



Edited by

Kirsi Brolén, Kent Wilska and Max von Bonsdorff

Aid for Trade: from policies to practice

The cases of Mozambique, Tanzania, Vietnam and Zambia

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Vietnam and Zambia

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Kirsi Brolén, Kent Wilska
and Max von Bornsdorff

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PREFACE

Trade can serve as a strong catalyst for growth and poverty reduction in developing countries as the example of East-Asian countries clearly shows. However, poorer countries, especially in Africa face serious problems in their efforts to better integrate to world trade. These countries lack the ability to produce competitive products for world markets, which inhibits them from using the full potential of trade in reaching their development goals. This is a serious challenge, to which Aid for Trade initiative tries to respond.

Aid for Trade emerged as the spearhead for our trade and development policy in 2006 during our EU presidency, which offered us an unique chance to influence a new and dynamically developing international initiative from its birth. In October 2006, Finland organized the first joint EU trade and development ministers' session as part of the EU General Affairs and External Relations Council. One of the key elements was to anchor the EU closely to the Aid for Trade process by agreeing to launch a Joint EU Aid for Trade strategy in 2007, just in time for the first global Aid for Trade monitoring Conference at the WTO in November 2007.

For us Aid for Trade is one concrete example of policy coherence in practice. We are also fully aware that aid is not going to resolve developing countries' trade problems without their domestic reforms, better market access and international trade rules that properly take into account the special needs of the poorest countries. At the same time, more liberal markets are of no use, if developing countries do not have the capacity to produce and sell. This is why trade and development policies must point in the same direction.

In the future we will continue our international advocacy work aimed at influencing the international debate so that increased and more effective Aid for Trade can be mobilized. We are also planning to enhance our own Aid for Trade by scaling up our multilateral support and by putting the future Joint EU Aid for Trade strategy into operation as part of our development policy at country level.

These two research projects were commissioned to provide us new insights for developing the thinking on Aid for Trade. Commissioned development policy studies serve as part of our policy planning and development processes, and the topics are chosen based on the needs of the development policy actors. The function of research is increasingly important as we develop further the systems for knowledge and evidence based policy planning. The research communities of different disciplines are significant partners in this process, and we would like to thank all the researchers for their valuable contributions. We wish all the readers an interesting experience among the challenging world of trade and aid.

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Trade Capacity, Poverty Reduction and Development Cooperation: Case Studies of Mozambique and Vietnam

by

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A report commissioned by The Ministry for Foreign Affairs of Finland

Executive Summary

The focus of this study is on the relationship between trade, growth and poverty in Southeast Asia and Southern Africa. Setting out from a comparative perspective, it asks whether there is something in the experience of Asian 'emerging economies' which have successfully integrated into global markets while simultaneously reducing the level of poverty, something which African countries could learn from? However, instead of looking at regional averages or general models, we examine two individual countries, Vietnam and Mozambique, which have both important similarities and major differences.

Vietnam and Mozambique share a number of significant characteristics. Both benefit from a relatively abundant natural resource base and a favourable coastal location. Both are also transition countries which gained independence after a protracted war of liberation and at independence adopted a socialist economic system. They suffered from war and conflict with neighbouring regional powers during the post-independence period. At the same time the socialist experiments in Vietnam and Mozambique proved to be failures, and by the mid-1980s both countries were obliged to reform their economies towards a free market system. By 2005, however, they had emerged as regional success stories in terms of high and consistent rates of economic growth over more than a decade.

There were some crucial differences in initial conditions between the two in terms of human and social capital as well as in the transition strategy chosen. For example, the population density in Vietnam is more than ten times higher than in Mozambique, and the population is almost five times larger. Differences in the level of human development would, however, seem to be even more important factors. The transition strategies adopted by each country were fundamentally different, and this has also had a bearing on the way Vietnam and Mozambique have been able to integrate in and benefit from the globalisation process.

The structure of the report

The report is divided into five main parts. After the introduction, we introduce our general theoretical approach, which is also used to characterise the two regions, Southeast Asia and Southern Africa. We continue by analysing trade flows in selected key commodities, and conclude the second part with a description of the relevant global and regional trade regimes.

The third part concentrates on Vietnam. After describing the economy and hu-

man resource base, we analyse the renovation (*doi moi*) process and the way it related to changes in regional and global economy. Thereafter we present a detailed analysis of Vietnam's economy in the key sectors of industry and agriculture, with a focus on trade capacity and poverty reduction.

In the fourth part we look at Mozambique's unusual growth performance in the Southern African context. The focus is on the development of physical, human and social capital, and the impact of this on the process of economic liberalisation. We analyse Mozambique's trade capacity and access to markets, with special emphasis on industry and agriculture and their contribution to poverty alleviation.

Finally we conclude the report with a review of the main findings and lessons learnt, interest centering on the role of trade as a potential motor of pro-poor growth.

Conclusions: Pro-poor growth in Vietnam and Mozambique

We sought here to answer three questions presented in the introduction. The first is: *What type of growth is best for poverty reduction in each country-specific context, and what policies will help bring about more equitable patterns of growth?*

Mozambique and Vietnam embraced independence and national unification with high hopes of rapid and egalitarian economic growth following the socialist model. Both, however, ended up involved in civil or regional wars linked to Cold War conflicts, while their socialist experiments in economic development proved to be drastic failures. While their level of economic development had been close to the average regional level at the end of the colonial period, by the 1980s they were among the poorest countries in their respective regions. As a result, both were forced to turn to a market economy as a way out of the economic crisis. There are, nonetheless, important differences in the way Mozambique and Vietnam addressed economic reform.

Vietnam

Vietnam initiated the renovation process with a gradual liberalisation of small-scale agriculture, thus reversing the socialist collectivisation policy. Family business was encouraged in agriculture, forestry and fishery, while households were made the basic unit of production, and finally land tenure reform was implemented in the early 1990s. Restrictions on trade in major agricultural products were removed in the late 1990s, making direct export possible. At the same time, new cash crops such as coffee and cashew were effectively introduced. This made possible a broad-based increase in rural household incomes before wholesale market liberalisation and privatisation of the large state-owned sector was addressed in the context of Vietnam's process of accession to the WTO.

A parallel gradual reform in the systems of trade, private enterprise and ownership was carried out in light manufacturing industries, making use of a wide range of investment sources. These labour-intensive industries have had an important role in absorbing the workforce released by the agricultural sector, which has gained in productivity, thus providing an important mechanism for wider distribution of the benefits of economic growth. Nevertheless, a large number of uncompetitive state-owned enterprises (SOEs) still remain. Investment has been crucial in structural change in the industrial sector, and increased foreign direct investment (FDI) from a number of different sources has made an important contribution especially to the export-oriented industries.

In Vietnam foreign aid has constantly been slightly above the average for developing countries. During the 1960s and 1970s aid to the two parts of the divided country reflected the Cold War alignments, and after unification in 1975 came from the Soviet Union alone until the latter's collapse. Overseas development assistance (ODA) has increased again since 1990, and with a current value of about four per cent of the GDP it goes far to covering the balance of payment deficit. It does not, however, dominate investments or the government budget, except in the case of agricultural development.

The success of Vietnam's economic transition has relied on favourable initial conditions linked to both natural resources and location, and to intangible capital. High population density and relatively small geographical size, combined with coastal location, create favourable conditions for the efficient production, transport and marketing of agricultural produce. This is supported by favourable agro-climatic conditions and considerable mineral wealth. A relatively high initial level of human capital (e.g. literacy rate surpassing 90%), combined with long-established social institutions which at least partly survived the socially destabilising early post-independence period, have created a good starting-point for controlled economic liberalisation.

Mozambique

Mozambique is one of the few Southern African countries which have experienced a decade-long period of sustained economic growth. The growth has been based on two sectors, agriculture and industry, and has been accompanied by a relatively rapid reduction in absolute poverty.

The main factor in poverty alleviation has been increased production in agriculture, the main source of livelihood. The problem with this growth is, however, that it represents a return to normal production levels after the catastrophic war years without any substantial improvement in productivity, which remains particularly low. While an important development potential exists for various cash crops (e.g. cotton and cashew) as well as for aquaculture and timber plantations, the production is only

barely competitive on the international markets except for a few crops (sugar and tobacco) with efficient private sector investment in productivity. Production of food crops for local and regional markets is also potentially an important source of rural income, but remains underdeveloped. If the constraints on agricultural productivity are not effectively addressed, the already slowing growth is likely to stagnate.

Small-scale agriculture was practically neglected by the government even after the official reversal of the collectivisation policy in the mid-1980s. Despite repeated resolutions to invigorate commercial agriculture and linkages between small-scale farmers and the private sector, on the ground very little has been achieved. Government policy remains top-down, inefficient and inchoate, and does not encourage and facilitate investment in the sector. Public services such as extension, quality control and research are under-capacitated and their coverage is markedly limited. A new land law passed in 1997 makes possible strengthening the position and tenure rights of small-scale farmers while providing for long-term leasehold for private enterprises, but it has not been implemented.

While growth in industrial production has been the main driving force behind Mozambique's rapidly growing exports, it has contributed very little to poverty reduction in terms of employment or public revenue. The new industries, which are closely linked to the South African mining and energy complex, rely on imported inputs or export products with very low value-added. Due to the enclave character of such industries, the spillover effect in terms of technology transfer or skills development has been minimal. The new industries have been financed almost entirely by FDI, which implies that a large part of the profits leave the country.

Mozambique continues to be highly dependent on ODA. Advisers and loans from the Soviet Union and its allies, as well as the Nordic countries, were prominent before Mozambique joined the Bretton Woods institutions in the mid-1980s. Thereafter growing amounts of aid from Western donors have more than compensated for the ending of Soviet aid, reaching a peak of over 90 per cent of national income during the peace process in 1992. While the share of ODA has subsequently declined, it continues to be very high, covering the trade balance deficit and constituting the main source of funding in a number of sectors, notably education, health and transport.

Compared to Vietnam, Mozambique suffers from sparse population and an underdeveloped infrastructure. Monopsonistic markets and high transport costs make inputs expensive and keep producer prices low, which discourages investment in agriculture. The extremely low level of human capital constitutes an even more severe constraint: despite considerable public investment since the early 1990s the literacy level is still below 50 per cent. Combined with a drastic lack of social capital, which is crucial for effective markets, the competitiveness of export production outside of the recently emergent enclave sectors remains very low.

The role of trade liberalisation and correct sequencing

Our second question is: *What is the correct sequencing of policies and how much priority should deep trade liberalisation receive early in the reform process?*

Vietnam's trade liberalisation has been gradual and tightly controlled by the government. The opening of international trade was carried out in the context of the ASEAN free trade area, where Vietnam initially benefited from preferential treatment due to its less developed economy. The process was supported by similar agreements with key developed countries. Economic reforms in the ASEAN framework paved the way for the long process of WTO negotiations, which gave Vietnam sufficient time to adapt its economy to approaching full trade liberalisation. The government has largely been able to retain control of the liberalisation process, gaining exceptions in areas considered crucial. It has also managed to keep foreign trade relatively well balanced between three major blocks, the ASEAN, the EU and the USA.

The liberalisation process has not proceeded without problems. Tariff reductions have undermined the basis of government revenue and provision of public services. In the industrial sector SOEs are still important especially in the heavy industries. Their eventual privatisation is likely to cause a major reduction in labour force, and may even cause the disappearance of entire industrial branches. In light industries the Vietnamese contribution to the value chain tends to be relatively limited, as most of the key sectors rely on imported raw materials. Also in the agricultural sector there is ample room for development in agricultural processing and agroindustries.

In Mozambique market liberalisation and privatisation were implemented under considerable external pressure in the mid 1980s. The urgent need to end the civil war became even more pressing after the virtual collapse of the Soviet bloc in the late 1980s, and rapid transition was accepted in return for Western aid. As the state structures had practically disappeared in many rural areas, the country was entirely unprepared to carry out the requisite rapid market liberalisation and privatisation. Consequently, the process was confused and little transparent, and rendered even more complicated by the political situation, which prompted the political leadership to 'sell' the peace process to political and military elite groups, which substantially reduced transparency and the viability of the resulting private enterprises.

While state farms were divested at an early stage, the process did not benefit small-scale producers, while the emerging new large-scale agricultural enterprises did little to improve productivity. Subsequent government policies with respect to specific cash-crops have often been incoherent and unstable, reflecting donor pressure rather than producer interests. The national research capacity in agriculture remains totally inadequate, while extension services rely mainly on NGOs and the private sector,

the agricultural budget being consumed by central administration. Without effective government policy and support structures serving the producers, investors avoid agriculture, preferring less risky investment in sectors which bring rapid returns, while small-scale producers rely on risk aversion.

The development of the labour intensive industries during the special transition periods granting least developed countries (LDCs) differential access to developed country markets has been largely unsuccessful. Due to its underdeveloped human and social capital Mozambique is unlikely to be able to benefit substantially through technology and know-how transfer from the recently installed capital intensive industries. Especially selling rights to non-renewable natural resources without adequate capacity to benefit from spillover effects and foregoing a large part of potential public revenue benefits due to over-generous 'tax holidays' to lure FDI may have been inappropriately timed.

Trade capacity building and pro-poor growth

The final question we address is: *On what conditions can the strengthening of trade capacity contribute to pro-poor growth?*

Increasing openness and participation in global trade can contribute directly to pro-poor growth if it takes place in sectors which either increase the income of the poorest groups, or create sufficient public revenue to improve and maintain essential public services benefiting the poor. Economic growth through increased trade capacity can also benefit the poor indirectly, if it increases the demand for the services they offer or the goods they produce and thus improves their income. However, it should be noted that the poverty alleviation effect of growth depends also on distribution: the larger the share of any increment to growth captured by the poor, the faster will be the rate of poverty reduction. Promoting pro-poor growth requires, therefore, a strategy deliberately biased in favour of the poor so that they benefit proportionally more than the rich.

In our view, efforts to strengthen trade capacity in Vietnam and Mozambique should focus primarily on the supply side of the agriculture sector. This is because agriculture constitutes the livelihood of the majority in both countries, and is pursued in the areas where most of the poor live. In Mozambique special efforts are needed to build social capital, especially in sectors relevant to rural development, for example credit systems, government extension and quality control services, and agricultural research. Due to insufficient government revenue and the related problem of absorption capacity, new solutions should be sought from the public-private partnership approach. Along with cash crops for export markets, it is important to support pro-

duction of traditional food crops, which are crucial for both food security and income creation through domestic and regional trade. In the long run these can serve as an entry point to global markets.

In Vietnam the government has been able to control the transition process more efficiently than in Mozambique, but especially in the agricultural sector it remains dependent on foreign aid, which constitutes approximately one half of the agricultural budget. Benefits from global trade can be increased most effectively by extending the domestic production chain, as has already taken place for example through the vigorous development of aquaculture. Access to international markets can also be facilitated by strengthening government services in agricultural research and quality control in order to comply with increasingly demanding developed country regulations for food products.

Support to supply-side activities in the agriculture sector will strengthen current Finnish aid to rural development in both countries, and thus provide an efficient means towards the pro-poor growth target. Finnish aid to basic services strengthening human capital, in Vietnam focusing on health and national poverty programmes, in Mozambique on health and education, can in the long run provide crucial indirect support for pro-poor growth. In the social sector certain specific issues must, however, be considered. In Mozambique it seems that the education and health sectors cannot effectively absorb much higher volumes of aid directed to physical facilities, which creates increasing pressure on government revenue for running costs. In Vietnam the current model of economic growth has not been able to address the threat of marginalisation faced by ethnic minority groups. Moreover, a new problem is emerging in the increasing number of 'temporary' rural-urban migrants lacking access to social services provided by the recipient municipalities. These issues need to be addressed in new social sector policies.

1. Introduction

1.1 Trade, growth, poverty and equity

The question of inequality and its relationship to globalisation is a subject of heated debate among academics, international and non-governmental organisations, and policy-makers. Globalisation can be defined as the ongoing process of greater economic interdependence among countries, reflected in an increasing amount of cross-border trade in goods and services facilitated by improvements in transport and communications technology, an increasing volume of international financial flows and increasing flows of labour. The modern globalisation process can be further divided into three distinct periods: the first period from 1870 to 1913, which was characterised by international flows of permanent migrants; the second period from 1950 to 1980 by a spread of advanced production technologies through trade; and the third from 1980 to the present, which has been based on technological advances in transport and communications (Dowrick and Golley 2004).

The process of globalisation has given rise to a debate over trends in global income distribution and whether integration into global markets is leading to a convergence or a divergence of income between the rich and the poor. According to an influential series of articles by David Dollar and Art Kraay (2000; 2002a, 2002b) from the World Bank¹, trade liberalisation leads to higher growth in average incomes, which – on the average – tends to bring the same benefit to the poor as to the non-poor. The ‘mainstream’ policy recommendation derived from the results is that standard neo-liberal economic policies will generate the growth and distribution patterns needed for successful poverty reduction. Even though strongly suggestive of the old ‘trickle-down’ model of economic development (Kakwani et al. 2004), this policy recommendation has since been widely adopted by international financial institutions (IFIs) and major donor countries in their advice to developing countries such as Mozambique and Vietnam (e.g. Bolnick 2002; Hung 2005; Nathan Associates 2002; World Bank 2001). It is also reflected in the original research question in this study, which sought to establish:

What is the role of trade in pro-poor growth, and how can its role be strengthened through development co-operation when the causal link is positive?

¹ The articles of Dollar and Kraay owe their international influence to the World Bank report *Globalization, growth and poverty* (2002), which refers extensively to their work. It should, however, be noted that research reports produced by the bank do not constitute a monolithic body with one unified economic policy, but provide a number of different results and recommendations. We do not, therefore, find it pertinent to refer to World Bank policy as such. See e.g. Dorwick and Golley 2004; Oxfam 2000.

It is necessary, however, to study more closely the claims made by Dollar and Kraay, which constitute the hard core of the ‘mainstream view’. On the basis of a cross-country regression analysis they attempt to show that: (i) Developing countries which undertook greater shifts in favour of a more open trade regime than others in the period from the early 1980s to the late 1990s (countries they call ‘globalisers’), have experienced greater increases in growth of per capita incomes than others, from which they conclude that growth of the share of trade in GDP is positively associated with increases in the growth of average incomes; and (ii) there is no systematic tendency for the share of national income captured by the bottom quintile of the income distribution to change as per capita income grows (Dollar and Kraay 2000). We shall examine the two claims separately.

The income distribution argument can be summarised as follows: (i) On average across countries and over time, growth is distribution-neutral; thus (ii) any factor which increases the growth rate is good for the poor; (iii) neo-liberal economic policies increase the growth rate; therefore, (iv) such policies should be the core of poverty reduction strategies (Dollar and Kraay 2002b). Various critics have, however, pointed to serious shortfalls in both the data and the methodology the authors used.² They argue that while the stability of income distributions is both well established and well known, the second point of the argument is a *non sequitur* (what is true on average is not necessarily true for the components of an average), and the third point is based on a biased reading of the growth literature. Since Dollar and Kraay do not establish points two and three, their sweeping policy conclusion does not provide a credible basis for country-specific policy recommendations (Lübker et al. 2002; Nye et al. 2002).

Furthermore, even if the incomes of the poorest quintile grow at the same rate as the GDP, as claimed by Dollar and Kraay (2002a; 2002b), the absolute income gain to the bottom quintile will be smaller than that to the non-poor, which means that absolute disparities between the rich and the poor actually increase (Kakwani and Pernia 2000). While the authors acknowledge this, mentioning China as an example, they maintain that growth as such suffices, as higher growth rates in globalising developing countries have translated into higher incomes for the poor (Dollar and Kraay 2002a). While few scholars would seriously claim that growth has totally failed to reduce poverty, the point is that in many countries distributional factors have seriously weakened the effects of growth on poverty reduction. The larger the share of any increment to growth captured by the poor, the faster will be the rate of poverty reduc-

² On the basis of a detailed analysis of Dollar and Kraay (2000), for example Lübker and associates show that the conclusion the authors draw “*is not robust because the statistical modelling used to sustain it is flawed, the data used to test the model are unsafe, and the statistical inferences drawn from that testing do not follow best professional practice*” (Lübker et al. 2002; cf. Galbraith 2002).

tion. Promoting pro-poor growth requires, therefore, a strategy deliberately biased in favour of the poor so that they benefit proportionally more than the rich (Kakwani and Pernia 2000; Oxfam 2000). Consequently, the pertinent question is:

What type of growth is best for poverty reduction in each country-specific context, and what policies will help to bring about more equitable patterns of growth?

According to Dollar and Kraay (2002a), a strong correlation links increased participation in international trade and investment on the one hand, and faster growth on the other. But while they admit that it is impossible to establish the direction of causality between real export growth and real GDP growth – except in purely formal terms³ – they claim that evidence confirms the ‘mainstream view’ that increasing openness to international trade and investment is the key instrument for poverty reduction in low-income developing economies (Cf. USAID 2004a). However, since higher growth may be the cause of higher trade volumes rather than the other way around, and since there are other factors (such as investment in intangible and physical capital) which impact on both growth rates and trade volumes, the inferences Dollar and Kraay draw are suspect, and do not provide a robust basis for assessing the relative weight and optimal sequencing of different policy measures (Nye et al. 2002; Samman 2005; cf. Dorado 1993).

In this context it is interesting that China, India and Vietnam are presented as three of the five major examples of ‘globalisers’ (Dollar and Kraay 2002a). In both India and China, the main trade reforms took place about a decade after the onset of greater growth while their trade restrictions remain among the highest in the world. Both Vietnam and China also remain under the control of their communist parties, and can hardly be considered ‘free economies’⁴. Missing from the list, on the other hand, are the true globalisers of recent times, for example Russia (Galbraith 2002; Rodrik 2000). Various critics have also pointed out serious flaws in the way the authors constructed the group of ‘globalisers’. As the countries with the greatest change in trade volumes happen to be those with lowest initial and final ratios of trade volumes to GDP, it is misleading to refer to these as ‘globalisers’. When one carries out the test used by the authors without making arbitrary choices which bias selection of the country samples, the results actually provide a mixed record (Dowrick and Golley 2004; Nye et al. 2002; Rodrik 2000; Samman 2005).

³ As GDP equals total consumer spending, business investment, and government spending and investment, plus the value of exports, minus the value of imports, any growth in the value of foreign trade (exports minus imports) increases the GDP, provided other factors remain unchanged or grow.

⁴ According to the 2007 Index of Economic Freedom, both China and Vietnam are ‘mostly unfree’ economies (Heritage Foundation 2007).

The issue is not one of free trade vs. protectionism, for most scholars recognise that there are strong efficiency grounds for opening markets, even though the process inevitably produces both winners and losers (Kaplinsky 2005; McPherson 2002; Oxfam 2000; White 2001). What is involved is rather the immensely more difficult task of defining the right combination of economic and social policies which actually promote pro-poor growth in a given regional and historical context. According to Dani Rodrik (2000), the experiences of India and China (and we would like to add Vietnam) provide interesting lessons suggesting a gradual, sequenced approach to trade liberalisation. The interesting question is, therefore:

What is the correct sequencing of policies and how much priority should deep trade liberalisation receive early on in the reform process?

During a period of 35 years starting from the early 1960s, Korea, the Taiwan Province of China, Hong Kong SAR and Singapore followed the example of Japan's economic transformation between 1952 and 1973, changing from technologically backward and poor countries to so-called newly industrialised countries (NICs). Subsequently Thailand and Malaysia took the same path, and they have since been followed by China and Vietnam (Nelson and Pack 1999; Chamon and Kremer 2006). Rapid economic growth in the world's poorest and most densely populated countries such as China has led to a decrease in global inequality across individuals.⁵ The fact that the growth performance of these countries has vastly exceeded that in other developing economies with comparable productivity and income levels in the 1960s has encouraged a number of sub-Saharan African countries to try to emulate their model.⁶

The development success of the above East and South East Asian countries has been intimately associated with the export of manufactures, while most sub-Saharan African countries, whose exports consist largely of primary products, have experienced slow growth or economic stagnation, at least until the late 1990s. According to some scholars the main reason for this is that the different resource endowments of the two regions differ in the relative availability of human skills and natural resources.

⁵ While income inequalities within countries and across countries have on the average increased over the past 20 years, global income inequality across individuals (i.e. population-weighted) shows a downward trend over the same time-span (Sala-I-Martin 2007).

⁶ For example, the 8th National Development Plan (1997-2001) for Kenya was expected to lay the foundation for the transformation of Kenya into an NIC (Republic of Kenya 1997), while the same model has been publicly endorsed by the government of post-apartheid South Africa (Vale and Maseko 1998). The idea has also been promoted by the Chinese themselves: for example Hu Biliang, a senior economist with the Chinese Academy of Social Sciences, maintains that "*China offers many African states an example of development, a road to follow*" (International Herald Tribune 1.2.2007, p. 12).

Countries with high skill/natural resource ratios have a comparative advantage in manufacturing, while those with low ratios have a comparative advantage in primary production. According to the logic of comparative advantage, the global benefits will be greatest if countries specialise in line with their resource endowments, suggesting a focus on primary product exports for sub-Saharan Africa and labour-intensive manufacture in East Asia (White 2001; Wood and Berge 1997).

Adrian Wood and Kersti Berge (1997) maintain that variation in trade policies explains only a minor part of the variation in manufactured/primary export ratios. While changes in trade policy during the past three decades enabled many East Asian countries to realise a previously stifled comparative advantage in manufacturing, the scope for similar progress in African countries seems limited. In their view, the substantial differences in export composition which obtain between East Asia and Africa arise mainly from differences in resource endowments, which cannot be overcome by a more open trade policy (Cf. Dowrick and Golley 2004). For example, in those sub-Saharan countries which adopted the World Bank's structural adjustment programmes in the 1980s, rates of growth of manufacturing and GDP actually dropped to very low or even negative levels during the following decade, while manufacturing employment and labour productivity declined in most cases. This has been explained, at least partly, by an insufficiency of human capital and a lack of entrepreneurship (Noorbakhsh and Paloni 1999; cf. Nelson and Pack 1999).

During the same period China and other East Asian countries have assumed an increasingly dominant position in the global economy. The growth of these economies has generated a high demand for raw materials and foodstuffs in the international markets. Should countries of sub-Saharan Africa, which do not have the skills-base to compete with the exports of the East Asian economies, then accept the role of suppliers of primary products to these growing markets? (cf. White 2001) If we agree that manufacturing has an inherently greater growth potential than primary production (DESA 2006), while the skills/natural resource ratio is not a primordial and static but a dynamic factor, we should perhaps rather question the universal applicability of the neo-liberal policy package. For even though opening to trade may be beneficial for countries with a comparative advantage in manufacturing at present, it is not necessarily good for countries which suffer from low skill/natural resource ratios, where more open trade policies may cause manufacturing to contract (Dowrick and Golley 2004; Kaplinsky 2005; Wood and Berge 1997).

As noted above, an increasing openness to the international economy can provide various advantages such as access to foreign capital, import of capital goods and transfer of technology, which can stimulate and support economic growth. For most of the countries in sub-Saharan Africa which suffer from limited domestic demand, the opportunity to tap wider markets can bring substantial benefits, for example in the

form of increased efficiency and improved product quality due to scale economies and higher market prices.⁷ It is, however, prudent to recall that such advantages are merely potential and require certain minimum preconditions to be achieved. Exports are unlikely to respond strongly to trade liberalisation if the level of investment in physical and intangible capital, for example in transport infrastructure and the financial system, is low. If on the other hand, investment is concentrated heavily in physical capital, trade liberalisation may lead to an increase in commodity exports without structural transformation, or a concentration of industrial production in capital-intensive enclaves highly dependent on imported capital and inputs, failing thus to deliver tangible benefits for the wider national economy (USAID 2004a).

For low income countries poorly integrated into world markets, the 'mainstream' strategy of economic growth through export promotion would not seem to be appropriate, as it tends to provide very few benefits, while on the other hand increasing the risk of decline in the manufacturing sector. This is because export-led growth is essentially unstable in the long run if the country in question is highly dependent on international markets while suffering from a low degree of national/regional integration and a low level of income (Kaplinsky 2005; Matteis 2004). A more selective and gradual approach towards participation in the global economy, backed up by strategic investment in intangible capital, might in such cases be a more appropriate strategy. Economies of scale and improved productivity can also be achieved by gradual means such as the development of stronger intra-regional economic networks (DESA 2006; SAPRIN 2004).

The neo-liberal doctrine focuses on getting the economic fundamentals right as a necessary precondition for economic growth, while arguing that improvement in human development comes as a result of economic growth. Some studies seem to indicate, however, that there is a two-way linkage between economic growth and human development, which can generate self-reinforcing, virtuous or vicious cycles of development. Based on a cross-country study on patterns of economic development in the period 1960 to 1992, Ramirez and associates (1997) found a strong regional pattern with East Asia heavily represented in the virtuous cycle case and sub-Saharan Africa much to the fore in the vicious cycle quadrant. The analysis suggests that economic growth alone will not be sustainable unless preceded or accompanied by improvements in human development, as was the case in the East Asian countries which have experienced sustained growth over an extensive period. However, a virtuous cycle linking human capital accumulation with high output growth cannot operate unless the demand for educated workers rises in parallel to the rise in education. In East Asia this took

⁷ It should be noted that external market conditions are at least as important determinants of export growth rates in sub-Saharan Africa as the domestic policy regime (see e.g. Love and Turner 2001).

place in those countries which were successful in generating rapid growth in output and rapid accumulation of physical capital, embodying more sophisticated technologies demanding more educated workers (Nelson and Pack 1999; You 1998).

Global competitive pressures tend to restrict a country's policy choices and may have an adverse effect on human development, since investments in social policies and social equality have often been perceived as unnecessary costs. In development discourse, the simple increment in material output or economic growth has formed the primary focus over the last decade. It can be argued, however, that the single most important challenge facing the world is that of enhancing the quality of growth, that is, increasing levels of well-being and reducing socio-economic inequalities (Arimah 2004; DESA 2005). The starting-point in this study is that greater openness to trade, like economic growth, is not an end in itself: it is a means for expanding human welfare. This approach can be justified with reference to the eradication of extreme poverty and hunger, which is the first Millennium Development Goal (MDG). It is, therefore, necessary to rephrase the research question posed here to read:

On what conditions can strengthening trade capacity contribute to pro-poor growth?

1.2 Neo-liberal policies and the aid for trade initiative

During the last decade international organisations have placed increasing emphasis on their multidimensional role in solving regional, national and local problems. This kind of governance, covering also international trade, focuses on the overall notion of liberal order deriving its concepts from economic liberalism and political pluralism. The economic aspect of global governance emphasises the 'mainstream' approach, consisting of free markets, unrestricted market forces and private property rights, reflecting thus the issues and principles also emphasised in the normative framework of the World Trade Organisation (WTO).

A process of institutional harmonisation is currently under way between major international organisations (IOs, including OECD/DAC, the World Bank, and the IMF) and major Western donors. It aims to boost the economic principles of the new global order and combine them with the poverty and trade issues which featured in WTO's Doha Development Agenda. In the Ministerial Declaration of the Doha meeting, trade-capacity building was made one of the key components in implementing the new development agenda. This process is reflected in the discourse on trade and development and in the donors' interest in trade capacity-building.

In the statement of the DAC High Level Meeting upon endorsement of *DAC Guidelines on capacity development for trade* in April 2001, this multidimensional character of governance is eminently manifest. The accumulation of trade is aimed to

reinforce pro-poor growth and support “*sound environmental practices and good governance*” (OECD 2001, pp. 8-10). Accordingly, trade-related ODA has increased by 50 per cent since 2001 (WTO 2006). Following the Doha Development Agenda, the IOs – the World Bank and the IMF in particular – have intensified their funding for developing trade capacity. The aid for trade package for the LDCs, as proposed by the World Bank and the IMF, includes five elements: technical assistance, capacity building, institutional reform, investment in trade-related infrastructure, and assistance to mitigate specific adjustment costs. Technical co-operation and investments in the communication system are intended to help market access for products from developing countries, but a great deal of emphasis was placed on the capacity to implement the new WTO laws on liberalisation of services and intellectual property rights, and to entice the developing countries to trade away their rights to special and differential treatment granted under GSP agreements (OECD 2001; IMF and World Bank 2005a; 2005b; cf. Randiamaro 2003).

A number of country reports seeking to guide implementation of the ‘mainstream’ agenda have been produced for individual countries such as Vietnam (see e.g. Fox 2000; Kokko et al. 2006; Le Thu Duc et al. 2003; Narray et al. 2005) and Mozambique (see e.g. Nathan Associates 2002; Sarkar 2002; USAID 2004a). In addition to national poverty reduction strategies prepared by the respective governments with substantial donor support, the relationship between trade, development of different sectors, and pro-poor growth has been addressed in specific reports (for Vietnam, see e.g. Dinh Duc Thuan 2005; Klump 2007; Klump and Bonschab 2004; Phan Lan Huong et al. 2003; World Bank 2006b; for Mozambique see e.g. Arndt et al. 2006; Bolnick 2002; Haaparanta and Kerkelä 2006; James et al. 2005; World Bank 2005c).

While such reports tend to treat trade capacity building as a politically neutral, technical issue, this ‘mainstream’ approach has been challenged by both academic researchers and civil society representatives (see e.g. Hunsmann 2006; SAPRIN 2004). The latent contradiction between special treatment conceded to LDCs and the principles of free trade is obvious in the IOs’ policies for trade capacity building in developing countries. Therefore, the side of the package which seeks to help developing countries in reforming relevant legislation and building their administrative capacity is often also aimed at facilitating the access of the same donor countries to LDC markets. Recent critique of the trade for aid package has pointed out that longer transition periods are needed for the LDCs to survive the implementation of the WTO legislation. It has also been observed that aid should in first place be directed to those areas which support the recipient country’s own export capacity, rather than increasing the possibilities of foreign actors to take advantage of the LDC’s resources (South Centre 2005).

1.3 The focus and structure of the study

The focus of this study is on the relationship between trade, growth and poverty in Southeast Asia and Southern Africa. While it is important to note that not all Asian countries are experiencing high rates of economic growth and not all sub-Saharan African countries are suffering from economic stagnation (see e.g. Paap et al. 2005; Pattillo et al. 2006; You 1998), grouping countries on the basis of geography does have some relevance in terms of economic performance. In a recent study where 69 countries were assigned to clusters on the basis of highest average growth rate over a period of 40 years (1961–2000), Africa was strongly over-represented in the low-growth cluster, while no African countries were assigned to the high-growth cluster. Further, four of the eight African countries assigned to the middle cluster were somewhat untypical micro-states.⁸

In the case of Asia the results were the opposite, with strong over-representation in the high-growth cluster and only two countries assigned to the low-growth cluster (Table 1.3.1).

Table 1.3.1 Regional distribution of countries into growth clusters

	Low-growth		Middle-growth		High-growth		Total	
	No.	%	No.	%	No.	%	No.	%
Sub-Saharan Africa	26	76	8	24	0	0	34	100
America ¹	7	50	6	43	1	7	14	100
Asia	2	15	5	38	6	46	13	100
Middle East ²	1	13	7	88	0	0	8	100

¹South and Central America; ²Middle East and North Africa. *Source:* Paap et al. 2005.

The present study sets out from a comparative perspective, asking whether there is something in the experience of Asian ‘emerging countries’ which have successfully integrated into global markets and during the process reduced substantially the level of poverty, which African countries could learn from? However, instead of looking at regional averages or general models, we examine two individual countries, Vietnam and Mozambique, which have both prominent similarities and major differences.

Vietnam and Mozambique share a number of important characteristics. They are both medium size countries with a relatively abundant natural resource base and a favourable coastal location. Both are also transition countries which gained independence after a protracted war of liberation and at independence adopted a socialist economic system. In the case of Vietnam, this took place in two phases. In the northern part socialism was adopted immediately after independence in 1955, whereas in the

⁸ Cape Verde, Mauritius, Seychelles and Lesotho.

southern part the transition to socialism was made after the collapse of the US-supported capitalist state in 1975. In Mozambique the new government adopted socialist policies after independence in 1975. Both countries suffered from war and conflict with neighbouring regional powers (China and South Africa) during the post-independence period. At the same time the socialist experiments in Vietnam and Mozambique proved to be failures, and by the mid-1980s both countries were obliged to reform their economies towards a free market system. By 2005 they had emerged as regional success stories in terms of high and consistent rates of economic growth over more than a decade. Especially in the case of Mozambique this is a rather exceptional achievement, considering the general trend in Southern Africa.

There were, however, some crucial differences in the initial conditions in terms of human and social capital in the two countries, as well as in the transition strategy chosen. While some of the differences are related to demographic factors (the population density in Vietnam is more than ten times higher than in Mozambique, and its population is almost five times larger), but differences in the level of human development would seem to constitute even more important factors. The transition strategies adopted by each country were also fundamentally different, and this has also had a bearing on the way Vietnam and Mozambique have been able to integrate in and benefit from the globalisation process. A crucial question is:

To what extent has increasing market integration contributed to pro-poor growth in each case?

1.3.1 The structure of the report

The report is divided into five main parts. After the introduction, we set out our general theoretical approach, which is also used to characterise the two regions, Southeast Asia and Southern Africa. We continue by analysing trade flows in selected key commodities, and conclude the second part with a description of the relevant global and regional trade regimes. The analysis concentrates on agriculture, which is the main source of livelihood in both countries and is, therefore, crucial for poverty alleviation, and manufacturing, which is a key element in the traditional process of economic growth based on industrialisation.

The third part concentrates on Vietnam. After describing the historical context in which the economic reform process took place, with emphasis on the economy and human resource base, we analyse the renovation (*doi moi*) process and the way it related to changes in regional and global economy. Thereafter we present a detailed analysis of Vietnam's economy in the key sectors of industry and agriculture, with a focus on trade capacity. Finally we analyse the relationship between export trade, eco-

conomic growth and poverty reduction, and address the issue of aid and trade.

In the fourth part we look at the historical and regional context of Mozambique's unusual growth performance. Here the focus is on the development of physical, human and social capital, and its impact on the subsequent process of economic liberalisation. We analyse Mozambique's trade capacity and access to markets, with special emphasis on industry and agriculture. This gives a basis for assessing the situation of poverty and inequality, and their relationship to different strategies of economic growth. This leads to a discussion on aid, trade and growth.

