century, and they will need new, twenty-first century answers. In some cases they will involve strengthening, and in other cases changing, rural livelihoods. The answers will differ according to the situation of each group. The basic issue for poor rural people—and for IFAD—is how to help strengthen livelihoods through raising on- and off-farm productivity, and translate higher output into higher incomes through effective engagement in market processes.
Introduction

The role of trade in economic growth and development processes has long been recognized. However, more recently its contribution to poverty reduction, especially in the context of the Millennium Development Goals (MDGs), has gained growing attention. Goal No. 8, on the global partnership for development, for example, calls for an open trading system that is rule-based, predictable and non-discriminatory, and that also recognizes the special needs of the least developed countries in relation to tariff- and quota-free access for their exports.

The March 2002 International Conference on Financing for Development in Monterrey, Mexico, held to assess the means that would be necessary to achieve the MDGs, reached consensus on measures in which both developing and developed countries would play a coherent and complementary role. Developing countries would strengthen policy frameworks and mobilize domestic resources for development and poverty reduction. For their part, developed countries would contribute to accelerated poverty reduction by increasing official development aid, encouraging direct foreign investment, achieving debt sustainability and providing market access.
At the Fourth Ministerial Conference of the World Trade Organization (WTO) held in Doha, Qatar, in November 2001, Members stated that they would seek to place the needs and interests of developing countries at the heart of a new round of multilateral trade negotiations. This round, envisioned as the ‘Doha Development Agenda’, promised to build up a multilateral trading system that would provide developing countries with the opportunity to trade out of poverty and contribute to meeting the MDGs. The expectations from the Doha Development Agenda are great, yet, as the Fifth Session of the WTO Ministerial Conference in Cancun, Mexico, has illustrated, delivering on those expectations will not be an easy task.

The objective of this paper is twofold. On the one hand, it stresses that the international trade regime – especially in agricultural products – not only affects developing countries in an aggregate, macroeconomic way but it impinges more directly on the economic lives of the rural poor. On the other hand, the paper argues that addressing the trade regime is not sufficient to achieve the poverty reduction goals. There is the critical question of what constitutes the basis for a vibrant and expanding smallholder economy within a liberalized trade regime – and how to create it. That is what the Strategic Framework for IFAD 2002-2006 reaches out to address. This necessarily involves aid as well as trade – but aid specifically directed to enabling the poor rural producers themselves to forge new capacities and relations to deal with new sets of economic relations. Addressing these issues effectively is of priority to IFAD, and the only way for IFAD to be effective is as part of a very broad set of partnerships in which farmers, the private sector and national governments play key roles. A basic precondition for effective partnership is an understanding of the issues involved – from the perspective of the rural poor.

The debate on the effects of the existing trade regime on global poverty has inevitably come to revolve around issues of agricultural trade and prices. For the poorest countries, the reason for this is obvious: agriculture represents a major part of national employment and income, and agricultural exports typically represent a large proportion of their total exports. For them, agricultural production is the key to income and agricultural exports are the key to input capacity. From the perspective of these countries, the current situation is doubly hard to accept: on the one hand, there is a perception that the existing trade regime in agricultural products is biased against them; on the other hand, these countries perceive that such adverse effects arise from practices in the developed world (agricultural subsidies, protective tariffs and trade barriers) that poor countries have been ‘forced’ to abandon as part of the reform process, often at the urging of the developed countries themselves.
In many of the poorest countries ‘agriculture’ is largely dominated by small-scale production: it is at the heart of the livelihood of the rural poor. It is not true to say that the rural poor bear all the burden of depressed agricultural prices in the international market and at the farm-gate in developing countries. But it is true that a large part of the cost is borne by the poor, particularly in the poorest countries. The implications of this for sustainable poverty reduction are clear: to the extent that the trade regime actually lowers returns to poor farmers, it is an obstacle to development. If trade is to serve as a pillar for development, it will have to be a different sort of trade.

In IFAD’s strategic framework, the objective of improving the access of the rural poor to markets is identified as a key element of IFAD’s engagement to create the conditions for poor people to overcome their poverty. This engagement is not only about advocating the interests of the rural poor in trade discussions. The challenge of trade for the rural poor is not limited to establishing more equitable rules, and the comparative advantage of IFAD itself does not lie in the realm of global trade negotiations. It lies in addressing the policy, institutional and material constraints that affect the ability of the rural poor to take advantage of the opportunities available as a result of the liberalization of trade.

The fact is that if liberalization of global trade in agricultural products is achieved, there is no guarantee that the income of the rural poor will rise, or that it will rise sustainably. For that to happen, small producers in the developing countries will have to be equipped with the resources and partnerships necessary to access those markets and profit from them. The point about the global agricultural economy is not only that the trade regime is somehow ‘unfair’, but that it is changing qualitatively as part of the much larger transformation of global and local economic relations. Trade will be essential to the well-being of the small rural producer in the developing countries. But trade needs to take place within new sets of relations in which the rural poor gain a stronger bargaining position. This is not only a North-South matter because these challenges can also arise in trade among and even within developing countries. Neither is it about a particular set of global regulatory institutions. It is about empowering the rural poor to establish a new and better position and set of relations in a changing economic system that is marked by strong asymmetries of assets among participants, with small farmers in developing countries at the lowest end of the scale.
Markets and the Rural Poor

For many, linking the condition and fate of the rural poor to trade and markets is counter-intuitive. There has long been a conceptual association between poor rural households in the developing world and ‘subsistence’ agriculture, where subsistence agriculture has come to mean a system of household independence from others for its survival. Thus the idea that poor households are somehow isolated from trading systems, and that the major challenge is not the rules of the international economy but getting the rural poor integrated into the modern/global economy in the first place.

The reality of the rural poor is different. Large numbers of the world’s rural poor have little land and are dependent upon labour and food markets for their existence. Moreover, agricultural economies have always been characterized by complex sets of exchanges, and for centuries many ‘local’ economies of the poor have been shaped by various more-or-less imposed forms of relations with external, international and even ‘global’ economies and markets. Substantial parts of developing-world agrarian societies have been integrated into larger economies and market systems for a very long time, often on disadvantageous terms.

In concrete historical terms, relations with markets and trade regimes are nothing new for small farmers in the developing world. What has changed is the nature of those relations. On the one hand, cash exchange has become central to the
survival of the rural household. Most poor rural households participate in, and depend upon, markets. On the other hand, market prices – for both export crops and goods for local consumption – are increasingly determined by international market prices as a result of the liberalization measures adopted in many areas as part of the structural adjustment process and the progressive dismantling of government price-setting bodies such as commodity boards.

Virtually the entire access of the rural poor to modern goods and services, but also increasingly to basic requirements of existence, is dependent upon what they can sell and the prices they receive on local markets that are increasingly linked to international market conditions. Put in another way, at the micro level among the rural poor, nearly all goods and services that contribute to a significant expansion of productive assets are accessible only through the market. It is imperative to help the rural poor and their communities to capitalize more upon natural resources and their traditional knowledge, but the role of purchased goods is already vital and will increase.

Many rural economies of the developing world – particularly in the poorest countries – are undifferentiated. Fifty-four developing countries depend on three or fewer commodities for 20% of their export earnings. Over 40 countries depend on a single agricultural commodity for more than 20% of their total export income. Of these, 12 countries earn more than 40% of their total export income from one commodity. Food crops are poor people’s main products, principally involving staples and relatively low levels of commercialization. In addition, production of a very narrow range of exported raw materials serves major cash generation requirements. Very little income and employment is derived from local agro-processing in low-income countries. The economy of the poor – including food security and development of productive assets – rests on this narrow commodity basis. When international agricultural prices for just a few commonly traded commodities are good, the incomes of the poor rise significantly and they invest. When they are bad, incomes fall and productive investment declines sharply. This is very clear for producers of ‘traditional’ export crops. It is also true for producers of food crops, particularly for those selling on national and regional urban markets.

The proportion of output commercialized by poor farmers in developing countries is, of course, considerably lower than is the case among producers in the developed world. However, the value of the part that is commercialized is vital to the micro development prospects of the rural poor and that value is definitely affected by the nature of the international trade regime. The big question is how much the poor are affected by the present trade regime, including the impact of artificial distortions, of new challenges regarding standards and specifications, and of overproduction.
Some 75% of the world’s poor live in rural areas and depend primarily on agriculture and related activities for their livelihood. The agricultural product market is perhaps the most distorted market in the international trade system. While overcoming these distortions has the potential for considerable poverty reduction, efforts to that end are being dealt with only on a commodity-by-commodity basis instead of focusing in a coherent way on the impact of present distortions and prospective liberalization on the most vulnerable segments of the world population.

Protection faced by developing-country exporters of agricultural products in industrialized-country markets is four-to-seven times higher than that faced by exporters of manufactured products. Commodity-specific tariffs, quotas and safeguards, as well as subsidies in industrialized-country markets, represent major barriers to access by developing-country agriculture. The impact of the current trade regime is not, of course, restricted to access to the domestic markets of developed countries, but embraces the depressing effect of developed-country agricultural production and export subsidies on global prices and farmer returns and opportunities in developing countries, particularly prices for sugar, cotton, rice,
wheat, maize, meat and dairy products\textsuperscript{iii}. For Mozambique, sugar is a high-potential export crop that provides employment for some 23,000 workers, but this number would rise to 40,000 if more sugar mills were to be rehabilitated. However, subsidized sugar from the European Union (EU) has caused world prices to fall by some 17%, considerably reducing the viability of rehabilitating more sugar mills in the country\textsuperscript{iv}.

Cotton is one of the agricultural products for which Africa could effectively compete in world markets if a level playing field existed. In 2001, United States subsidies for cotton producers amounted to USD 3.4 billion, which encouraged overproduction and drove world prices to a 30-year low. Notwithstanding the fact that farmers in western and central African countries produce cotton at about one quarter of United States production costs, losses for the region as a whole amounted to USD 301 million, with small farmers being hardest hit\textsuperscript{v}. An estimated 10-11 million households in the region depend on cotton for their livelihood. A 25% increase in cotton prices (which corresponds roughly to the effect of eliminating United States cotton subsidies) would lift 250,000 people out of poverty in Benin alone\textsuperscript{vi}.

In the developing countries' own domestic markets, industrialized-country agricultural subsidies create distortions and difficulties for local producers. The dumping of skimmed milk powder from the EU has had a detrimental impact on dairy production and on small-scale producers\textsuperscript{vii}. In the Dominican Republic, for instance, 20,000 poor farmers were squeezed out of milk production by the year 2000, largely as a result of EU export subsidies – the price of EU milk powder is 25% lower than the equivalent price of local fresh milk. Milk powder exports to the country by a Scandinavian company are worth about 66 million euros (EUR) and are currently subsidized by the EU to the tune of almost EUR 18 million\textsuperscript{viii}. In Mexico it was estimated that with the North American Free Trade Agreement (NAFTA) it would take 15 years for domestic maize prices to fall into line with international prices. In fact, it took just 30 months. Between 1993 and 2000, Mexican maize imports increased eighteenfold and one quarter of the corn consumed in Mexico now comes from the United States. An estimated 700,000-800,000 rural livelihoods have been lost due to subsidized maize imports. This is equivalent to 15% of the economically active population employed in agriculture\textsuperscript{ix}.