Finally we conclude the report with a review of the main findings and lessons learnt, focusing on the role of trade as a potential motor of pro-poor growth, seeking to answer the principal question underlined above:

On what conditions can strengthening trade capacity contribute to pro-poor growth?

2. Pro-poor growth in Southeast Asia and Southern Africa

The principal development goal in the Millenium Declaration is to reduce by half by 2015 the proportion of people living in extreme poverty, defined as those whose income is less than one US\$ per day. There are a number of different definitions of poverty and pro-poor growth (see e.g. Datt et al. 1998; James et al. 2005; Kakwani and Pernia 2000; Myles and Picot 2000; Sala-i-Martin 2007).⁹ The various indicators have different and complementary uses. Quantitative income or consumption measures can be used to give a picture of the extent of poverty at national level while also allowing aggregation and comparison at international level. For analysis and detailed planning, however, more qualitative and historically contextualised assessment methods are more appropriate (Maxwell 1999).

The MDG figure of one US\$ per day (in 1985 purchasing power parity, PPP) is used by various international organisations such as the World Bank to determine absolute poverty. An alternative approach is to define poverty as relative deprivation. In developing countries, most definitions of poverty rely on calculation of the cost of a basket of basic needs. A third approach is provided by the current human development index (HDI) used by UNDP, and based on the physical life quality index developed in the 1970s. It combines information on life expectancy, infant mortality and

⁹ An excellent introduction to basic tools used in analysing growth and poverty can be found in McKay (2005).

literacy with GDP calculated per capita. The HDI measure is developed on the basis of Amartya Sen's idea of human development as opportunities and choices to lead a long, healthy and creative life, and to enjoy a decent standard of living, freedom, dignity, self esteem and respect for others (Maxwell 1999; Sen 1992). In this paper both qualitative and quantitative aspects of poverty are analysed.

A number of donors usually measure pro-poor growth by the change in the incomes of those below the poverty line (Pattillo et al. 2006). Another broad definition used by the World Bank is that growth is pro-poor when the poverty incidence falls. This would mean that growth is considered pro-poor even if the income of the poor grows at a slower pace than that of wealthier groups (James et al. 2005). Kakwani and associates (2004) from the UNDP International Poverty Centre consider the above definition too weak, and suggest a measure of pro-poor growth which takes into account both reduction in poverty and improvement in equality. According to their definition, growth is pro-poor if it benefits the poor proportionally more than the non-poor. In a similar approach, pro-poor growth has also been defined as sustained high growth from which the poorest 20 per cent capture a proportionally larger share of the increment to growth (Oxfam 2000). In this paper the relative concept is used.

2.1 Export-led growth and reduction of poverty in the regional perspective

This report analyses the linkages between growth and poverty in Mozambique and Vietnam, which belong to Southern Africa and Southeast Asia, respectively. The regions show partly divergent cultural, demographic and economic patterns and trends. In Southeast Asia a wide variety of cultures (Buddhist, Islam, Hindu, Chinese, Christian) and languages meet, partly mixed with the colonial heritage. In Southern Africa Bantu cultures dominate, mixed with Islamic, Christian and colonial influences. A demographic transition towards lower birth rates has taken place in Southeast Asia, while in Southern Africa annual population growth still exceeds two per cent. In life expectancy at birth the gap between the regions is especially wide. In Southern Africa life expectancy is around 40 years (for men and women almost equal). Obviously HIV/AIDS is an important factor in the region. In most countries in Southeast Asia life expectancy is about 68 years for men and 72 years for women (World Bank 2006).

Some of the world's poorest countries, among them Mozambique, Tanzania, Malawi, Cambodia and Lao People's Democratic Republic (PDR), are found in these regions. The general economic level of Southeast Asia is, however, considerably higher than that of Southern Africa, where only the most affluent countries, South-Africa and Botswana, reach the global average income level. Also in economic growth Southeast Asia has long shown better results, but since 2000 growth has speeded up in some

relatively poor Southern African countries such as Mozambique and Tanzania, thus narrowing the gap. In the following we discuss the two regions separately.

2.1.1 Economic growth and poverty in Southeast Asia

Asia includes four countries which have experienced a relatively consistent period of economic growth since the 1970s. The long-term average annual economic growth rates of Malaysia, Thailand, Indonesia and Singapore have been quite impressive, ranging from 3.9 to 5.1 per cent over the period 1975 to 2003. The rates in other Southeast Asian states have been less spectacular in the long run, with the previous leader Philippines stagnating to a marginal 0.3 per cent over the same period. However, the trend has picked up (albeit haltingly) in the Philippines during the last decade, while Cambodia, the Lao PDR and even isolated Myanmar have recently shown relatively high rates of growth.¹⁰ The fastest growing country over the last decade has, however, been Vietnam. In 1990, Vietnam's per capita income was only 22 per cent of Thailand's and 41 per cent of Indonesia's respective figure. In 2003, however, the figure was one third of Thailand's and three quarters of Indonesia's, while its economy was growing consistently faster (Klump and Bonschab 2004; UNDP 2005). As the average growth rate of the GDP has averaged 4.4 per cent for the ASEAN member states since 2000, Vietnam's catch-up is clearly remarkable.

In terms of economic power (measured by GNI), Indonesia, Malaysia, Singapore, Thailand and the Philippines have been the major powers, but Vietnam is rapidly joining the group. Table 2.1.1 shows that in terms of human development and equity, Southeast Asian countries comprise a wide variety from high-income countries such as Singapore and Brunei to LDCs such as Cambodia, Lao PDR, Myanmar and East Timor. While inequality is especially high in Malaysia (Gini index 49.2), and high in the Philippines (46.1), it is moderate (40.4-43.2) in such different countries as Cambodia, Singapore and Thailand. Vietnam and Lao PDR benefit from relatively low levels of inequality (37.0), while Indonesia has the lowest figure (34.3) in the group.

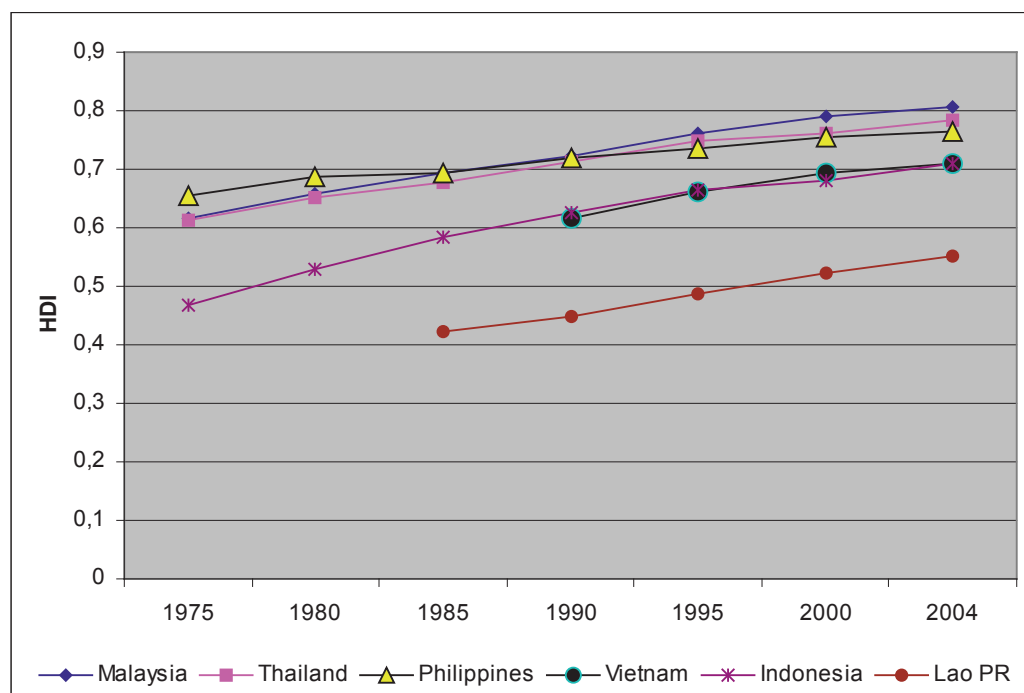
Among the major Southeast Asian economies, Malaysia has achieved substantially greater improvement in human development than the Philippines, even though the latter started from a higher level (Figure 2.1.1).

¹⁰ Data for Brunei, Myanmar and East Timor are, for different reasons, defective (UNDP 2005).

Table 2.1.1 Poverty and inequality in Southeast Asian countries in 2003

	HDI		GDP per capita ¹		HPI-1 ²		Gini index ³
	value	rank	value	rank	value	rank	
Singapore	0.907	25	24,481	21	6.3%	6	42.5
Brunei	0.866	33	19,210	29	–	–	–
Malaysia	0.796	61	9,512	58	8.9%	16	49.2
Thailand	0.778	73	7,595	66	12.8%	28	43.2
Philippines	0.758	84	4,321	103	16.3%	35	46.1
Vietnam	0.704	108	2,490	124	17.8%	41	37.0
Indonesia	0.697	110	3,361	115	47.6%	91	34.3
Myanmar	0.578	129	–	–	21.9%	50	–
Cambodia	0.571	130	2,078	133	41.3%	81	40.4
Lao PDR	0.545	133	1,759	140	38.2%	72	37.0
Timor-Leste	0.513	140	–	–	–	–	–

¹ At purchasing power parity (PPP) US\$ rate. ² Proportion of people living below threshold level in basic dimensions of human development, developing countries. ³ The extent to which the distribution of income (or consumption) among individuals or households deviates from a perfectly equal distribution: a value of 0 represents perfect equality, a value of 100 perfect inequality. Source: UNDP 2005.

Figure 2.1.1 Development of HDI in selected Southeast Asian countries, 1975–2004

Source: UNDP 2006.

After an initial success comparable to that of Malaysia, in the 1990s Thailand's trajectory has slowed down to the level of the Philippines. The trend of both Indonesia and Vietnam (since 1990) parallels that of Malaysia, but starting from a considerably lower initial level in 1975. Lao PDR represents a third trajectory, showing improvement almost equal to that of Malaysia and Indonesia/Vietnam, but starting from an even lower initial level. Among the countries included in the sample, Lao PDR is the only one still classified as an LDC.¹¹

2.1.2 Economic growth and poverty in Southern Africa

African (including North African) exports grew fairly rapidly between 1963 and 2000. However, this represented a much slower rate of growth than that for world trade generally. As a result, Africa's share in world exports dropped from 5.7 per cent in 1962 to 2.4 per cent in 2000. In no other region has the trend been continuous over the whole period (Gibbon and Ponte 2005). Marginalisation of Africa is even more evident in manufactured products, which constituted more than 70 per cent of all developing-country merchandise trade in 2001. In the Middle East and North Africa, and in sub-Saharan Africa, however, manufactures comprised only about 30 per cent of total merchandise exports, exceeding agricultural products but being dwarfed by mineral resource and fuel exports, which constitute an exceptionally high proportion (Kaplinsky 2005).

Another characteristic of the current world trade system is the declining role of Africa as a trade partner with the North in both absolute and relative terms. Even within the categories of food and minerals/fuels, where African exports are concentrated, they have generally failed to increase their share in value-added. Instead, the data show an unchanged level of dependence on primary products combined with a low level of investment in human and social capital. For example, the proportion of intra-industry trade,¹² which can be used as an indicator for global production sharing and integration in global value chains for manufactured products, was below ten per cent for sub-Saharan African countries, while it was close to 45 per cent in the NICs. Overall, Africa's export trade is currently characterised by a degree of dissociation from Northern markets and isolation from the more dynamic developments in the composition of international trade (Gibbon and Ponte 2005; cf. Kaplinsky 2005).

Overall, sub-Saharan Africa's poverty rates in 1970 were similar to those of South and East Asia at about 35 per cent. By 2000, however, poverty rates in Africa had risen

¹¹ In addition to Lao PDR, Cambodia, Myanmar and East Timor are classified as LDCs by the UN.

¹² Intra-industry trade in parts and components represents a high and generally rising share of all manufacturing exports for more industrialised developing countries such as the East Asian NICs.

to nearly 50 per cent, while those in Asia had declined to three per cent. With over 600 million inhabitants, sub-Saharan Africa currently accounts for about ten per cent of the world's population, but almost 68 per cent of the world's poor (Sala-i-Martin 2007).¹³ Table 2.1.2 shows the high incidence of poverty which characterises Southern Africa, especially if the small Indian Ocean island states of Seychelles and Mauritius (which belong to SADC) are excluded. In addition to the high level of poverty, attention is drawn to substantial differences in per capita income between countries as well as very high levels of inequality, especially in the relatively well-off countries, where the Gini index ranges between 57 and 63. Among the group of poor countries, the relatively low level of inequality in Tanzania and Mozambique is worth noting, even though inequality has increased somewhat in Mozambique since the mid-1990s.

Table 2.1.2 Poverty and inequality in SADC countries in 2003

	HDI		GDP per capita ¹		HPI-1 ²		Gini index ³
	value	rank	value	rank	value	rank	
Seychelles	0.821	51	10.332	56	–	–	–
Mauritius	0.791	65	11.287	49	11.4%	24	–
South Africa	0.658	120	10.346	52	30.9%	56	57.8
Namibia	0.627	125	6.180	81	33.0%	60	70.7
Botswana	0.565	131	8.714	61	48.4%	94	63.0
Zimbabwe	0.505	145	2.443	125	45.9%	89	56.8
Swaziland	0.498	147	4.726	100	52.9%	97	60.9
Lesotho	0.497	149	2.561	123	47.6%	91	63.2
Angola	0.445	160	2.344	126	41.5%	83	–
Tanzania	0.418	164	621	175	35.8%	63	38.2
Malawi	0.404	165	605	176	43.4%	85	50.3
Zambia	0.394	166	877	167	46.4%	90	52.6
Congo, DR	0.385	167	697	173	41.4%	83	–
Mozambique	0.379	168	1.117	156	49.1%	96	39.6

¹ At purchasing power parity (PPP) US\$ rate. ² Proportion of people living below threshold level in basic dimensions of human development, developing countries. ³ The extent to which the distribution of income (or consumption) among individuals or households deviates from a perfectly equal distribution: a value of 0 represents perfect equality, a value of 100 perfect inequality. Source: UNDP 2005.

¹³ Sala-i-Martin uses an adjusted \$1-a-day line definition of poverty which puts the threshold annual income at US\$ 495.

The region is also characterised by marked differences in economic capacity: South Africa is undisputedly the dominant economic power in the region, while the other middle-income countries of SADC (Seychelles, Mauritius, Namibia and Botswana) have small populations and thus relatively small economies. Except for Botswana and Mozambique, the GDP per capita growth rates of Southern African countries were extremely low or even negative between 1975 and 2003. Lesotho and Swaziland achieved somewhat higher overall rates (3.1 and 1.8%, respectively), but even there growth has declined since the 1990s. The growth rate of Mozambique has been especially high since 1994, and also Tanzania has experienced a substantial improvement during the last decade (Table 2.1.3).

Table 2.1.3 GDP per capita growth in selected Southern African countries, 1975–2003 (%)

	1975–2003	1990–2003		1975–2003	1990–2003
Lesotho	3.1	2.3	South Africa	-0.6	0.1
Angola	-1.1	0.4	Namibia	-0.1	0.9
Tanzania	0.8	1.0	Botswana	5.1	2.7
Malawi	0.2	0.9	Congo DR	-0.1	-1.4
Zambia	-1.9	-0.9	Zimbabwe	-	-0.8
Mozambique	2.3	4.6	Swaziland	1.8	0.2

Source: UNDP 2005.

Analysis of the economic development and the poverty situation in the Southern Africa region conspicuously underlines the crucial role of economic growth in poverty alleviation in low-income countries. Figure 2.1.2 shows the development of HDI in Zambia, Malawi and Mozambique from 1980 to 2004. In contrast to the case of Southeast Asia, where all countries show an improvement even though starting levels have been very different, in Southern Africa human development indicators are actually declining in some countries and have stagnated in others. In the case of Zambia, Malawi and Mozambique there is increasing convergence of HDI values, caused by reversal in the case of Zambia, which has suffered from virtual stagnation and negative per capita growth, by slight and somewhat volatile improvement in Malawi, which has suffered from very low long-term growth rates, and finally in the case of Mozambique, first a decline to the status of the world's poorest country, and then steady improvement reflecting high economic growth.¹⁴

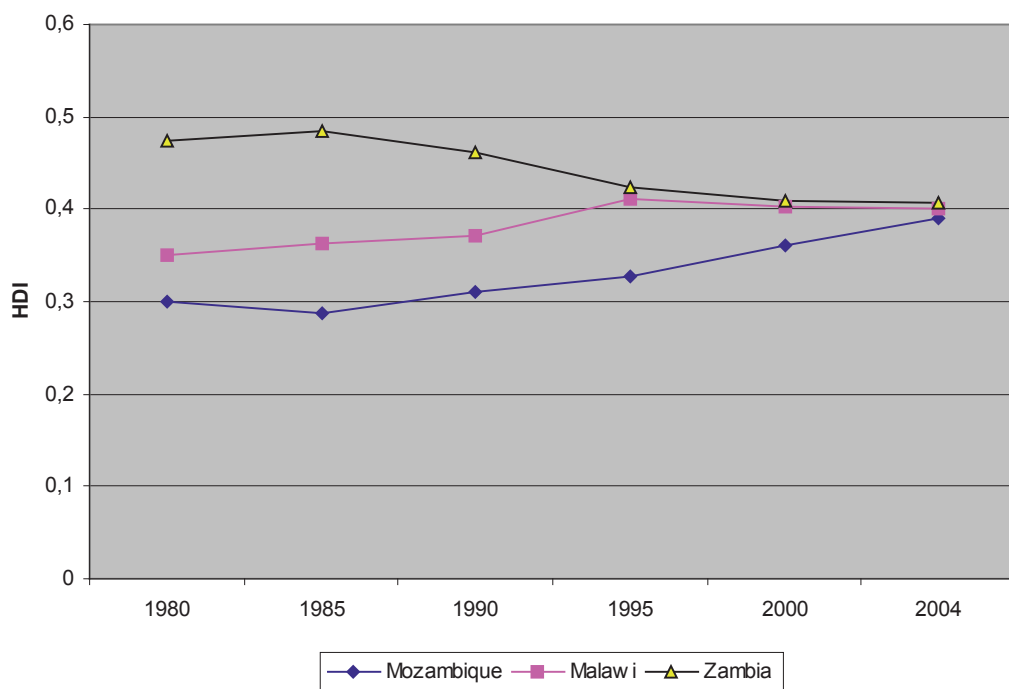
While wars of independence and/or civil wars have ravaged fully one half of the 12

¹⁴ There were altogether 18 countries which experienced HDI reversal in the period 1990 to 2003. These include eight countries from Southern Africa (Botswana, Congo DR, Lesotho, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe), five countries from other sub-Saharan Africa, and five now independent countries which were part of the Soviet Union (UNDP 2005).

Southern African countries, war is not the only or arguably even the major cause for the bleak growth and human development rates observed. Among the three countries in Figure 2.1.2, only Mozambique suffered from civil war during the period under study. Even so, it has experienced rapid economic growth over the last decade, and its GDP per capita is currently substantially higher than that of Malawi or Zambia (Table 2.1.2).

To some extent these economic fortunes can be explained by external factors such as world market prices and climatic conditions. For example in the case of Zambia, which is heavily dependent on revenue from copper mining, the fall in world prices in the late 1980s caused a deep recession in the whole economy, which eventually recovered somewhat after copper world prices improved in 1996–97. Mozambique and Malawi, on the other hand, are mainly agricultural producers where low-input subsistence agriculture has an important role. Economic development under such conditions is highly susceptible to adverse weather conditions such as the regional drought in 1991–92, catastrophic floods in Mozambique in 2000, and the serious drought in Malawi in 2001–02. These, however, are not the full story, and do not adequately explain the relative success of Mozambique.

Figure 2.1.2 Development of HDI in selected Southern African countries, 1980–2004



Source: UNDP 2006.

As noted above, for poor countries like Mozambique, Zambia and Malawi, economic growth is a pre-condition for human development. Export production has arguably an important role as a motor of growth, and has been a key factor in Mozambique's recent high growth figures. Among the Southern African countries Mozambique is, along with Botswana, the only country to achieve NIC-type growth rates on a consistent basis over a sustained period (over ten years). The interesting question is whether the growth in Mozambique is likely to be sustainable and whether it will continue to reduce poverty effectively in the future? Here comparison with the case of Vietnam may bring some valuable insights.

2.2 From absolute and comparative advantage to competitive exports

In classical economic theory natural resources, labour and physical capital are the basic factors of production determining the absolute and comparative advantages and export structure of an economy. Human capital (educational level, know-how) has also since been included. A related, broader concept is intangible capital, including human and social capital and the quality of institutions and governance. Increasing focus on social capital reflects the observation that while the classical theory is based on the ideal of perfect competition, in order to function this actually relies on a sophisticated set of institutions which make information available and define and enforce the regulations and laws setting the boundaries for competition (Poulton et al. 2004).

In low-income countries where capital is scarce, resource- and labour-intensive products prevail also in exports. In countries with low levels of income and education, conditions for the accumulation of capital and know-how are usually limited. Competitive advantages are, therefore, found in industries relying on natural resources and cheap labour. According to World Bank estimations, in low-income countries the share of intangible capital in wealth creation is 59 per cent and that of natural resources 25 per cent, the rest comprising that of produced capital. In high-income countries the corresponding proportions are 80 per cent and three per cent (Hamilton 2006). The accumulation of produced and human capital is a result of investment activity, which requires a certain level of savings. In the poorest countries, most of whose income is consumed on basic necessities, the required net savings rate is often not attained. An increased savings rate is, however, a prerequisite for sustained economic growth and constituted a crucial factor for example in the performance of the East Asian NICs (see e.g. You 1998).

The basic macroeconomic factors of economic growth do not provide an adequate picture of the real comparative advantages of nations. In poor, resource-dependent economies comparative (often even absolute) advantages are typically connected with

natural conditions such as tropical climate, soils or locations affording easy access to large, growing markets or deposits of resources.

2.2.1 Resource-based economic growth

In low income countries the value of natural resources is on the average almost twice that of produced capital. Natural resources play fundamental roles in development as the basis of subsistence and source of foreign exchange. Economies relying for their wealth and development on resources of land and sea face a number of problems related to the utilization of natural resources. These include vulnerability to natural hazards (drought, floods, pests), sustainability and depletion of resources, type of resource and its impact on the distribution of income, and vulnerability to price fluctuations on world markets.

Agricultural production in low-income countries is typically subject to natural hazards, which in richer economies can often be mitigated by preventive measures such as anti-flood precautions, irrigation systems and so forth. In the former most farmers depend on rainfall and hence are extremely vulnerable to the weather. As a result of growing greenhouse gas emission levels, the prevalence of extreme climatic phenomena such as floods and droughts is likely to increase.

Depletion of resources is often related to population pressure, and has commonly been associated with the overgrazing or slash and burn cultivation practised by traditional populations under restricted access to land. Resource depletion can, however, also result from ecologically unsustainable use of land in the commercial sector, e.g. for cattle ranching or monoculture plantations. As far as renewable resources are concerned the maintenance of sufficient stocks, which allow sustenance of a steady or growing level of flows is important. Typical of such resources are fish and forest stocks.

The spatial distribution of resources has important implications for the distribution of income and reduction of poverty. Fossil fuels and metals are extracted at point sources (boring holes, mines), while agricultural products are typically diffuse, creating extensive spatial linkages. In the first case it is easy to concentrate ownership and retain profits in the hands of a few, and the income distribution effect remains limited or local. They also tend to have a relatively capital-intensive structure of production. In the case of agricultural products, the structure of production is generally more labour-intensive, and thus export revenues are usually more widely distributed among rural producers. For example, the exports of many African countries have traditionally been heavily dependent on mining products and fuels, which in 1985 constituted almost 70 per cent of all merchandise exports, while the domestic economy is based on agriculture. The situation had changed somewhat, but fuels and mineral still made

up almost 60 per cent of Africa's exports in 2001 (Gibson and Ponte 2005).

Price fluctuations are typical of global raw material markets, causing irregular flows of export incomes and complicating economic planning. There are basically two strategies available to counteract the harmful effects of export price fluctuations: (i) Upgrading of domestic raw materials through further industrial processing. This strategy requires substantial capital and know-how inputs, which in the case of low-income countries are often not readily available from domestic sources; (ii) Diversification of the product structure. A tropical climate allows an extremely wide range of agricultural products. In subsistence agriculture farmers often cultivate a number of different crops and local varieties, thus reducing the risk of crop failure. The same strategy is also practised by cash crop cultivators as one way of diminishing environmental and market risks. Most lucrative cash crops (tea, sugar cane etc.) are traditionally produced on plantations, but a large variety of such crops are cultivated on family farms. Recently even such typical plantation crops as tea have been successfully adopted by small-scale African farmers, for example in Uganda and Kenya.

2.2.2 Investment-based economic growth

Sustained economic growth requires investment in both physical and human capital, whose share in wealth creation increases compared to that of natural resources. Resources may retain their role in absolute terms but lose in importance. In the first phase of investment-based growth the necessary technology is typically imported, but its absorption requires a certain level of domestic technical know-how. Improving technical skills and educational level may lead to indigenous development of technologies and a strengthening of national competitiveness. This was arguably a key factor in the success of East Asian NICs (Nelson and Pack 1999). Investment-based growth may encourage the emergence of competitive clusters, within which local raw materials are processed by means of domestic technology into competitive products.¹⁵

From the development perspective, clusters are interesting in that they are able – at least in theory – to exploit both supply- and demand-driven cumulative external economies. The former may include pooling labour supply and cooperating in skills development, collective learning and innovation, as well as proximity to specialised support services, input suppliers and finance. These require the creation of a favourable investment climate by the state, a relatively high level of investment and human

¹⁵ According to Altman et al. (2003), “an industry cluster is a regional concentration of competing, complementary and independent firms that drive economic development and growth. An industry cluster includes companies that sell inside as well as outside the region, and also supports firms that supply raw materials, components and business services to them”.

capital, which has been created by public efforts to raise the educational level of the population. Demand-driven factors include access to dynamic, large and growing markets. Low-income countries are often handicapped by the lack of supporting industries, dynamic domestic markets, and low levels of human capital, which impede networking and clustering (Altman et al. 2003; Porter 1990).

Resources, investment in physical and human capital, state and financial institutions are necessary, but not sufficient conditions for economic development. The concept of social capital has been introduced to better explain divergent economic performance between nations. Social capital means “*features of social organization, such as networks, norms and trust, that facilitate action and cooperation for mutual benefit*” (Putnam 1993, pp. 35-36). Such elements of social capital as networks and trust have to be especially emphasised.

Social networks form a crucial element in competitive clusters, where trust relations between key decision-makers in different firms are assumed to reduce inter-firm transaction costs as the problem of opportunism is reduced (Iammarino and McCann 2005). In the modern business environment characterised by globalised competition and a strong role of science and technology, the significance of various business nets and linkages is stressed.

Networking is, however, not simple. Business networks require a culture oriented towards learning, trust and project management capabilities. Building bridges across boundaries between participants to enable them to work together is crucial (Möller 2006). One of the key requirements for a functioning network is that participants honour their commitments and trust each other. This is typically the result of a shared history and experience among the decision-making agents (Iammarino and McCann 2005).

In many cultures distrust of other sub-national groups based on ethnic, religious or some other factor is typical, and networks are created mainly within discrete groups. In some countries lack of trust between the private sector and government officials is a major obstacle to the formation of linkages and networks. In this kind of socio-economic context information flows tend to be poor and mechanisms for contract enforcement weak, which restricts the use of trade credit and raises the cost of finance to prohibitive levels. It also makes personal relationships and knowledge the key elements of transacting (Haaparanta and Kerkelä 2006; Poulton et al. 2004).

2.3 Global commodity trade flows

Broad primary products still constitute the majority of merchandise exports in developing countries. There are, however, substantial regional differences. Whereas the share of commodities fell in Asia from 76 per cent in the late 1960s to 22 per cent in

the late 1990s, in sub-Saharan Africa the figure fell only 11 percentage points over the same period (Table 2.3.1). At the same time the market share of Asian countries in the high-income OECD countries increased to more than 13 per cent, while that of sub-Saharan Africa fell to below two per cent.

Table 2.3.1 Commodity dependence of developing countries in Asia and sub-Saharan Africa, 1966–1970 and 1996–2000 (%)

	Primary products in exports ¹		Share in OECD imports ²	
	1966–1970	1996–2000	1966–1970	1996–2000
Asia (19)	76	22	4.5	13.4
Sub-Saharan Africa (38)	97	86	3.9	1.5
Low income (47)	93	74	4.7	3.0
Overall (93)	90	63	17.1	21.8

¹Five-year simple averages of broad primary products in total exports of specified regions and groups of developing countries; ²Cumulative share of 23 high-income OECD countries' imports from the countries belonging to the specified region or group in proportion to their imports from the world. The number of countries analysed in each region and group is given in parentheses. *Source:* OECD 2006.

2.3.1 Trade flows of selected key commodities

Primary products continue to constitute the backbone of both Vietnam's and Mozambique's export trade, although industrial goods are gaining in importance in Vietnam's export revenues. In the following the main supplying and buying regions for selected key commodities are presented.

Rice

Rice is the most productive of all tropical cereals, and wet-rice cultivation has formed the material basis of a number of Asian civilizations. Rice has also spread to other continents, but Asia has remained the dominant producing and consuming area, currently accounting for about 90 per cent of global harvest. The bulk of international trade in rice is also conducted within Asia, where only four per cent of the total output is exported. The major suppliers of rice to world markets are Thailand, Vietnam, India and China (Table 2.3.2).

Table 2.3.2 Major exporting countries for rice in 2004

	US\$ million	%		US\$ million	%
Thailand	2,696	30.2	Pakistan	627	7.0
India	1,478	16.6	Italy	381	4.2
USA	1,169	13.1	Others	1,623	18.3
Vietnam	950	10.6	Total	8,933	100.0

Source: FAO 2006a.

Table 2.3.3 Major importing regions and countries for rice, 2000–2004

	2000		2004	
	US\$ million	%	US\$ million	%
Africa	1,388	19.0	1,735	18.8
Near and Middle East	1,544	21.1	1,658	17.9
Europe	1,237	17.0	1,650	17.8
ASEAN	780	10.7	675	7.3
North America	322	4.4	437	4.7
Japan	265	3.6	343	3.7
China	276	2.6	472	5.1
North and South Korea	157	2.1	167	1.8
Brazil	141	1.9	253	2.7
Others	1,472	20.1	1,857	20.1
Total	7,306	100.0	9,247	100.0

Source: FAO 2002; 2006a.

Some shifts in trade flows have taken place since 2000. In Europe and North America the rice markets have grown moderately, and in Africa slightly more slowly. In a number of Asian countries such as Korea and the ASEAN area imports have stagnated or even declined, but on the other hand growth in China has been conspicuous (Table 2.3.3).

Coffee

The cultivation of coffee has spread from its African homeland to tropical America and Asia. At present over 60 per cent is produced in South and Central America, over 20 per cent in Asia and only 14 per cent in Africa. Since the early 1990s production has grown modestly in South America, stagnated in Central America and declined in Africa, but expanded in Asia, mainly thanks to Vietnam, the main supplier in the continent (Table 2.3.4).

Table 2.3.4 Major exporting countries and regions for coffee in 2004

	US\$ million	%		US\$ million	%
Brazil	1,796	19.7	Indonesia	408	4.5
Colombia	1,095	12.0	Africa	625	6.9
Other Latin America	1,736	19.0	Others	2,764	30.3
Vietnam	693	7.6	Total	9,117	100.0

Source: FAO 2006a.

The main markets for coffee are in Europe, where over one half of all coffee is consumed, and in North America. Together these regions consume over 83 per cent of the world's coffee (Table 2.3.5). Japan consumes seven per cent and the Arabic countries about five per cent of the total (International Coffee Organization 2005). Price development has been declining, this being reflected in import values. No important shifts have taken place in regional consumption, even though the share of Europe has

increased slightly. Actual coffee consumption has also increased in terms of volume, although diminished in value terms as a result of falling prices.

Table 2.3.5 Major importing regions and countries for coffee, 2000 and 2004

	2000		2004	
	US\$ million	%	US\$ million	%
Europe	5,693	54.3	5,368	56.2
North America	3,062	29.2	2,588	27.1
Japan	812	7.7	672	7.0
Other Asia	445	4.2	350	3.7
Others	468	4.6	569	6.0
Total	10,480	100.0	9,547	100.0

Note: Export statistics include re-export of processed coffee.

Source: FAO 2002; 2006a.

Fishery products

World fish imports grew more than 25 per cent between 2000 and 2004, reaching more than US\$ 75,000 million in 2004. Developed countries (Japan, the USA and the EU) accounted for more than 80 per cent of the value of imports. The share of developing countries in total fishery exports was 48 per cent by value and 57 per cent by quantity in 2004, with China, Thailand and Vietnam as the leading developing country exporters along with Chile (Table 2.3.6).

Table 2.3.6 Major exporting countries of fish products in 2004

	US\$ billion	%		US\$ billion	%
China	6.6	9.2	Spain	2.6	3.6
Norway	4.1	5.7	Chile	2.5	3.5
Thailand	4.0	5.6	Netherlands	2.5	3.5
USA	3.9	5.5	Vietnam	2.4	3.4
Denmark¹	3.6	5.0	Others	35.8	50.1
Canada	3.5	4.9	Total	71.5	100.0

¹ Including Greenland. Source: FAO 2006c.

Frozen shrimp and prawns are the most important internationally traded fish products in terms of value, accounting for over 16 per cent of the total value in 2004 (FAO 2006c). In Mozambique they are the second largest export item, comprising approximately 11 per cent of total exports, and in Vietnam they account for 45 per cent of fishery exports. Vietnam's fishing industry has shown steady growth since the early 1990s, while in Mozambique production has stagnated. The problem is common in Africa, where the steady increase in fish catches and exports experienced up to the late 1990s has subsequently fallen off. This has been brought about by a rapid increase in the fishing effort, which has raised the catch levels of most commercially valuable species to the maximum sustainable. Aquaculture and shrimp farming have

begun to take hold in Africa only during the last decade, reaching 530,000 tons in 2003 (Akpaniteaku et al. 2005; Harsch 2006).

A few Southeast Asian countries, including Vietnam and Thailand, have developed a thriving export industry of frozen and canned seafood, based increasingly on aquaculture and shrimp farming (Table 2.3.6). This has been the only way to increase production, as natural fish stocks are diminishing. The efforts of the Vietnamese government to develop the fishing industry and fish farming have been successful in promoting exports and reducing poverty, although the production system and its management are often inadequate (Bonaglia 2006). Over one third of world exports of frozen shrimp and prawns originate in Southeast Asia (Table 2.3.7).

Table 2.3.7 Major exporting regions and countries for frozen shrimp and prawns in 2003

	Volume (1000 tons)	Value (US\$ million)	% (of total value)
Denmark (incl. Greenland)	165	384	4.6
Vietnam	125	1,058	12.6
Thailand	113	841	10.0
Indonesia	116	786	9.4
North America	75	350	4.2
South America	200	1,267	15.2
Mozambique	10	73	0.9
Others	362	3,160	37.8
Total	1,429	8,360	100.0

Source: FAO 2005C.

Vietnam has succeeded in expanding exports especially to the EU. At the same time the share of Mozambique has decreased from about two per cent of the world market in the 1990s to around one per cent. It is also worth noting that the value per weight unit is about US\$ 7.6 per kg for exports from Southeast Asia and Mozambique, compared to US\$ 3.1 per kg for exports from Denmark and North America. The difference is explained by the size (which determines the market value) of the shrimp and prawns caught in the southern seas.

The main markets of frozen shrimps and prawns are in high-income countries. The EU accounts for about one third of world imports, North America for nearly 37 per cent and Japan for close to 17 per cent (Table 2.3.8). Again there is a difference in price and quality: the shrimp and prawns imported to North America, the EU and Japan fetch around US\$ 7.0-8.5 per kg, while imports to other regions are valued at US\$ 2.5-4.0 per kg.

Table 2.3.8 Major importing regions and countries for frozen shrimp and prawns in 2003

	Volume (1000 tons)	Value (US\$ million)	% (of total value)
North America	398	3,273	36.6
European Union	430	3,000	33.5
Japan	186	1,574	17.6
China (incl. Hong Kong)	85	213	2.4
South Korea	22	89	1.0
Others	285	793	8.9
Total	1,431	8,942	100.0

Source: FAO 2005C.

Cotton

Cotton cultivation is profitable in the tropical and subtropical zones as it requires a long, hot growing season. Important production areas are China, the USA, India and Pakistan, which in the 1990s accounted for more than 60 per cent of total world production, and a similar share of total world consumption. Cotton is also widespread in sub-Saharan Africa, Central Asia, Brazil, Australia and some Mediterranean countries (Greece, Spain, Italy, Turkey and Egypt). In some major producer countries such as China, India and Pakistan domestic textile industries consume practically all the cotton lint produced. In general cotton production by individual countries has been somewhat erratic owing to changing climatic conditions, pests and international price fluctuations. In the international trade in cotton lint US companies make up 44 per cent of global exports, while sub-Saharan Africa represents about 12 per cent (Table 2.3.9). Production figures per country in the latter region are relatively small. For example, the annual value of cotton lint exports from Mozambique during the period 1999–2002 was on the average US\$ 21 million (USAID 2004a). A third major export area is Central Asia, especially Uzbekistan.

Table 2.3.9 Major exporting regions and countries for cotton lint in 2004

	US\$ million	%		US\$ million	%
USA	4,251	44.0	Greece, Spain & Italy	472	4.9
Sub-Saharan Africa	1,130	11.7	Brazil	406	4.2
Central Asia	876	9.1	Other Latin America	200	2.1
Australia	714	7.4	Others	1,141	11.6
Egypt	483	5.0	Total	9,673	100.0

Source: FAO 2006a.

Important shifts in trade flows have taken place since 2000 (Table 2.3.10). The demand for cotton has gradually shifted to newly industrialised low-cost countries, where the textile industries are competitive. China's expanding textile industries have

vigorously boosted imports, as have also some other Asian countries such as Pakistan and Vietnam. China and Southeast Asia now form the main market for cotton lint,¹⁶ along with other major importers such as Turkey and Mexico. In Europe demand has stagnated, and imports to the EU only slightly exceed that of Turkey.