The general consequences of agricultural protection for the developing countries are now broadly recognized. The question is: how important are they in terms of impact on income and poverty? According to World Bank simulations (see Annex), static gains in income for developing countries by 2015 as a result of the elimination of agricultural trade distortions by all countries have been estimated at USD 101 billion. It should be noted, however, that the bulk of these gains, as much as 80%, come from
elimination of trade restrictions by the developing countries themselves. Measured in dynamic terms, including effects on sectoral productivity, the gains of developing countries by 2015 would be USD 240 billion. Here again, the bulk of the gains, nearly 70%, would be due to elimination of restrictions by the developing countries themselves. As regards the impact on poverty levels, the number of people living on one dollar per day or less would decline by 61 million by 2015.

These figures, and similar estimates by the Organisation for Economic Co-operation and Development and others, suggest that decisive action to reduce trade distortions arising from protection, subsidies, etc., would make a significant contribution to income increases in developing countries. The estimated gains from trade liberalization and the impact on poverty are significant and sufficiently impressive to underline the urgency of progress in the Doha Round negotiations. At the same time they make it clear that trade liberalization is not a panacea for eradicating rural poverty, and certainly would not justify relaxation in other areas, such as the commitment made in Monterrey to substantially increase official development assistance and pursue a pro-poor economic reform process within the developing countries themselves.

The direct impact of trade liberalization on the rural poor would be less than the total benefits, moreover. On the one hand, it is probable that a major share of total benefits would accrue to middle-income developing countries, a number of which are important agricultural exporters. On the other hand, a significant share of benefits would accrue to larger-scale (non-poor) producers in developing countries, the commercialization of the production of which is necessarily at a higher level than among the rural poor. The conclusion must be that since progress in agricultural trade negotiations would bring substantial benefits to developing countries, it should be pursued. Even more important, the direct effect will be the opportunities opened up by offering new markets for their exports, and market conditions and prices that would bring the potential for expanded smallholder production. In this context, it is imperative to combine successful trade negotiations with decisive measures to help poor rural producers to take advantage of, and benefit from, the opportunities created.

When there was little inequality in access to assets (physical, financial, technological, human and social), and labour-intensive technologies were used, agricultural growth contributed substantially to poverty reduction. This was the case in Indonesia, where the development strategy simultaneously addressed and interlinked trade, growth and poverty reforms to promote investment that linked the agriculture and industrial sectors. As a result, every 1% of growth in agriculture
corresponded to a 1.9% reduction in poverty: 1.1% urban and 2.9% rural. This was also the case in Viet Nam, where trade reform was part of a larger agenda of reform in public institutions and in property rights aimed at closing the distributional divide between urban and rural areas and, to a lesser extent, between skilled and unskilled workers. Here, agricultural production grew by 4.6% per year from 1990 to 1998, partly due to a boom in coffee exports, and the incidence of poverty among the rural population declined from 66% to 45%. In Uganda, non-food crop production surged after market liberalization in the early 1990s, and rural poverty fell from 60% in 1992 to 39% in 2000 while agricultural production grew by more than 4.4% per year. In contrast, in countries where inequalities were already high, unfettered trade liberalization accentuated income disparities as poor rural people lacked the assets necessary to take advantage of new opportunities presented by trade.
For the rural poor in the developing world, both market access and trade are essential to any meaningful and sustained process of poverty reduction. However, even under benign distribution conditions, trade reforms alone will not make a decisive difference to their income and market prospects. For most poor rural people, the issue is not only that international prices are distorted but that it is impossible for them to bring together the local conditions to establish a position in a ‘globalizing economy’ where many agricultural prices are declining and where demand is shifting in technically inaccessible directions. This inability is exacerbated by the trade regime. However, it does not originate in the international trade regime and will not be solved by changes in it. At the same time it should be recalled that, under the present trade system, opportunities do exist to expand exports that countries like Viet Nam have been able to exploit.

As indicated above, studies on the impact of trade liberalization suggest that production, income and distributional effects are heavily influenced by the institutional, policy and social organization of the countries concerned. This insight can be broadened and recast: the ability of the rural poor to establish a profitable and stable position in the system of trade depends upon institutional, policy and
Trade Issues in a Broader Perspective

social factors inside their local and national environment, and upon the way in which these relate to the characteristics of the external environment. Trade liberalization in itself is unlikely to ‘automatically’ generate a positive local environment for the economic and social development of the rural poor. However, a ‘good’ local environment for smallholder production is also likely to be a good (if not sufficient) foundation for establishing a viable market position for the rural poor. This ‘environment’ of the poor includes their access to land and water, to capital, to relevant technology and information, as well as to the opportunity to organize and associate to address common concerns. These are among the conditions necessary for the development of any sort of enterprise. They are equally necessary for the development of the enterprises of the poor, with the difference that the poor have a greater need for opportunities to associate.

But who are the rural poor, and how supportive are their policy, institutional and material environments and assets for developing global competitiveness? The rural poor are those with the least land and water, and with the least secure control over what they do have. They typically have little access to formal financial institutions for capital of any sort. They often have very little access to modern technology relevant to their requirements, and they have the least preparation for the development and management of modern forms of association. More often than not, they are women and, as such, have special obstacles (e.g. few property rights and little access to, and participation in, decision-making processes) to accessing key development resources and opportunities.

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Assisting remote and marginal communities

IFAD-funded projects seek to enhance the capacity and skills of the rural poor in mountain areas and improve rural infrastructure so that they can benefit from new market opportunities. For example, the Western Uplands Poverty-Alleviation Project in Nepal is working with a non-governmental organization and an international research centre in assisting the mountain farmers to grow high-value medicinal plants, which will be bought by a private-sector Ayurvedic drug manufacturer under contract farming arrangements. This will avoid the exploitation of poor producers by middlemen. In Bhutan, according to extension workers on the IFAD-supported Tashigang and Mongar Area Development Project, farmers were prompted to take up extension opportunities and increase their use of inputs, credit and improved agricultural practices thanks to new roads that gave them access to markets to sell their crops. In addition, the roads provided the only means by which farm families could reach health and education services, and have better access to consumer goods.
Often they are socially marginalized groups – including indigenous and tribal peoples – upon whom those responsible for the development of modern institutions and services have all too often turned their backs. It is upon these people that agricultural development and exploitation of vital trade opportunities rest in many of the poorest countries, and it is upon the efforts of these people themselves that the reduction of rural poverty hinges.

Liberalization in the developing world might have reduced some of the constraints on the livelihoods of the rural poor represented by public institutions that were sometimes not very supportive of rural income growth. Liberalization in the developed world may open up greater opportunities for trade (and more profitable engagement by small-scale producers in developing countries). However, neither sort of liberalization has addressed or will address the structural problems faced by the rural poor as they seek to make a living in the marketplace. The task of reducing rural poverty and stimulating national growth through greater and more profitable engagement of smallholders in trade involves the construction of a material, organizational and policy framework that directly addresses the specific issues and constraints faced by small-scale producers in their social and gender specificity, and one that reverses the processes of exclusion of the poor that have been characteristic of principal institutions and policies for so long.

Going upmarket

The beneficiaries of the IFAD-supported Smallholder Cash and Export Crops Development Project in Rwanda are some 28,000 rural families. Virtually all live below the poverty line, and many of them are headed by women. The project aims to maximize and diversify family incomes through a particular focus on coffee, tea, and new cash and export crops. The project, which will involve the Fair Trade Organization, Twin Trading Ltd (TWIN), as a technical partner will assist smallholder coffee growers to establish primary cooperative societies and produce high-quality coffee. It will also support the development of modern coffee processing facilities that, over time, will be taken over by primary cooperative societies of growers. For tea, the project will help to privatize a large government industrial estate by parceling it out among 4,000 poor smallholders; it will establish and train primary cooperative societies formed by participants in the land redistribution; and it will finance the construction of a factory to process their tea, which will also gradually be taken over by the cooperatives. The project will also seek to develop new cash and export crop opportunities for smallholder producers, supporting research on new market outlets, assisting in the formation and training of farmers’ groups looking to develop new cash and export crops, providing them with credit financing, and assisting them to develop commercial relations with market intermediaries.
While liberalization means that all these issues have to be addressed in ways that respect market principles and the reduced modern role of the state, there is ample evidence that comprehensive and sustainable answers for the rural poor do not spring into being of their own accord. It is true that, in the wake of liberalization, private-sector activity has tended to increase in key areas (trading, finance, technology) but by and large this has affected the smallholder sector only marginally. Relations and institutions critical to smallholders have to be constructed in close collaboration among the rural poor, the private sector, government and donors. It is a field in which government commitment and donor support are critical – and one in which engagement has fallen to perilously low levels as both governments and donors have focused rural efforts on social services at the expense of building up the new institutional framework and relations that are essential to the effective functioning of a market economy among the rural poor.

This is precisely the focus of IFAD’s strategic framework – the development of a framework in which the rural poor are enabled to build a new and better base for livelihoods in a globalizing economy. Many public-sector ‘solutions’ of the past are no longer relevant and many of the classic private-sector solutions are not directly applicable (because they were built upon an entirely different sort of private sector than a mass of poor and very small-scale producers). These issues require new approaches and partnerships to help create sustainable local responses to the key issues of smallholder competitiveness and investment.
Successfully addressing generic issues relating to the ‘commercialization’ of smallholder production in developing countries is essential if smallholders are to gain access to the goods and services essential for their development. However, it is not true that generic responses on their own will solve the problems increasingly encountered by smallholders in international trade. Smallholders engage in concrete exchanges under concrete conditions. What they engage with is an international economy at a specific and special stage of development – an international economy in the process of globalization. Globalization has many dimensions, but for the purpose of this discussion, key elements of globalization as it affects the rural situation in the developing countries include the following:
• economic organization across the globe is rapidly moving towards a situation in which market relations are the key to the organization of economic life and increasingly influence every aspect of the production and consumption process;

• a high level of concentration of demand for traded products in the developed countries, where final consumption is widely diversified beyond basic commodities and where final consumption goods have a very high level of value-added beyond the raw material value;

• the concentration of demand for fresh products in a limited number of market channels in the developed world involves an extraordinary asymmetry between producer and trader/purchaser; and

• an increasing divergence between the products that developing-country farmers consume and the products they have to produce for developed-country consumers. The latter requires modes of production and commercialization that are increasingly outside their experience, traditional knowledge and technologies. Consequently, these farmers are increasingly dependent on outside knowledge, expertise and information as well as on trade intermediaries to organize the production process itself.

The implications of the above for the smallholder’s position in the international trade system may well be dramatic with regard to both the future composition of production and the economic relations necessary for profitable operations. The first issue involves the possibility that the ‘traditional’ agricultural exports from developing to developed economies may be subject to continuing declines in real prices and a high degree of price volatility. Prices for most of the high trade-volume agricultural commodities have been subject to a secular decline. They are likely to decline further as the imperative to increase production for the market leads to a relative concentration on expanding crops that are capable of rapid production increases even under weak institutional and service conditions. Unfortunately, this process is likely to accelerate the long-term decline in real prices (and smallholder returns in the absence of consistent increases in productivity) and lead to increased price volatility as falling prices lead to major and rapid shifts in production from crop to crop within a narrow range of effective choice. This phenomenon was recently experienced in the coffee market with the rapid and large-scale production of Robusta coffee in Viet Nam, leading both to serious downward pressure on international prices and to lagged, but important, diversification of coffee producers (worldwide, 70% of coffee production is accounted for by smallholders) into other, relatively unsophisticated, commodities.
In effect, this suggests that smallholder incomes from agricultural trade will only be maintained and expanded if there is a constant and successful pursuit of diversification into less ‘populated’ (because of harder access, for economic, technical or ecological reasons) commodities. The task is not only to discover new niche markets for the rural poor (e.g. organic production, fair trade products, non-timber forest products, etc.) but to keep innovating in a process of permanent

### Price trends, cents per kilogram for selected commodities 1970-2000

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### Cotton prices, 1970-2001

Annual prices (£/kg)

revolution in production and trade. This is a dramatic challenge given that many public agricultural support services in the developing world have not been very successful in assisting smallholders in the production and sale of even staple commodities. Given the depletion of public services associated with the new role of the state, it is difficult to envisage how this critical problem could be addressed within traditional service models. Ultimately, the issue may not be of how the public sector gears up to this challenge but how private sector participation can be ensured.