Table 2.3.10 Major importing regions and countries for cotton lint, 2000 and 2004

	2000		2004	
	US\$ million	%	US\$ million	%
China	517	6.9	3,585	32.8
ASEAN	1,457	19.5	1,567	14.3
Turkey	677	9.0	836	7.6
Europe	1,571	20.1	1,521	13.9
Mexico	542	7.2	566	5.2
Pakistan	81	1.1	523	4.8
Russia	380	5.1	268	2.5
Others	2,265	30.2	2,068	18.9
Total	7,490	100.0	10,934	100.0

Source: FAO 2006a.

Tropical wood

The main markets for tropical wood are the expanding Asian economies, with China, India, Japan and Taiwan in the forefront (Table 2.3.11). Compared to these, the demand in Europe and North America has been modest. The main sources of tropical wood are the rain forests of Southeast Asia and Africa. Excessive removals have depleted tropical forests especially in Asia and export restrictions have been imposed. The tropical log supply from Southeast Asia seems, therefore, to have reached its peak. Especially export restrictions in Indonesia have affected the market, even though illegal removals still continue.¹⁷

¹⁶ After being traditionally a net importer, China became a net seller of cotton lint in 1998. Since 2001 it has again become a net importer. China's 2001 accession to the WTO included a 4.1 million bale tariff rate quota (TRQ) with a one per cent tariff, compared with a 40 per cent tariff for above-quota imports. However, with imports exceeding 15 million bales, China's unilateral trade policy decisions are a crucial factor in world cotton markets (Macdonald and Vollrath 2005).

¹⁷ Russia has been the other important source of timber for China. Russian authorities have, however, imposed export taxes on wood, which will affect the supply to China and activate Chinese buyers elsewhere. The rapidly changing role of China in the global forest product trade has been analysed in detail by White et al. 2006.

Table 2.3.11 Major trade flows of tropical logs to Asian countries in 2004 (million m³)

Importing country	Exporting country						Total
	Malaysia+ Indonesia	Papua-N. Guinea	Myanmar	Gabon	Congo	Others	
China	3.8	1.3	0.9	0.6	0.5	0.2	7.3
India	1.6	0.2	0.5	0.1	–	0.6	3.0
Japan	1.2	0.2	–	–	–	0.1	1.6
Taiwan	0.8	0	0	0.1	0	0.2	1.1

Source: FAO 2006b.

The largest buyer of tropical wood, China, has been compelled to look elsewhere for new supplies, notably in such African countries as Gabon and Congo (Holslag 2006). This has led to imposition of export restrictions even there. The other major Asian importers have so far covered their needs from forest-rich countries of the region.

It is obvious that Chinese and also other Asian importers will be even more attracted to Africa's forest resources in the future. This is already evident in such Southern African countries as Mozambique and Tanzania, where Chinese wood merchants are markedly active. As to Vietnam, there is no timber left to export and domestic wood industry companies (e.g. furniture manufacturers) are currently importing roundwood from the Lao PDR. In the future imports are likely to grow.

Changing trade flows

There is considerable regional variation in markets for products which are important for Vietnam's and Mozambique's exports. The largest markets for coffee, cashew nuts and shrimps and prawns are in high-income countries in Europe and North America. As to rice, the largest markets are in Asia and Africa. The demand for cotton and timber has shifted to low-wage countries, notably China, in which processing and manufacturing industries are most competitive.

The changes in commodity markets reflect changes in the global economy, notably the rapidly increasing share of Asia and especially China in manufacturing exports. Subsequently, the main change in global trade flows over recent years has been the rapid emergence of China as an important buyer for commodity exports, especially oil and minerals, but also timber and selected agricultural products, notably cotton lint (Kaplinsky 2005). Over the past 20 years, China's primary energy consumption has increased by 70 per cent. Whereas it still possesses abundant coal reserves, it is running out of oil and natural gas deposits. Currently almost 50 per cent of its oil consumption is imported, and the rapid increase in the number of cars – among other

things – means that gasoline consumption increases by more than six per cent annually. It has also been estimated that China will overtake the USA as top consumer of aluminium within two years, while its demand for imported wood products is expected to increase by at least 33 per cent within the next five years (Holslag 2006; Tull 2006).

Most of the agricultural products exported by low-income economies are destined for high-income consumers. One key problem for developing countries is that agricultural production suffers from systemic overcapacity. The main industrialised economies (the USA, the EU and Japan) provide substantial subsidies and effective protection to domestic agricultural producers, forcing global prices down to sub-economic level.¹⁸ The other key problem is that despite the process of global trade liberalisation, agricultural exports (especially foods) face increasingly demanding non-tariff barriers and demand driven conditions in respect of quality, lead times, volumes and prices established by both public authorities and private actors such as NGOs (e.g. independent certification systems) and large private retail chains (brand-based criteria). Aside from a few exceptions such as horticultural products in Kenya and fresh fruits in South Africa, the level of processing of food products exported from sub-Saharan Africa has failed to adjust to the current increasingly demand-driven markets. Unprocessed primary products still account for about 83 per cent of Africa's agricultural exports, intermediates about seven per cent and final products only about ten per cent (Gibbon and Ponte 2005; Kaplinsky 2005).

2.4 Developing countries in global and regional trade regimes

Developing countries are becoming increasingly differentiated in terms of their position in global trade. Some such as the Asian NICs and other emerging countries are likely to benefit from the increasing liberalisation of world trade and the principle of reciprocity currently pursued under the WTO framework. At the same time LDCs, which include a number of sub-Saharan African countries, continue to rely on the system of preferential access to developed country markets under specific unilateral concessional agreements established by the latter. For LDCs, the problem is often not access to these markets, but rather a weak capacity to produce goods which are competitive in these increasingly demanding markets. For both groups, however, the WTO provides a key institutional framework – even though for somewhat different reasons.

¹⁸ The sugar industry provides a good example: over 80 per cent of world sugar supplies sell at prices above the world price. Producers of over 40 per cent of world production receive prices 50 to nearly 400 per cent higher than the world price (Borrell and Pearce 2004).

2.4.1 Developing countries and the GATT/WTO trade rules

Despite the fact that developing countries have formally participated in the multilateral trade negotiation rounds in the GATT system from the late 1940s, their influence in trade negotiations and their agenda setting did not get under way until the GATT Uruguay Round (1986–1994). There are both political and economic reasons for this. In the global context, the GATT negotiations were solely activities of the Western hemisphere, and this automatically excluded the Soviet-allied developing countries. Developing countries have started to participate in global trade negotiations only since the breakdown of the two-bloc system and the establishment of the WTO.

However, the global Cold War constellation explains only a minor part of the changes observed in the developing countries' trade policies. As newly independent countries which had just broken away from colonial domination, they were still bound to old economic ties and production structures. Similarly, their emphasis on sovereignty was not limited to external affairs, but was also expressed in domestic social and economic policies striving for self-sufficiency and the establishment of new production sectors. This promotion of domestic production did not favour multilateral trade liberalisation in their trade policies.

GATT and UNCTAD

During the Cold War, the international trade regime was divided into two spheres. The GATT negotiations were dominated by the USA and actively attended by other developed countries. The United Nations Conference on Trade and Development (UNCTAD), on the other hand, was led by the major developing countries. In spite of the fact that prominent developing countries were also participants in the GATT negotiations and agreements, their major attention was directed to UNCTAD, which was focused particularly on commodity trade. Whereas the GATT negotiation rounds developed from *reciprocity* to a general liberalisation of trade, the UNCTAD system emphasised the prevalent interests of developing countries, whose major approach to development was designed to guarantee uncompelled and self-reliant economic policy. Thus the goals of national development adopted emphasised an opposite tendency to the GATT development, namely *non-reciprocity*, *preferential treatment* and *concessions* for the developing countries.

In practical terms this meant that world trade law developed on the terms of the developed countries while some sectors of particular importance for developing countries, for example agriculture and textile products – commodity trade – were excluded from the negotiations. The success of the developing countries in GATT – the partial inclusion of non-reciprocity advocated in UNCTAD – turned out to be an expensive

victory for them. Non-reciprocity relegated the developing countries to the sidelines and weakened their negotiating position in combating trade barriers in developed countries, which were set against the Third World's commodity exports (Srinivasan 1998). The ostensible defence of sovereign national lines in international economic relations turned into an even stronger dependency outside the GATT system: the trade relations between developed and developing countries were regulated through long bilateral trade agreements between ex-colonial powers and their ex-colonies, giving certain preferential treatments which maintained the old colonial ties, but no relative advantage in global terms (Page 2002).

Emerging countries and the WTO

In the late 1980s the world trade system began to alter dramatically. This meant that the number of countries participating actively in negotiations increased and the coverage of trade issues broadened. Two obvious changes took place: certain developing countries which took an active part in the formulation of the GATT Uruguay Round agenda in the pre-negotiation phase turned their nationalist and anti-colonialist rhetoric into judicial-economic argumentation for a more rule-based trade system. This means that those countries gave up non-reciprocity and claims for exceptions and waivers for a *most-favoured-nation* (MFN) clause, opted for reciprocity in negotiations and took the MFN clause as a leading principle. The adoption of a new language was reflected in changes in the identities of these countries (Ford 2003).

Second, the united front of the developing countries, Group 77, disintegrated when the export-oriented developing countries (Brazil, Argentina, and the ASEAN countries) started to ally with those developed countries which shared common trade interests with them. The most important of these has been the Cairns Group, which has defended the interests of agricultural exporters in the GATT/WTO. The group consists of three developed countries (Australia, Canada and New Zealand), nine countries from South and Central America (including Brazil and Argentina), and four ASEAN countries and South Africa, who joined the group in the 1990s. There have been several other more or less temporary pressure groups since the beginning of the Uruguay Round, emphasising the particular interests of members and the changing identities of developing countries (Narlikar 2003).

The changes seen in the policies of developing countries in multilateral trade negotiations suggest that the category of developing countries is too broad to explain the interests and identities of the non-developed countries. Similarly, they reflect changes in production structures in certain developing countries and their need for international trade. In export-oriented developing countries, certain production sectors in agriculture as well as development of labour-intensive industries, first in garments but

then in other sectors such as the electronic industry, have created stronger interests to concentrate on export promotion. The interests and capabilities of these countries differed substantially from those of the least developed countries, particularly in sub-Saharan Africa.

During the Uruguay Round negotiations, which led to the establishment of the WTO, the export-oriented developing countries which managed to include agriculture and textile products in the trade negotiations, accepted new trade principles and trade issues for the negotiations agenda and the forthcoming WTO system. Most important here was the principle of national treatment (NT), which sets foreign producers in equal position with domestic producers. The importance of this new principle is emphasised in the context of the 'new issues' of services and intellectual property rights. The agreement of GATS (General Agreement of Trade in Services) opened the possibility for foreign producers of services to penetrate into sectors which in many countries had traditionally belonged to the public sector. Similarly, the Agreement on Trade-Related Aspect of Intellectual Property Rights (TRIPS) opened up the possibility for foreign governments to interfere in an area which had traditionally belonged to domestic public authority. In these agreements the developing countries backed down from their strict interpretation of national sovereignty.

The WTO principles

In the new WTO trade system there are principles which address three different kinds of orientations. These three elements have been established during different phases in the development of the trade system: *special and differential treatment* (SDT), including *transition periods* for the developing countries before they are required to fully implement the agreement, *concessions* to imports from developing countries made by developed countries, and quantitative import restrictions for balance of payment reasons following the ideas of UNCTAD. In fact the WTO treaty incorporated the *General System of Preference* (GSP) directly from UNCTAD. Accordingly, developing country status allows for non-discriminatory trade preferences from developed WTO members, which is not compatible with the MFN principle. Similarly, there are certain *extra concessions* for the Least Developed Countries (LDCs). LDC status makes possible non-reciprocal market access preferences, which is strictly against the principle of reciprocity. The WTO is using the UN list of LDCs comprising 50 countries, 32 of which are WTO members and eight LDCs which are in the process of accession to the WTO. Mozambique is included in the LDC list, but Vietnam is not (WTO 2006).

Among the WTO principles, SDTs seem to be more important for the developing countries than *reciprocity*, *MFN*, *transparency* and later *NT*. Historically SDTs are well

established in the WTO agreement. They were an integral part of the Uruguay Round Agreement on Agriculture (URAA), and were included in the Doha Development Agenda and again reinforced in the Framework Agreement of August 2004. Nevertheless, there are some aspects which limit their importance for developing countries and even for the LDCs. For emerging countries such as Vietnam in a certain respect is, market access without reciprocity would be beneficial. Now it is included only in the GSP system, and Vietnam does not have GSP status with its main potential export target country, the USA. For the LDCs the problem is, in most cases, that the country does not really have competitive products to export. Perhaps the most critical issue is, however, that in receiving SDTs developing countries lose their negotiating power and reciprocity with developed countries even though this would arguably be more beneficial in the long run (Josling 2005).

There are, however, concrete situations where the above concessions seem to be crucial for developing countries in boosting emerging industrial sectors. The concessions are needed particularly in view of WTO regulations aiming to abolish state subsidies and non-tariff trade barriers (NTBs). The mechanisms used up to the 1990s by both developing countries and the newly industrialised countries (NICs), particularly in East and Southeast Asia, to protect their emerging industries are not permitted in the WTO system without extra concessions.

Liberalisation of trade in textiles and garments

The old Multi-Fibre Arrangement (MFA), set up in 1974 by the European countries, Canada and the US, provides an interesting example. MFA limited textile and clothing exports by producing countries to major world markets in the USA, Canada and the EU, protecting these countries' domestic textile industries from more efficient producers emerging in Asia. The system also created advantages to many smaller textile-exporting countries which were less constrained by quotas and/or enjoyed preferential market access. The preferential access schemes encouraged the development of textile and apparel industries in Southern Africa, notably in Mauritius, South Africa and Lesotho. In most cases the export-oriented textile industries were subsidiaries of major Asian textile companies from Taiwan and mainland China. In some countries such as Lesotho, the textiles and garments industry became the main source of export revenue. During the Uruguay Round of trade negotiations (1986-1994), Asian producers started to argue more vocally that quotas were an unfair restraint on trade. They were joined by large retailers in industrialised countries, who argued that the system forced them to buy from too many different sources (Minor 2005; Mutume 2006).

In 1994, the WTO set up an Agreement on Textiles and Clothing, which provided for a phased removal of all quotas in the sector within ten years. The MFA system thus

ended in 2005, opening up a sector which had been protected for more than 30 years. The system does, however, permit 'safeguard' clauses, which allow for temporary restrictions on imports up to 2008. The USA has already used this opportunity to restrict textile imports from China, which increased by 250 per cent during 2005. Over the last few years more than 250,000 jobs in the African textile industry have been lost, most of them in Southern Africa (Lesotho, South Africa, Swaziland, Mauritius, Zambia, Madagascar, Tanzania, Malawi and Namibia). These countries are rapidly being squeezed out of the world market by giant, highly efficient producers in Asian countries such as China and India. A submission to WTO by the affected African countries noted that by 2008, when the full impact of the end of quotas will be felt, as many as 27 million people could be out of work (Mutume 2006).

It is generally believed that a large proportion of textile factories in Southern Africa will be forced to close down in the next few years as duty-free access alone does not give sufficient competitive advantage against goods made more cheaply in the dominant Asian textile-producing countries. According to some estimates, the cost of doing business in Africa is about 20 to 40 per cent above that in other developing regions, while the inadequate provision and high cost of infrastructure services is another major hindrance. The current GSP rules of origin, which apply under the European Everything but Arms (EBA) initiative, create another barrier. They are based on a system of cumulation of origin, which does not allow for use of imported fabric. Under the US African Growth Opportunity Act (AGOA), LDCs benefit from a four-year transition phase (until 2008) under less stringent rules of origin, giving them a comparative advantage over non-LDC neighbours. For example, by 2006 only about one third of apparel exports from such non-LDC Southern African exporters as South Africa and Mauritius have qualified for AGOA preferences. Also the Cotonou framework allows for use of regional fabrics and yarns in imports to the EU. These preferential access systems could, at least in theory, induce development of the spinning and weaving industry based on locally grown cotton to supply regional textile and apparel exporters. The transition period is, however, soon ending while the US and EU have proposed a complete phasing-out of tariffs on textile and apparel imports by 2015 (Minor 2005; Mutume 2006; Nathan Associates 2002).

Developing countries in the WTO

The reasons for the weak status of the 'UNCTAD aspect' in the WTO system would seem fairly obvious. Although the concessions for the industries in the LDCs are important, the concrete trade negotiations in the GATT Uruguay Round and particularly in the WTO have proved the differences to the UNCTAD. The Uruguay Round and the WTO have exposed the particular interests of developing countries, which

differ between the LDCs and the emerging (Asian) countries. This contradiction is clear in the textile trade, but is also particularly conspicuous in the trade in other labour-intensive products. Apparently this 'UNCTAD aspect' in the WTO system is of minor importance to the other principles of the WTO, both due to the incoherence of non-developed countries and to the incompatibility of SDTs with the general free trade ideology of the trade law.

The SDT principle must, therefore, be seen rather as an exception from the general trade rules than an equal principle of international trade with the same standing as the two other key elements in trade legislation. *Reciprocity* represented the general idea of the GATT negotiations for decades. In multilateral agreements it was concretised by the MFN clause, which emphasises equality and sovereignty between trading partners. This is thus where the interests of developed and emerging countries meet. Together with *transparency*, which principle was adapted to the GATT system in the discussion concerning the banning of NTBs, reciprocity and MFN represent the core political principles of the GATT process.

The last elements – the only elements which refer to the economic system – were adopted during the establishment of the WTO. In spite of the fact that the premises of international trade are based on liberal market economy, these have not been expressed in trade principles. *National treatment* together with *intellectual property rights* refer for the first time to the premises of the market economy. The WTO members have to acknowledge the primacy of private property and free market forces over political authority in certain sectors.

Above and beyond the trade principles, trade-related development issues have received increasing attention in the WTO agenda. The question is how the interests of the LDCs and the WTO trade principles can be combined. In the Doha Development Agenda, concrete steps have been taken to reconcile developing countries' trade interests and the WTO trade principles, including SDTs. Progress has been made on the issues of agriculture, where the previous policies of developed countries have deviated from the general line of trade liberalisation and the related trade principles. Therefore, the SDTs allowed to developing countries and the policy requirement that developed countries open their agricultural sectors in the July 2004 Framework Agreement balance the situation more towards reciprocity and are in harmony with the other trade principles rather than give favourable treatment to developing countries (Josling 2005).

2.4.2 Regionalism: the possibilities of developing countries to cope with global trade trends?

During the late 1980s and in the 1990s, Third World countries began to make regional

trade arrangements (RTAs), particularly through regional organisations. The number of these arrangements increased steadily, so that by 2005 all the WTO members except Mongolia were parties to regional trade agreements. The specific characteristic of trade agreements during the 1990s was that developing countries had themselves established them without developed countries. The context of such arrangements varies; they may be solely RTAs (such as MERCOSUR , *Mercado Común del Sur*) in South America, or they can be parts of broader regional arrangements (SADC, *Southern Africa Development Community* and ASEAN, *Association of Southeast Asian Nations*), while a few of them have managed to establish free trade areas (FTAs) such as ASEAN's AFTA (the ASEAN free trade area).

Old and new regionalism

Regionalism between developing countries, known as 'new regionalism' (Hettne 1994; Hettne et al. 1999) or 'open regionalism' (Palmer 1990), is characterised by the attempt to preserve national sovereignty and to cope with global economic trends. Accordingly, political integration combined with economic integration is not the driving force as in 'old regionalism', of which the European Community is an example. Instead, other instruments of regional co-operation are utilised, including the construction of a common identity with different kinds of cooperative ventures in for example culture, education, industry and trade.

The trade aspect in new regionalism has been emphasised since the 1990s. Particularly the Southeast Asian AFTA arrangement (following administrative arrangements within member countries) refers very much to integration, a key aspect which Hettne and Palmer regard as not belonging to new/open regionalism. Similarly, the trade aspect of regionalism implies that different kinds of RTAs and FTAs must be compatible with WTO regulations.

There are special articles on RTAs in the GATT Agreement. Article XXIV, originally compiled in the pre-WTO period, gives broad possibilities for different kinds of regional agreements, including the custom union. A general prerequisite for RTAs is that the general customs level is not higher and trade is not more preventive than "*prior to the formation of such union*" (Article XXIV: 5, a). In the WTO agreement there are correctives to the GATT agreement, particularly concerning how pre-RTA tariff rates and customs are evaluated, and how long the transitory period when those rates are valid can be (WTO 1994).

Nevertheless, there may be a latent contradiction between certain RTAs. For example, in the case of EC between Article XXIV of GATT and the other GATT rules, particularly those concerning MFN. The WTO documents indicate that these exemptions are accepted as historical necessities. In every case, the GATT and the WTO

rules strongly suggest that the RTAs are not based on customs union, as the contradiction to MFN is obvious, but on other arrangements such as FTAs, which do not have common customs barriers (WTO 2002).

In fact the RTAs established during the 1990s followed the WTO agreement. If there are considerable trade arrangements in the RTAs, they have been made on the basis of FTAs. This means that regional member countries agree on mutual customs and tariff rates, but preserve their own custom levels with other countries. Norman Palmer's concept of open regionalism refers to this. Thus the developments in the world trade regime during the GATT Uruguay Round and the WTO period have had a strong influence on the present model of RTAs. Political recognition of the RTAs, particularly of their importance to developing countries, was reiterated in the Doha Ministerial Declaration in November 2001 (WTO 2001).

The trade regime has not suggested the RTAs; rather they have been, in many cases, responses to developments in the trade regime and politico-economic globalisation. The development of ASEAN indicates this clearly. The ASEAN documents from the late 1960s and 1970s emphasised political means to find an independent line between superpowers and old colonial masters. Economic integration was largely excluded, and the countries sought a common external political line in important political questions. In the late 1980s, during the first years of the Uruguay Round, ASEAN set on to formulate a common external economic policy in the trade regime. Later, at the beginning of 1990s, a common economic area was created in which the FTA would play a central role.

The RTAs in developing countries thus differ clearly from the kind of common economic area which prevails in the EU. Similarly, most RTAs between developing countries have not as strong trade implications as for example NAFTA (North American Free Trade Agreement) between the USA, Mexico and Canada, which had the effect of creating a common market. The main reason for this lies in the production structure. Unlike the EU and NAFTA, the production structures in most of the regionally grouped developing countries are competitive rather than complementary, due to the fact that the main exports of developing countries are minerals/fuels and agricultural products.

Regionalism in Southern Africa

Mozambique's membership in SADC involves both the competitive production structure and the old colonial economic ties. The SADC Trade Protocol, which establishes a free-trade agreement in Southern Africa, became effective in 2000, and Mozambique completed implementation of the initial phase in 2001. At that time, nearly 45 per cent of Mozambique's imports and exports were destined for or originated in

SADC countries. The Republic of South Africa (RSA) accounted for the largest share, with 40 per cent of imports and 20 per cent of exports (Nathan Associates 2002). These figures have changed somewhat since 2004, when two major minerals and energy projects (aluminium and natural gas) reached full operational status. Due to Rotterdam's role as the international hub for the trans-shipment of aluminium, the Netherlands currently provides the principal export market, followed by the RSA, Malawi and Portugal. The largest source of imports continues to be the RSA, followed by the Netherlands, Portugal, India and the USA (AfDB/OECD 2006).

Mozambique is the only member of SADC which is not also a member of one of the two customs unions, the broad but rather weak Common Market for Eastern and Southern Africa (COMESA, which excludes the RSA) or the Southern African Customs Union (SACU). The latter was created during the apartheid era to serve South Africa's political and economic interests, and in 2002 SACU member countries (Botswana, Lesotho, Namibia, Swaziland and the RSA) accounted for more than three quarters of the GDP in sub-Saharan Africa. They have a common external tariff and act as one country with regard to exports from other SADC countries (Nathan Associates 2002). With the exception of the five members of SACU, intra-SADC tariff rates are high and uneven across countries in the region. In certain sectors such as food processing and apparel especially high tariffs against other specific SADC countries are in place. In many cases average tariffs against imports from the EU are lower than against those from some other SADC countries (Lewis et al. 2002).

Regionalism in Southeast Asia

The adaptation of an export-oriented trade strategy in Southeast Asia was dictated by economic imperatives. When the United Kingdom acceded to the EC at the beginning of the 1970s, the old economic ties between Britain and Southeast Asia were severed. The ASEAN countries sought similar preferential treatment with the EC as the Lomé countries enjoyed, but the EC did not accept the proposal. The ASEAN countries then turned toward other markets, including the USA, other Asian countries and particularly Japan. They started to apply the so-called NIC (newly industrialised countries) model which Taiwan, South Korea, Hong Kong and Singapore had already adopted. This means simply that the governments concerned concentrate on export-oriented labour-intensive industries. This emphasis means a strong authoritarian governmental role, including the undervaluation of currency and strict control of wages and trade unions. Success in this called for governmental stability, paraphrased in ASEAN jargon as *national resilience*.

The ASEAN countries had already in the pre-Uruguay Round period attempted to enforce regional trade. In 1977, after they were turned down by the EC, they estab-

lished a Preferential Trade Agreement (PTA). The ASEAN PTA provided for a reduction in tariffs in intra-ASEAN trade on an item-by-item basis. It was established in the spirit of reciprocity, but the countries never succeeded in creating extensive lists of products. It became clear that the PTA had failed when intra-ASEAN trade dropped below the pre-PTA period level during the 1980s (Palmujoki 2001).

The changes in global trade – particularly the Uruguay Round negotiations, the establishment of RTAs elsewhere (including NAFTA), the formation of the EU and activities among APEC (Asia-Pacific Economic Cooperation) - provided the context for the free trade agreement in the ASEAN organisation. In the Uruguay Round negotiations, the Asian-Pacific members of the Cairns group, including Australia, Indonesia, Malaysia, New Zealand, the Philippines and Thailand, started to organise a pressure group against the EC in order to boost the trade in agricultural products. After the USA promoted the initiative, the APEC was born. AFTA was a direct consequence of this development. The primary intention of AFTA was to preserve ASEAN countries' competitiveness, first in the Asia-Pacific area and then in global trade in general. The reductions in custom rates were defined as coming before the reductions in APEC and GATT/WTO.

There has been a modest increase in intra-ASEAN trade during the AFTA period. This increase has been particularly due to the increase in trade between Vietnam and the other ASEAN countries. Similarly, there has been a substantial increase in intra-ASEAN investments, which surprised even regional experts and governments. In fact, the expectation was that creating a common free trade area in the region would attract FDI from the outside. However, the ASEAN enlargement, particularly with Vietnam, created a situation favourable for intra-regional investment.

Southeast Asian regional integration reflects very much the developments in the global trade regime. In this sense it has been reactive. However, the active participation of ASEAN countries, also in the common front, suggests flexible adaptation to changes in the world economy. Here the policies of the ASEAN countries differ from those of the majority of developing countries, this due to their economic policies, stage of development and trade strategies. In fact the majority of ASEAN countries hardly fit in the category of developing countries. The concept of *emerging countries* is more appropriate even in the case of Vietnam, where the stage of socio-economic development is comparable with that in developing countries, but economic indicators such as the growth rate tell of exceptional economic dynamism.

3. Vietnam

3.1. *Country fact sheet*

The area of Vietnam is about 332 000 square kilometers. It measures 1,650 kilometers from the northern border to its southernmost tip on the Eastern Sea, with a coastline of 3,260 kilometers. Vietnam has land borders with China in the north, with Lao PDR in the west and with Cambodia in the southwest. Mountains and tropical forests cover three quarters of Vietnam, but the population is concentrated in the flatlands. Vietnam's population was 83.1 million in 2005, and population density about 240 people per square kilometer. With an annual population growth of 1.2 per cent, the population is estimated to be 95 million in 2015. The share of the rural population is 73 per cent, and agricultural labour force comprises (together with forestry and fishery) about 56 per cent of the total labour force.

The agricultural sector produces about 21 per cent of the total GDP, industries and construction 41 per cent, and services 38 per cent. State-owned industries account for 40 per cent of the industrial GDP, while domestic private manufacturing produces 25 per cent and FDI-based enterprises 30 per cent. Private manufacturing, however, employs four times more than the state sector. Agricultural products account for about ten per cent of exports. Fishery output is about four per cent of the total GDP output, but its share in total exports value is about ten per cent, making Vietnam one of the world's ten largest aquatic product exporters. The textile industry employs 25 per cent of the labour force, creates 31 per cent of industrial output and 18 per cent of the value of exports. The share of oil exports in total exports is 24 per cent, but its role in the industrial GDP is only ten per cent.

Vietnam's potential crude oil reserves in the southern offshore area are about 600 million tons and are likely to increase substantially with continued exploration. Vietnam has proven gas reserves of 640 billion cubic meters. Vietnam's primary coal resource, anthracite, is concentrated in the Northeast. It has potential recoverable reserves of seven to eight billion tons, of which 600 million tons are shallow (within a depth of 100 meters). The country also has abundance of other minerals, including bauxite, iron ore, copper, gold, precious stones, tin, chromate, apatite, and building materials such as granite, marble, clay, silica sand and graphite. The present hydro-power capacity is 10,000 MW. Arable land covers 21 per cent of the total land area, and forest about 30 per cent. One third of the cropland is irrigated.

Vietnam's economy is regarded as a transition economy. The USA considers it a non-market-economy owing to its still large state sector, and thus justifies anti-dumping measures against Vietnamese products. From the point of view of international

trade, Vietnam has become an open economy, as the share of external trade (exports + imports) has grown from 81 per cent in 1990 to 140 per cent in 2004.

Table 3.1 Key development indicators for Vietnam, East Asia and the Pacific region, South Asia and Developing countries

Indicator	Vietnam	East Asia and Pacific	South Asia	Developing Countries
Human Development Index 2004	0.709	0.760	0.599	0.679
GDP per capita 2004 (PPPUS\$)	2,745	5,872	3,072	4,775
Life expectancy at birth 2004 (years)	70.8	70.8	63.7	65.2
Adult literacy rate (% of popul. over 15 yrs)	90.3	90.4	58.9	76.6
Combined gross enrollment rate 2004 (%) ¹	63	69	56	63
Annual popul. growth rate 1975-2004 (%)	1.9	1.4	2.1	1.9
Total fertility rate ² 1970-1975 & 2000-2005	6.7/2.3	5.0/1.9	5.6/3.2	5.5/2.9
Imports per GDP (%): 1990 and 2004	45/74	32/52	13/23	24/36
Exports per GDP (%): 1990 and 2004	36/66	33/56	11/21	25/39
ODA per GDP (%): 1990 and 2003	2.9/4.5	1.0/0.5	1.6/0.7	2.7/3.0
FDI per GDP (%): 1990 and 2003	2.8/3.7	1.7/3.1	-0.6	0.9/2.3

¹Combined primary, secondary and tertiary schools; ² Births per woman. *Source:* UNDP 2005; 2006.

3.2 Human resources: the legacy of the past

The most common way to examine Vietnamese economic development during the last two decades is to concentrate on the policy of economic liberalisation and Vietnam's integration into the world economy. This point of departure is, of course, perfectly legitimate. However, the questions how economic liberalisation is conducted and how Vietnamese society can take advantage of economic liberalisation are of the utmost importance. The issue does not therefore lie solely in material resources, physical capital or natural resources, but in human resources, which can take advantage of scarce material resources.

The human basis of Vietnam's economic development leans on different historical extremes: institutional development of the society before the colonial period and after, the socialist development path in the North particularly after 1955, and the economic culture of South Vietnam before 1975. These form the three layers on which Vietnam's present economic, political and social developments are based. These layers contain both the strengths and the weaknesses of these developments.

3.2.1 Education policy

Vietnam is one of the most homogeneous Southeast Asian countries and it had a structured state system before French colonisation. The pre-colonial state administration followed the Chinese mandarin model in which society was constructed on

hierarchical relationships, starting from family level to village level and from village to province and up to state level. This governance was based on the Confucian education system, which produced civil servants at every hierarchical level, starting from village chief up to provincial mandarins (Nguyen Loc 2006).

The administrative system was supported by the educational system, which penetrated different social strata. Education was broad-based, providing the possibility of social rise for a wide section of the population. The traditional education system started to change after 1910, when the French system gradually replaced it particularly in higher education (Woodside 1976). The comprehensive traditional education which still prevailed at village level up to Vietnam's independence provided a basis for the modern primary education which continued on divergent paths in North and South Vietnam after 1955.

The post-colonial school system was originally formulated after the French model, but the curriculum was revised to give more emphasis to Vietnamese history, language and literature. In the North the curriculum was completed by the teaching of revolutionary ethics and Marxism-Leninism. At the beginning of the 1970s, 70 per cent of the population enrolled in primary education in South Vietnam and in the North 90 per cent received primary education (Porter 1993). After 1975, all public and private schools in the South were taken over by the state as a first step toward integration into a unified socialist school system. The current system includes Primary (five years), Lower secondary (four years) and Upper secondary education (three years).

The difficulties encountered by the Vietnamese economy in the late 1970s and early 1980s hampered the development of education. Despite the high literacy rate (over 90 per cent) the problems occurred in primary education. The government sought to make the first nine years of general education compulsory, despite the continuing shortage of teachers, school buildings and equipment, particularly modern equipment for teaching applied sciences at higher grades. The low morale of underpaid teachers with low job status complicated development. At village level, where the lack of teachers was most obvious, even voluntary teachers were invited.

This pattern changed when economic growth set in in the late 1980s. The situation in primary education is good if compared to that in other countries at the same development level. Primary education from the age of six to eleven is now compulsory. The enrolment rate in lower secondary education is still over 70 per cent, but problems arise in vocational training. The fact that the enrolment rate in vocational training is under five per cent of the age-group has created a severe problem for the development of the Vietnamese economy. There has, however, been some progress in this field, as in 2000 only 13 per cent of labourers had received some kind of training, whereas in 2006 the figure was already 21 per cent (Vietnam Economic Times, 31.1.2007).

The situation is still not totally satisfactory even in primary education. Despite current high overall literacy in Vietnam and despite relatively small differences in access to education among males and females, wide regional differences prevail. In the remote northern province of Lai Chau, for example, the literacy rate is about 49 per cent, and there are twice as many literate men as women. School participation rates remain lower in the mountainous areas of Vietnam's North and Central Zones with their ethnic minority populations. These account for over 13 per cent of Vietnam's population, but they comprise only four per cent of the student population.

Nevertheless, the educational system has remained fairly viable for decades despite Vietnam's severe economic and political difficulties, and this has apparently been an advantage in Vietnam's recent economic and social development. Foreign investors have easily gathered male and female workforce for new factories who learn the requirements of production. Similarly, basic education has supported the development of agriculture, fishery and forestry, as peasant farmers have adopted new species, cultivation methods and production techniques in a relatively short period.

3.2.2 The heritage of bureaucratic socialism

The North adopted the Soviet-style centrally planned socialist economy – bureaucratic centralism and state subsidisation. Individual enterprises followed the production targets they received from the State Planning Commission following hundreds of norms. The central government provided the enterprises with all the materials, collected all their profits and compensated their losses. The equilibrium between production and needs – supply and demand – was to be achieved with careful planning and by means of administrative control.

However, as the economic history of socialist countries has proved, this equilibrium is very difficult to achieve with bureaucratic planning. Moreover, rigid planning and an inflexible supply created and fed corruption. Enterprises were dependent on the bureaucrats in their attempt to achieve production goals: in order to obtain raw materials, equipment and other inputs they had to gain support from higher cadres and co-operate with them. The high cadres were able from safe positions to curb necessary production forces and when an enterprise failed to achieve the goals, the company management was punished, not the cadres. This created a corrupted system where enterprise managers bribed the Party cadres (Porter 1993).

Similarly, the system gave factory managers possibilities for malpractice. The companies were not eager to show their real capabilities and there was a tendency to produce off the balance sheet, which inevitably strengthened the black market. The problem was the difference between state-subsidised official price and black market price. There were abundant cadres, apparatchiks and civil servants who had possibilities to

benefit from this situation. The system thus produced a corruption lane starting from the enterprise down to consumers.

After 1975 this system also spread to South Vietnam. In fact the Fourth Party Congress confirmed highly orthodox Soviet-style economic policies and industrialisation plans. The failure of these policies was due not only to the system itself, but to the political constellation in Southeast Asia, where the Kampuchean conflict caused a strained relationship between China, Vietnam and Kampuchea.

3.2.3 Political unification and exodus of the Hoa people

The Kampuchean conflict dealt a severe blow to Vietnam's economy, such as is likely to prove irremediable – the expulsion of the Chinese residents (Hoa people) from Vietnam. Vietnamese policies toward ethnic Chinese had both external and internal reasons. The Kampuchean conflict which had turned Vietnam and China against each other was an external incentive to this policy. The fact that the ethnic Chinese has such a powerful position in South Vietnam's economy forced the Vietnamese Communist Party, when introducing a Soviet-style economy in the South, to crush Chinese business. There were about 1.2 million Hoa people in Vietnam in 1975, and 85 per cent of them lived in the South. It is estimated that the Chinese controlled more than 80 per cent of the food, textile, chemical, metallurgy, engineering and electrical industries, 100 per cent of wholesale trade, more than 50 per cent of retail trade, and 90 per cent of foreign trade in the South. In fact they controlled nearly all key sectors in the South – banking, trade, transport and industry (Vo Nhan Tri 1990). This situation changed when the US-backed government fell and the Communists took power in the South. However, the position of the Chinese particularly in trade and small scale manufacturing remained crucial in the South and in Ho Chi Minh City dominant even after Vietnam's unification.

As a result of the Vietnamese policies (including campaigns against small-scale trade, pressure to adopt Vietnamese nationality, closing all Chinese newspapers and schools) and the China – Vietnam diplomatic conflict which ultimately led to the Chinese military offense in North Vietnam in February 1979, the Chinese residents started to leave Vietnam in the spring of 1977. The exodus of the Hoa people culminated during 1978 and continued during the following year. Eventually, more than half of the Hoa population left Vietnam (Amer 1991; Palmujoki 1997).