This participation is critical given the increasingly narrow and demanding specifications of products required by developed-country processors and distributors. A likely ‘winning’ configuration may be even tighter relations between producers and upstream operators, with the latter exercising tight control over the former – a relation that might well provide smallholders with access to markets but brings with it a whole host of questions about the bargaining power of the small producer. A recent IFAD review of contract farming operations in eastern and southern Africa highlighted both the benefits of close private-sector linkages in accessing market and finance and the internal tensions in the relationship that lead so many to break down.

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**Marching into the higher-value zone in trade-liberalized China**

To assist farmers in remote mountainous areas of China in switching to the production of high-value, labour-intensive products such as fruit, vegetables and livestock products, IFAD-funded projects seek to enhance the capacities and skills of the rural poor in mountain areas and improve rural infrastructure. These farmers face greater difficulty in making such a switch due to their inadequate knowledge, technology and infrastructure. Thus, these farmers would be enabled to share in the gains of trade liberalization by engaging in primary and value-adding activities presented by new markets. China’s commitments to the WTO require it to lower the average agricultural tariff from 22% to 17.5%. The abolition of China’s protection of maize may turn the country into a major importer and reduce the income of the millions of people dependent on agriculture and related activities, unless they can switch to producing the more lucrative high-value crops that are also labour-intensive.
There are many examples of organized linkages between larger-scale processors and traders and small-scale producers, but they give no grounds for complacency. In the case of the China-Japan horticultural trade, the need to satisfy stringent Japanese phyto-sanitary standards (that cannot be reduced simply to tools to block imports but must also be seen as elements of sophisticated consumer demand) has led to a trend towards concentrating trade in the hands of larger-scale Chinese producers or to the establishment of joint ventures directly involving Japanese distributors in the organization of larger-scale and tightly controlled production. In Kenya, the percentage of production attributed to smallholders in the country’s successful horticultural export business has declined significantly because of the difficulty of maintaining and documenting quality and phyto-sanitary standards in smallholder products.

Organizing for the natural products niche in southern Africa

PhytoTrade Africa is a membership-based trade association that seeks to stimulate the development of a natural products industry in which poor rural communities living in dryland areas in southern Africa can participate actively. Established in 2001 with support from IFAD, the association currently has 45 members, encompassing private-sector players, non-governmental organizations and research institutions. Given its development goal, PhytoTrade Africa focuses on products derived from species that require wild-harvesting - a labour-intensive task that favours low-income rural producers; additionally, it accepts as members only those who are willing to commit themselves to the principles of fair trade and environmental sustainability. Its activities comprise: investing in new product research and development (R&D); identifying market opportunities and assisting association members to establish business linkages with export buyers; and providing technical and business advisory services to its members. Its recent achievements have included: signing collaborative R&D agreements with three major international players in the natural products industry and leveraging USD 600 000 in complementary R&D investments; securing orders for baobab fruit pulp and marula oil worth USD 4 million for its members; and developing agreements with two prominent global bio-prospecting facilities, to screen high-value pharmaceutical products. Its Phase II Strategic Plan was expected to be launched in January 2004: projections suggest that its implementation could generate an annual trade of USD 16-24 million, involving 80 000 producers.
Smallholders can be very effectively involved in higher-value commodity production in association with the private sector; the issue is to identify what makes them attractive (or unattractive) partners in these systems, and to make sure that they receive active support in developing their competitive advantages. The private-sector’s interest in profiting from this potential is clear. What is less clear is its participation in developing and maintaining the potential advantages of smallholder production.

Opportunities for smallholder diversification into higher-value (and higher-return) crops do exist and, in many of these areas, smallholders possess a comparative advantage (for example, because of the labour-intensity of production). However, all these producers face a common dilemma: they seek to increase incomes by raising production but developed-country demand for agricultural products shows a much slower growth in demand for raw materials than in demand for processed final products. Put in a different way, the expansion of value production and retention seems to be much greater in the area of agro-processing (in the broadest sense) than in the production of raw materials. The gap between consumer and producer prices is widening, with growers receiving 4-8% of the final price for raw cotton and tobacco and 11-24% for jute and coffee. It is often observed that the lion’s share of rewards from diversified production tends to be realized at the retailing end of the chain. A case study on the value-added chain of fresh vegetables produced in Africa for the European market found that approximately 27% of the final price accrued to the retailer; the share of consumer prices to producers was 12% for a vegetable like mangetout in Zimbabwe and 14% for fresh vegetables in Kenya.