This constituted a tremendous loss in human capital. Besides losing the know-how to operate in a market economy, manufacturing and trade, Vietnam lost access to the Chinese networks which have been an important part of China's modernisation and economic growth during the last two decades. Thus Vietnam lost both domestic and foreign trade capacity and, above all, important foreign investment and funding links

which play a crucial role in China. After the economic liberalisation in Vietnam, the role of Hoa trading capacity is now acknowledged. A part of the Chinese community stayed in South Vietnam, particularly in the Ho Chi Minh City area. According to government estimates there are about 500,000 ethnic Chinese in the city running about 30 per cent of its business activities (Vietnam News Agency 21.2.2007).

3.3 The interlude of centralised socialist economy, 1975–1986

The Soviet-style economy was established in the North 20 years before Vietnam's unification. Thus the central structure of economic governance was already established and in fact, the economy in the South fell into the hands of the North. It has been estimated that when the North Vietnamese army entered Saigon the economy of the South was in a state of collapse. This was for reasons similar to those for which North Vietnam's economy was also shaking: despite opposite paths of economic development, both sides depended heavily on foreign aid and were suffering from insufficient indigenous production. The excess of consumption over production turned to a negative balance in foreign trade and to a large budget deficit. In the South heavy dependence on US aid distorted economic relations and corrupted business (Vo Nhan Tri 1990).

In the new situation US aid in the South switched to the fraternal help of the Soviets and their allies which covered the whole country's enormous budget deficit. The Soviet model, stressing industrialisation, was now adopted also in the South. The construction of heavy instead of light industry was in central focus in the steady and rapid transformation into socialism. The emphasis on heavy industry also took place at the cost of agriculture. Although the Southern Party cadres warned of the tempo of socialist transformation, the Party leadership carried out a hastened transformation into Soviet-style economy.

The consequences, even before the outbreak of the Kampuchean conflict and Vietnam's isolation, were obvious: production in agriculture declined and Vietnam was even unable to produce enough rice for her own consumption. The collectivisation of agriculture was already completed in the North in 1960, and 97 per cent of peasant households were members of co-operatives in 1975. After unification, the collectivisation of agriculture started in the South. The system was particularly non-incentive: grass-root farmers had no links to final product. Work was not economically motivated, as the benefits of the crop went to production brigades. The Vietnamese authorities admitted the problems in agriculture already in the late 1970s, but did not point to the system as such: the key was the development of heavy industry with the support of large-scale production in agriculture, forestry, fishing and light industry (Nguyen Xua Lai 1979).

When agriculture, the basic function of an agrarian country such as Vietnam, failed

to function properly, the whole economy and social development stagnated. During the years 1976–1980 neither industrial output nor national income grew. In fact, during this period national per capita income decreased, indicating the failure in agriculture. Similarly, production targets were not achieved in any industrial sector: in some sectors production was even reduced.

The failure of the domestic economy was repaired by foreign aid. As Vietnam's relations with China deteriorated, the Soviet Union became an increasingly important ally and donor. These economic ties were confirmed by Vietnam's membership in the Council of Mutual Economic Assistance (CMEA).

The failure of the agricultural sector was clearly stated in many Party documents before the economic renovations which started at the Sixth Party Congress of 1986, but the Communist Party was unable to make changes to the economic system and economic governance during Le Duan's leadership. The concentration on agriculture during the period 1981–1985 suggested quite the opposite to the policy adopted in the late 1980s. Despite earlier failures the new emphasis on agriculture meant an acceleration of the socialist transformation, including the collectivisation of redistributed land in the South, integration of agricultural production, the distribution of products into an overall economic plan, and the introduction of a scientific and technological revolution in agriculture.

Like the earlier campaigns for orthodox socialist agriculture, this new attempt failed and the Party had to acknowledge that Vietnamese development needed a household economy as “an integral part of socialist economy”. This official recognition, approved by the Party, was an incentive which finally halted the decline in agricultural production. The fact that although households covered only five per cent of land allotted to the cooperatives, they brought about 50 to 60 per cent of total income to cooperative members plus the major part of their own food supplies, indicated the efficiency of household production. As a result the Vietnamese Communist Party found the solution to Vietnam's economic decline before the political situation allowed its adaptation as official policy (Vo Nhan Tri 1990).

3.4 Doi moi and Vietnam's economic development

The Vietnamese authorities as well as foreign commentators refer to the policy of *doi moi* (renovation) in explaining Vietnam's macroeconomic success starting from the beginning of the 1990s. The *doi moi* process has both domestic and foreign origins. In 1984–85 the Communist Party began to re-evaluate its disastrous economic policy, which concentrated on the collectivisation of agriculture and heavy industry. This policy, together with the Kampuchean conflict, had ruined the Vietnamese economy and brought about large-scale hunger among the population. The foreign input to the

new policies was the Soviet *perestroika*, which gave justification to the turn from the orthodox Marxist-Leninist line.

3.4.1 Political and economic aspects of Vietnam's reforms

The Vietnamese followed Soviet policies only partly in spite of the fact that *doi moi* seemed to be a direct consequence of Gorbachev's *perestroika*. The political aspect of the Soviet model, *glasnost* – openness, was applied in the early phase of Vietnam's *doi moi* in order to oust the most conservative followers of real socialism, but it was never fully implemented outside the Communist Party. The political aspects of *doi moi* were finally detached from the renovation process after the Tianamen incident in China in 1989. The Party leadership reverted to the traditional Marxist-Leninist point of view to emphasise unity and to condemn pluralism in the political system and in the Party (Palmujoki 1997).

This, however, has not prevented the Party from making thoroughgoing changes in Vietnamese society. These changes were the results of economic reforms which the Party had implemented since 1986. They include important reforms such as the liberation of markets, de-collectivisation (including agricultural reform), the possibility to run a private enterprise, and changes in international orientation. All of them were strongly motivated by economic considerations.

The reforms were adopted step by step. Market liberalisation set out from the VI Party Congress (1986) decision to liberate the production of goods and to develop family businesses in agriculture, forestry and fisheries. Private enterprises became a legal basis of the market economy by two laws on Private Enterprises and on Companies passed in 1990. It was permitted to engage directly in international trade, and private property rights received constitutional status in 1992. Similarly, the reforms in agriculture which became decisive for Vietnam's economic development during the 1990s were launched in different stages. In 1988, Party Resolution No. 10 recognised households as the basic unit of agricultural production and the Land Law allowed long-term land use for agricultural purposes. The Amended Land Law (1993) made land-use rights transferable. In 1997, restrictions on trade in the most important agricultural product, rice, were removed. This included the removal of restrictions on domestic trade and private sector direct rice exports (Arkadie and Mallon 2003; Central Institute for Economic Management 2003).

These domestic reforms called for a new orientation in foreign relations. Of course, this orientation was dictated not only by Vietnam's economic reforms, but also by the breakdown of the two-bloc structure. Vietnam's integration in the World economy commenced from the regional setting. When the Cambodian issue was settled in Paris in 1990, Vietnam and the ASEAN countries started talks for Vietnam's membership in ASEAN. After joining ASEAN in 1995, Vietnam received the APEC membership

in November 1998 and finally the negotiations for Vietnam's WTO membership were concluded in December 2006.

The development path which Vietnam took, a combination of market economy and Communist Party power, resembles very much that of China. The problem of authority has therefore been rather similar: how to maintain the political power of the Communist Party and at the same time liberalise the economy and increase the interaction with the rest of the world. In this situation, a new kind of language where the old political concepts refer to the political system and neoclassical economic concepts refer to the market system, were created to justify the respective systems. On the other hand, many central concepts from the old political system have prevailed. For example, the concept of *who will win* (over whom in the socialist or capitalist road of development) or *basic contradictions* is still used in the Communist Party cadres' vocabulary. Similarly the concept of *peaceful evolution*, which is adopted from China, refers to foreign elements dangerous to the Vietnamese political system attending the trend of globalisation (Palmujoki 2007).

Officially Vietnam's economic system is called a 'socialist-orientated market economy', but what "socialist" means here, is far from clear. There are still abundant state-owned enterprises (SOEs) in certain sectors, but their importance is declining particularly since WTO membership. In a reference book made by the staffs of the Central Institute for Economic Management titled *Developing the Socialist-Oriented Market Economy*, the word *socialist* appears on the cover but not in any positive connotation in the book (Developing the Socialist-Oriented Market Economy). It may be argued that the word *socialist-orientated* refers to the prevailing political system and the Party's controlled policy in market liberalisation, while *market economy* refers to the economic system toward which the Vietnamese economy is directed.

It is legitimate to ask, however, how indigenous the Vietnamese strategy is? The emergence of *doi moi* many years before international donors, funding institutions, international organisations and non-governmental organisations commenced their operations and full activities in Vietnam, suggests a strong domestic origin and guidance of development. The Chinese model was mentioned above, but this does not mean that the Vietnamese development model has been directly adopted from outside. Nevertheless, over ten years, foreign donors have had a conspicuous role in Vietnam's economy. Their input is not comparable to that of the Soviet Union, but in some sectors, particularly in agriculture, it has been decisive. The ODA covers the government's budget deficit or balance of payment deficit. This has been four to five per cent of the GDP between 1995 and 2001, i.e. slightly higher than the average ODA in countries of the same development level and clearly higher than the average of low-income countries. Only the heavily indebted poor countries receive markedly higher ODA (UNDP 2004).

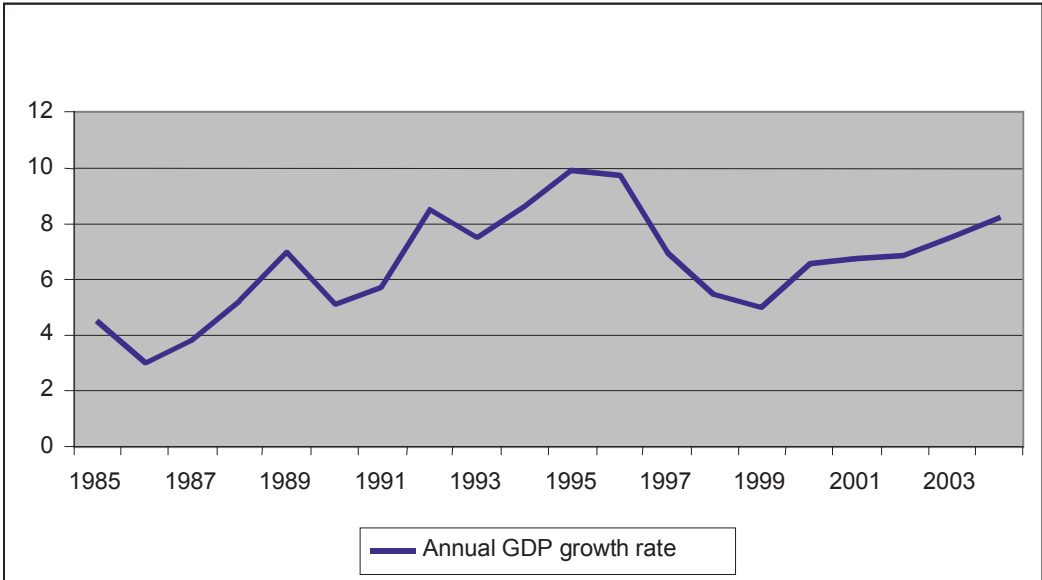
Whether the ODA guides Vietnam's domestic policies according to the intentions of the donors is difficult to say. The emphasis on the agricultural sector emphatically suggests donor influence in the development of agriculture. However, Vietnam has retained firm possession of on the country's funding and projects. The donors do not feature in the Communist Party's publications. These are emphatically interested in other international issues such as Vietnam's WTO accession, rather than Vietnam's relationship with the donors (Palmujoki 2007). This does not, of course, prove anything as to donor influence on Vietnamese development policies, but emphasises the Communist Party's intention to express Vietnam as a sovereign actor.

There are some policy lines and concepts adapted to government's policies, programmes and jargon which clearly refer to Vietnam's donors. For example, the Comprehensive Poverty Reduction and Growth Strategy (CPRGS) launched in 2002 follows the general lines of the World Bank's Poverty Reduction Strategy Paper's lineation and therefore the objective, *"to support Vietnam's transition to a market-economy, will continue to be a central focus of the Bank Group's activities, with a shift in focus from 'design' to supporting the Government on 'implementation' of the policy reform agenda"* (The World Bank 2006a). However, the fact that the donors are eager to help the transition to market economy is still far from saying that Vietnam is following their guidelines. Quite the opposite, the eagerness of the donors to support Vietnam more extensively than average countries at the same development level is explained by the fact that there is *"continued enthusiasm among donors for the general direction of policy change and for the country's economic potential"* (UNDP 2005, p. 5).

3.4.2 The nature of economic growth

Since the late 1980s Vietnam's economic and political development has been phenomenal in two respects. Economic growth has been steady and rapid except for a short period during the Asian economic crisis, and the political system has been stable despite changes in the Communist Party leadership, which have passed without visible political upheavals. Vietnam's economic growth surpassed five per cent in the late 1980s (Figure 3.4.1); in the period 1992 to 1997 it was nearly nine per cent and in the period 1998 to 2001 about six per cent despite the Asian economic crisis (Klump and Bonschab 2004). In the first decade of the millenium economic growth in Vietnam has exceeded eight per cent (Central Institute of Economic Management 2006; Current report of economic indicators).

Figure 3.4.1 Annual GDP growth rate (%)



Source: RSPAS 2006.

The total GDP growth as such tells little of the economic realities in a given country. For example, the surrounding countries, Lao PDR, Cambodia and Myanmar enjoyed strong growth rates during the late 1990s and early 2000s, but when the growth of the GDP per capita is examined, only in Vietnam’s case was the growth positive (1996 index = 100, 2002 index = 130¹⁹, implying an annual per capita growth of 4.5%²⁰). Similarly, the gap between Vietnam’s per capita income and other countries in the region, for example the Philippines and Indonesia was not as desperately wide as it was in the late 1980s, reflecting changes in both domestic production and consumption, as well as in regional economic relations (Arkadie and Mallon 2003).

This economic growth has been accompanied by a reduction in poverty. The figures are rather impressive: every indicator reflects a strong reduction of poverty during the 1990s. The government’s official statistics-based measurement (GSO) follows the World Bank’s assessment of poverty based on food basket, according to which the poverty line lies at the value which ensures a ratio of 2100 per capita calories per day. The MOLISA (Ministry of Invalids, Labour and Social Affairs) poverty line is based only on the value of rice. The one dollar poverty line utilises a monetary unit which is easy

¹⁹ ASEAN Statistical Yearbook 2003.

²⁰ Klump and Bonschab 2004, 9.

to compare internationally, but difficult to apply in a situation where the difference between the really poor and people living on the frontier of traditional and modern economy is difficult to estimate. According to these respective estimates, in Vietnam either 28.9 per cent (GSO), 12.4 per cent (MOLISA) or 13.6 per cent (US\$ 1-line) of the population lived under the poverty line in 2002. In 1990 the figures were 65 per cent (GSO) and 50.8 per cent (US\$ 1-line),²¹ indicating that over one half of the population were living in poverty (Klump and Bonchab 2004). According to the latest (2005) World Bank estimate, which is the same as the GSO, the prevalence of poverty has fallen below 20 per cent (World Bank 2005a, Statistical Yearbook 2005).

The development has been outstanding, even if Vietnam is compared to other Asian countries which have been successful in poverty reduction. Applying the one US\$ per day poverty line, China reduced its absolute poverty from 32 per cent in 1990 to 17 per cent in 1999; Thailand reduced poverty from 11 per cent in 1985 to 2 per cent (1996), and Malaysia from 5.6 per cent in 1989 to one per cent in 1995. Despite the different stage of development and the difficulties in making comparisons, Vietnam's figures were good (Klump and Bonchab 2004). The fact that Vietnamese growth has been broad-based strengthens Vietnam's position even more in these comparisons. World Bank researchers found education to be one obvious explanation for this, while other factors – geographical location in particular – worked against broad-based growth. The growth was focused in urban areas, Red River Delta and the Southeast, while the poverty incidence remains high in rural areas (Glewwe et al. 2002).

3.5 Doi moi, regionalisation and trade

The difficulties in fitting the word *socialism* to the new economic policy have not slowed down Vietnam's development policy either from the domestic, or from the international standpoint. On the other hand the Communist Party has expressed itself as a dynamic but sole leader of Vietnam in a turbulent world, which in the best way can guarantee Vietnam's path to becoming part of the global economy.

The new international orientation was closely associated with economic reforms. Already in the early years of renovation the Vietnamese foreign minister Nguyen Co Thach emphasised that the *doi moi* process calls for changes in thinking not only in domestic economic orientation, but equally in the thinking in external policies and Vietnam's position in the region and the world (Palmujoki 1997).

When the economic reform commenced in the mid-1980s Vietnam's international trade was regulated by inter-governmental agreements and overall trade was particularly low if compared to Southeast Asian capitalist countries. More than half of the

²¹ MOLISA's estimate was not available.

trade was with the Soviet Union and her allies and only ten per cent of domestic production was exported. The necessary imports exceeded exports and the trade deficit was financed by Soviet aid. When the Soviet Union's capacity to support Vietnam decreased and ceased as the Soviet Union disintegrated, Vietnam was compelled to adopt its foreign minister's advice on globalisation. Following the reforms described above, Vietnam's exports and imports began to increase at the beginning of the 1990s. In the early years of the present decade the value of exports reached 55 per cent of the GDP (Jenkins 2004).

Although the international setting compelled Vietnam to liberate foreign trade, this involved a series of governmental policy delineations. Liberation of trade activities was one such delineation, and the removal of most export taxes another. However, the long-term policy outline was to engage in free trade, first at regional and then at global level.

Vietnam's accession to the ASEAN organisation coincided with the formation of the ASEAN Free Trade Area (AFTA). AFTA was an ambitious plan of the ASEAN countries to create an FTA if not mainly to increase regional trade, then to attract FDIs into the region. As the main instrument to promote AFTA and reduce the general tariff level, the Common Effective Preferential Tariff (CEPT) scheme includes major elements for trade liberation in Southeast Asia. Although Vietnam was not obliged to follow the fast-track tariff reductions, the CEPT agreement addressed other elements such as the non-tariff barriers (NTBs) which Vietnam encounters in negotiations with the WTO (Palmujoki 2001). In the ASEAN Hanoi Summit in December 1998, the ASEAN governments decided to accelerate AFTA. This decision nullified those benefits which Vietnam and other less developed ASEAN members enjoyed in the earlier CEPT scheme and compelled them to undertake a stricter schedule in tariff reductions. By the year 2010, 80 per cent of all products will enjoy zero-level customs in the whole AFTA area (The Jakarta Post, 12 January 2007).

ASEAN's role in Vietnam's foreign trade is important, but not dominant: it is one of the country's three major trading partners. Trade statistics show that the production structures of the ASEAN countries are competitive rather than compatible. Although Vietnam is clearly less developed than the so-called *ASEAN Six*, it is not at the bottom of the production ladder of ASEAN, and is thus competing with many of the Six's products. Hence, despite AFTA, the proportion of ASEAN trade in Vietnam's total foreign trade was about 22.8 per cent in 2005. This is close to the average of the more developed ASEAN Six countries.²² On the other hand, Vietnam's figure is rather far from two other poor ASEAN members, Lao PDR and Myanmar, where the shares of intra-ASEAN trade exceeded 50 per cent. Only in Cambodia was the share of intra-

²² ASEAN's share in trade in the Philippines was 18.1%, in Thailand 20.0%, in Indonesia 23.1%, in Malaysia 25.8 %, in Brunei 28.1 % and in Singapore 28.9%.

ASEAN trade markedly lower than in Vietnam and the ASEAN Six. If the total trade is counted, the ASEAN share is greatest in Vietnam's foreign trade. However, ASEAN is still not the main export market for Vietnam. According to ASEAN's own statistics, 21.9 per cent of Vietnam's exports go to the USA, while the share of the EU is 21.4 per cent. The ASEAN region is in third place in Vietnam's export markets with a 17.6 per cent share (ASEAN 2005).²³

Obviously these figures do not fully reflect the importance of ASEAN in Vietnam's road to globalisation. The significance of ASEAN has been both political and practical. Membership in ASEAN notably eased Vietnam's membership in APEC. Although the latter has not gained such economic importance as was expected, membership has been a vehicle in gaining contact with different trading partners, particularly with the USA. On the practical side, Vietnam's integration in ASEAN and AFTA has compelled it to adopt ASEAN's customs procedures, which were already following universal standards, and to reform its foreign trade administration.

3.6 Vietnam's integration in global economy

Trade constitutes only one element, albeit an important one, in dealing with a country's integration in the world economy. Another component of global integration is FDI, which has had an important role in the development strategy of the old ASEAN countries. Most of the economic reforms carried out in Vietnam from 1986 onwards helped to attract foreign investments into the country. The Law on Foreign Investments of 1987 was the prologue for the various laws and regulations designed to facilitate FDI in Vietnam. As a consequence of the reforms, FDI increased rapidly between 1992 and 1995, reaching over 20 per cent of the GDP before the Asian economic crisis, when foreign investors withdrew their funds from Southeast Asia, including Vietnam. From 1999 onwards FDI started to grow again, but has not reached its previous share in the GDP (Arkadie and Mallon 2003).

The role of FDI was particularly important in export-oriented industries when Asian companies invested in the footwear and garment industries. In 2005 Asian investments represented 50.6 per cent of invested foreign capital in Vietnam. At the same time the European Union member countries' investments comprised 21.7 per cent of total investments, while FDI from the USA remained small, amounting to

²³ The statistics vary greatly according to source. In the Vietnamese statistics (Ministry of Trade and General Department of Customs), the USA occupies first place, while ASEAN's ranking in Vietnam's exports is either third (2004) or second (2005), thus changing places with the EU (Central Institute of Economic Management 2005). According to the WTO's statistics (2006), Vietnam's first export partner is the EU (19.9%) and second is the USA (19.6%) (WTO 2007).

only 3.6 per cent of the total. In 2005 FDI contributed about 16 per cent of the GDP and 34.5 per cent of exports. The direct workforce in this sector was 870,000 workers, excluding innumerable indirect workplaces in construction and services (Central Institute of Economic Management 2005).

3.6.1 Membership in the WTO

Vietnam's last step on the way to globalisation has been membership in the WTO. The process started with Vietnam's application, which was submitted in January 1995, and ended with formal accession on January 11th, 2007. The accession process thus lasted for 12 years. The Vietnamese had to give up many of the goals they had set for the accession negotiations. For example, the general customs level which the country sought to maintain was 25 per cent, but in the accession treaty it was only 13.5 per cent.

The export-oriented development path Vietnam took makes access to export markets crucial. As the current global trade regime is based on the idea of *reciprocity*, emphasising that access to foreign markets requires opening to imports in turn, membership in the WTO was seen as the best way to achieve this. However, the path that developed countries have used in building their industrial sectors was based on the protection of domestic markets. This was also a conscious policy of many East Asian countries, starting from Japan after the Second World War. In fact, Vietnam also protected its domestic markets during the period of rapid economic growth from 1990 to 2005. The long negotiation process benefited Vietnam in protecting its markets and in giving time to adopt its domestic economy to global competition. Thus, as much as the difference between Vietnamese intentions and the final results tell of the unequal character of multilateral negotiations, the negotiations also made possible a reasonable transition period.

The opening of the domestic market to imports and its threat to domestic production were not the only difficult issues for Vietnam. The TRIPS (trade-related aspects of intellectual property rights) and GATS (General Agreement on Trade in Services) agreements, for example, hardly coincide with the interests of developing countries, but serve rather those of developed countries with strong economies and advanced technologies. Similarly, complex trade negotiations call for a broad range of experts who can identify the different interests underlying proposed legislation and details in trade negotiations in order to foresee the consequences of new agreements. Thus the view that developing countries have joined the WTO rather reluctantly would seem justified. The reason for joining the WTO is not in its rules as such: it is rather that WTO membership is seen as a guarantee for the donors and funding institutions that the recipient country will conduct proper economic policies. WTO membership can thus help to obtain funding from international institutions.

Whether such considerations lay behind Vietnam's WTO membership is not clear. Such a conclusion is supported neither by the Vietnamese development strategy, nor by the activities of the international agencies and funding institutions such as the World Bank. Nor do Vietnamese political texts refer to this consideration. In any case, there was at least a latent dilemma for Vietnam. The WTO principles introduce risks to the social and political system by limiting political authority as well as granting market access to imports against which Vietnam's domestic production cannot compete. The traditional demand of the developing countries for preferential treatment thus tempts Vietnam to adopt protectionist policies. On the other hand, however, when Vietnam is identified as an emerging export-oriented Southeast Asian country, the WTO principles, particularly non-discrimination and transparency, open up new possibilities to defend its interests globally (To Huy Rua 2004).

The WTO principle of *non-discrimination* meets Vietnam's general idea of globalisation with sovereignty. The ASEAN countries have invoked this and the WTO's negative stance against production-based certification (which is considered a non-tariff trade barrier, NTB, derived from the *transparency* principle) when developed countries – especially the USA – have imposed environmental and labour-related trade barriers. ASEAN countries have also appealed to these principles when developed countries, led by the USA and the EU, have insisted that ILO agreements and other social standards be included in the WTO legislation. In most cases, this policy of appealing to the WTO rules has been successful, and the WTO's Dispute Settlement Body has supported the ASEAN countries' lawsuits.

The legal framework of the WTO can thus provide for a poor and weak country victories in its trade disputes with a rich country. Whether these victories are essential to the whole economy is questionable, but they may be vital to a specific sector. They are particularly important for political identity when countries emphasise national sovereignty as a basic principle in their external relations.

Although Vietnam was forced to accept a low level of customs duties after these negotiations, the Vietnamese managed to make important revisions to the coverage of GATS in order to support their political system. The implementation of the GATS treaty in Vietnam does not cover 'culturally sensitive areas', the most important of which is communication and media. This means that Vietnam's accession conditions allow the Communist Party to maintain absolute control over media. It can decide on the developments of the communication system, for example mobile phone network providers' operation possibilities in Vietnam.

3.6.2 Reform of the revenue system

Accession to the WTO also created an immediate revenue problem for the Vietnamese

state, the solution to which has a profound influence on the country's development. Before economic reform, a major share (60%) of Vietnamese state revenues came from import and export taxes. However, due to AFTA and the gradual lowering of customs levels in order to prepare for the WTO system, state revenues were reduced by 40 per cent. After accession they have continued to decrease, and with a weaker economic growth rate Vietnam would be facing a serious budgetary deficit. There are two choices if negative state budget and borrowing are excluded: (i) privatisation of public services according to the neo-liberal mode, or (ii) reform of tax administration in such a way that the revenues can be maintained at a level which secures public services.

According to the latest figures available (from 2004), indirect tax revenue (51%) is slightly higher than direct tax revenue (49%). The total tax revenue is 22.9 per cent of the GDP. However, the share of indirect tax will decrease drastically due to the WTO treaty. In 2004, the corporate income tax share was 27 per cent and consumption tax 23 per cent of total tax revenue. Hence, the basic problem is personal taxation, which in practice does not exist. In theory there is a system of progressive income tax in Vietnam, according to which the tax rate can increase even to 65 per cent of income (Investment and Trade Promotion Center 2007), but in practice income tax has been collected from only a few (foreign) people. Total income tax revenue is only two per cent of the overall income revenue (Japan National Tax Agency 2007).

Two facts explain this. First, Vietnam's taxation bureaucracy had not managed to reform its traditional system where personal taxation was unnecessary. Second, total incomes are rather difficult or even impossible to monitor due to the variety of income sources citizens (even state employees) have. There is a major reform strategy in tax administration to be launched in 2010 in order to maintain tax revenue at about 20 to 21 per cent of the GDP. It consists of structural reforms in the administration, including modernisation of the tax collection system through IT technology and Individual Income Tax Law, which is expected to be submitted to the National Assembly in the year 2007 (Asian Development Bank 2006). If this proceeds successfully, it will make major changes to Vietnamese governance structure. At the same time it would be a logical development according to the Asian model Vietnam has chosen.

3.6.3 The structure of export industries

How Vietnam will adapt to the global economy is very much related to the structure of the economy and production, especially the role and structure of exports. The economic reform process and the exploitation of oil resources have brought new sectors to the top of the exports list. The rising price of crude oil has increased its importance in Vietnam's economy over the past few years. Crude oil has been the main export product (in terms of value) for a decade, but coal has risen in importance in

the mid-2000s thanks to exceptional international demand (Vietpartners 2006), but its importance in the future depends on the government's activities to restrict exports of crude oil and compliance of these actions with the WTO rules (Vietnam Industry 2006; Minh Anh 2006). Agricultural reform and de-collectivisation have made agricultural and marine products the two most important export sectors after petroleum. The rise in commodity prices on the world markets during the 1990s raised the value of rice exports to second place (6% of total exports) in an item-based examination of exports (Narray et al. 2005).

Table 3.6.1 Vietnam's export structure by commodities

	2000		2004	
	US\$ million	%	US\$ million	%
Fishery products	1,479	10.2	2,408	9.1
Coffee	600	4.1	693	2.6
Other foodstuffs	1,701	11.8	1,846	7.0
Oil, lubricants	3,825	26.4	6,233	23.5
Other crude materials	384	2.6	831	3.1
Chemical products	159	1.1	421	1.6
Electronics	789	5.4	1,427	5.4
Textiles, garments	1,892	13.1	4,474	16.9
Footwear	1,472	10.2	3,040	11.5
Machinery, transp.	1,276	8.8	2,562	9.7
Others	906	6.3	1,855	7.0
Total	14,483	100	26,485	100

Source: Statistical Yearbook of Vietnam 2005.

The relatively high share of exports, about 55 per cent of the GDP, suggests that Vietnam, at least generally, benefits from open trade. The role of agriculture in exports and particularly the intensiveness of labour in this sector (55%) further suggest that the effects of the WTO treaty on Vietnam's employment are mostly positive. Similarly, the sectors which have benefited from FDI, notably the textile and footwear industries, have a strong position and are labour-intensive. There are, however, certain sectors which are not competitive against imports. Especially state-owned enterprises (SOEs) in old industrial sectors which have so far benefited from subsidies will face difficulties and lose workplaces. Accordingly, those SOEs which have benefited from the two-price system particularly on cheap energy, for example thermo-power plants, and the pulp, fertiliser, construction, and metallurgical industries, are expected to suffer from Vietnam's WTO accession and are facing major institutional changes and even declining. These products have not occupied an important place in Vietnam's exports, but the SOEs do, however, account for 40 per cent of Vietnam's industrial GDP.

How SOEs will survive during the next few years will be crucial for Vietnam's economic and social development at least in the short run. Nevertheless, not all SOEs are threatened by imports. For example, those engaged in joint ventures with foreign

companies are still major actors in the textile and garment industry (Nadvi et al. 2004). From the point of view of direct employment, the issue is not as crucial as, for example, the non-state manufacturing sector which employs four times more people and has a much more important role in foreign trade, even though its contribution to the GDP is only about 60 per cent that of the SOEs' industrial production.

Membership in ASEAN ensured that the tariff rate will continue to decline, and with ASEAN members will be below the WTO level. The multilateral negotiations forced Vietnam to reduce its customs level more than it expected and this, together with other WTO rules such as NTB-rules and the negative stance against government subsidies, will intensify competition in Vietnam. In bilateral negotiations with the USA, the Vietnamese encountered what was perhaps the most irritating point: in order to gain access to the WTO, Vietnam had to accept a bilateral treaty with the USA which gives Washington the legal right to discriminate against Vietnamese products for 12 years. Vietnam had to agree to allow the USA to continue defining Vietnam as a 'non-market economy'. This definition is applied to socialist economies such as Cuba and North Korea, and to some transitional countries like Vietnam and China, which still have a large state sector in the economy. The 'non-market economy' definition makes it easier for the USA to impose anti-dumping tariffs on Vietnamese products, as it has already done with catfish and shrimp.

The significance to Vietnam of the potential negative trade clauses inscribed in the USA-Vietnam bilateral trade agreement is, however, not as great as the political debate on it may have implied, because Vietnam's exports are divided fairly equally between three trade blocs, the EU, the USA and ASEAN.

3.7 Trade Capacity and Production Sectors

The starting-points of Vietnam's Communist Party and the government in the export-oriented economic strategy has been comprehensive. Export promotion has covered all the production sectors in which the Vietnamese have a comparative advantage. However, despite this basic strategy, the government and the Party have protected the weak state sectors of industry and manufacture which would not be competitive in global markets by means of a long transition period in the WTO accession negotiations. This step-by-step approach, including legal and administrative changes, both in the status of the SOEs and the administration, facilitated the adaptation of Vietnamese producers to the WTO rules. The other side in this approach has been that the Vietnamese managed to secure trade agreements with its major donors, for example the EU and Japan, which have guaranteed large-scale market access even in GSP terms and without the WTO treaty (Kokko et al. 2006).

Vietnam's comparative advantage lies in agriculture, light industry and manufactur-

ing. These are sectors which were despised by the traditional socialist development orientation. Interestingly enough, these sectors have made by far the greatest contributions to social development, particularly to poverty reduction. The question is not simply of profitability between public and private enterprise, for in the light industry sector (textile and garments particularly) SOEs are still the major players ahead of the private sector.

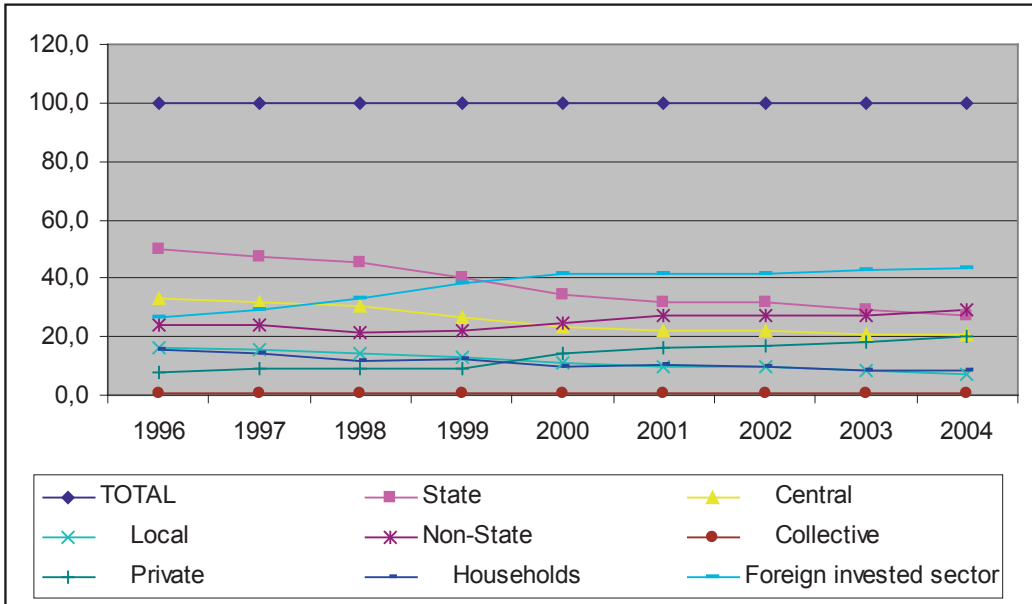
3.7.1 Industrial development

Despite the agricultural reform, and the fact that agriculture has played a central role in Vietnam's economic development during the last 20 years, the growth of industry has been decisive. It is the largest sector in Vietnam's economy, constituting 41 per cent of the GDP. Its growth rate has been two and half to three times higher than that of agriculture and one third higher than services, while its contribution to total GDP growth is nearly 50 per cent (Central Institute of Economic Management 2005, p. 10). In Vietnam's exports particularly light industry characterises the country's economic strategy.

The state sector's role continues strong in industry. Although free enterprises have had a legal basis for a decade, lack of capital means that the state owns the major part of the capital-intensive industries. It also has a large share in some labour-intensive sectors such as the textile industries. The state companies are also co-partners in joint ventures with foreign companies in Vietnam. The GDP in the industries is formed by SOEs (40%), domestic private manufacturing (25%) and FDI-based companies (30%). However, as already noted, many of the capital-intensive SOEs are suffering from poor efficiency and are in danger after WTO accession.

The industrial output value of the private sector has already passed that of the state sector, and private (including household) manufacturing already employs four times more than the state sector (Figure 3.7.1). Together with foreign industrial companies, which have the highest output value, the private sector is strongly involved in those industrial branches which are currently taking a strong foothold in exports.

Figure 3.7.1 Industrial output value by ownership (%)



Source: GSO 2006.

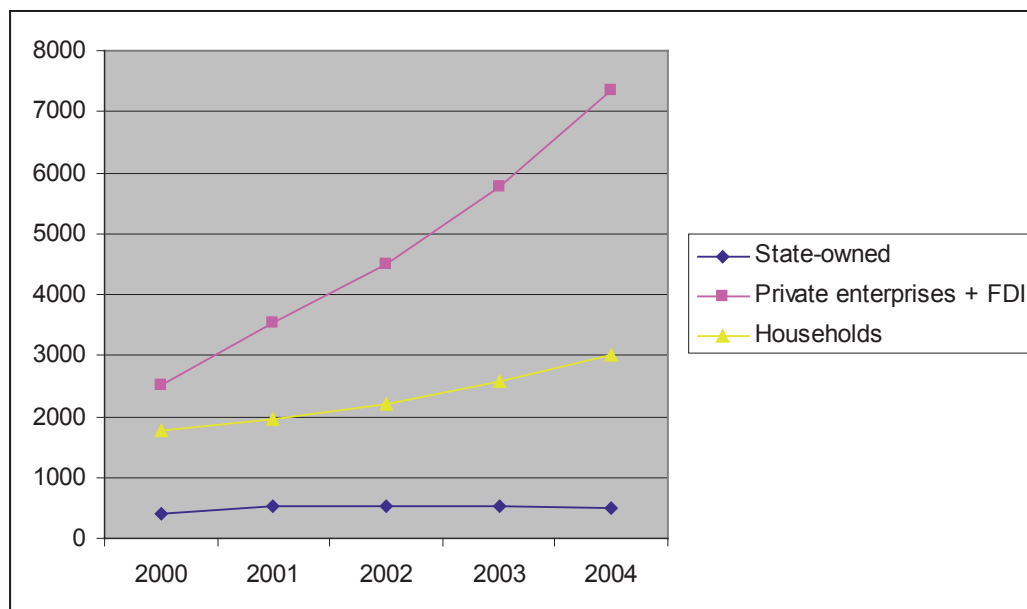
The Furniture Industry

The development of the furniture industry represents an example of the above trend. The private sector, including both Vietnamese enterprises and foreign companies has taken a firm grip on furniture manufacturing in Vietnam. During the 2000s, the country has developed into a world-scale exporter, and private actors have played a crucial role in this process. Figure 3.7.2 shows how private enterprises (including foreign-funded companies) have reaped the main benefits from exports. The household manufacturing sector has also benefited from Vietnam’s furniture boom, while the state-owned furniture industry’s role is declining.

Furniture production has been concentrated in Ho Chi Minh City, with a cluster of main exporters targeting the US and European markets, whereas manufacturers in Hanoi specialise in more traditional furniture aimed at Asian markets. Ho Chi Minh City is the home of 70 per cent of Vietnam’s 600 largest furniture producers. There are about 60 companies with foreign capital, both joint ventures and purely foreign-owned companies which have been established in Vietnam. These companies typically operate in the export markets. Some companies have a regional origin (mostly Singapore and Taiwan), but there are other big players such as IKEA (Ministry of Foreign Affairs of Denmark 2007).

The furniture industry reflects Vietnam's new export sector in several respects. First, it is composed of both private and foreign companies. It benefits from cheap labour costs, but at the same time from quality craftsmanship.

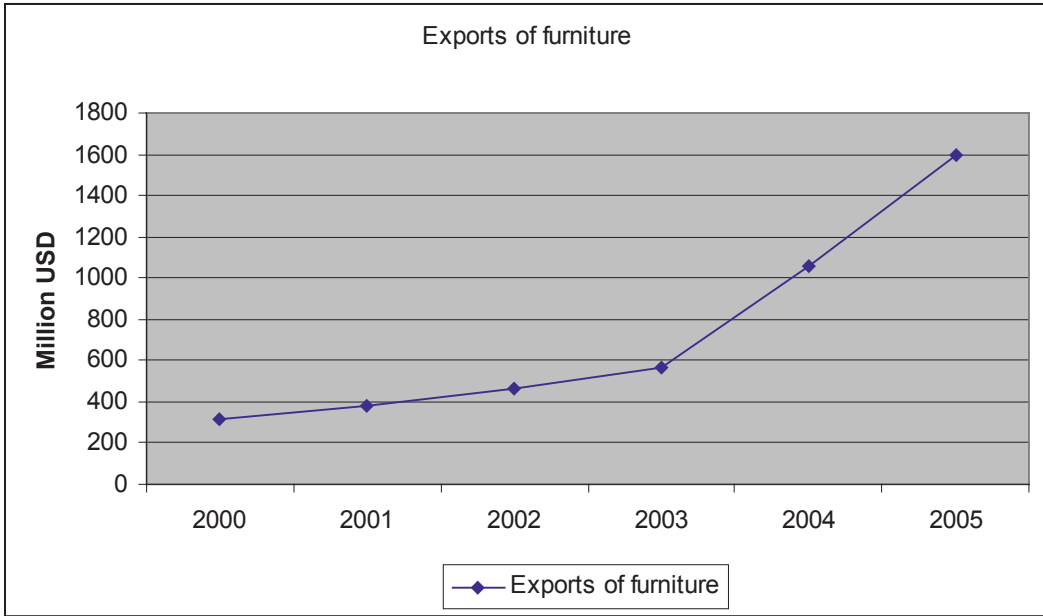
Figure 3.7.2 The output value of furniture manufacturing by ownership 2000–2005 (billion dong)



Source: Statistical yearbook of Vietnam 2005.

The fact that most of the raw material is imported to Vietnam (about 75% of timber), is also characteristic of Vietnam's export-oriented furniture sector. This naturally shortens the value chain in Vietnam, which is not, however, as short as in certain branches, such as the textile and footwear industry.

Figure 3.7.3 Export turnover of furniture



Source: Statistical Yearbook of Vietnam 2005; Ministry of Foreign Affairs of Denmark 2007.

3.7.2 Case study: textile and garment industry

Textiles and garments have traditionally been a key industry in employment and export revenue creation in Asian countries. The textile industry employs 25 per cent of the labour force, creates 31 per cent of industrial output and constitutes 17 per cent of the value of exports. In Vietnam garments are the largest foreign exchange earner in the manufacturing sector. Indeed, Chinese and Vietnamese companies have expanded while several Asian producers in India, Thailand, Indonesia and Turkey have declined in world markets. Vietnam's share in global exports is negligible (about 1.5%), but the sector's growth has been conspicuous and its role in employment creation, especially for women, is crucial.

Vietnam's comparative advantage lies in the labour-intensive garment industry, in which wages account for about 40 per cent of production value. In the textile industry this share is below 20 per cent (Bonaglia 2006). Besides, textile production is handicapped by the lack of an adequate raw material base and also low quality. Most textiles are used domestically as inputs into the garment industry, which works primarily for exports (84% of output, Nadvi et al. 2004). The share of domestic textiles in garment production has declined to near 20 per cent (Bonaglia 2006) e.g. for quality reasons.

The size and ownership structure of the industry is diversified, reflecting the ongoing transition process in the manufacturing sector. Large state-owned textile and garment firms still occupy an important though declining position. These firms are grouped within the national textile and garment corporation Vinatex, whose share in the industry's export was reported to be 30 to 40 per cent in 2000. Vertical integration of fabrics and garment production is typical of the state-owned firms. After the dismantling of the command economy, a large number of private and also foreign-owned firms have emerged. These mostly use imported fabrics. In the production assortment woven garments (trousers, coats, anoraks, shirts) dominate (Nadvi et al. 2004).

Export performance has been impressive, but net export earnings remain relatively modest due to imports of inputs (cotton and other fibre, yarn, equipment, design). According to some estimates, only about 25 to 30 per cent of the FOB price of a garment remains in Vietnam (Knutsen 2004).

The Vietnamese garment exporters operate mostly under so called cut-make-trim contracts. Buyers or intermediaries provide the machinery, raw materials, other inputs, design and supervisory staff. Also marketing remains the preserve of the retail buyers (Bonaglia 2006; Nadvi et al. 2004). The Vietnamese manufacturers undertake labour-intensive tailoring processes, packaging and delivery. This is actually very much what enterprises did in the centrally planned economy, in which both the procurement of inputs and the distribution of products were in the hands of planning authorities, not of the company management, who were responsible for fulfilling the production plans and manufacturing operations within the factory. However, a transition towards a market economy has taken place: companies compete for orders, and they have the right to make investment decisions and reduce their work force, which was not possible in the old system.

Textile and garment industry in poverty reduction

Any industry can contribute to poverty reduction if it remains competitive, but often measures improving competitiveness may require a reduction in workers, which is poverty-increasing at least in the short run. The employment effects of textile and garment production have diverged in Vietnam. The textile industry has been compelled to reduce its workforce in order to improve its weak competitive position. Its productivity has substantially increased but employment has declined, except in the case of some foreign-owned companies, where it has grown. In the garment industry the export boom has led to higher output and employment, accompanied by improved labour productivity. This branch has thus contributed substantially to poverty reduction. Much of the employment gains have been captured by women, including migrants from poorer regions (Nadvi et al. 2004).

International companies in the garment industry, burdened by high labour costs, have increasingly shifted production to low-wage countries like Vietnam while retaining such operations as design, branding and marketing in their own hands (Gibbon and Ponte 2005; Knutsen 2004). The industry is then very much buyer-driven, as a number of key decisions are made by intermediaries or buying organisations.

How could the industry be developed so as to remain competitive, bring in more added value to the Vietnamese economy and help in fighting poverty? At present the main competitive advantage is low wages, but this may be lost in the future to such neighbours as Cambodia or Lao PDR. One possibility could be the emergence of a competitive textile and garment cluster. This would require a solid raw material base, supporting industries, a business-friendly economic policy and also companies willing to develop the know-how and business skills demanded in international markets. As Vietnam lacks adequate fibre resources and engineering industries, the emergence of a competitive cluster is not likely in the foreseeable future. However, the garment industry could gradually upgrade its activities by assuming more design and marketing functions and other activities requiring know-how.

3.7.3 Agriculture

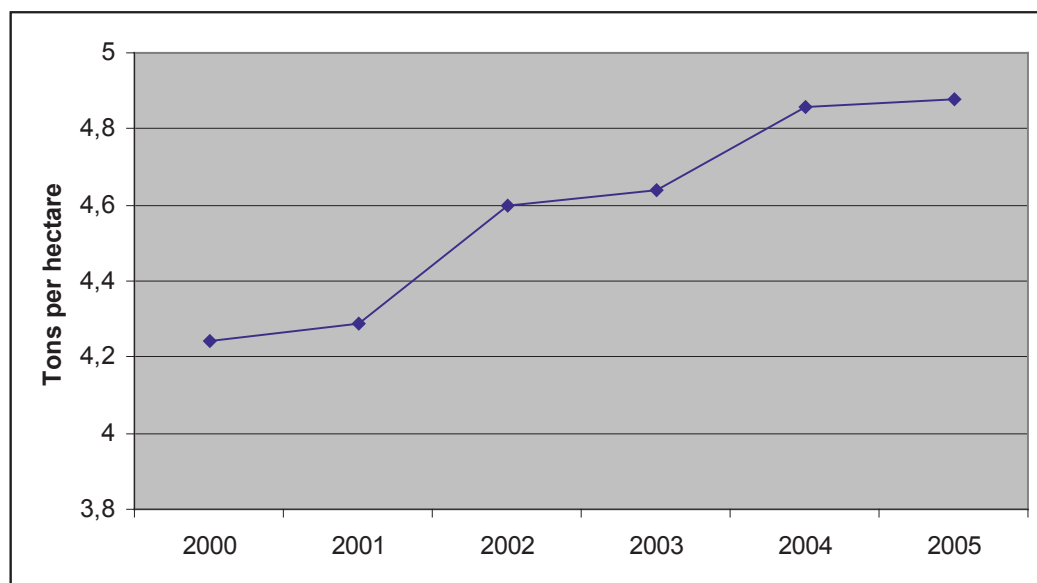
Agriculture, including cultivation and livestock breeding, can be grouped together with fishery and forestry. Although the share of agriculture in Vietnam's GDP has been constantly delining, its importance in the country's economy is obvious. While in 1991 agriculture produced 40 per cent of Vietnam's GDP, in 2005 it produced about 20 per cent. However, agriculture employs about 55 per cent of the labour force and only a constant increase in its efficiency has prevented uncontrolled migration to the cities or social unrest in rural areas. With fishery included, the sector's contribution to exports is 29 per cent. From this perspective, public expenditure for agriculture is surprisingly low, only six per cent of the total. Ever since non-Soviet ODA began to flow into Vietnam, donor money has played a crucial role in the development of the agricultural sector. In 1997 the share of ODA in the agricultural budget was nearly 90 per cent, declining (relatively, not absolutely) in the present decade to below 50 per cent (World Bank 2006).

The increase in efficiency in agriculture has been realised in two ways: first, by developing working methods and introducing new types of species, fertilizers and pesticides. Second, by introducing new cultivation branches, e.g. shifting from cereals to cash crops (coffee, tea, cashew), which have increased the value of agricultural output (FAO 2005a).

Cultivation of traditional food crops

The cultivation of rice well illustrates this situation. The output of paddy has increased by about 1.3 million tons from 1990 to 2004. This has been due particularly to the spring and autumn harvests, where outputs have increased about 30 per cent and 50 per cent, whereas the yield in the winter harvest has decreased about 30 per cent (Statistical Yearbook of Vietnam 2005). The cultivated area under rice has decreased slightly (by about 300,000 ha) during this decade, but the output of production still increased by about 260,000 tons. The reduction in rice growing area is not necessarily due to the shift to cash crops: most cash crops are cultivated in the highlands and in areas not particularly suitable for rice cultivation. Rather, some of the traditional rice-growing areas are now growth poles where industrialisation has been launched. In these areas, for example the Red River Delta and the Southeast, the rice fields have been converted to other uses such as housing, transport and industry. The increasing efficiency of rice production is illustrated in Table 3.7.4.

Figure 3.7.4 The output of paddy per hectare



Source: Statistical Yearbook of Vietnam 2005.

The declining share of labour in agriculture reflects the increase in efficiency in the same way: while in 2000 the workforce in agriculture was 62.5 per cent of the total labour force, in 2005 it had declined to 53.3 per cent (Statistical Yearbook of Vietnam 2005).

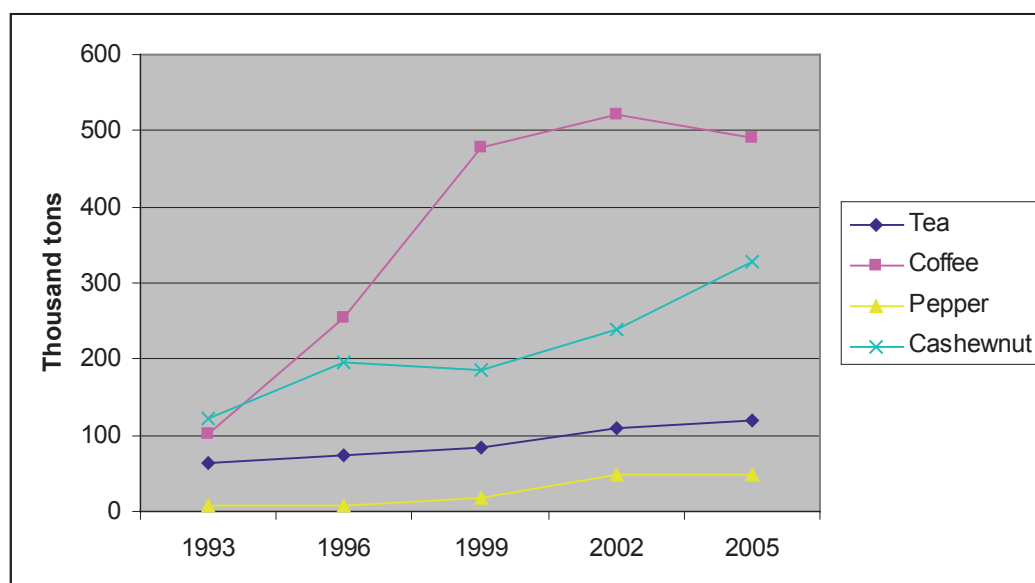
The role of new cash crops

The shift from traditional cereals to cash crops has qualitatively altered Vietnamese agriculture. This shift is, however, relative rather than absolute. The change has also affected the use of land, but in most cases the introduction of cash crops has not interfered with the major cereals. Coffee production in Vietnam is a good example of this. The major production areas are the central highlands, namely Giai Lai and Dac Lac provinces, where the agroclimatic conditions are favourable. In 1975 the cultivated area was about 13,000 hectares, and the output about 6,000 tons, while the present output exceeds 700,000 tons with a cultivated area of 500,000 hectares.

The increase in coffee production since the first half of the 1990s was a result of government incentives and led to a deluge of Vietnamese coffee on the world market, which created oversupply and falling prices, particularly on the lower-quality Robusta variety. The low market price forced producers to withdraw from the markets. This also occurred with Vietnamese producers (Figure 3.7.5). After the subsequent increase in world demand, producers have returned to the markets and the output of Vietnamese production has turned upwards.

Although there is a comparative advantage for coffee production in Vietnam due to climatic conditions and relatively short transport distances, the problem lies in quality and in the shortness of the production chain. International buyers mainly buy raw beans which are further processed by the roasters. Vietnam has so far failed to produce the higher-quality Arabica coffee to any substantial extent despite the government's encouragement and donor support. Robusta coffee is used as raw material for instant coffee and for espresso due to its bitter taste. In higher-quality brands, however, it needs to be blended with Arabica beans. The purchasers of Vietnam's coffee beans are, therefore, mainly the large companies (Nestlé buys 25% of the whole produce) who can determine the price. Some Vietnamese companies have processed coffee beans to final products for the Vietnamese markets and even created their own trademarks, but without success in the export markets (Johnston 2001; Thanhnien News, 27.2.2007; Kraft Foods 2007).

Another cash crop, the cashew nut, offers a further example of the volatility of export prices in commodity trade and the problem of a short production chain. Cashew has been identified as one of Vietnam's key export products for the next 15 years. Owing to this, the government has encouraged the establishment of new plantations and the output of cashew nuts has increased steadily during the last few years. After India, Vietnam is the second largest cashew exporter in the world. However, the cashew markets are highly volatile. For example, despite the increase in cashew exports during the first half of 2006, the export revenues decreased due to falling world market prices.

Figure 3.7.5 Output of selected cash crops, 1993–2005

Source: Statistical Yearbook of Vietnam 2005.

Poverty reduction and value chains

The agricultural reform has managed to curb absolute poverty and catalyse economic growth. Particularly the production of rice has played a crucial role in the eradication of hunger in Vietnam. However, due to the shortage of land, possibilities of growth in agriculture are limited, this placing certain limits on its role in poverty reduction in the future. For example, the cash crops have brought some money to minority groups, but have seldom offered a major source of income. The fact that the world markets for cash crops, like most commodities, are volatile and do not offer secure prospects for their producers, implies limits for agriculture in poverty reduction.

There are, however, possibilities to extend the production chain in agricultural products. Vietnam's large population and growing demand support such a conception. Products for domestic markets have thus a great potential for increased value-added. The increasing demand for these products is closely connected to the general rise in the standard of living.

There are already some sectors where an advance to more fully processed food has been achieved. Here the dairy industry offers one example. The demand for milk is very low in Vietnam when compared to developed countries or even to other countries in the region. Milk consumption is highest in Ho Chi Minh City, where the per

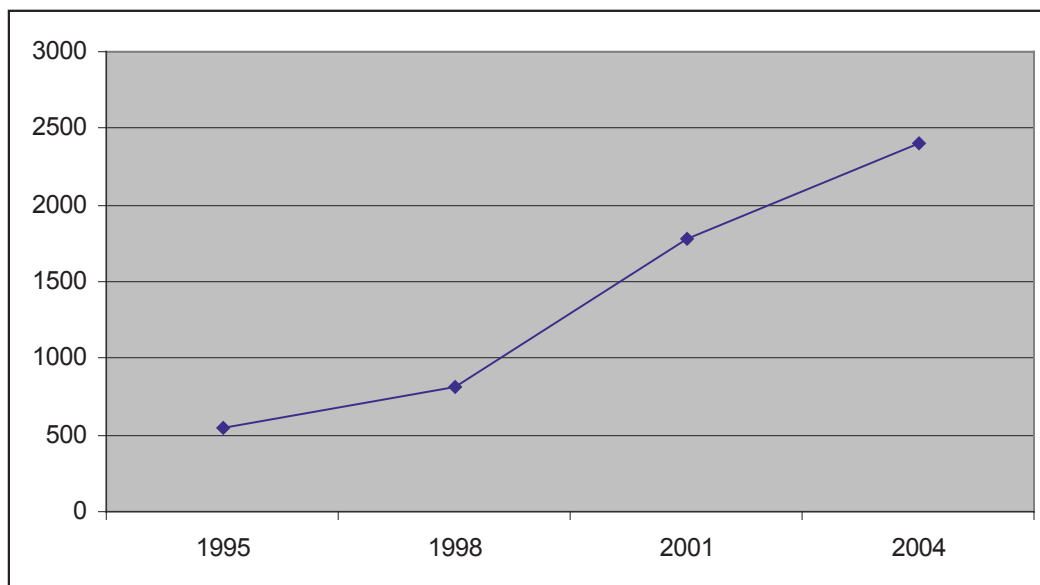
capita consumption is five to six litres per year. Nonetheless, the demand for milk products in Vietnam exceeds the supply. Imports cover about 90 per cent of Vietnam's fresh milk consumption, which is growing at a rate of 25 per cent annually. There are, therefore, possibilities to increase milk production in Vietnam, but this will need to be combined with the development of the milk-processing industry.

Vietnamese Vimamilk dominates the dairy sector. A Malaysian company (Dutch Lady) controls one fifth of the market while the multinational Nestlé holds about eight per cent. Despite domestic and foreign investment in milk processing, the management of the procurement network from the farm gate to the factories needs to be developed. First of all, an increase in the number of Vietnamese dairy farmers is needed in order to provide sufficient raw material. The scarcity of pasture land sets an effective limit on numbers of dairy cattle. However, the government has set self-sufficiency as the target for the dairy sector and has taken steps to develop feeding and fodder production, even granting tax exemptions for enterprises entering the dairy processing sector (Phan Quang Dieu and Nguyen Trung Kien 2005).

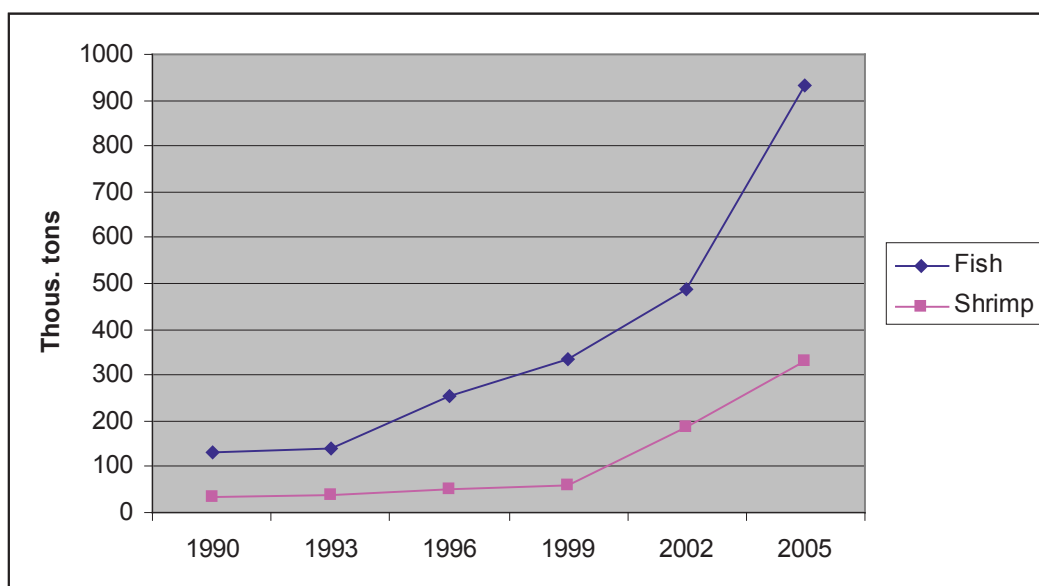
3.7.4 Fishery

In contrast to agriculture, the influence of fishery on employment is small, although the workforce in fishery and aquatic production has increased from 2.6 million in 2000 to four million in 2005. On the local level, however, its significance may be highly important and its influence on overall employment crucial. The growth of the Vietnamese fishing fleet alone has meant thousands of workplaces in construction and repair. Aquaculture production, in particular, plays an extremely important economic role in certain coastal areas (Le Thu Duc et al. 2003). Marine catches are the highest in Central and Southeast Vietnam. Over 75 per cent of the country's fishing harbours are in the Mekong river delta, and thus most of the fishing industry is concentrated in the southern provinces between Khanh Hoa and Ca Mau (FAO 2005b). Moreover, its significance for the Vietnamese economy is substantial on national level. During the last few decades fishery has become one of Vietnam's main export sectors, accounting for about ten per cent of the value of exports (Figure 3.7.6).

Despite the slight decline in the share of exports in recent years, its total value has increased, together with the value of investment in the sector. The increase in output in both fishery catches and aquaculture products (Figure 3.7.7) has, however, created environmental problems which should be solved before increasing investment and output in this sector have irreversible consequences. The Vietnamese authorities have admitted that the coastal resources are over-exploited and fishing activities should have a more viable management system. This is due to the growth of the Vietnamese offshore fleet.

Figure 3.7.6 Seafood exports, 1995–2004 (in US\$ million)

Source: Ministry of Fisheries 2005.

Figure 3.7.7 Aquaculture production of fish and shrimp, 1990–2005

Source: Statistical Yearbook of Vietnam 2005.

In 2004, the marine fishery catches were about 1.7 million tons, which is above the sustainable level (Ministry of Fisheries 2005). As the limits of open-range fishery have already been reached, fish farming now produces the major part (about 65% in value) of the sector's total output (Statistical Yearbook of Vietnam 2005).

The uncontrolled expansion of aquacultural production has created different, but equally severe environmental problems. Apart from degradation of coastal waters due to fish and shrimp farming, aquaculture creates risks for biodiversity by introducing exotic species. Similarly, a negative impact of the aquaculture industries on tourism has been observed. Owing to the local impacts on poverty reduction and broader national economic importance, these issues have not been given high priority among the Vietnamese authorities.

The impact of fishery on poverty reduction is emphasised by reason of a relatively long production chain when compared to agriculture. This is due to the high share of exports in total output. The nature of the product in fishery compels export of products in processed form (frozen, dried or canned) (Le Thu Duc et al. 2003). The strong international demand for aquacultural products made it possible for Vietnam to increase the share of value-added products from US\$ 250 million (17%) to US\$ 780 million (35%) during the first years of this decade. The demand for fishery products is expected to remain high. Most seafood is exported to Japan and the USA (over 60%), and to neighbouring countries, mainly to China. However, the role of the EU as an importer of Vietnamese seafood is increasing due to the strong Euro and the American anti-dumping measures against Vietnamese catfish and shrimp. This situation may alter now that Vietnam is a WTO member, although the USA has reserved the option on these measures in Vietnam's WTO agreement.

3.7.5 Forestry

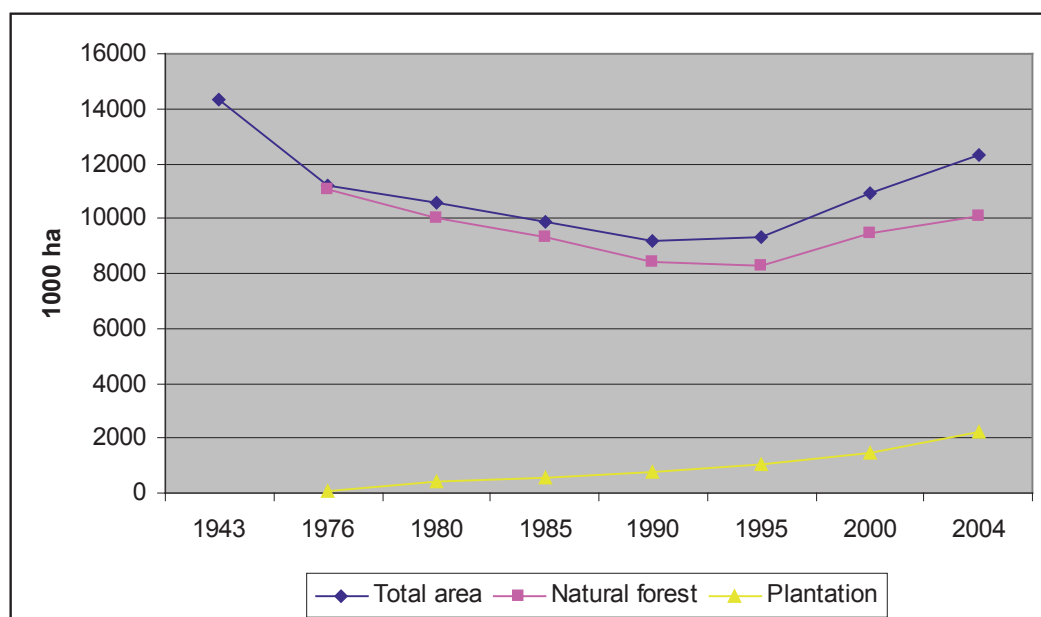
From the Second World War up to 1985, Vietnam's forest area diminished and the quality of forests deteriorated. The forest cover declined from 43 per cent to 30 per cent (in some estimations 20%) between the years 1943 and 1993 (Figure 3.7.9). Estimations of forest stocks are highly unreliable, but indicate the poor condition and productivity of all forest land (Castrén 1999).²⁴ Total growing stock in 2000 was 751.5 million cubic meters and 8.4 billion bamboo culms, of which plantation wood was 30.6 million cubic metres and bamboo plantation 96 million culms (Trieu Van Hung 2003).

The main causes of deforestation have been both demographic and economic growth: demand for forest products has increased while there is also a growing need

²⁴ Total stock was estimated to be about 30 m³/ha and annual growth about 1-3 m³/ha.

for agricultural land. The use of bulldozers, bombs, herbicides and napalm by the US army during the Vietnam War exacerbated the process, since which the Vietnamese government's post-war resettlement programmes and migration have further increased it. Moreover, the State Forest Enterprises (SFEs) perpetrated over-logging in the post-war period (Castrén 1999; Sunderlin and Huynh Thu Ba 2005).

Figure 3.7.9 Change in Vietnam's forest cover, 1943 and 1976–2004



Source: Jong et al. 2006.

According to the GSO, the forest area in Vietnam in 2005 was 12.4 million hectares, of which 9.5 million hectares were natural forests and 2.9 million hectares plantations (Statistical Yearbook of Vietnam 2005). The official figure for forest land is about 36 per cent of the total land area. This figure is also repeated in a World Bank study (2006c). The study also states that a large part of the seven to eight million hectares of forest (in different categories) degraded during the decades of deforestation are now being reforested. These figures are also used in various other studies.

However, the official information is disputed. According to some sources the figure given over-estimates the forest cover, which in reality is closer to 20 per cent (Castrén 1999, Sunderlin and Huynh Thu Ba 2005). Estimates of the forested area prevailing in the late 1990s and the early years of the present decade vary between 30 and 19.5 per cent. A CIFOR study refers to the possibility that the error is created intention-

ally, the authorities exaggerating the results of their reforestation effort (Sunderlin and Huynh Thu Ba 2005). Finally, it is not very clear to what extent the official forest area represents a merely administrative classification and how much it actually correlates with real forest cover on the ground.

Whether the real area of forested land is closer to the official figure or to that of independent estimates remains an open question. In any case, in 1998 the Vietnamese government launched (along with other rehabilitation efforts) a forest rehabilitation initiative called 'Five Million Hectare Reforestation Programme' (5MHRP) which aims to reach a forest cover of 43 per cent by the year of 2010. According to MARD the programme was behind schedule in 2005, but from the point of view of reforestation and forest conservation, the achievements are already encouraging if those reported are true (World Bank 2005b; 2006d; Ministry of Agriculture and Rural Development 2007).

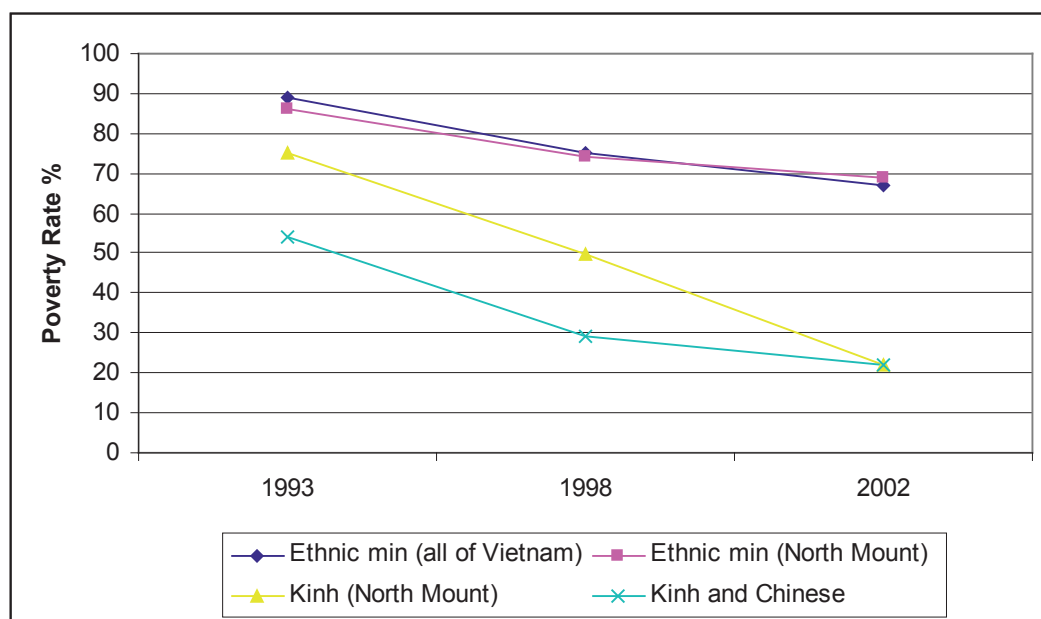
Theoretically, the conditions for the success of 5MHRP and other forest-related programmes are good. First, the politico-economic system gives the government sufficient administrative capacity to control the use of land. A study conducted by CIFOR estimates that political control in environmental management is the best way to achieve environmental conservation in the Vietnamese system (Wunder et al. 2005). Second, the SFEs control about 40 per cent of forest land. However, the ongoing land allocation process has already cut their holdings from 6.8 million hectares in the late 1990s to 4.9 million hectares in 2004 (World Bank 2006c). A reservation regarding the assumption of effective state control in forest management has, however, to be posed, as it has been estimated that in 1995 some 37 per cent and in 1997 even 41 per cent of commercial logging was illegal (Castrén 1999).

There is a widening gap between the demand for and the supply of timber. The government seeks to narrow this gap by establishing forest plantations, but the present area of 2.8 million hectares (GSO)²⁵ does not provide enough timber for the construction and wood-processing industries. The plantations under the control of SFEs have been established particularly to supply material for the pulp and paper industry, while the expanding export-oriented furniture industry, for example, relies on imports from other countries, notably from the Lao PDR. In 2002 imports from the Lao PDR were estimated to be between 600,000 and 660,000 cubic metres. This includes both legal and illegal imports (Barney 2005). In Castrén's study (1999), which is based on an assessment made in the mid-1990s, it was estimated that as much as 1.11 million cubic meters of illegal logs were imported to Vietnam mainly from Cambodia.

²⁵ The World Bank figure is 1.9 million hectares.

There are three subsequent land laws from 1993, 1998 and 2003, and particularly two Decisions (no. 327 effective from 1993 to 1998, and no. 661 effective from 1998 to 2010) which were incorporated in the 5MHRP. These laws include land allocation, which seeks to activate people and enterprises to use the forest in a more sustainable manner. Forest allocation is also associated with poverty reduction programmes. One general observation is that high forest cover and the highest poverty incidence rates are found in the same areas. The pattern of forest use seems thus to affect the rate of poverty, and may have dramatic effects on the local standard of living. This situation is particularly emphasised in the remote and mountainous rural areas where the forest cover is relatively high: these are also the areas populated by the ethnic minorities (Figure 3.7.10).

Figure 3.7.10 Incidence of poverty by ethnicity, 1993–2002



Source: World Bank 2006b.

In 2002 there were about 24 million people living in or around the forests. Most belonged to the *Kinh* ethnic majority, but there were about 8.5 million people belonging to various ethnic groups in the mountainous areas close to the forests. Some elements among these minorities may be reluctant to adopt the way of life of modernising Vietnam, but in most cases the problem is simply that these areas provide few possibilities for improving livelihoods.

In these areas the forests provide very important minor activities that constitute one part of livelihood. For example, in the Northwest area 23 per cent of total incomes come from forestry (Jong et al. 2006). For the people living there, conservation of natural forests is an important safety net to ensure a minimum standard of living. Thus, although land allocation is the central element of the 5MHRP to improve forest management and increase the output of the forests, the conservation aspect of these programs must also play a crucial role.

3.8 Production sectors, trade and poverty

The common notion regarding the relationship between Vietnamese economic development and poverty reduction is that economic growth has been a key element in alleviating poverty. Various studies emphasise, however, that the key element in pro-poor growth has actually been the development of agriculture, which has played a central role in eliminating absolute poverty (Klump and Bonchamp 2004; FAO 2005). In regional comparison this broad-based economic growth is evident (Table 3.8.1). The Vietnamese reforms at the beginning of the 1990s and the subsequent economic growth manifest a close correlation between growth and poverty reduction.

Regional comparison brings out the fact that fast growth as such does not guarantee poverty reduction, neither does participation in world trade. For example, Thailand, where the growth rate was very high and the share of the exports over 40 per cent of the GDP (WTO 1995), poverty reduction was rather slow in the 1990s. By the same token, however, the fact is that after the elimination of absolute poverty, which has already largely taken place in Thailand, rapid growth tends to increase economic inequality. Nonetheless, in regional comparison, economic inequality has so far remained relatively low in Vietnam, reflecting the broad basis of growth there (see the Gini Index in the table 2.1.1).

Table 3.8.1 Poverty reduction in Vietnam and other Asian developing countries

Country	Period	Percentage-point reduction per year	Average growth of GDP per capita (%)
Vietnam	1993-98	- 4.1	6.8
East Asia and Pacific	1993-98	- 2.0	5.6
Bangladesh	1992-96	- 1.7	2.8
Cambodia	1994-97	- 1.0	2.6
PRC	1993-98	- 2.5	10.4
India	1992-97	- 1.4	3.8
Philippines	1994-97	- 1.3	1.9
Indonesia	1990-96	- 2.1	6.4
Thailand	1992-96	- 1.0	7.2

Source: Balisacan et al. 2003.

3.8.1 Poverty according to established measurements

Vietnam's experience goes against the 'mainstream' thesis of international organisations that open trade is necessary for export success, which then leads to poverty reduction. While there is a positive relationship between exports and employment in Vietnam, the pre-WTO period in the Vietnamese economy indicates that a country can achieve excellent export results without opening its borders. This requires, first, that the country is able to establish trade treaties outside the multilateral agreements, and second, that exporters are able to offer competitive prices. By protecting domestic markets Vietnam managed to maintain workplaces in a number of industrial branches (Jenkins 2004). Hence the country in fact shares the common experience of many other East Asian countries such as Japan, South Korea, Taiwan and most of the ASEAN members.

Despite broad-based economic growth in Vietnam, regional differences are evident. The new manufacturing sectors and other sectors which create new employment opportunities in construction and services are concentrated in a few growth poles on the Red River Delta and in Hanoi, the Southeast and the Ho Chi Minh City region, the Mekong River Delta and certain regions on the Central Coast such as Da Nang. In those rural areas, where agricultural development has been slow or has not provided the main source of livelihood, for example the remote mountainous areas, the poverty incidence remains high. In the Northern Uplands, particularly in the North-West, the poverty incidence is extremely high, reaching nearly 60 per cent of the population. A similar situation prevails in the remote communities in the North Central and Central Highlands.