Exploring organic agriculture

Farmers in developing countries are increasingly interested in taking advantage of the opportunities offered by the organic products market, a market with an annual growth rate of some 10-20%. To do so they must overcome problems such as lack of infrastructure and technical know-how, inadequate market information, complex certification processes and insufficient financing. In 2003, IFAD contributed to starting a project on organic agriculture to benefit some 1,800 small producers in Guatemala and Honduras, two countries suffering from acute rural poverty. The objective of the project is to support the process of transition by small farmers from traditional agriculture to organic agriculture and to enhance networking activities between the organizations involved in production, certification and marketing. The project places strong emphasis on the process of innovation and learning about the best ways to support small farmers. If successful, it will be replicated, and scaled up, in a larger number of countries.
The low percentage of the producer price in the final consumer price of agricultural products is frequently cited as the result of monopolistic and exploitative relations. There are often elements of these sorts of phenomena in trade relations involving smallholders and the rural poor, but the lesson is not (only) that trader and processor organization should be changed to ensure greater equity in exchange. There are three important dimensions to the situation. First, substantial value is added between the raw material producer and the consumer (in developed-country markets). Second, consumers in the developed countries seem more willing to pay for that added value (or what it physically represents) than for an increased volume of ‘raw’ goods. And third, developing countries in general, and the rural poor in particular, have very little presence in these value-adding activities. The challenge, therefore, is in not ‘breaking monopolies’ but in creating the conditions for poor rural people in developing countries to enter the value-adding chain. If the future of the rural areas is to remain closely tied to agriculture, a less poor future would necessarily involve the development of value-adding activities in the rural areas – involving the rural poor either as direct producers/processors/handlers or as employees of larger-scale local operations. This would necessitate real change in the environment for industrial investment and development in many developing countries, where effective transaction costs are very high. It would also necessitate important change in world trade regulations, which currently have escalating tariffs.

### Tariff escalation

<table>
<thead>
<tr>
<th>Product</th>
<th>Processing Level</th>
<th>United States</th>
<th>EU</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cocoa</td>
<td>Beans</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Chocolate</td>
<td>6.9</td>
<td>21.1</td>
<td>21.3</td>
</tr>
<tr>
<td>Coffee</td>
<td>Green</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Roasted</td>
<td>0</td>
<td>9.0</td>
<td>12.0</td>
</tr>
<tr>
<td>Sugar</td>
<td>Raw</td>
<td>32.8</td>
<td>134.7</td>
<td>224.9</td>
</tr>
<tr>
<td></td>
<td>Refined</td>
<td>42.5</td>
<td>161.1</td>
<td>328.1</td>
</tr>
<tr>
<td>Oranges</td>
<td>Fresh</td>
<td>3.5</td>
<td>16.7</td>
<td>24.0</td>
</tr>
<tr>
<td></td>
<td>Juice</td>
<td>11.0</td>
<td>34.9</td>
<td>31.0</td>
</tr>
</tbody>
</table>

* Average final bound most favoured nation tariffs (simple averages at the 6 digit of the harmonized system).

on processed or semi-processed goods compared with raw materials. The following table on tariff escalation illustrates an important underlying reality of the agricultural trade regime: not only is agricultural production highly protected in the developed world, but so is agro-processing. In fact, processed agricultural products are subject to higher tariffs than raw materials.

As tariffs for processed and semi-processed products are much higher than for raw products, tariff escalation creates disincentives for investment in local processing and is a major factor in hindering diversification into processed products that would create new employment opportunities. Given the higher income elasticity of the processing, it would pay those interested in the role of agriculture in poverty reduction to give more attention to finished products, tariff escalation and rural employment. Production of and trade in agricultural raw materials is important, but is likely to remain at the 'low end' of the agricultural chain in the future. Exports of processed agricultural products grew at 6% per annum during 1981-2000; export growth in primary agricultural products was much slower at 3.5% per annum in the same period. Developing countries’ share of processed agricultural exports is falling: from 53% of world exports of processed agricultural products in 1981-1990 to 48% in 1991-2000.
Some Key Questions

The organization of the international agricultural trade system is distorted at the expense of agricultural producers in developing countries, among whom the rural poor figure prominently, particularly in the poorest countries. It is important for future growth and poverty reduction in many parts of the developing world that these serious distortions be removed. However, the future of the world’s 900 million rural people living in absolute poverty does not hinge only upon the redistribution of the benefits of the existing global agricultural system. It also hinges upon how well the rural poor are empowered to respond to a new global system in-the-making that poses major problems for them. This involves the development of completely new sets of capabilities, activities and relations.

Poverty reduction strategies rarely identify the crucial role of markets; do not identify the critical problems of and constraints on the rural poor in relation to agricultural trade; and rarely map out the appropriate programme of policy reform, institutional development and farmer-capacity expansion. There is, certainly, a growing emphasis in developing countries upon the need to ‘commercialize’ the small farm sector, but extremely little analysis is being done of what that will require in the current national and global context. The development ‘gaze’ on trade and
poverty questions concentrates – at the policy level, at least – on WTO and the Doha Round, notwithstanding the fact that governments and their development partners should be responding now to the problems facing poor rural producers that make it difficult for them to take advantage of new market opportunities.

The practical issues of smallholder trade development in a structural and medium-to-long-term sense have still to be addressed in development thinking and action. There are no answers yet, but enough is known to suggest that the answers do not lie in simply more or better of the same. Sharp questions about conventional ‘answers’ have already sprung from IFAD’s experience as it has moved to implement its strategic framework, particularly in the areas of market access and linkages. Among these are the following:

Is the emphasis on staple crops that has typically been pursued in assistance to smallholder development a safety net or a trap?

Agricultural development assistance to the rural poor has strongly emphasized the priority of raising food production among them as an essential element of food security. In the context of existing distortions of the international trade regime, this means that smallholders produce precisely those commodities (staples) that are subject to high levels of protection in developed-country markets and that are dumped on international and developing-country markets as a result of over-production (and production subsidies) in developed countries. Under these circumstances, while recognizing the importance of staple production, it might be more beneficial to rural poverty reduction if development assistance were to have a broader focus on promoting crop diversification. At the same time, market failures and infrastructure inadequacies need to be addressed, issues that continue to force many rural poor to produce their own food irrespective of possible comparative advantages in other areas.