The poverty rate is low among the Chinese population and in the *Kinh* majority, whose situation is clearly above the average. Except for the Chinese, all of the minority groups suffer from a high poverty incidence. The poverty rate in these groups has decreased much more slowly than average. In one minority group, the rate has actually increased, reaching 100 per cent (Glewwe et al. 2002; see also Figure 3.7.10).

The prominent characteristic of poverty in Vietnam – according to international standards of poverty – is that its main dimensions are spatial and ethnic (Klumb and Bonshab 2004). The basic division is between rural and urban areas, as poverty seems to be concentrated in rural areas and in certain districts. However, as Figure 3.7.10 indicates, even the spatial dimension seems to be fading in comparison to ethnicity. A number of studies therefore suggest that to curb absolute poverty institutional measures are needed. Economic growth in general and the growth of agricultural output in particular have been the main elements in reducing poverty among the majority of the population. Participation in international trade, which has created export-oriented industrial and agricultural sectors, has been contributing factor in general poverty alleviation in Vietnam.

This development was obviously possible only by merit of the strong institutional basis of Vietnamese society, which made way for the reform in agriculture and in business while maintaining relatively strong ownership in the economy. Apparently, however, curbing poverty among ethnic minorities is not only a question of economic growth, but requires the kind of institutional development which strengthens the participation of minority groups in the key sectors of education, economy and politics.

3.8.2 The new poverty

Rapid economic growth and economic reforms during the last 15 years have created social problems which are also associated with poverty but not captured by general poverty statistics. We may refer to these phenomena as the *new poverty*. Its nature is different from the absolute poverty in remote rural areas, and it is conspicuously linked to the development of the export-oriented industrial sector and urbanisation. Its growth has concentrated in certain areas, particularly the Southeast, Ho Chi Minh City and its environs, and the Red River Delta with Hanoi and surrounding areas, i.e. areas where the poverty incidence is lowest.

Despite the good performance of Vietnamese agriculture, rural employment did not grow fast enough (World Bank 2006b), which has caused migration to urban areas. Since the beginning of *doi moi* about 22,000 people have moved to Hanoi each year, while Ho Chi Minh City has assured about 100,000 new inhabitants every year. One symptom of this phenomenon is the growing number of street children in Ho Chi Minh City and Hanoi (numbering about 20,000 in 2001), reflecting the poverty in rural areas and the economic possibilities in growing centres. Most of these children are from surrounding provinces, only a minority of them coming from broken families in the respective cities (Duong Kim Hong and Ohno 2005).

One aspect of this situation is a direct consequence of globalisation. The FDI-financed factories have gathered a workforce from all around Vietnam, and these employees are living temporarily in 'guesthouse' accommodation arranged by the companies. This kind of migration is not necessarily directed to the cities as such, but rather to the industrial parks situated in the growth areas. Similarly, a new consequence of the liberal economic policy is the growth of temporary or seasonal migration. The 2004 census did not cover the migrant population, either permanent or temporary. However, in the estimation of Ho Chi Minh City authorities, there are about 700,000 seasonal migrants per year (ODI 2006), and in Hanoi earlier estimates give similar figures for temporary migrants (Goldstein 1999, Liem and White 2002).

These migrants are not necessarily poor, if compared to the average Vietnamese income level. Seasonal migration is actually considered an important livelihood strategy (Viet Nam News 2006). However, both living conditions and the population

management system easily place them in a lower economic and social position than the average population. This is due to the Vietnamese population registry system and housing policy, which seek to control and prevent migration. According to this system, every citizen has to register with the local police place of birth and place of residence together with other personal and demographic information. When a person moves, re-registration has to be done both in the place of origin and at the destination. However, the status the migrants receive, i.e. permanent or temporary, determines their rights to social services such as healthcare and children's education. Permanent migrants gain access to these services, but temporary migrants are excluded from all social services in their new place of residence. Permanent status is increasingly difficult to achieve, as cities are in difficulties with the growing population. The magnitude of immediate problems such as lack of drinkable water and electricity, illuminates the housing problems the migrants are facing (Viet Nam News 2006; Liem and White 2002).

So far the problem does not yet constitute a major policy issue, but with the current speed of economic change it is likely to become more serious in the future. The Vietnamese registry system may have managed to constrain uncontrolled migration until now, but economic opening could create a situation difficult to handle if the Vietnamese political authorities do not respond in time to the problem itself (Klump and Bonchab 2004). In fact the question whether poverty is caused by migration or merely reflects relative poverty caused by unequal growth is a moot point. In any case state intervention is necessary to provide basic social benefits to those who have failed to take advantage of economic growth to gain access to education and healthcare.

3.9 Aid and Trade?

There is thus a positive relationship between economic growth, trade and poverty alleviation. However, one has to ask what kind of economic growth and what kind of trade? The Vietnamese example shows that the speed of economic growth is not the only and perhaps not even the most important element in poverty reduction. One very important factor has been the growth of agriculture, which has comprised the main component in the elimination of absolute poverty. The development of export-oriented sectors, including industry, is also an important factor. In Vietnam this development has not, however, taken place in the context of free trade. The government has protected domestic markets in order to develop both old and emerging new industries before opening the markets.

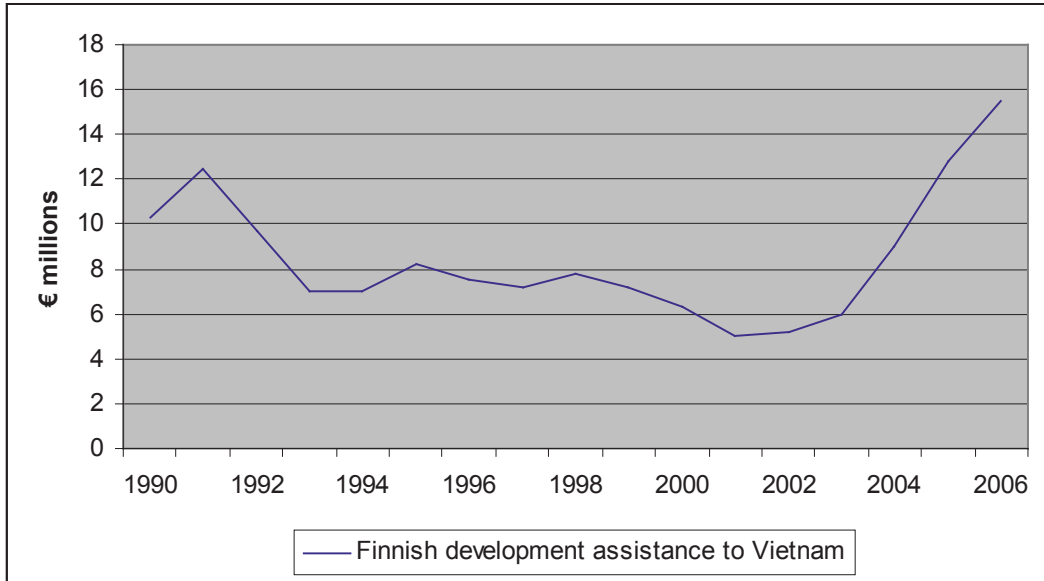
Trade in agricultural products was a very natural consequence of the agricultural reform in Vietnam. The advent of Vietnamese agricultural products on the world markets was also due to an open niche for low-quality and low-price agricultural

products, notably coffee, in developed country markets and rice in Asian and other developing country markets. In this sense, Vietnam's access to international markets was not particularly difficult. However, in order to take further advantage of these openings, Vietnam must be able to develop the quality of its export products. In the long run, this requires investment in higher education, research and training. This would also help Vietnam to extend the domestic section of the production chain.

The short production chain is characteristic of export-oriented industries in Vietnam, especially in the footwear and textile industries, but also in some other export-oriented industrial sectors such as furniture, in which the raw material is mostly imported. In the furniture industry it is possible in the long run to increase the domestic supply of timber by developing forest plantations. With domestic timber it would also be easier to assure the customers in developed countries of the environmental sustainability of the timber used. The dubious origin of the raw material in furniture produced in Vietnam may limit market access in the EU and the USA while also affecting the prices fetched.

The Finnish ODA to Vietnam varied between five and 15 million Euros between 1990 and 2006 (Figure 3.9.1). The share of direct support to trade capacity has been small. There is only one bilateral project directly addressing trade capacity, while the role of capacity building (excluding normal technical training) in other projects has been very modest. By 2001 the assistance to trade-related capacity building was well below two per cent of cumulative Finnish funding (Williams et al. 2001).

Excluding the increase in assistance which has taken place in the last three years, Finnish ODA to Vietnam has not followed the general trend of international assistance, which increased from US\$ 250 million in 1993 to US\$ 2000 million in 2003 (UNDP 2004). The Finnish assistance is to be increased during the next few years, reaching 20 million Euros in 2010, but over a longer time-span, the Finnish government is preparing to phase out grant aid and transfer to multilateral support as she has done with European transition economies (MFA 2006).

Figure 3.9.1 Finnish development assistance to Vietnam 1990–2006

Source: Williams et al. 2001; Embassy of Finland, Hanoi 2006.

In 2005 there were about 58 trade-related assistance (TRA) projects with total disbursements of about US\$ 57 million in Vietnam. They were supported by 21 donors. These projects concentrate on capacity building of stakeholders in trade policy issues, support in technical issues in WTO legislation and their incorporation into national legislation. In Vietnamese legislation some regulations are not compatible with each other in dealings with a market economy. The main donors in TRA are the EC, the USA, IMF, the World Bank and Australia. The aims of the projects have been to help Vietnam to fulfil the commitments consequent upon WTO accession, to facilitate the efforts of Vietnamese business and authorities in taking advantage of WTO membership and to help Vietnamese business to access foreign markets and provide information on the technical regulations involved in it, and to help Vietnam to restructure its economy in the context of WTO membership (Narray et al. 2005).

In theory, there is donor coordination on TRA projects. In practice there is a severe lack of coordination. One apparent reason for this lies in the particular interests of individual donors. There is an obvious intention on the donors' side to ensure their own market access to Vietnam through WTO legislation (Narray et al. 2005). It is clear that the donors seek via the TRA projects to guarantee adoption and implementation of the WTO rules such as national treatment and intellectual property rights, in order to support their own business (South Centre 2005).

Direct trade capacity assistance is not included in the present Finnish bilateral aid to Vietnam. Assistance concentrates on rural development, the forest sector, national poverty programmes, and the health sector (MFA 2006). These areas are manifestly relevant on the basis of the above review. There are also certain other areas indirectly connected to trade capacity which Finland could contemplate when deciding on its future assistance either on a bilateral or a multilateral basis. In order to enable Vietnam to develop its exports and further process its export products – particularly agricultural products – to meet the increasingly demanding quality requirements in global markets, it will need to increase training and research in these fields. It would, therefore, be important to examine the possibilities of directing part of the assistance to these areas.

4. Mozambique

4.1 Country fact sheet

The land area of Mozambique is about 799,000 square kilometers. It has a coastline of 2,700 kilometers on the Indian Ocean, and land borders with South Africa and Swaziland in the south-west, Zimbabwe, Zambia and Malawi in the west, and Tanzania in the north. With a population of about 19 million, Mozambique has a low population density of 22 inhabitants per square kilometer (Map 4.). Currently about 73 per cent of the population is rural, and some 80 per cent of the work force draw the bulk of their income from agriculture, forestry and fisheries. At 19.4 per cent of GDP in 2003, agriculture and forestry constitute the key sector in terms of economic production. Other important sectors include commerce (22.5% of GDP), transport and communications (12.2%), manufacturing (11.7%), and construction (11.7%) (World Bank 2005c).

Mozambique is a natural resource-based economy. Along with agriculture, fisheries, mining and tourism are crucial for the national economy. A wide range of soils and climatic conditions makes possible the cultivation of a variety of both subsistence and cash crops, including maize, cassava, vegetables, coconuts, cashew nuts, fruits, tea, tobacco and cotton. The central and northern regions have generally more fertile soils and better rainfall, as well as indigenous forests, whereas the region south of the Save river suffers from poorer soils and less dependable rainfall. Nearly one half of the land area is considered suitable for agricultural production, but currently less than 15 per cent of arable land is under cultivation. The sea provides another major natural resource in the form of fish and prawns, though the limit of sustainable production has already been reached. Other key natural resources include hydroelectricity, natural gas and minerals, including titanium, gem stones and coal. The extensive coastline and spectacular wildlife also provide a potential for ecotourism (USAID 2004a).

Despite an average annual economic growth rate of eight per cent between 1996 and 2003, Mozambique remains a poor country with a relatively low level of human development in comparison to per capita income (Table 4.1). Key human development indicators such as literacy rate and life expectancy are well below the average for sub-Saharan Africa and LDCs. The relatively low rate of population growth between 1975 and 2003, despite a close to average fertility rate, was caused mainly by the combined effects of a 16-year civil war (1977–1992) and the high prevalence of HIV/AIDS (16.2%, compared to an average of 7% in Africa).

Mozambique has a relatively open economy. The share of external trade (exports + imports) grew from 44 per cent in 1990 to 68 per cent in 2004, with a substantial 22

per cent annual growth in exports between 1996 and 2004 (Table 4.1). The growth has been due mainly to a small number of very large ‘mega-projects’ financed by foreign capital. The trade balance, however, remains negative, while the deficit is largely made up by an unusually high volume of ODA and the rapid growth of FDI.

Table 4.1 Key development indicators for Mozambique, sub-Saharan Africa and LDCs

Indicator	Mozambique	Sub-Saharan Africa	LDC
Human Development Index 2004	0.390	0.472	0.464
GDP per capita 2004 (PPPUS\$)	1,237	1,946	1,350
Life expectancy at birth 2004 (years)	41.6	46.1	52.4
Adult literacy rate 2003 (% of population over 15 yrs)	46.5	61.3	54.2
Combined gross enrolment rate 2004 (%) ¹	49	50	45
Annual population growth rate 1975-2004 (%)	2.1	2.7	2.5
Total fertility rate ² 1970-1975 and 2000-2005	6.6/5.5	6.8/5.5	6.6/5.0
Imports per GDP (%): 1990 and 2004	36/38	26/34	22/32
Exports per GDP (%): 1990 and 2004	8/30	27/33	13/23
ODA per GDP (%): 1990 and 2003	41/24	12/19	13/19
FDI per GDP (%): 1990 and 2003	0.4/7.8	0.4/2.2	0.1/3.6

¹ Combined primary, secondary and tertiary schools; ² Births per woman. *Source:* UNDP 2005; 2006.

4.2 *The colonial legacy of unequal growth*

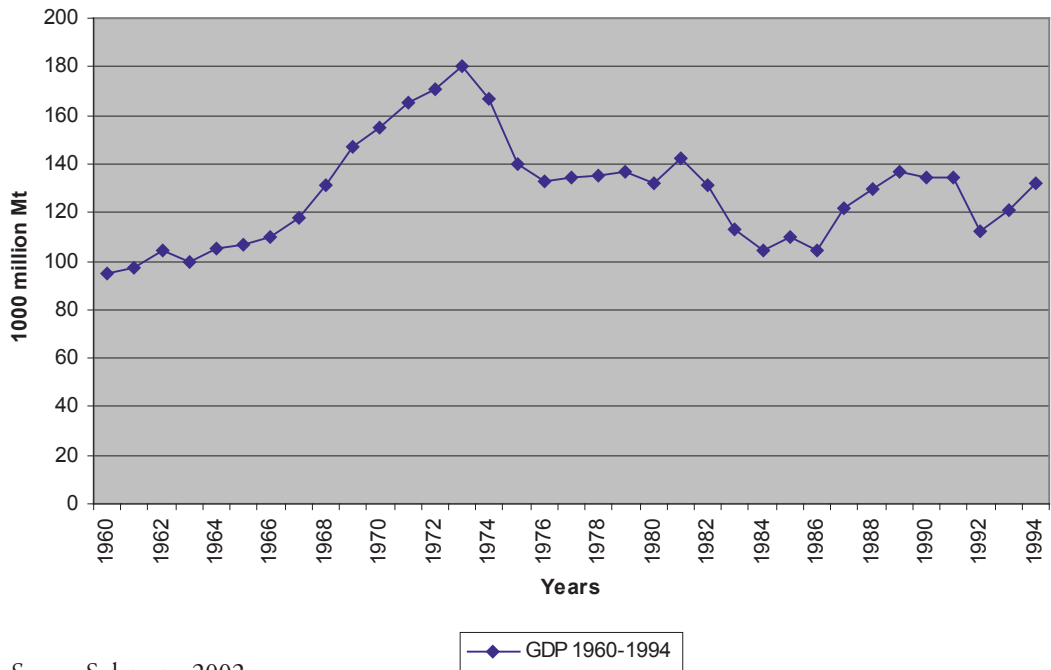
In the literature, colonial Mozambique is often depicted as a drastically underdeveloped semi-feudal economy geared to producing cheap unprocessed commodities to serve Portuguese industries located in the metropolis. However, while up to the 1950s Mozambique was heavily reliant on exporting resource- and labour-intensive commodities, by the early 1970s it had become the eighth most industrialised country in Africa (Torp 1979).

Instead of underdevelopment and stagnation, in the late colonial period the Mozambican economy was actually characterised by steady annual growth in GDP, on the average five per cent during the period 1960 to 1973 (Figure 4.2.1). This was slightly higher than the average for sub-Saharan Africa (4.9%), and well above the LDC average (3.5%) (Sulemane 2002). The growth was relatively broad-based, including development of agriculture and fisheries and related processing industries, establishment of import substituting manufacturing industry and related services, extension of the transport infrastructure to serve export industries in Mozambique and the neighbouring British colonies, and finally remittances from migrant labour working mainly in South Africa. Considerable investment was made into physical capital, whose share in wealth creation had increased substantially by 1974 (Newitt 1995; Francisco 2003).

The main problem Mozambique faced at independence was thus not a low level of

income per capita²⁶ or weak development of physical capital, but underdevelopment of indigenous human and social capital and related socio-economic inequality, as the economy and its benefits were almost exclusively controlled by the Portuguese settler community (Francisco 2003). For example, only about seven per cent of Mozambique's ten million inhabitants were literate at the end of the colonial period (Ferreira 1974; UNDP 2000). The failure to develop intangible capital, a problem which the subsequent Frelimo government proved unable to resolve, constitutes the main impediment to broad-based economic development and poverty reduction even today.

Figure 4.2.1 Growth of GDP in Mozambique, 1960–1994



Source: Sulemane 2002.

4.2.1 Investment in physical capital, 1960–1974

The Mozambican economy during the final period of Portuguese colonial rule (1960–1974) was characterised by intense growth in the industrial sector. A large part of the expanding industries were controlled by Portuguese groups operating under quasi monopoly conditions, but foreign – notably South African – capital was increas-

²⁶ According to UN statistics, Mozambique had a GDP per capita of US\$ 139, well above the average for African countries, which was US\$ 121 (Francisco 2003).

ingly penetrating the economy through joint ventures in certain key sectors such as energy (Cabora Bassa Dam), banking and other fields where new technology and licensing were involved. During this period, manufactured production trebled while the industrial workforce increased more modestly from 64,100 in 1961 to 95,800 in 1972 (Newitt 1995; Torp 1979). The industrialisation process was driven by three somewhat contradictory factors: (i) international political pressure to abolish forced labour, (ii) internal pressure to modernise commercial agriculture, which was losing competitiveness in global markets, and (iii) the colonial authorities' financial austerity and the policy of colonial financial autonomy, which reflected the fiscal difficulties of the Portuguese state (Castel-Branco 2002).

During the 1960s the production – and increasingly also processing – of key agricultural and fisheries export commodities such as sugar, cotton, cashew and frozen prawns was gradually consolidated. The greatest increase was, however, in the production of such intermediate goods and services as petroleum, paints, machinery repairs, fertilisers, transport assembly and iron and steel rolling, which were critically important for the development of an integrated industrial sector. The largest investments in last years of colonial rule (1971–1974) were in textiles, cashew, sugar and wood, which utilised local raw materials. Except for textiles, which were mass consumption goods for the local market, the other products were intended for export. Industrial production was heavily concentrated in the two major conurbations in the centre and south: 50 per cent of the enterprises were in Maputo and 16 per cent in Beira. These two large cities were also the hubs of the regional transport systems serving Southern Rhodesia (now Zimbabwe) and a large part of South Africa (Francisco 2003; Torp 1979). At the same time the previously neglected north was gradually integrated to the global economy through development of cash crop production (mainly cotton) with the corresponding marketing channels, and transport infrastructure (railways and ports, but also road network) connecting Malawi and the Mozambican interior to the Indian Ocean port of Nacala (Newitt 1995; Nhabinde 1999). Eventually about one third of the total foreign exchange earnings of Mozambique came from the use of its transport routes (Abrahamsson and Nilsson 1994).

Economic links between Mozambique and South Africa were strengthened by an elaborate system of migrant labour. In order to keep labour abundant and cheap, South African mining capital had developed a regional labour strategy which resulted in massive recruitment of migrant labour from all over Southern Africa. In Mozambique, the region south of the Save river was defined as a labour reserve for the South African mines, which became the single most important employer of Mozambican wage labour, employing an average of 110,000 migrant workers per year in the first half of the 1970s. Moreover, in the late 1960s and early 1970s, total income accruing to migrant workers was one and a half times higher than total income from commer-

cial agricultural production in southern Mozambique. The South African mines thus became the most important source of income and finance for the agricultural sector in the south (Castel-Branco 2004; Roesch 1991).

4.2.2 The failure of human development under colonialism

While the last decade and a half of colonial rule was characterised by intensive investment in physical capital, investment in intangible capital continued to be heavily biased towards the Portuguese settler minority. For example, less than 20 per cent of Mozambican children of primary school age were in school in 1955, and in the early 1970s the figure was still only 30 per cent. At secondary level there was a clear bias: in technical schools four per cent of the pupils were African, while they constituted only one per cent of general secondary school pupils. Expansion in African education since the 1960s continued to have the same bias, reflecting the modernising economy's need for more skilled manual labour (Ferreira 1974; Newitt 1997).

The bias in the investment in human and social capital was reflected in the marginal position of the African population in agricultural production. Initially the colonial economy relied heavily on the use of forced labour and strict control of labour mobility, which continued even after 1961–62 when *indigenato*, or the colonial legal code applied to control the African population, was officially abolished. The labour regime was reinforced by the parallel institutions of native reserve and customary authority. Native reserves, where land and natural resources were administered under customary tenure, were set up by the colonial state outside prime commercial land. Land rights under the customary system were essentially residual, or subject to withdrawal as settler and plantation cultivation expanded. All African inhabitants, even urban dwellers except for a small number of *assimilados* (Africans at least nominally assimilated as Portuguese citizens), were legally subject to a traditional chief who was responsible for administering the local system of land tenure, collecting poll taxes, recruiting workers for forced and contract labour, enforcing and supervising forced cropping, and organising local markets (Bailey 1969; O'Laughlin 1996).

A private trading network operated parallel to the customary system. By the end of the colonial period this consisted of nearly 6,000 traders (mostly Portuguese and Asian) who travelled between rural and urban areas, selling consumer goods and agricultural implements and buying agricultural produce, including cash crops such as cashews. Other cash crops such as rice, cotton and tobacco were collected from the African producers by large-scale concession companies with monopsony²⁷ status (Cravinho 1998). The colonial economy was, therefore, based on both socio-political

²⁷ Monopsony is a state in which demand comes from one source. It is analogous

dualism and economic integration, even though the latter was characterised by profound inequality. The majority of the African rural population were involved in commercial production, but in a subordinate position where they were not allowed to sell their labour freely or realise an equal price for their market produce compared with Portuguese settlers. As the economy became more export-oriented from the 1960s onwards, the constraints posed by the low level of human capital development became increasingly obvious (Newitt 1995; O’Laughlin 1996).

Different colonial stakeholders reacted to the dilemma of human capital in different ways. On the one hand, forced labour was – in its prevailing disguised forms – used to complement the increasingly prevalent voluntary contract labour in plantations by keeping down wages and maintaining labour discipline (O’Laughlin 1996). On the other hand, production shifted to commercial farmers relying on increasingly capital-intensive technology in other cash crops such as cotton (Newitt 1995; Pitcher 1998). In the industrial sector emphasis was placed on increasing productivity through investment in physical capital and imported know-how, typically acquired from South Africa on the strength of joint venture capital.²⁸ While such strategies helped to bypass the human capital problem without restraining the growth of production, they created relatively few jobs for the African population, thus perpetuating the process of growth without inclusion. Finally, in its last development plan the colonial government recognised the problem of increasing unemployment and continuing marginalisation among the African population, which continued to be aggravated despite recently initiated policies to expand the coverage of public health and education services (Francisco 2003; Newitt 1995).

4.3 Economic development under single-party rule (1975–1994)

The Frelimo government, who took power in Mozambique after the collapse of the Portuguese colonial state in 1974, sought to tackle the dual problem of economic exclusion and weak human development faced by the African population, through a rapid expansion of public education and health services, combined with effective into monopoly, but on the demand side not the supply side. A common theoretical implication is that the price of the commodity is pushed down close to the cost of production. clusion of the whole population in the modern economy through collective forms of production (Machel 1978). In theory, at least, the new strategy thus

²⁸ The move to capital-intensive technology in the manufacturing sector is visible in the relationship between labour force and contribution to GDP: while the percentage of the labour force employed in the sector (out of the economically active population) remained essentially the same between 1962 and 1970, its contribution to GDP increased from ten to 23 per cent (Francisco 2003).

entailed tackling the bias on physical capital and the unequal distribution of benefits, which had made the colonial project of economic growth unviable despite impressive growth figures achieved over the last decade and a half of Portuguese rule.

However, while the official adoption of Marxist socialism in 1977 created an evident break on the level of political ideology, the level of concrete development policies was characterised by a complex mixture of continuity and dislocation in relation to the colonial era. Dislocation was manifested in the deliberate destruction or curtailment of various capitalist and customary institutions on both local and national level, considered incompatible with the new socialist economy to be constructed under the party leadership. These included, for example, customary authorities, the private retail network, and the system of financial services, these being replaced by new collective institutions under the direct control of the central government/party structures (Cravinho 1998; O’Laughlin 1996). At the same time there were important continuities in the administrative system, which retained the colonial centralised structure and authoritarian approach despite rhetorical commitment to popular sovereignty. In agriculture the new policy meant directing resources to large-scale production at the expense of the small-scale sector (O’Laughlin 1996; Pitcher 1998).

4.3.1 Development of human capital, 1975–1994

In the first years of independence in Mozambique, primary education and basic health care services were extended to cover most of the African population. In primary education, for example, the number of pupils grew from 700,000 in 1975 to over 1,376,000 in 1981, while the numbers in secondary education grew from 20,000 to 135,000 over the same period (Newitt 1995). The growth in coverage was complemented by a substantial increase in the number of schools and health facilities in rural areas. A fundamental role was given to literacy and adult education, which were seen as prerequisite to eradicating poverty and increasing production and productivity. In the health sector a network of community health workers was created to support the expanded provision of primary health care (PHC) services. Due to the civil war (1977–1992) and economic destabilisation many of these progressive social sector policies were, however, never put into practice, while the physical infrastructure suffered heavily from rebel attacks. By 1992, nearly 60 per cent of the primary schools had been destroyed and/or were closed. Of the 1,373 health centres and posts in operation in 1982, one third had been destroyed by 1987 (UNDP 2000; UNICEF 1994).

The decline in the social services was not, however, caused solely by the escalating civil war. Despite relatively high allocation for social services in the state budget, the expansion relied on a large number of rather poorly trained human resources with little if any means to operate. In primary education, for example, wages made up 99

per cent of recurrent costs in the late 1980s. Many of the health posts and primary schools had actually ceased to function due to lack of operational resources and staff well before the civil war reached the area. At the same time the continuing southern bias in resource allocation tended to perpetuate the regional inequality inherited from the colonial era. For example, specialised hospitals in the capital accounted for almost one half of health service running costs in 1991, leaving very little to spend on drugs, staff and maintenance in over one thousand rural and provincial PHC facilities. In education, Maputo City received over 60 per cent of all investments in the early 1990s (UNICEF 1994; cf. O’Laughlin 2000).

4.3.2 Collapse of the planned economy, 1975–1986

The lack of sustainability of the Frelimo government’s investment in human development was closely linked to its failure to effectively integrate the majority of the rural population in the state-controlled economy. The objective of Frelimo’s economic policy was to increase the rate of capital accumulation in state enterprises, which would make possible rapid modernisation of the economy and egalitarian provision of basic social services. This entailed collectivisation of agricultural production and replacement of the private market institutions with state-controlled systems of distribution and collection (Cravinho 1998; Pitcher 1998).

Mozambique’s economic record for the post-independence period up to 1986 is bleak. During the initial transition period, the social and economic confusion which accompanied the socio-economic changes caused a decline of 26 per cent in the GDP between 1973 and 1976. This was followed by very slow growth in the GDP (3% overall) from 1976 to 1979, and a virtual collapse (a decrease of 27% over five years) after a short-lived growth peak in 1981 (Sulemane 2002). Marketed production in nine key agricultural commodities (rice, maize, sunflower, cotton, beans, citrus fruits, copra, tea and cashew) show a similar trend (Cravinho 1998). Lack of foreign exchange, a shortage of inputs, irregular power supplies and transport problems led to a 50 per cent fall in industrial production between 1981 and 1986. By 1984 the foreign debt had reached US\$ 2,400 million, while annual debt service required approximately ten per cent of the GDP (Arndt et al. 2006).

In addition to the rapidly escalating civil war, the precipitous economic decline experienced after 1981 was caused by misguided economic policies and bad management. In agriculture public investment was concentrated in the state farm sector, which had taken over most of the plantations and settler farms,²⁹ seeking to expand

²⁹ In the industrial and service sectors the Frelimo government nationalised most utilities, the banking system, large transport companies, oil refining and distribution, mines, and large building material industries (Castel-Branco et al. 2001).

large-scale mechanised production of cereals and export crops which were expected to create substantial revenue for the government. Colonial financial institutions, which included specialised crop institutes providing credit to settler farmers, were nationalised and reorganised to serve the collectivised enterprises. Outside of state farms and co-operatives, the supply of investment goods was tightly restricted, thus undercutting the productivity of independent small-scale producers and the remaining private farms (O’Laughlin 1996; Verschuur et al. 1986). However, as the narrow basis of human and social capital inherited from the colonial era made the economy extremely vulnerable to socio-political instability, the exodus of most of the 250,000-strong Portuguese settler community after 1974 created a major human capital shortage, which the government was unable to adequately fill with experts from eastern Europe. This made for inefficient management of agricultural enterprises. The exodus of skilled manpower also weakened the operational capacity of nationalised manufacturing industries and the economically important transport sector, which linked neighbouring countries’ export industries to global markets through the Mozambican railway and port network (Hall and Young 1997; Newitt 1995).³⁰

4.3.3 Structural adjustment with foreign aid, 1987–1993

In order to halt the deepening economic crisis of the early 1980s and to access the desperately needed western foreign aid, Mozambique joined the IMF and the World Bank in 1984.³¹ Three years later, the government adopted an IMF-sponsored Economic Reform Programme (*Programa de Reabilitação Económica*, PRE), which advocated a massive devaluation, a reduction in state subsidies for social services, the restoration of markets, the elimination of most price controls, and privatisation (Arndt et al. 2006; Bowen 1992).

The economic results of the PRE were, however, somewhat disappointing. As the growth achieved with the inflow of aid money during the first years of the programme turned to negative figures, the value of the GDP again declined (Abrahamsson and Nilsson 1994; Francisco 2003). At the same time inflation remained high, oscillat-

³⁰ The decline in the level of utilisation of the transport network was caused by three major factors. In addition to declining operational capacity in Mozambican ports and railways, technological change (adoption of container technology) in the international transport system, and both economic and military pressure by the apartheid government in South Africa, made the Mozambican transport routes less attractive than alternative routes through South African ports, which were heavily subsidised by the government (Nhabinde 1999; Stephens 1986).

³¹ In 1981 Mozambique applied for membership in the Soviet-led Council for Mutual Economic Assistance (CMEA), but was turned down, and by the early 1980s the Soviet-bloc allies were reluctant to increase their financial assistance to Mozambique (Arndt et al. 2006).

ing between 40 and 68 per cent in the period 1988 to 1994 after peaking at 175 per cent in 1987 (Sulemane 2002). As productivity did not improve, national savings remained negative (reaching -11% in 1993), while the internal investment rate increased from a low level of ten per cent of GDP in the early 1980s to more than 20 per cent in 1988 (Francisco 2003). The gap between the low level of domestic savings and investment was filled with foreign aid, which grew from slightly over ten per cent of GDP in 1984 to more than 40 per cent of the GDP in 1987, reaching a high-point of close to 100 per cent in 1992 (Arndt et al. 2006).

Increasing foreign aid came with a number of conditionalities, including privatisation of public enterprises, which was emphasised relative to other market constraints by major donors such as the World Bank. By 1990 about two hundred firms – roughly 17 per cent of all state enterprises – had been privatised (Castel-Branco et al. 2001). Most of the small and medium industries and large tracts of prime agricultural land were divested on highly beneficial conditions to members of an emerging state-sponsored business elite consisting of senior party members, bureaucrats, military officers and re-established businessmen. State farms and large industries, on the other hand, were sold mainly to foreign investors, typically in the form of joint ventures with the government (Bowen 1992; Pitcher 1996). While privatisation is generally expected to raise economic efficiency and the investment rate, in the Mozambican context it also had an additional – albeit not fully explicit – political objective. It was used to ‘buy’ the support of influential people for the peace process (Arndt et al. 2006; Castel-Branco et al. 2001). While this may have been well justified in terms of maintaining social stability over a difficult transition period (especially in the light of the failed peace process in Angola), it hardly improved the transparency and economic efficiency of the process or of the resulting private enterprises. It also contributed to the eventual exclusion of the small-scale sector from the process (Cramer 2001; West and Myers 1996).

Price and product-movement controls were gradually removed as stipulated by PRE. For example, the share of products with fixed prices (as percentage of GDP) decreased from 70 per cent in 1986 to 30 per cent in 1989, while restrictions on the movement of agricultural products were removed (Coughlin 2006). The reduction in state subsidies and the elimination of price controls worked to the detriment of especially the poorer sections of the urban population. However, even though the liberalisation of agricultural producer prices was expected to benefit the rural population, the terms of trade for small-scale producers actually deteriorated, leading to stagnant or even reduced market output (Bowen 1992; Cravinho 1998). Access to social services was negatively affected by the reduction in public expenditure imposed by the PRE. For example, the combined share of education and health in the state budget fell from 24 per cent in 1986 to 3.2 per cent in 1991 (Bowen 1992). Overall, only a small proportion of the emerging commercial farmers and businessmen seem to have benefited

directly from the economic reforms of the 1987 to 1994 period.

4.4 Transition to market economy: the post-war period

As described above (chapter 4.3.3), the transition to a market economy was initiated by the Frelimo government in the mid 1980s. The process accelerated considerably after the end of the civil war in 1992 and the shift from a one-party state to a multi-party democracy after the national elections of 1994. The Bretton Woods Institutions have been highly visible external partners for Mozambique since the PRE was instituted in 1987, playing an important role in planning, financing and implementing reform initiatives. Especially during the post-war period, the Policy Framework Papers prepared by the government for the Consultative Group meetings have been substantially influenced by technical assistance from the IFIs (Arndt et al. 2006; Soil and Water 2001). The IFIs, and particularly the World Bank, have provided crucial assistance in drafting the current economic policy, which is well in line with the 'mainstream' recommendations. Currently Mozambique's average tariff rate is one of the lowest in Africa, while the economic recovery and related privatisation process have been hailed as a major success story by leading pro-liberalisation donors (see e.g. USAID 2004a; World Bank 1998; 2005c).

The first poverty reduction strategy for Mozambique was prepared immediately after the elections in 1995. In 1999 the government elaborated a policy framework document with the objective of eradicating absolute poverty, which was required in order to benefit from the Heavily Indebted Poor Countries (HIPC) initiative. This document was later incorporated into an interim Poverty Reduction Strategy Paper (PRSP) for 2000–2004, and submitted to the relevant Bretton Woods institutions in 2000, again in the context of the HIPC initiative. The interim document was later developed into a full PRSP (PARPA 2001–2005). Meanwhile Mozambique has benefited from two rounds of the HIPC initiative (in 1999 and 2001), which have substantially reduced the country's external debt (Soil and Water 2001; World Bank 2005c).³²

The PRSP 2001–2005 document is based on the notion that lack of economic growth is the key cause of poverty, setting an average annual economic growth rate of eight per cent as the key target for the period 2001 to 2005. In addition to economic growth, the focus was on the development of physical and human capital, notably in terms of the transport and social services (health and education) infrastructure (Republic of Mozambique 2001). While these sectors were already emphasised in the pre-PRSP government plans, the renewed emphasis on investment in human capi-

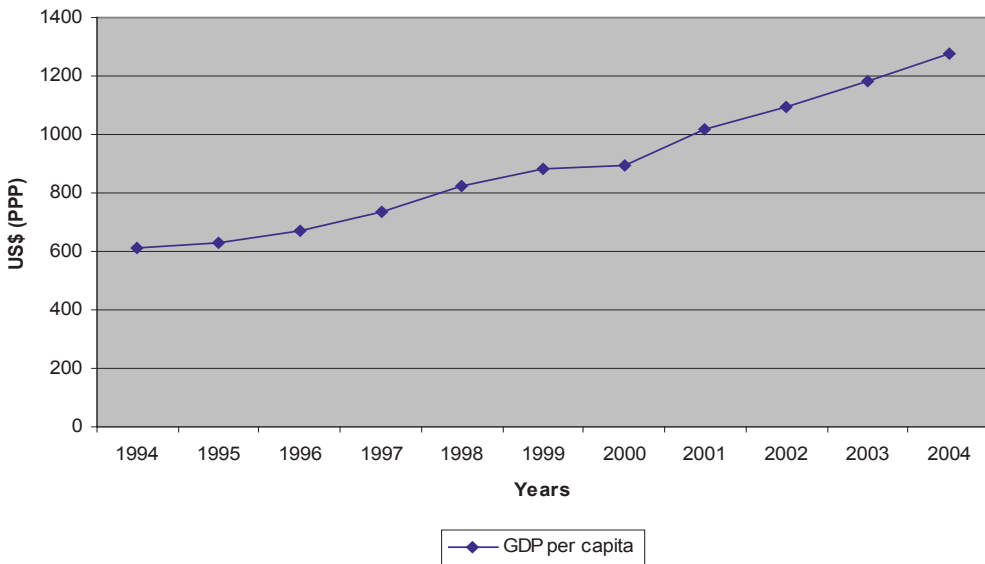
³² In 2005 a further cancellation of the multilateral debt was announced, reducing the public external debt-to-GDP ratio to approximately ten per cent (AfDB/OECD 2006).

tal reflects a major change in the policy recommendations of the major IFIs when compared to the 1980s structural adjustment strategies. The change has also been reflected in aid flows: assistance to social sectors has increased from an average of seven per cent of total aid for the period 1985 to 1989, to 26 per cent in the period 2000 to 2004 (Arndt et al. 2006).

4.4.1 Economic growth and investment

The policy of market liberalisation and privatisation has, in the context of relative political stability, led to both powerful economic growth and a profound structural change in the economy. The GDP per capita doubled between 1994 and 2004 (Figure 4.4.1). The real annual growth rate has remained steadily above seven per cent except for the year 2000, when it fell below two per cent due to catastrophic floods. The growth has been driven mainly by mega-project construction, investment from neighbouring countries, a high level of donor support and the post-war recovery of agricultural sector (World Bank 2005c).

Figure 4.4.1 GDP per capita Mozambique, 1994-2004



Source: IMF 2006.

The mean annual growth in agricultural production between 1995 and 2003 was 5.2 per cent, while the fishing industry was practically stagnated. Growth in the agri-

cultural sector is thus substantially lower than the overall mean GDP growth rate of 8.6 per cent. High rates of growth (above 10%) in construction (12.8%), electricity and water (43.1%), and finance and insurance (10.4%) result essentially from mega-project³³-driven high growth rates in manufacturing (18.9%) and mining (16.2%), and to a lesser degree from growth in the tourism industry (World Bank 2005c). Diverging sectoral growth rates have caused a relatively rapid structural change in the economy, at least in terms of output (Table 4.4.1).

Table 4.4.1 Composition of GDP, 1995–2004 (% of GDP, at current prices)

Sector	1995	1999	2004
<i>Agriculture & Fishing</i>	34	28	26
<i>Industry</i>	14	22	31
<i>Services</i>	52	50	43

Source: IMF 2006.

In terms of employment the change has been much less radical. Approximately 80 per cent of the economically active population are still employed in agriculture and fishing. The service sector employed 15 per cent of the work force, while the manufacturing industry employed only five per cent. Further, if the mega-projects are excluded, the growth rate in manufacturing fell to below ten per cent, with considerably lower growth rates after 2000 (Castel-Branco 2004; World Bank 2005c).

4.4.2 Tariff structure and government revenue

Government income is made up of taxes, nontax revenue and grants. In Mozambique the total government revenue increased from 11.3 per cent of the GDP in 1998 to 14.2 per cent in 2002, but has since fallen closer to 12 per cent. A large part (0.9 percentage points) of the overall increase was due to growth in nontax revenue. Total income (revenue and grants) increased from 19.4 per cent to 26 per cent of the GDP over the same period (Table 4.4.2). Due to a relative increase in other forms of taxation, the share of import duties and export taxes decreased from 18 per cent of domestic revenue to 15 per cent in 2002. However, as the GDP had grown, trade taxes generated about one third more revenue in 2002 compared to 1998 (USAID 2004a).

³³ The concept of mega-project refers to large capital-intensive undertakings, typically in the minerals and energy sector and financed almost entirely by FDI. Currently there are three major mega-projects, namely the Mozal aluminium smelter in Maputo Province, the Cabora Bassa hydroelectric plant in Tete Province, and the Sasol gas project, which extracts natural gas in Inhambane Province and exports it to South Africa via pipeline. Two mining projects (mineral sands extraction) are currently under way in Nampula and Gaza provinces (World Bank 2005c).

Table 4.4.2 Government revenue and grants, 1998–2002 (% of GDP)

	1998	1999	2000	2001	2002
Tax revenue	10.5	11.1	12.0	11.8	12.5
Taxes on income and profit	2.0	1.7	1.8	2.1	2.5
Taxes on goods & services	6.1	7.0	7.6	7.3	7.5
Taxes on international trade	2.0	2.0	2.2	2.1	2.2
Other tax revenue	0.3	0.4	0.4	0.3	0.3
Nontax revenue	0.8	0.9	1.2	1.5	1.7
Total revenue	11.3	12.0	13.2	13.3	14.2
Grants	8.1	11.7	8.0	14.8	11.8
Total revenue and grants	19.4	23.7	21.2	28.1	26.0

Source: USAID 2004a.

After cumulative revisions since the mid 1980s, Mozambique's tariff structure is currently among the most liberal in Southern Africa. In 2003, the average tariff rate was 12.1 per cent and the trade-weighted average was below nine per cent. A reduction in the tariff rate for consumer goods from 25 to 20 per cent in 2006 lowered the average rate even further. Additional surcharges are applied to imports of sugar, cement and some steel products, while the respective domestic industries are rehabilitated, though in general domestic industries benefit from few protective measures. The competitiveness of Mozambican exports has been strengthened by the creation of export-processing zones (EPZs) and by permitting duty-free entry of goods in certain approved industries. In addition, a number of FDI-funded mega-projects benefit from special arrangements which considerably reduce their tax burden (USAID 2004a).

While tax exemptions are arguably an important incentive for increasing investment in export industries, they also substantially reduce the public revenue-generating capacity. Under the standard tax system the tax burden on investors (46 %) is higher in Mozambique than the SADC average. However, the government enacted a new code of fiscal incentives in 2002, establishing a wide range of concessions for approved investments and bringing Mozambique's average marginal effective tax rate closer to the average SADC level (Haaparanta and Kerkelä 2006; USAID 2004a).³⁴ Various critics have argued that even though the currently practised policy of granting large tax reductions for mega-projects may be useful in terms of attracting FDI, it is over-generous and deprives the government of desperately needed revenue (see e.g. Beaumont 2004; Castel-Branco 2004; Franco 2002a).

Since 1992, the tax-to-GDP ratio has remained close to 12 per cent despite a comprehensive reform of the tax and customs administration systems. While this reform can be considered a success, subsequent improvements in the tax-to-GDP ratio – as

³⁴ Mozambique has considerably simplified its tax system during the last decade. The main change was the introduction of a value-added tax (VAT), with a single rate of 17 per cent. In 2002, VAT generated 38 per cent of government revenues (USAID 2004a).

recommended by the IMF – have not been realised. For example, in PRSP 2001–2005 the target for tax contribution was set at 14.2 per cent of the GDP by 2004. However, less than 12 per cent were collected, implying that no lasting improvement was made during the five-year period (Arndt et al. 2006). The new PRSP 2005–2009 document sets the target for 2009 at 15 per cent of the GDP, i.e. the same as the previous PRSP had set for 2005 (Republic of Mozambique 2006).

4.4.3 External aid

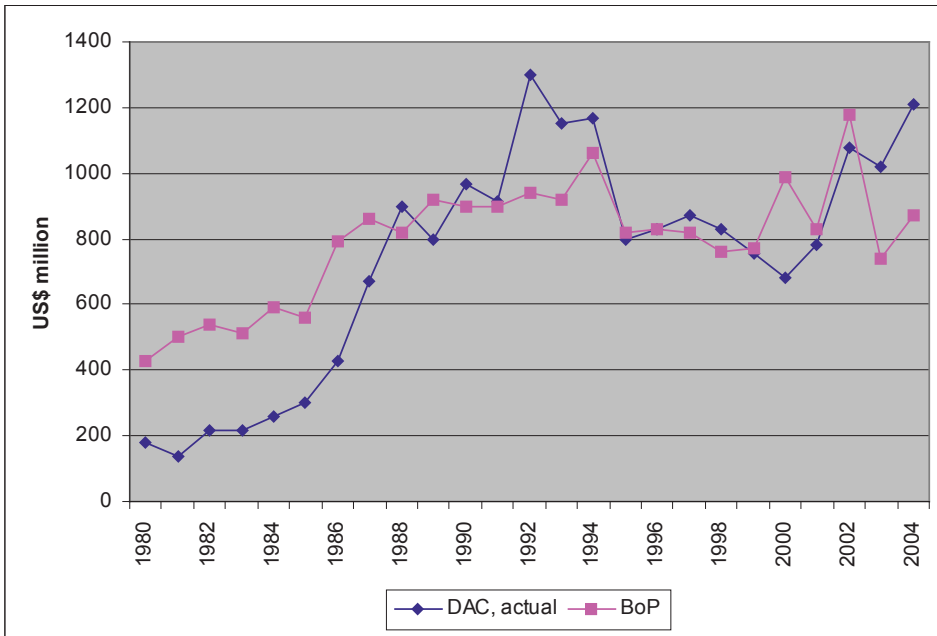
External aid³⁵ to Mozambique has grown substantially since 1985, when agreement was reached between the government and the Bretton Woods institutions (see chapter 4.3.3). According to some estimates, over 65 per cent of all foreign exchange available to Mozambique comes through foreign assistance (Arndt et al. 2006). Figure 4.4.2 shows net aid according to both OECD Development Assistance Committee (DAC) data on aid disbursements and national Balance of Payments (BoP) statistics.

The BoP data series shows higher aid figures than the DAC data for the period 1980–1989, when substantial external financing not reflected in the DAC database was received from Soviet-bloc countries. In the early 1990s the DAC disbursements show much higher inflows than the BoP data. This is due to substantial humanitarian funding and funding to the UN peacekeeping force (ONUMOZ) and NGOs between 1992 and 1994 (Arndt et al. 2006).

Gross aid (including debt relief grants) from the DAC data have averaged over 40 per cent of GNI in per capita terms since 1985, with a peak of 93 per cent in 1992. In the late 1980s over 50 per cent of gross aid was being used to pay debt obligations. As a result of the HIPC initiatives and Paris Club programmes since the late 1990s, net external funding effectively available to support government expenditure has increased substantially from an average of US\$ 555 million during the 1980s to US\$ 825 million in the 2000–2004 period. Since 1985, external financing has thus been equal in value to overall government investment and approximately one half of total government expenditure (Arndt et al. 2006; cf. Francisco 2003). As these figures exclude off-budget expenditures financed from external sources, Arndt and associates (2006) estimate that external finance in total government expenditure, including off-budgets, has been around 55 to 60 per cent. According to government data, net ODA has amounted to around 31 per cent of GNI in the post-war period (Republic of Mozambique 2005).

³⁵ Analysis of external aid is limited by lack of consistent and comprehensive time series data at both government and national economy level. Both data sets in Figure 2 reflect net aid before debt service charges (Arndt et al. 2006).

Figure 4.4.2 Net external assistance to Mozambique, 1980–2004



Source: Arndt et al. 2006.

There has been a major change in the type of assistance granted to Mozambique. During the civil war period the bulk of aid went to humanitarian relief as well as some early impact funding (e.g. balance of payment support), but since 1992 there has been a shift into late-impact funding such as assistance to social sectors. At the same time, grant-based financing has largely replaced credit, comprising 71 per cent of aid flows compared to less than 20 per cent in the early 1980s. An increasing proportion of aid (about 40% of gross aid in the government budget) is currently in the form of direct budget support or sectoral aid instead of being tied to specific projects (Arndt et al. 2006).

4.4.4 Foreign investment capital

Capital accumulation has historically been a problem for the Mozambican economy: the current account has been in deficit over a long period and continues to be so today. The high level of deficit compared to other Southern African countries has partly been covered by an unusually high level of foreign aid. In the post-war period, the remainder has been covered by substantial FDI inflows (AfDB/ADF 2006; Haaparanta and Kerkelä 2006).

The recovery and later expansion of fixed capital stock has been the foundation of high post-war economic growth in Mozambique. It has been estimated that during the period 1993 to 1998 capital accumulation explained 41 per cent of economic growth, while in the period 1999 to 2004 it explained 53 per cent. Out of the average 47 per cent over the whole post-war period, the role of private fixed capital contributed 33.6 per cent and public fixed capital 13.5 per cent (Arndt et al. 2006; Jones 2006). This process has relied almost totally on external sources of finance attributed to a favourable investment climate. Since the first PRE was instituted in 1987, the government has passed new laws to facilitate foreign investment and privatisation. In 1993, a new Investment Act was passed, and in 1999 (revised in 2002) the government adopted legislation for export-processing zones (EPZs). Currently full foreign ownership is permitted, except in a few special sectors such as fishing (USAID 2004a).

Between 1995 and 2003, investment as a percentage of the GDP rose from 23 per cent to 28 per cent, which is considerably higher than the sub-Saharan average of 19 per cent (World Bank 2005c). Subsequently, the stock of FDI capital has increased dramatically, rising from 29 per cent to almost 45 per cent of the GDP between 2000 and 2002 (USAID 2004a). In the whole post-war period, private investment has accounted for almost 55 per cent of all investment in the Mozambican economy, while public investment accounted for the remaining 45 per cent. The latter has also been almost entirely financed by external sources, mostly official multi- and bilateral grants and loans. Between 1990 and 2003, private investment in Mozambique consisted of FDI (approximately 36 per cent), national direct investment (NDI, 6%) and loans and other sources (58%), coming mainly in the form of non-market-based inflows of foreign capital (Castel-Branco 2004). Most of the FDI (89%) has been absorbed by the manufacturing and mining sectors (Table 4.3.3).

Table 4.3.3 Allocation of FDI and private investment in Mozambique, 1990–2003 (per cent of total)

Sector	FDI	Total private
Manufacturing industry	67	50
Mineral resources	22	16
Tourism	6	15
Agriculture	2	8
Other	3	11

Source: Castel-Branco 2004.

During the post-war period South Africa has emerged as the largest investor, representing 35 per cent of FDI flows to Mozambique. In most years, South African FDI has been substantially higher than domestic private investment (World Bank 2005c). According to Carlos Castel-Branco (2002), projects with South African participation

absorb 85 per cent of FDI flows. The main areas of investment have been aluminium, energy, natural gas, heavy/mineral sands, sugar, beer and cement, where nine corporations (all except one with South African participation) have taken 63 per cent of total FDI, 25 per cent of total NDI and 60 per cent of total private investment (Castel-Branco 2004; cf. Simon 2001).

4.4.5 Financial services

At the microeconomic level, the cost of financing new investments emerges as a constraint on investment, either in the form of credit rationing or in very high interest rates and collateral requirements. The constraint is linked to the low level of domestic savings, which has been identified as a major obstacle to growth in sub-Saharan Africa (Gulde and Pattillo 2006). This is because mobilisation of savings and the functioning of financial markets and their capabilities to attract savings and mediate them efficiently to borrowers is weak. For example, bank deposits in low-income sub-Saharan African countries were only 19 per cent of the GDP in 2004, compared with an average of 38 per cent in other regions. The problem can be traced back to institutional conditions for efficient financial system operation, for example registering property, obtaining credit, protecting investors and enforcing contracts, where the region is ranked lowest in the world. While regulatory and supervisory norms have recently been brought in line with international norms in many African countries including Mozambique, actual supervision and enforcement remains in most cases weak (Gulde and Pattillo 2006; Haaparanta and Kerkelä 2006). The problem is especially evident in transition economies.

In Mozambique, the Frelimo government nationalised in 1977 all private banks except for one, transforming the national bank (*Banco de Moçambique*) into a combined treasury, central bank, controller of the state plan, and commercial bank. The role of the bank institution in the first years of independence was also somewhat unorthodox. In the context of the nationalisation process, the government priority was to keep production going despite the exodus of Portuguese managers and technicians, and state-controlled banks were instructed to finance the deficits of these enterprises to keep them running. Naturally this helped destroy the institutional basis of the banking system. Procedures became increasingly irregular as financial sustainability ceased to be a criterion: state enterprise deficits were regularly covered by 'loans' which were never expected to be paid back (Cravinho 1998; Hanlon 2001).

More traditional banking practices were officially resumed after 1987, when the government recognised one third of the national bank's portfolio (then about US\$ 160 million) as bad loans to public enterprises. However, the practice of using 'loans' (now often to private individuals) from state financial institutions to achieve political

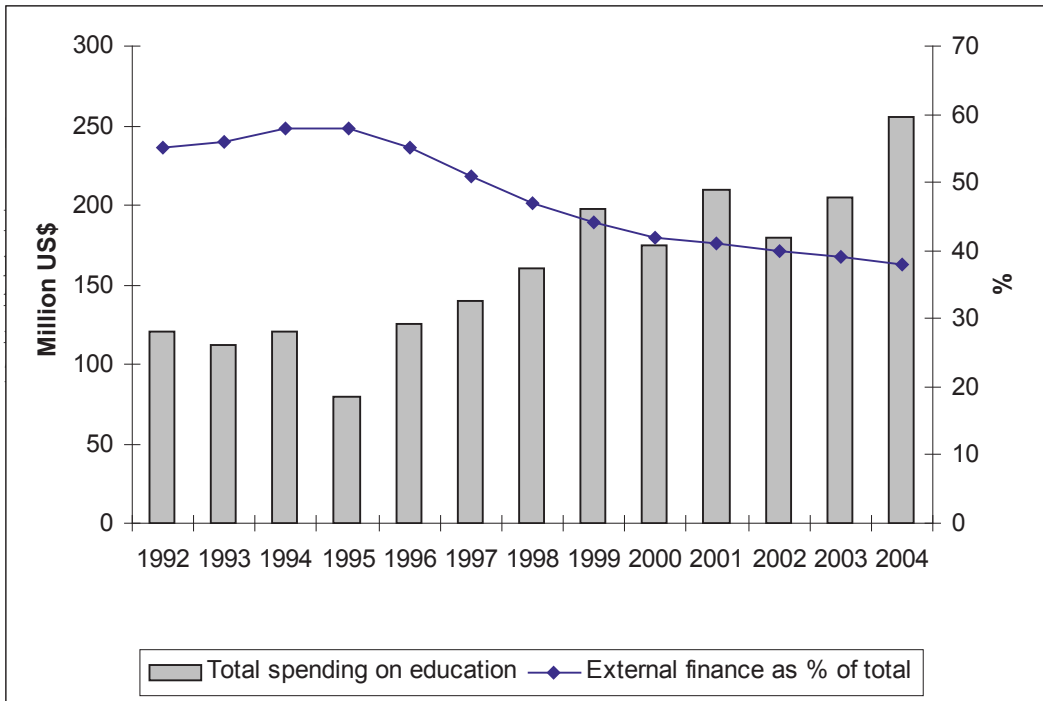
and security-related objectives continued.³⁶ The volume of bad loans further increased in the context of the privatisation process, often involving corrupt practices (Bowen 1992; Hanlon 2001; 2004b; West and Myers 1996). A new phase of financial reform began in 1992, when commercial banking was formally separated from the core central banking functions of the national bank. This led eventually to privatisation of the resulting two financially non-viable commercial banks in 1996 and 1997. By 2001 both banks had entered into insolvency, necessitating a large bail-out which was accomplished by issuing government debt (Arndt et al. 2006; Hanlon 2004b). It seems that this has not resolved the problem, as the percentage of nonperforming loans has reportedly increased since then to more than 20 per cent of total loans (Gulde and Pattillo 2006).

By 2002 the number of commercial banks had grown to 11, and new institutions had emerged for insurance, micro credit and so forth (USAID 2004a). While liberalisation of the sector has thus progressed fairly rapidly, it continues to be hampered by persistently high and volatile lending rates and difficulties in obtaining credit without meeting high collateral requirements (typically 100-150% of the loan amount). The spread between loan and deposit rates has varied between seven and 16 per cent over recent years, prime lending rates being above 24 per cent. This implies real interest rates above ten per cent. These rates are much higher than in other developing countries, especially in Asia. While access to credit is not a problem for the few, mostly foreign-owned and capital-intensive large companies who have access to subsidised credit in collaboration with IFIs and national governments, most Mozambican-owned micro- and small-scale enterprises suffer heavily. Only about ten per cent of firms have access to bank credit. This obliges them to finance investment from internal funds, which are the only source for some 70 per cent of firms (Haaparanta and Kerkelä 2006; USAID 2004a).

The domestic banking sector in Mozambique is entirely dominated by foreign, mostly Portuguese, capital. However, while Portuguese banks own most of the banks in Mozambique, it is important to note that the domestic banking system is responsible for less than 20 per cent of investment funding, production and trade in the country. In many cases domestic banks serve merely as an agency to channel international capital flows, which come from South African and international financial institutions operating through South African banks. Arguably, these latter are more important than Portuguese banks, even though the former in most cases operate directly with FDI projects and firms and are less visible on the ground (Castel-Branco 2004).

³⁶ According to a World Bank assessment (quoted in Cramer 2001, p. 86), “As of the end of 1993, over 50 percent of the loan portfolio of the Commercial Bank of Mozambique (BCM), the state owned largest bank, was non-performing”. Various state-owned firms were among the largest bad debtors.

4.4.6 Investment in public services



Source: Arndt et al. 2006.

With increased funding, relatively good progress has been made in the education sector since 1997 (Table 4.4.4).

Table 4.4.4 Education level indicators in Mozambique, 1997 and 2001 (%)

	1997	2003
Net enrolment rate in primary education	44	69
Primary education (EP1) completion rate	22	39
Literacy rate of 15-24-year-olds	52	58
Literacy rate in population above 15 years	40	46

Source: Republic of Mozambique 2005.

Between 1992 and 2004, the number of primary schools increased from 3,556 to 9,489. Better coverage of the educational infrastructure was also reflected in literacy rates, and indirectly in the labour force. While approximately 86 per cent of the economically active working population had no educational qualifications in the early

³⁷ Sector-wide support is based on Education Sector Support Plans (1999–2003 and 2005–2009). A joint Education Sector Support Fund, to which Finland also contributes, was established in 2002.

1990s, the proportion had fallen to 77 per cent in 2004. It has been estimated that the contribution of education to economic growth in the 1999 to 2004 period was close to 14 per cent, which represents a relatively high return to education for a developing country (Jones 2006; Simler et al. 2004).

The overall level of education, however, remains particularly low despite recent improvement in the provision of primary education. According to a recent study, only 15 per cent of students entering the system completed seventh class (EP2), and at grade 12 the percentage had shrunk to one. This means that more than 60 per cent of primary school-age children are likely to leave the system without acquiring appropriate skills in reading, writing and numeracy. The situation is aggravated by continuing problems with the efficiency and quality of education, which have either improved only marginally or deteriorated. For example, the pupil per teacher ratio has increased from 53 in 1992 to 59 in 2004, while repetition and drop-out rates remain high (Arndt et al. 2006; Republic of Mozambique 2005).

The average figures conceal substantial geographical and gender disparities. For example, the Net Enrolment Ratio (NER) was only 53 per cent in Nampula Province, while it was between 66 and 78 per cent in the other provinces, and above 96 per cent in Maputo Province and City. Similar differences were registered in the literacy rate, which varied from 71-85 per cent in the south, to 39-55 per cent in the centre and only 32-36 per cent in the north. The regional disparity is partly explained by the higher share of the urban population in the southern region, as this population has higher average literacy levels than the rural population (70% compared to 34%). Despite substantial expansion in the EP1 and EP2 networks, access to school is still limited in peripheral rural areas (Republic of Mozambique 2005).

While the gender gap in the enrolment ratio has gradually decreased, girls remain disadvantaged: in 2003 the NER for girls was 66 per cent compared with 72 per cent for boys. The literacy rate (above 15 years) remains highly skewed towards men, only 31 per cent of women being literate compared to 63 per cent of men (Republic of Mozambique 2005). This is a significant factor in terms of economic development, as it reduces the employment opportunities available to women. Currently women constitute about 54 per cent of the total labour force. However, almost 90 per cent of them work in the agricultural sector (mainly small-scale), where they make up more than 62 per cent of the labour force. Men constitute over 90 per cent of the labour force in manufacturing, construction and transportation, 75 per cent in government service, 65 per cent in service industries, and almost 60 per cent in commerce. Of the occupied female labour force, only 4.5 per cent had a secondary school or higher level of education, while the proportion for men was 15 per cent (Republic of Mozambique 2006).

Due to the increasing coverage of primary education the number of workers without any education has been falling in absolute terms during the post-war period. In the agricultural sector the contribution to growth from skilled labour has this far come mainly from workers educated to primary level – a result of the comparably low expansion of secondary schooling in rural areas. In the other sectors the contribution attributed to the skilled workforce has been increasingly driven by secondary-level education, suggesting that further expansion of education at this level and beyond will be necessary to support future employment needs and demands of modern technology (Jones 2006; cf. Republic of Mozambique 2006).³⁸ This conclusion is supported by studies from the more industrialised South Africa, which show that with increasing access to primary education, secondary education is rapidly becoming a basic requirement for entry into the labour markets (Leibbrandt et al. 2007).

Health sector

Similar to education, development in the health sector has been highly dependent on external financing.³⁹ Since the late 1980s, aid has financed from 60 to 70 per cent of total spending in the sector, and approximately 80 per cent of all capital investment. In the post-war period, external and internal funds have grown at similar rates. A subsequent rapid increase in funding has made possible extensive rehabilitation and construction of the health service infrastructure, which was the government's major sectoral priority in the 1990s. As a result, the number of public health centres grew from 162 in 1994 to 683 in 2004, while the total number of beds increased from approximately 9,000 to 17,000 during the same period (Arndt et al. 2006).

Increased service coverage has had some concrete effects in terms of reduced infant and under-five mortality. In the period 1997 to 2003, the incidence of the former declined from 147 to 124 (per thousand live births), while the latter decreased from 219 to 178. There are, however, huge differences between provinces: for example, under-five mortality varied from 241 in Cabo Delgado to 108 in Maputo Province and 89 in Maputo City. At the same time nutritional status, measured by the prevalence of under-weight children under five years of age, has remained high without significant improvement. The prevalence was almost twice as high in rural (27%) as in urban areas (15%) in 2003 (Republic of Mozambique 2005; cf. Simler and Ibrahim 2005). Among other things, the geographic differences in health indicators reflect continu-

³⁸ Despite recent growth, in 2004 only about five per cent of adults were educated above primary school level (Arndt et al. 2006).

³⁹ Support is based on a Health Sector Strategic Plan (2001-2005). Finland has supported the sector through the Health Sector Support Fund.

ing unequal allocation of resources. For example, Maputo City receives four times the average funding per person, and has three times the average number of beds per person (Arndt et al. 2006).

Transport sector

The road network is the principal means of transport in Mozambique, representing over 60 per cent of value added of the transport and communications sector. Since 1992, substantial progress has been made in rehabilitating and upgrading the classified road network. At the end of the war only some 10 to 25 per cent of roads were in good or fair condition, while 50 per cent were impassable. By 2002, 56 per cent of the road network had been restored to good or fair condition and only eight per cent were impassable. Roads covered by routine maintenance had also expanded from less than 4,000 kilometres per year in 1994 to 10,000 kilometers by 2002. Over the same period road cargo traffic grew over six fold, and passenger traffic more than doubled. Survey evidence confirms that rehabilitation of the road network has made a significant contribution to poverty reduction (Arndt et al. 2006; USAID 2004b).

Management of the major railroad lines and ports has been leased to international concession companies, starting from the ports. The port of Maputo was gradually transferred to private management between 1993 and 2003, and Beira in 1998. Management contracts on the main railway lines (Ressano Garcia, Beira/Sena and Nacala) were awarded to private companies during the period 2000 to 2005, but the lease for the Ressano Garcia line was cancelled by the government in 2005. The total volume of transport by rail has increased from 2.5 million tons in 1994 to 4.2 million tons in 2001, while handling of cargo in Mozambican ports has increased from 6.2 million to 9.0 million tons over the same period. The volumes achieved remain, however, well below capacity. For example, the port of Maputo is currently using only 40 per cent of its capacity, while both Beira and Nacala have only about 62 to 66 per cent of the capacity built in the 1980s and 1990s (with Nordic support) in operational condition. Also in the case of railways the figure for rolling stock registered as operational has actually decreased during the last decade, reflecting mostly disposal of destroyed and/or obsolete stock from the official registers (Nhabinde 1999; USAID 2004b).

Support to the public infrastructure has been one of the main priorities of aggregate external aid to the country. During the period 1996 to 2002 donors have financed approximately 75 per cent of all expenditure in the roads sector. While the majority of donor funds have been targeted for rehabilitation, with the government covering less than ten per cent of such costs, donors have also supported recurrent maintenance and administration expenditures. In recent years the share of external funding has slightly declined, being approximately 60 per cent (excluding general

budget support) of total expenditure in the sector for 2003 and 2004.⁴⁰

4.5 Trade capacity and access to markets

As noted above (chapter 4.4.1), the structure of the Mozambican economy has altered drastically since 1995. The statistics indicate the growing importance of the industrial sector⁴¹, which now accounts for some 31 per cent of the GDP, compared to 14 per cent in 1995. At the same time, the share of agriculture and fishing declined from 34 per cent to 26 per cent.

According to a World Bank Country Economic Memorandum, between 1996 and 2003 the main growth sectors were construction, tourism⁴², certain manufacturing sub-sectors (food, beverages and tobacco, and aluminium), transport, services, and certain agricultural sub-sectors (sugar, tobacco and horticulture). Agriculture and fishing, and industry, the main economic sectors in terms of potential contribution to export growth and/or poverty alleviation, will be analysed in greater detail in chapters 4.6 and 4.7 below.

4.5.1 Recent trends in Mozambican export trade

The structural change in the Mozambican economy was linked to the rapid growth of gross export earnings from US\$ 230 million in 1997 to US\$ 682 million in 2002 (Figure 4.5.1). During the period 1997 to 2004, the share of export earnings in the GDP increased from 6.7 per cent to 24.7 per cent (AfDB/OECD 2006). Export growth was, however, almost entirely attributable to three large capital-intensive projects, namely the restoration of electricity exports from the Cahora Bassa hydro-electric dam, the Mozal aluminium smelter, and the Sasol natural gas pipeline (Table 4.5.1). These mega-projects amounted to 15 per cent of the GDP, while other exports grew by just 0.5 per cent per year in US dollar terms (USAID 2004a). They have also changed the situation in terms of export markets, where the Netherlands currently

⁴⁰ The World Bank has been the lead agency since 1992, coordinating a large group of donors through two Roads and Coastal Shipping (ROCS) projects from 1992 to 2002, and presently through the Roads and Bridges Management and Maintenance Programme (2002-2011). The bank has thus come to dominate both policy development and analysis in the sector (AfDB/OECD 2006; Arndt et al. 2006).

⁴¹ Industrial sector includes mining, manufacturing, electricity and water, and construction.

⁴² Tourism is one of the fastest growing industries in the world, and particularly in southern Africa. In Mozambique tourism has grown rapidly over recent years, with a more than ten per cent annual increase in arrivals. However, its contribution to the GDP remains at around 1.2 per cent (World Bank 2005c).

provides the largest market due to the role of Rotterdam as a hub of trans-shipment of aluminium. Other, more traditional export destinations include South Africa, Portugal, Spain, Japan, India and the USA (AfDB/OECD 2006; World Bank 2005c). According to EU data (Comext 2003), the principal Mozambican exports to the EU in 2003 consisted of aluminium (80% of total exports to EU), crustaceans (10%), tobacco (4%) and cotton (2%).

Table 4.5.1 Principal exports and imports in Mozambique, 2004

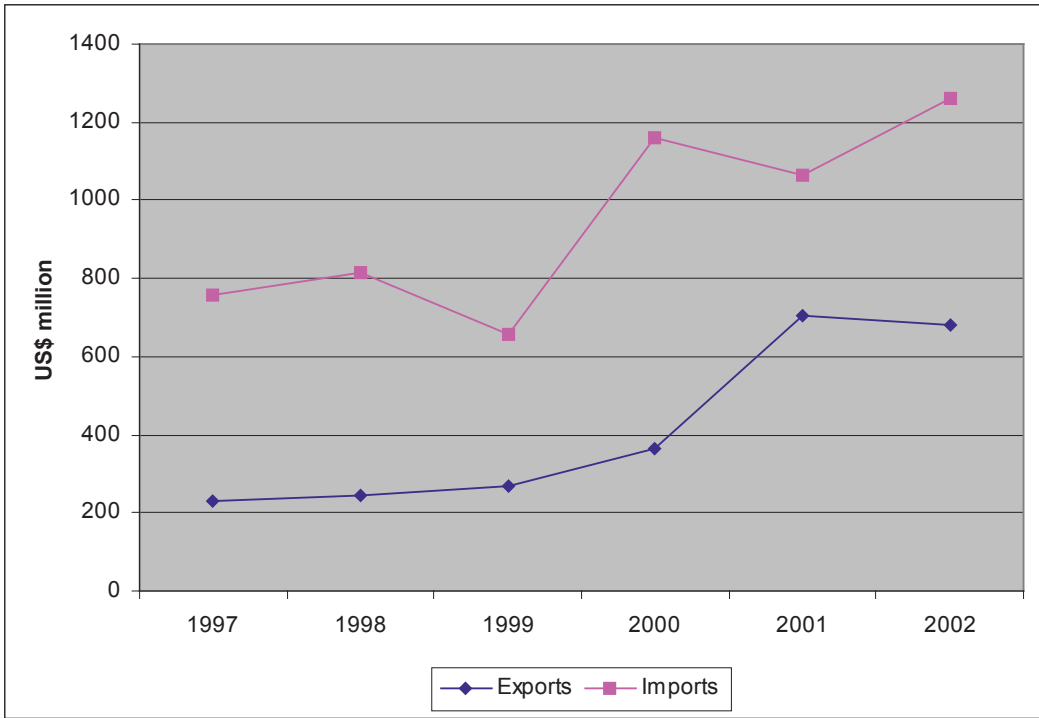
Principal exports	US\$ million	Principal imports	US\$ million
Mega-projects (aluminium, electricity, gas)	1,049	Machinery and equipment	139
		Transport equipment	114
Prawns	101	Fuel	92
Cashew	82	Textiles	43
Manufacture	24	Metal products	39

Source: AfDB/ADF 2006.

The concentration of exports in a few capital-intensive sub-sectors (aluminium, energy and gas) has significantly reduced the diversity of exports, thus increasing the economy's vulnerability to the volatility of world commodity prices. While Mozambique's diversification index improved from 8.1 in 1998 to 9.2 in 2000, in 2001 it had fallen to 2.9, dropping further to 2.4 in the following year. This implies that Mozambique moved from the most diversified quartile among the 49 African countries included in the ranking to the lowest third (Kauffman et al. 2006).

Between 1997 and 2002, imports increased from US\$ 756 million to US\$ 1,263 million (Figure 4.5.1). The share of imports grew from 22 per cent of the GDP in 1997 to 33.4 per cent in 2004 (AfDB/OECD 2004). Much of the increase was associated with mega-projects, initially for construction and subsequently for procurement of imports. For example, Australia, whence the raw material (alumina) for the aluminium industry is imported, accounted for ten per cent of imports in 2004. Other imports have also increased by seven per cent annually, due partly to the steep rise in world prices for petroleum. With approximately 35 per cent of imports in 2005, South Africa is overwhelmingly the largest source even though its share has decreased since 1999 (AfDB/ADF 2006; USAID 2004a). Portugal is the third most important source of imports (after Australia), followed by Japan, France, the USA and India. In general, both imports and exports are increasingly dominated by the Mozal and Sasol mega-projects. In the regional context, Malawi has become an important trade partner, while the role of Zimbabwe has diminished (AfDB/ADF 2006; World Bank 2005c).

Figure 4.5.1 Development of exports and imports in Mozambique, 1997–2002



Source: Nathan Associates 2002; USAID 2004a.

There is still a large gap between imports and exports. The trade balance has been consistently negative, oscillating around 15 per cent of the GDP up to 2003. In 2004 there was a notable improvement when the export of natural gas from the Sasol commenced. While mega-projects have contributed strongly to exports, their net impact on the balance of payments has been less positive, owing to substantial imports of capital goods during the construction phase as well as recurrent inputs needed in the production process, and repatriation of profits and remittances. Imports have been very closely related to investment. On the average, investment goods (raw materials, intermediate goods, spares, equipment and machinery) have accounted for more than 60 per cent of total imports. However, during periods of intensive investment associated with the mega-projects, investment goods accounted for some 80 per cent of total imports. The high elasticity of imports with respect to FDI is caused by weak investment capacity in the domestic economy and poor inter- and intra-industry linkages (AfDB/OECD 2006; Castel-Branco 2004).

4.5.2 Access to export markets

Mozambique has been a member of the WTO since 1996. As an LDC, it benefits from the special and differential treatment afforded to developing countries in the form of exemptions from or delayed implementation of certain provisions (see chapter 2.4.1 above). Mozambique also enjoys preferential access to key export markets in the EU and the USA. In the former, this access is regulated by two agreements, the Everything But Arms (EBA) initiative which took effect in 2001, and the Cotonou Partnership Agreement signed in 2000, which is the successor of the Lomé IV convention. After 2008 the Cotonou agreement will be replaced by Economic Partnership Agreements (EPAs) negotiated between the EU and ACP countries. In the USA, the African Growth and Opportunity Act (AGOA) signed in 2000 provides a framework giving products from selected sub-Saharan African countries (including Mozambique) preferential access to the US market (EU 2004; USAID 2004a).

EBA provides duty- and quota-free access to the EU market for all products originating in beneficiary LDCs, which include Mozambique. In addition to arms and ammunitions, which are excluded, there are three sensitive products (bananas, rice and sugar) for which duties will be gradually phased out (for bananas by 2006, for the others by 2009). EBA uses the GSP rules of origin, which are sometimes difficult to meet. As a result, as in the case of other ACP LDCs, most preferential exports from Mozambique come currently under the Cotonou agreement, which applies more flexible rules of origin while also providing unilateral preferential market access (USAID 2004a). Mozambique has participated in the EPA negotiations under the Eastern and Southern Africa (ESA) region and SADC configuration since they started in 2004 (EU 2004). The parties have not reached agreement on a number of issues, notably the role of mutual trade liberalisation vs. development cooperation in the agreement, and proposed contractualisation of EBA market access to Mozambique and two other countries. Currently the negotiations are effectively on hold (Julian 2006).

AGOA provides for duty-free access for over 1,800 items not included in the national GSP agreement, for example Burley tobacco, apparel, footwear, luggage and certain fruit juices. In 2004 AGOA was extended until 2015, and the revised legislation provides the possibility for technical assistance in certain sectors such as agricultural product sanitary and phytosanitary (SPS) standards. While the textile and apparel sector has been indicated under the AGOA as a special growth opportunity for Mozambique (Minor 2005; USAID 2004a), in reality the pressure created by the phasing out of the MFA quotas in 2004 squeezed out even relatively well-established African producers, who were not able to compete with more efficient Asians (Mumtaz 2006).