Are producer cooperatives the critical factor in increasing smallholder incomes in a globalized economy?

Recognition of the diseconomies of trade involving a very large number of very small-scale producers, and the extraordinary asymmetry of economic power between individual small-scale producers and the national and international actors in international trade, have combined to generate a renewed interest in cooperatives and associations among the rural poor. In many developing countries, cooperatives and their equivalent were important players in the export systems for ‘tropical’ crops, and cooperatives are important forms of organization among small- and
medium-scale farmers in many developed countries today. The assumption appears to be that cooperatives and similar entities will be a viable solution to the issues of developing-country smallholders today.

These sorts of organizations among the rural poor can play an effective – indeed, vital – role in discharging some functions essential to improving the smallholder condition, particularly commodity bulking for trade, organizing access to finance and basic technology, and moderating the asymmetry in relations between the individual small farmer and large upstream market operators. However, cooperatives of poor farmers can rarely address by themselves the technical, financial and trade issues that are increasingly the critical elements of a globalized trade system. This suggests that linkages to the organized and large-scale private sector are important in the exploitation of many trade opportunities for the rural poor. This is already the dominant model for small-scale producers entering into the global market for non-traditional products. The question is to what extent the importance of these private-sector linkages are recognized and what efforts need to be made to create the conditions under which both the private sector and small farmers are able to develop them further in the ‘win-win’ box of common interest.

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Those who help themselves

For more than 50 years groundnut has been the major source of export earnings and a key contributor to the incomes of more than 300,000 households in central Senegal. In the last ten years, competition from imported vegetable oils has increased. For Senegalese producers to remain competitive in the face of an increasingly difficult international environment, marketing costs (much inflated in the past due to state intervention) need to come down, but in ways that ultimately benefit producers. IFAD has set up a pilot programme to help grass-roots producer organizations develop the capacity to perform key functions in groundnut marketing and input provision. Four cooperatives, set up in four rural districts, have been able to collect and deliver large quantities of groundnut to oil processing plants. This responsibility previously rested with the processors, and was very costly and inefficient. A seed multiplication and distribution system has now been organized by the same cooperatives and producers. Initiatives such as this are critically important accompanying measures when market reforms are necessary in order to boost competitiveness. As a result of this programme, a number of farmers’ groups have been able to market their groundnut at decent prices, get paid on time, and begin to multiply seed within a context where public seed distribution has all but collapsed.
This issue will not be solved by the rather modest support extended to the development of the rural micro- and small-scale enterprise sector (which is not able to contribute significantly to effective market linkages in high-value and processed crops except in a very subordinate way). Nor will it be solved by macro-level business stimulation measures alone. It requires major and specific assistance by governments and donors oriented to the specific questions of what brings the small farmer (sometimes organized; sometimes not) and the private sector together. And it requires innovative approaches by governments and development assistance agencies to provide support for direct relations between farmers and larger-scale private agents. The objective, however, should be to create conditions in which these private relations are easier to develop and more mutually profitable, and not to displace them with public or ‘social’ models that appear to offer more immediate effectiveness and equity but in fact suffer from problems of sustainability.

Are agricultural production and small-scale rural enterprises the only key to rural development and rural poverty reduction?

If movement into more profitable segments of the developing global agricultural market is difficult for smallholders, and if staple production holds no particular promise for expanding the incomes of the rural poor, then it should be seriously considered that direct agricultural production may not be the most effective basis for poverty reduction for a significant proportion of the rural poor. This suggests that the issue of value-added and employment in the agricultural value chain should be looked at much more carefully, and that the prospects for rural poverty reduction be seen from the perspective of overall rural employment rather than exclusively from the perspective of agricultural production. This also raises the possibility that rural poverty reduction (where it does not have a viable solution in terms of migration to urban areas capable of absorbing labour in higher-productivity employment) may require a shift from independent small-scale production to a situation where employment in larger agro-based enterprises will play an important role.

Should we think in terms of South-South trade as well as North-South trade?

The debate around the link between poverty and trade organization has principally revolved around relations between the developed and developing groups of countries. Clearly, protection and subsidies in the developed countries will affect poor smallholders under all circumstances. But this is not equivalent to the proposition that developed-country markets are the ‘natural’ markets for developing-country producers, or that changes in the trade regime will provide
relief for the poverty of all or most. Given the difficulties of entering and extracting value from developed-country markets arising from the changing nature of those markets, it may be the case that the most appropriate ‘target markets’ for many smallholders are the markets emerging in the developing world itself in response to urbanization and an emerging division of labour among the rural areas themselves.

Real barriers to internal agricultural trade in many developing countries are often as high as barriers to entry into developed country markets – whether in terms of infrastructure (with transport for internal commodity movements to satisfy domestic markets being much worse than that for traditional export products), or in terms of effective taxation (both de facto and de jure). Moreover, agricultural trade among developing countries is subject to significant tariff and non-tariff barriers. In this context, as described earlier, it is striking what a large proportion of the overall benefits of agricultural trade liberalization derive from reductions in restrictions by the developing countries themselves. Finally, while phyto-sanitary standards still tend to be less demanding in developing-country markets, they are now beginning to be more stringent in response to the growing awareness of these issues.

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**Getting smallholders onto the shelves**

In many developing countries’ domestic markets, rural producers have recently started to experience more and more difficulties in selling their products because access to local markets in their own country has increasingly been shaped by trade conditions similar to those faced in the international markets. The Latin American experience is long-lived and well documented in this regard. Supermarkets are increasingly dominant players in the region, controlling some 50% of the agro-food industry, and the boom of supermarkets is transforming the agro-food system in the region. This poses great challenges to and opportunities for small farmers. Small producers often find it difficult to comply with some of the procurement practices of large supermarkets, in terms of quality and safety standards, packing, volume, consistency and payment practices. Supermarkets, however, also create opportunities: they are both a motor for broadening and deepening the consumer market, and the ‘toll booth’ on the way to selling to the growing markets: the urban areas and the middle classes. Supermarkets are networks that facilitate the distribution of food at the national, regional and global levels. What is crucial here is to enhance good business practices that optimize retailer-supplier relations and to promote competition in the supermarket sector and in the retail sector in general. Overall, domestic market organization and local industrial regulations should fit the growth of the local economic environment and not simply duplicate what is fashionable in more developed economic environments. The market is now global: whether you are a larger exporter or a small subsistence farmer selling occasional surplus, merely selling crops is unlikely to provide substantial rewards.
Paradoxically, given the difficulty of exporting to developed countries, many developing countries (and their development partners) have done relatively little to overcome obstacles to internal, regional and South-South trade, notwithstanding the fact that for most smallholders this will always be the most ‘accessible’ market segment. It may be true that the presence of developed-country agricultural exports in developing-country markets is facilitated by export subsidies and the like, but it is also true that the viability of this commercial penetration is vastly increased by the great obstacles to internal trade encountered by many small producers, problems to which the solution lies not in multilateral negotiations but in the individual and collective policy decisions and investment plans of the developing countries themselves.
Trade is extremely important for the rural poor and for poverty reduction. It also involves a much broader question than the current discussion on the international trade regime. In principle and practice, the reduction or elimination of agricultural protection and other production subsidies will provide opportunities for developing-country producers. As the World Bank projections suggest, trade liberalization might well provide a significant but not decisive income boost to developing countries, especially taking into account the dynamic effects. But sustained and significant income growth among the poor will usually be trade-linked in some way, and will require much more than progress in international trade negotiations, although such progress would be extremely welcome and important. It will also require a major effort to empower smallholders and the rural poor to become more competitive market actors – an effort embracing policy change, institutional and human development and major material investments, particularly in rural infrastructure.
Unfortunately, international trade negotiations have not so far made sufficient progress, as brought out by the WTO Ministerial Conference at Cancún. Moreover, investment in the human, institutional and material capacity – as these relate to critical production and trade issues – of the rural poor in recent years has been at a low level among developing-country governments and development assistance priorities. Fortunately, there have been signs over the last three years that thinking and priorities are starting to change, with growing attention being given to the centrality of rural and agricultural development for poverty reduction and the achievement of the MDGs. In this regard a start has been made by governments and their development partners – but much more needs to be done if the rural poor are to have an effective basis for confronting the challenges of global trade changes and benefiting from them.

There are no simple answers to the questions posed in the previous section, and undoubtedly different local, national and regional situations will frame the answers in different ways. What is clear, however, is that smallholders and the rural poor in developing countries are facing new issues in engaging with market processes increasingly linked to the global economy. Support for poverty reduction through trade will not be effective if it focuses only on trade regulation reforms and only on liberalization of the trade regime. In parallel with these efforts, policies and resources will need to aim at enabling smallholder producers to deal with market forces and engage in a mutually beneficial way with larger-scale private-sector entities in marketing and processing. If this can be done, many rural poor will indeed be able to gain a more secure and sustainable livelihood by engaging in market processes, both internal and increasingly in a rule-based open trading system.
A large share of real income gains comes from the lowering of barriers in agriculture and food (real income gains in 2015 relative to the baseline in USD 1997 billion)

<table>
<thead>
<tr>
<th>Liberalizing Region</th>
<th>Low- and Middle-Income Countries</th>
<th>High-Income Countries</th>
<th>All Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gains to low- and middle-income countries</td>
<td>Agriculture and food: 80</td>
<td>20</td>
<td>101</td>
</tr>
<tr>
<td></td>
<td>Manufacturing: 33</td>
<td>25</td>
<td>58</td>
</tr>
<tr>
<td></td>
<td>All merchandise trade: 114</td>
<td>44</td>
<td>159</td>
</tr>
<tr>
<td>Gains to high-income countries</td>
<td>Agriculture and food: 23</td>
<td>64</td>
<td>91</td>
</tr>
<tr>
<td></td>
<td>Manufacturing: 44</td>
<td>-3</td>
<td>41</td>
</tr>
<tr>
<td></td>
<td>All merchandise trade: 67</td>
<td>63</td>
<td>132</td>
</tr>
<tr>
<td>Global gains</td>
<td>Agriculture and food: 103</td>
<td>84</td>
<td>193</td>
</tr>
<tr>
<td></td>
<td>Manufacturing: 77</td>
<td>22</td>
<td>98</td>
</tr>
<tr>
<td></td>
<td>All merchandise trade: 181</td>
<td>107</td>
<td>291</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Decomposition of Dynamic Impacts</th>
</tr>
</thead>
</table>

| Gains to low- and middle-income countries | Agriculture and food: 167 | 75 | 240 |
|                               | Manufacturing: 95          | 9  | 108 |
|                               | All merchandise trade: 265 | 85 | 349 |
| Gains to high-income countries  | Agriculture and food: 19   | 100| 117 |
|                               | Manufacturing: 36          | 13 | 48  |
|                               | All merchandise trade: 55  | 115| 169 |
| Global gains       | Agriculture and food: 185  | 174| 358 |
|                               | Manufacturing: 131         | 22 | 156 |
|                               | All merchandise trade: 321 | 199| 518 |

Endnotes

i WTO. Ministerial Declaration adopted by the Fourth Session of the WTO Ministerial Conference, Doha, Qatar, 9-14 November 2001 (WT/MIN(01)/DEC/1), para 2).


iii The problem of falling and highly volatile raw material prices for tropical crops such as coffee, tea and cocoa is not directly linked to developing country practices – except to the extent that the difficulties that developing countries face in diversifying crops leads to a high dependence upon the export of a narrow range of tropical products.