As noted above (2.4.2), Mozambique is a member of SADC⁴³, which in 2000 created a Trade Protocol establishing a free trade agreement in Southern Africa. The intention is to implement free trade in the region gradually by 2008. The implementation process is, however, asymmetric, and for example Mozambique will complete implementation on some sensitive products only in 2015. Harmonisation in customs and trade documentation has proceeded well, and there has been substantial progress in negotiations over product standardisation, quality assurance and measurement. Mozambique has also preferential trade agreements with individual SADC countries, notably Zimbabwe (2004) and Malawi (2006), and a nonreciprocal tariff concession agreement with South Africa, which provides specific imports of Mozambican origin with customs-duty-free entry into the South African market (Lewis et al. 2002; USAID 2004a).⁴⁴

There are differing views regarding whether Mozambique should intensify its links with SADC and especially with its leading member South Africa, or focus on accessing the lucrative markets of the developed northern countries, notably under preferential trade agreements with the EU and USA. Whereas some World Bank analysts are sceptical about the capacity of South Africa to serve as a growth pole for the region (e.g. Lewis et al. 2002), others have emphasised the role of regional economic integration under SADC as a necessary intermediary stage for entry into the more demanding markets of the EU and the USA (e.g. Haaparanta and Kerkelä 2006). While the growth potential offered by South African and other SADC markets is analysed further below (chapters 4.6 and 4.7), it should be noted that for LDCs, the role of tariffs and tariff preferences have arguably become less relevant. With a few exceptions, the WTO's SDTs and the above agreements with the EU and the USA have eliminated tariffs on most key exports to these markets. With the current implementation of tariff reductions under the SADC protocol, the vast majority of Mozambique's present and potential exports are covered. The main remaining hindrance are tariff quotas, especially in agriculture. On the other hand, production subsidies, export subsidies, rules of origin, technical barriers to trade, SPS regulations, and other non-tariff barriers have become the most important measures to control market access (Coughlin 2006). According to Haaparanta and Kerkelä (2006) Mozambique's export growth is constrained by a shortage of intangible capital, not a lack of access to lucrative foreign markets.

⁴³ SADC has 14 members, of which the following are implementing the trade protocol: Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia, Tanzania and Zimbabwe. Angola has postponed its implementation beyond 2008, while the Seychelles and the Democratic Republic of the Congo are not implementing the protocol.

⁴⁴ Mozambique was initially a member of the Common Market for Eastern and Southern Africa (COMESA), which also includes SADC members Malawi, Mauritius, Zambia and Zimbabwe, but withdrew together with Lesotho, Namibia and Tanzania in 1998 (USAID 2004a).

4.5.3 Enabling environment for trade

A number of ‘mainstream’ trade diagnostics and policy recommendations have criticised what they call “*unnecessary and excessive constraints embodied in policies, practices, laws and regulations ... that impede export expansion*” (USAID 2004a, p. 3-1). However, while these studies and consultancy reports have presented a long list of supposedly harmful administrative, regulatory and commercial legal orders related to company registration and inspections, labour and land regulations, tax policy and administration, and competition policy (see e.g. Macamo 2002; Nathan Associates 2002; USAID 2004a, Wells and Buehrer 2002; World Bank 2005c), it is not entirely clear whether removing all these ‘barriers’ would actually lead to or even substantially facilitate sustainable and pro-poor economic growth. While it is evident that improvement in the transparency and efficiency of the public services, as well as a reduction in the excessive discretionary powers of public servants are urgently needed in Mozambique, the problem is arguably not excessive government intervention in the economic sector. The problem is rather the arbitrary, non-transparent and poorly focused character of current state interventions, combined with weak and corrupt enforcement of the relatively modern and adequate legal framework.

According to a World Bank study on governance, in comparison with Southern African countries Mozambique fares relatively well in the areas of political accountability and human rights, political stability, and government effectiveness, where it is ranked in the lower middle cast. This is consistent with relatively high success in attracting FDI, which tends to be sensitive to such issues. Its ranking is, however, among the lowest four in regulatory quality and rule of law, where the only significantly poorer performers in the region are Angola and Zimbabwe, which (for different reasons) suffer from serious problems with political stability. The low ranking in these two dimensions of governance imply shortcomings in crucial areas of trade capacity. Regulatory quality reflects government policies affecting the business environment, for example the existence of price controls or financial repression, as well as perceptions of the burdens created by excessive government regulation, for example in foreign trade or business registration. The rule of law indicators measure the extent to which state agents have confidence in and abide by the official normative system. These include perceptions of the incidence of crime, confidence in the judiciary, and the enforceability of contracts (Kaufmann et al. 2006; cf. Andersson 2002b; Franco 2002b; USAID 2004a).

Various studies have noted substantial progress in speeding up and simplifying bureaucratic procedures. While problems persist in regulatory practices and tax administration, they do not constitute a major bottleneck to sustained economic growth. The principal constraints on investment are identified rather as difficulty of access

to and high cost of credit, and a high level of corruption. The problem of expensive credit (and a related low rate of domestic savings) is intrinsically linked to lack of trust between different commercial operators and between them and the banks, which leads to a vicious cycle. As credit is not available, firms operate on a cash-only basis and have to maintain large inventories, which means that operational costs are high and production is not internationally competitive. As firms are in constant financial difficulties, lending is very risky, which again pushes credit margins high (Coughlin 2006; Haaparanta and Kerkelä 2006).

Lack of trust between private firms and the government, on the other hand, both feeds on corruption and makes it grow. For example, profound distrust seems to prevail between tourism operators and government tax authorities in Inhambane, where corruption is perceived to be very high (BTU and GTZ 2004). Lack of trust between the private sector and the government is also prevalent in the cashew sector, where investment has stagnated largely due to incoherent government policy, which has increased the risk instead of reducing it (McMillan et al. 2003). Both the lack of credit and the high prevalence of corruption reflect a general lack of social capital, from which society suffers as a result of the destructive experience of colonialism, misguided socio-economic policies during the early independence period, and the subsequent civil war.

4.6 Development of the industrial sector

It is typically assumed that the industrial sector contributes more dynamically to overall growth than other sectors of the economy by reason of its higher productivity growth, which results from increasing returns to scale and gains from technological progress (DESA 2006). Mozambique's industrial sector includes mining, manufacturing, electricity and water, and construction. Even though all of these sectors have grown in the post-war period, the growth has been closely linked with the mega-projects, notably the Mozal aluminium smelter which began operating in 2001. Excluding these projects, the industrial sector is very small and concentrated. The main sub-sectors of the manufacturing industry are beverages and food processing, paper and wood products, textiles and clothing, and chemical products (Table 4.6.1). The industrial sector is highly concentrated geographically, the capital region accounting for more than 80 per cent of all industrial activity (Castel-Branco 2004; World Bank 2005c).

Despite low wages, the industrial sector – excluding the mega-projects – suffers from low productivity. According to official statistics, only about 25 to 30 per cent of the capacity of the manufacturing firms was in use in 2002. Labour productivity is among the lowest in sub-Saharan Africa. For example, a study based on an analysis of 72 countries to determine efficiency in the creation and spread of technology using the Technology Achievement Index (TAI), concluded that Mozambique was a technologically margin-

alised country, having the lowest TAI in the sample.⁴⁵ Despite substantial improvements in telecommunications and transport after recent liberalisation and consistently high investment in these sectors, extremely low levels of domestic investment and human capital development make accumulation of produced and intangible capital almost totally dependent on imported technology and FDI (World Bank 2005c).

Table 4.6.1 Manufacturing industry in Mozambique, 1998–2002
[% of manufacturing output including (excluding) aluminium]

	1998	1999	2000	2001	2002
Food processing	21.8 (21.8)	20.9 (20.9)	15.6 (20.0)	7.7 (24.4)	8.5 (23.6)
Beverages	23.8 (23.8)	28.2 (28.2)	20.0 (25.7)	8.8 (28.0)	10.1 (28.1)
Textiles and clothing	8.0 (8.0)	11.8 (11.8)	7.4 (9.5)	5.0 (15.9)	4.4 (12.4)
Wood and paper	12.9 (12.9)	12.2 (12.2)	14.0 (18.1)	6.9 (22.0)	8.9 (24.7)
Chemical products	5.0 (5.0)	4.5 (4.5)	3.7 (4.8)	1.9 (6.1)	2.0 (5.6)
Metallurgy¹	2.0 (2.0)	0.9 (0.9)	23.7 (1.9)	69.0 (1.2)	64.5 (1.1)

¹Except machinery. *Source:* USAID 2004a.

These are also key elements in Mozambique's industrialisation strategy inscribed in the PRSP document, which focuses on three main components, namely trade liberalisation, privatisation and attracting FDI. Mozambique has liberalised its trade policy fairly rapidly in the post-war era. Quantitative restrictions and export tariffs have been almost completely eliminated. Tariffs on fuel and capital goods are five per cent, and 7.5 per cent on intermediate materials. Tariffs on raw materials are 2.5 per cent. Further reductions in tariffs will be made as the SADC trade protocol implementation proceeds. Exceptions to the top tariff rate of 20 per cent include surcharges on imported sugar, cement and galvanised steel to protect emerging domestic industries in these sub-sectors, as well as surcharges on certain luxury items such as cars (World Bank 2005c). In the following we shall focus on privatisation and the rapid growth of manufacturing exports.

4.6.1 Privatisation

The structural adjustment programmes (SAPs) initiated by the World Bank in many African countries, including Mozambique, during the mid-1980s brought somewhat contradictory results (Bowen 1992; Schatz 1994; Temu and Due 2000). The SAP

⁴⁵ Like the HDI, TAI is a composite measuring instrument. It provides a vision of the technological condition of countries in four dimensions: the creation of technology, the diffusion of recent innovations, the diffusion of old innovations, and the number of personnel capable of sustaining the dominant level of technology (UNDP 2001).

approach to privatisation has been criticised, among other things, for its too broad generalisations, which are insensitive to both the specifics of the country concerned and the sectors involved in each country (Bayliss and Fine 1998). Subsequent studies indicate that, for example, political instability hastens privatisation as the process is not based on planned and cautious decisions but serves rather as a last-resort response to crisis. In many cases the process was also initiated from abroad as a part of an aid-for-reform package. Paradoxically, it appears that transition countries and others with poor or ill-adapted institutions privatised sooner, even though the process often got bogged down. Countries with a superior market infrastructure privatised later, but due to the existence of the necessary institutional mechanisms the process tended to be both faster and less controversial. In many cases widely expressed discontent with privatisation can be attributed to countries moving into divesting public assets without sufficient preparation with respect to strengthening regulatory structure and protecting equity considerations (Aron 2003; Banerjee and Munger 2004).

In Mozambique, a privatisation programme was initiated in 1989, but as noted above (4.3.3), it achieved only limited progress in the first years. About 86 per cent of the privatisations took place after 1992, including most of the large enterprises outside the agricultural sector. Overall, more than 1,400 privatisations have taken place, making the Mozambican programme the largest in Africa in terms of the number of transactions (Castel-Branco et al. 2001; Cramer 2001).

Results have, however, been mixed. Privatisation of key utilities such as railways and ports have in most cases failed to bring the expected efficiency gains at least initially. Most processes have been substantially delayed, and a few management leases (e.g. over the Ressano Garcia railway) have already been cancelled.⁴⁶ Privatisation of urban water services has achieved modest improvements after major problems over a number of years (Gökgür and Jones 2006; Walker 2005).⁴⁷ Many of the privatised manufacturing industries have closed down or been transformed for secondary uses such as warehouses (Castel-Branco et al. 2001; Cramer 2001). In particular the textiles, apparel and footwear industries, which a few years back were identified as major growth sectors under the EBA and AGOA schemes (e.g. Minor 2005; Sarkar 2002; USAID 2004a), have actually stagnated or fallen off since the Multi-Fibre Arrangement (MFA) ended in 2005 (MacDonald and Vollrath 2005; Mutume 2006; World Bank 2005c). Overall, privatisation has led to a substantial decrease in the industrial

⁴⁶ Yager 2006. According to local newspapers, the Maputo Port Development Company, the concession holder of the Maputo Port, has failed to pay the leases, and owes CFM and the state about US\$ ten million (Notícias 24.03.2006).

⁴⁷ The problems have been acknowledged by senior World Bank staff (see e.g. Nellis 2006), and seem to be prevalent in the process of privatising basic utilities in sub-Saharan Africa (Bayliss and McKinley 2006).

labour force in the affected sectors. Employment in the manufacturing sector declined from about 120,000 in 1997 to a mere 50,000 in 2003, i.e. by nearly 60 per cent (Cramer 2001; World Bank 2005c).

While the direct fiscal benefit of privatisation has been much less than expected (for example, only 17 per cent of the US\$ 52 million owed to the state was paid by 1996), there has at least been a reduction in recurrent costs needed to keep economically unviable public enterprises operational. However, due to a lack of coherent industrial strategy, a weak institutional capacity to direct and monitor the privatisation process, and to political interference the gains were substantially reduced while the role especially of the manufacturing sector in poverty alleviation has actually declined. Even though the 'mainstream' theory maintains that private ownership, de-regulation and market liberalisation are sufficient to achieve a socially efficient resource allocation, the evidence from Mozambique suggests that successful privatisation actually requires clear rules and strong state institutions to enforce them (Arndt et al. 2006; Castel-Branco et al. 2001). As noted by Castel-Branco and colleagues (2001), investment in social capital, including improved regulation of utilities, strategic industries, and financial institutions, is thus essential.

It should also be noted that in the case of Mozambique, privatisation also served an important political objective, that of facilitating the peace process. In fact privatisation interacted with military demobilisation and political transition to multi-party democracy, as the state assets to be privatised were to a substantial degree transferred to party and military elites from both sides of the conflict (Castel-Branco et al. 2001). A result of the interaction between political and economic objectives has been the politicisation and immature development of public institutions which are meant to promote accountability and transparency in the use of public funds. In this way the ruling elite have co-opted the reform process, using it as a vehicle for maintaining both economic and political power through the creation of a business elite with strong links to the party. The embracing of market-based reforms thus not only provided the opportunity to reward and strengthen the party elite, but also helped to support the ideological transition to a liberal-democratic market economy (Arndt et al. 2006; Cramer 2001).

4.6.2 Growth in the manufacturing industry

It is broadly believed that FDI offers a potentially significant source of financing because it can bring with it important spillover effects such as up-to-date technology, organisational skills and distribution networks, leading to crowding in of private investment (DESA 2006). In Mozambique some crowding-in of private sector investment took place in the post-war period, supported by largely donor-financed investment

in public infrastructure reconstruction for the re-establishment of broad markets and a reduction in transaction costs. Private investment in general (50% between 1990 and 2003) and especially FDI (67%) have been concentrated in the manufacturing industry (Castel-Branco 2004; Jones 2006).

During the last decade, South Africa has become Mozambique's main trading partner. The trade is, however, somewhat unbalanced: South Africa accounts for 44 per cent of Mozambique's imports, but only 20 per cent of its exports. Despite being South Africa's main trading partner in the region, Mozambique accounts for a very small proportion of its external trade. The crucial question is thus whether South African investment creates or induces enough exports from Mozambique to the rest of the world to compensate for Mozambique's increasing trade deficit with it (Castel-Branco 2004).

The crowding in of both domestic and foreign capital has been especially clear in the manufacturing industry, where aluminium and energy, sugar, beer, soft drinks and cereal milling absorbed 94 per cent of FDI, 50 per cent of NDI, and 72 per cent of all private investment. All the dominant enterprises in these sectors are South African or dominated by South African capital. The main problem with these industries is that they either perform only primary processing (sugar, cotton ginning) or are based on imported materials and inputs (aluminium, beverages, cereal milling), which have failed to create new economic dynamics. This means that national industries are not acquiring new technical capacities even in traditional sectors, not to mention areas of high technology (Castel-Branco 2003; 2004). In fact the other manufacturing sub-sectors (except for tobacco) have stagnated or declined. While aluminium is exported and energy to a large degree, the other expanding manufacturing sectors produce mainly for domestic markets and thus do not create export revenue to compensate for the large share of imported inputs (World Bank 2005c).

The weak development effect of the industrialisation process taking place in Mozambique can be explained by the dominant position of the South African Mining and Energy Complex (MEC). The Mozambican dimension of MEC consists of a few core industries (aluminium and energy, natural gas, heavy and mineral sands), which are exploited by very large South African-based multinational corporations in collaboration with international capital and IFIs (Andersson 2002; Castel-Branco 2004).

According to the classical models of economic development (chapter 2.2), developing countries go through a phase wherein under-productive labour moves away from the agricultural sector and into labour-intensive manufacturing sectors. The existence of a labour surplus keeps down wages, and manufactured exports can therefore be highly competitive. However, once the demand for labour increases, wages begin to rise and the economy moves into the development of more capital- and skill-intensive industries. According to the model, the emphasis on labour-intensive

export production is a necessary step in an economy which is capital- and foreign exchange-constrained. The newly-industrialised countries of Asia are often presented as an example of successful industrialisation following this model. It was also the model followed by Vietnam in the 1990s. However, it should be noted that the Asian NICs (and Vietnam) invested simultaneously in human capital development, so that the level of human capital developed alongside the structural shifts (Altman et al. 2003; Klump 2007; McPherson 2002).

However, in contrast to the labour-intensive industrialisation model, economies based on MEC tend to jump directly into heavy and chemical industries development, by-passing the stage of labour-intensive manufacturing. In this context the mass creation of jobs in labour-intensive exports is not viable due to high domestic cost structures: overvalued exchange rates caused by mineral exports render labour intensive agricultural and manufactured exports uncompetitive in world markets. Since MEC is highly capital-intensive, the benefits of increased trade are not distributed widely, which tends to result in high levels of income inequality and unemployment (Altman et al. 2003).⁴⁸

In Mozambique, concentration on a very narrow range of primary exports has made the economy and its external sustainability excessively vulnerable to volatile world markets. The economy is also susceptible to the 'Dutch disease', as the changes in exchange rate make the non-MEC sectors uncompetitive while domestic prices go up. Therefore, even though Mozambique has benefited from fast growth in its GDP, employment in the manufacturing sector is falling while trade and balance of payment deficits are high and likely to become unsustainable in the long run (Andersson 2002; Castel-Branco 2003; 2004).

4.6.3 Spatial development initiatives

Practically all investment in technologically advanced industries and services in Mozambique since 1994 has taken place in the context of Spatial Development Initiatives (SDIs), planned and managed from South Africa, mostly in the context of the South African-dominated MEC. Almost 80 per cent of investment in the transport infrastructure takes place around the three SDI corridors, with emphasis on the Maputo Development Corridor, and close to 90 per cent of total private investment in the manufacturing industry in Mozambique takes place in the capital region (Castel-Branco 2004).

The SDI programme in South Africa was conceived in 1995, immediately after

⁴⁸ This process was observed over the last decade in Mpumalanga, the neighbouring South African province. Both Middleburg and Witbank towns, which depend on MEC-based industries, grew at an annual rate of close to three per cent between 1996 and 2001, while formal employment contracted over the same period, even quite drastically (19 %) in the case of Witbank (Altman et al. 2003).

the transition to majority rule in 1994. The initiative is closely linked to the 'paradigm shift' in South Africa's industrial strategy, whereby the focus moved away from import-substituting manufacturing to trade liberalisation and the creation of an internationally competitive export-oriented industrial sector. Overall, the key principle in the new industrial strategy is the creation of an attractive environment for private sector investment through strategic targeting at the industrial (industrial clusters) as well as the spatial level (SDIs). The SDI approach aims, therefore, to complement rather than replace the more traditional cluster approach (Rogerson 2001; cf. Altman et al. 2003).

The programme is spearheaded by the Department of Trade and Industry (DTI) of South Africa, which has the role of developing strategies and fast-tracking the implementation phase. Considerable stress is placed on identifying bottlenecks to investment, for example inadequate infrastructure, which can then be removed by public sector interventions, while opportunities for private sector investment are identified and packaged for marketing. There are currently 11 SDIs in existence, some of them joint initiatives between South Africa and neighbouring countries or entirely in neighbouring countries. Daily management of all SDIs – including those outside South Africa – is entrusted to the Development Bank of Southern Africa, a publicly owned South African bank whose mandate is to develop the infrastructure in the Southern African region (Nuvunga 2002; Rogerson 2001).

Four of the SDIs are situated in Mozambique, namely the development corridors of Maputo, Beira and Nacala, which connect these Mozambican ports to South Africa, Zimbabwe, Zambia and Malawi, and the Zambézi Valley Development Initiative. The last mentioned is built around a project to re-open an existing (but practically paralysed) coal mining complex in Tete Province and rehabilitate the Sena railway to the port of Beira. Management of the railway has been leased to an Indian consortium which is also in charge of the Beira-Mutare line. Rehabilitation of the coal mines was given as a concession to Companhia do Vale de Rio Doce (CVRD), a Brazilian company. Despite the objective of fast-track implementation, both the Nacala and Beira corridor SDIs have progressed very slowly due to problems with the railway contract in the first case, and collapse of the Zimbabwean economy in the case of the Beira corridor (Nuvunga 2002; USAID 2004b).

The Maputo Development Corridor initiative was launched in 1996. It is rooted in major cross-border infrastructure improvements, including a toll-road from Witbank in South Africa to Maputo, a gas pipeline from Pande/Temane in Mozambique to Secunda in South Africa, rehabilitation and privatisation of the Ressaño Garcia railway line, upgrading of Maputo harbour, and new telecommunication linkages. The transport aspect of the project aims to restore the role of Maputo, which used to handle approximately 40 per cent of shipping and cargo from Gauteng (South Africa's major mining and in-

dustrial area), in the regional economy. The corridor has direct links to main industrial and high technology clusters in the region: the high technology cluster of Gauteng, the petrochemical cluster of Bethal/Secunda and the steel cluster of Middleburg/Witbank, as well as Platinum and Phalaborwa SDIs. Due to the dominant position of South Africa in the regional economy, there are no independent competitive clusters in the other SADC countries. In Mozambique the core industrial project is the Mozambique Aluminium Smelter (Mozal), a US\$ 2,300 million mega-project situated close to Maputo (Rogerson 1997; 2001; Söderbaum and Taylor 2001; 2004).⁴⁹

4.6.4 Case study: the Mozambique Aluminium Smelter

Mozal is the largest FDI project in Mozambique, owned by BHB-Billiton⁵⁰ (66% of shares), IDC (20%), Mitsubishi (12%) and the Mozambican government (2%). It has the capacity to produce 512,000 tons of aluminium ingots per year. Production started in 2000, and the main markets are the EU (where it benefits from GSP treatment) and the automobile industry in Asia. Aluminium represents 48 per cent of Mozambique's total manufacturing output, but only 28 per cent of manufacturing value-added (MVA). This considerable difference is caused by Mozal's heavy reliance on the acquisition of intermediate materials and services, which are mainly imported. Alumina (the raw material of aluminium) is imported from Australia, and electricity (which is the largest single production input) from South Africa under a very favourable tariff structure.⁵¹ In Mozambique, Mozal is exclusively focused on the direct production and export of aluminium with very little vertical integration, as it subcontracts the provision of almost all services and goods required (Andersson 2002; Castel-Branco 2004).

The impact of FDI on the balance of payments of the receiving country depends on the share of transnational corporation profits in value-added, the degree of import

⁴⁹ The corridor project also includes an FPZ planned to attract US\$ 500 million worth of foreign and national investment in manufacturing and high technology industries. The park currently hosts 17 small enterprises which are mainly filials of South African companies providing services to Mozal, with a total capital investment of around US\$ ten million (CPI 2006).

⁵⁰ BHB-Billiton is the largest aluminium producer in the world, controlling both mining of alumina and smelters. In 2006 it completed feasibility studies for a second expansion of the Mozal smelter, which would increase the rated capacity by an additional 250,000 tons per year by 2009. The decision was dependent on the outcome of negotiations on long-term power supply contracts (Yager 2006).

⁵¹ Electricity costs are typically 20-30 per cent of production costs for aluminium. Interestingly, in those countries which have been historically shielded from multinationals, electricity prices paid by smelters are significantly higher. The provision of cheap electricity to the aluminium smelter industry may constitute a form of subsidisation which can be challenged under the WTO Agreement of Subsidies and Countervailing Measures (Turton 2002).

dependence, external debt servicing by transnational corporations and the proportion of final goods sold on domestic markets (DESA 2006). Mozal has export-processing zone status, which means that it is exempted from duties on imports required for the activity of the company. It is also exempted from value-added tax, and corporate taxes are limited to one per cent of sales. This means that even though the net trade gains of Mozal are estimated at about US\$ 400 million per year at full capacity, when profit repatriation, payments for investment services and transfer of wages of foreign workers are accounted for, its net balance of payments gains are reduced to US\$ 100 million per year. Of these, for example in 2004 only about US\$ 45 million were actually retained by the Mozambican economy in the form of wages paid to Mozambican workers, purchases in the domestic economy, social programmes and fiscal linkages. Furthermore, the capital-intensive nature of the project implies that the factor returns are skewed toward profits for investors and toward debt services instead of wages (Andersson 2002; Castel-Branco 2004).⁵²

Even when industrial projects funded through FDI bring only marginal foreign-exchange and tax benefits, such investment may substantially improve the balance of payments if it creates significant externalities which enhance the export potential of the overall economy, or there are significant technological spillovers from FDI and the presence of transnational corporations (DESA 2006). However, no significant investment in the upgrading of industrial capabilities has taken place in the case of Mozal. This is partly due to marked deficiencies related to Mozambican business and productive capacities. Very little technology transfer took place during the construction phase, as the contracts were usually one-off and short-lived. Also expected benefits from externalities such as indirect employment and linkages have been marginal except for technically simple general services such as security, cleaning and catering.⁵³ Most of the technologically demanding support services have been contracted to South African firms or their Mozambican filials established for this purpose (Andersson 2002; Castel-Branco 2004; Haaparanta and Kerkelä 2006).

Failure in this respect is linked to the specific character of the modern aluminium industry. The idea of cluster-based growth is founded on the model of a traditional industrial complex, which is typical for example in the steel and chemical industries. It is characterised by long-term relations between the firms in the cluster, involving frequent transactions. In such a context local knowledge outflows may contribute to a 'virtuous cycle' by strengthening the knowledge and skills base of the location, making

⁵² It has been estimated that each direct job in a mega-project costs on the average well over US\$ one million in investment (Andersson 2002); in the case of Mozambique the figure is approximately US\$ 1.6 million (CPI 2006).

⁵³ For example, against an originally estimated ten per cent of inputs in the construction phase, only about four per cent of inputs were actually sourced from Mozambique (Andersson 2002).

it attractive for other innovation-bearing firms and thus leading to a cumulative process. Large oligopolistic multinational firms, however, do not receive similar benefits from spatial clustering, as they rely on internally developed technology and are usually able to hire appropriate specialist labour or tap into local technical expertise by simply locating themselves within the broad regional vicinity of the needed resources (Iammarino and McCann 2005). In the case of Mozal this means proximity to Gauteng and the transport facilities provided by the Maputo Development Corridor and especially Maputo port, while linkages to Mozambican industries and service providers have only a marginal role. The continuing dominance of the business linkage to South Africa derives at least partly from existing social networks built around the MEC. The development and persistence of such networks, which are essentially aspatial, depends largely on a shared history and experience of the actors involved (cf. Iammarino and McCann 2005).

Lack of social capital

In order to profit from FDI in modern high technology industries, the host country must possess a minimum level of social capital. This means both the overall ability of the economy to engage in innovative and organisational processes, and a capacity to implement the technical innovations connected to new industries. Conversely, when FDI is attracted in response to major tax incentives such as Mozal, or as a result of temporary trade policy distortions⁵⁴ without sustainable build-up of local capabilities and linkages between foreign and local firms, there is limited scope for long-term benefits for the domestic economy. Evidence suggests that certain threshold levels in income, human and social capital, technological know-how and enterprise development must be crossed before a significant positive impact can be attained (DESA 2006; Iammarino and McCann 2005). In the case of Mozal, cheap labour was relevant only during the construction phase, while the production process is highly capital-intensive and wages constitute only a marginal part of the company's cost structure. The key factors seem to have been access to cheap energy from South Africa, favourable location in terms of direct access to the Indian Ocean through the port of Maputo, and possibly non-stringent interpretation of environmental regulations.⁵⁵ While the generous incentive package may not have been a key factor in the decision to invest in Mozambique, it did substantially reduce the social benefits of the investment (Andersson

⁵⁴ Here investment in the textile industry under the pretext of temporary LDC quota systems under AGOA and EBA provide a prime example.

⁵⁵ The aluminium industry uses considerable amounts of water. While harmful emissions have been substantially reduced due to modern smelting technology, they still do occur, notably in the form of fluorides (including PFCs) and carbon dioxide.

2002; Castel-Branco 2004; USAID 2004a).

While some observers maintain that experience gained from the Mozal project has provided important lessons valid for developing other sectors and the trade and investment policy environment in general (e.g. Wells and Buehrer 2002), it is hard to find any positive lessons which would be relevant outside the context of mega-projects. The Mozal project followed the SDI 'fast-track implementation' model based on direct negotiations between high-level political and industrial leaders with minimal reliance on formal institutions or consultation with affected populations. The process relied largely on bypassing normal institutional procedures and seeking exemption from standing rules and regulations. The model of institutional shortcuts and high-level task forces hardly constitutes a viable option for normal medium and small-scale projects suffering from excessive red tape and increasingly corrupt administrative practices. If anything, the example of Mozal reinforced the existing authoritarian, non-transparent and rule-bending administrative culture which feeds clientelism and nepotism (cf. Castel-Branco 2003).

4.7 Agricultural production and trade

The new PRSP 2006–2009 links development of the agricultural sector directly to the government's main objective of reducing absolute poverty. It also notes that at this stage a mere increase in land area and labour will not be sufficient: higher productivity and intensification of the vertical and horizontal links within the economy are needed. In this context, the programme aims to support transition of the small-scale farming sector from subsistence orientation to commercial operations, and assist the commercial sector in boosting production and productivity, while also developing the agro-industries to serve both domestic and export markets. It also seeks to foster strong links between the small-scale and the commercial farming sectors in order to increase the global competitiveness of Mozambican agriculture (Republic of Mozambique 2006).

During the post-war period, the share of agricultural products in the total value of exports has declined steadily from about 45 per cent in 1997 to around 11–12 per cent by 2001–02 (Castel-Branco 2003; USAID 2004b). This reflects the structural change in the Mozambican economy discussed above (Chapter 4.4.1). In the late colonial period industries accounted for around 20 per cent of the GDP, agriculture about 25 per cent, and services 55 per cent. After independence the situation changed drastically – even though unintentionally – towards a heavily natural resource-based economy, where agriculture accounted for approximately 45 per cent of the GDP, while the share of industry declined to 15 per cent and services to 40 per cent. This was reflected in the structure of exports, where agricultural and fisheries products accounted for more than 60 per cent

of all exports in 1993.⁵⁶ During the post-war decade there has been a substantial increase in the contribution of industry towards both the GDP and exports, while the share of agriculture has declined anew (Castel-Branco 2003).

4.7.1 Major areas of export potential in agriculture and fisheries

The main traditional export crops in Mozambique are cotton, copra, cashew and sugar, but in recent years tobacco, horticultural products and fruits have gained a strong position. A major problem with agricultural exports is the high volatility of both supply and demand (Figure 4.7.1), which is caused by various factors ranging from changes in global markets to annual variations in weather and incoherent government policies in the sector. While there have been drastic changes in the annual export value of different agricultural products, the overall export value of the six main product groups (including wood) has altered very little.

Smallholder cash crops

Most of the essential cash crops produced for the export markets in Mozambique are grown mainly by smallholders. Cotton has traditionally been a key source of income for rural smallholders. Currently the potential for export of cotton lint is strong especially in China and other Asian countries, where the expanding textile industry's demand for cotton exceeds the domestic raw material production capacity. However, the productivity of cotton cultivation in Mozambique is very low even in comparison with other African producers (see Chapter 4.7.4 below).

Other smallholder crops include cashew, which remains important for about 40 per cent of Mozambican farmers despite a prolonged period of decline since the colonial period. Cashew production has suffered from falling productivity due to ageing of the tree stock, pests and diseases, and a general lack of investment on the supply side. On the processing side, major confusion in the privatisation process and related changes in government policies (under pressure from the major IFIs) resulted in the closing down of practically all processing factories privatised since the mid 1990s. The processing side already suffered from a lack of access to good-quality raw material, inappropriate processing technology as well as financial and management problems. There are, however, some signs that a switch to more labour-intensive processing technology may be leading to a revival in the sector (McMillan et al. 2003; Wandschneider and Garrido-Mirapeix 1999).

⁵⁶ The role of fish exports had grown steadily since the early 1980s, and by 1993 accounted for more than one half of all exports (Castel-Branco 2003).

Figure 4.7.1 Key agricultural export products, 1997–2002



Note: Other fruits includes nuts and vegetables; oil products include oil seeds and cakes, cotton includes other fibre such as sisal. *Source:* Nathan Associates 2002; USAID 2004a.

Coconut production along the coastal belt also primarily involves smallholders, even in Zambézia, where private estates remain dominant in processing and trade. Due to the lack of investment and weak demand on the global markets, exports are currently marginal (USAID 2004a). The situation of coconut and other palms may, however, change with the current biodiesel boom, which is largely based on the use of palm oils produced in developing countries (cf. Thoennes 2006).

Tobacco has become a major export crop since the late 1990s, with production growing from 1,500 tons in the 1996–97 agricultural season to almost 55,000 tons in 2003–04. Over the same period, the number of tobacco-growing households increased to more than 120,000. Production is promoted by international tobacco companies in partnership with local firms, and includes both smallholder contract farming schemes and large-scale commercial operations (Benfica et al. 2005). The recent construction of a processing unit in Tete will probably provide momentum for further expansion and increase domestic value-added (Benfica et al. 2004).

Plantation crops

Sugar is the main plantation crop in Mozambique. Before its post-colonial collapse, sugar production reached a peak of 325,000 tons in 1972. During the 1980s Mozambique became a net importer of sugar, but in the post-war period sugar has again become one of the leading export sectors in agriculture, and one of the few where productivity more or less meets international standards. This is largely due to Mozambique's favourable agroclimatic conditions, which have encouraged FDI in processing capacity and know-how (USAID 2004a; Wandschneider and Garrido-Mirapeix 1999). Since 2000 sugar production has increased rapidly, reaching 212,000 tons in 2002 (USAID 2004a). The sugar industry is heavily dependent on international markets especially in the EU and SADC countries, which are currently regulated through annual quotas. In the future the competitiveness of Mozambican production will depend largely on changes in agricultural policy (notably subsidies) in the main export markets (Coughlin 2006).

The other important plantation crop is tea. Until the early 1980s, Mozambique was Africa's third largest grower of tea, producing over 22,000 tonnes in 1981. However, production collapsed thereafter following the intensification of the civil war in the main production area. The state-owned tea company created in 1978 was privatised in 1994, and since then production has slowly recovered, reaching an average of about 21,000 tons in the period 2000 to 2002. The remote geographical location of the primary production areas is a major problem, as transport costs are elevated due to the poor condition of the road network (USAID 2004a; Wandschneider and Garrido-Mirapeix 1999; World Bank 2006e).

Food crops

Until very recently, Mozambique's horticultural production served only the domestic market and home consumption. However, during the last few years the export of fruit and horticultural products to the EU and SADC countries (mainly South Africa and Malawi) has got under way, even though still on a relatively small scale. There is constant demand for specific high-value and niche products such as processed vegetables in Europe, mangoes in the Middle East and South Asia during their off-season, and ginger and honey in South Africa. However, gaining access to niche markets such as the European fair trade and organic food markets, will require considerable investment in improved production and processing technology (USAID 2004a). Recent failures have taught that instead of jumping to such highly demanding products as cut flowers, it might be more prudent to invest in developing products which are more labour-intensive and less perishable, for example paprika and baby corn (World Bank 2006e; cf. AfricaScan 2006).

Basic food crops such as maize and rice are sold on the domestic markets, but increasingly also exported to neighbouring countries. Maize is particularly important for smallholder households in Niassa, Tete, Manica, and Sofala, where it occupies more than 50 per cent of cultivated land. Even though less than 20 per cent of maize is sold on the market, informal exports to Malawi (and to a lesser extent Zimbabwe and Zambia) amounting to an estimated 100,000 to 200,000 tons per year, provide an important source of revenue for smallholders. Rice is produced by both smallholders using rain-fed methods on low-lying land in Zambézia and southern Nampula, and by commercial farmers using irrigation in Gaza. Even though Mozambique is currently a net importer of rice, it possesses a comparative advantage in rice production due to favourable natural conditions (climate, soils and access to water). It could, therefore, become an important producer for the regional SADC market, where the deficit in rice is expected to reach six million tons by 2020 (USAID 2004a; World Bank 2006e).

Livestock

The number of livestock has grown significantly during the post-war era, but is still relatively low and remains marginal in terms of export. In 2003, there were some 970,000 head of cattle, 4,880,000 head of goats and sheep, and about 20 million head of small stock. The main constraint undermining an increase in livestock numbers is the high prevalence of diseases, which is aggravated by the inadequacy of animal husbandry services (World Bank 2006e).

Forestry

Forestry currently accounts for about 2.5 per cent of the GDP. According to forestry inventories, some 48 million hectares, or 60 per cent of the country has good potential for forests and wildlife management. About 19 million hectares can be classified as valuable for timber production. The area under forest plantations remains marginal (estimated 24,000 ha in 2001), but development potential in the plantation sector is considered good. While the annual allowable cut is estimated at 500,000 cubic metres, the current output is about 120,000 cubic metres per year according to official statistics (Cuco et al. 2003; World Bank 2005c). It is evident, however, that the statistics do not capture a significant part of actual forest exploitation. There is convincing evidence that a large amount of timber is logged and exported illegally, mainly to China (Mackenzie 2005; White et al. 2006).

Most of the national wood production is marketed in round-wood, and to a lesser degree sawn. The more sophisticated processing industries remain marginal. The gov-

ernment has sought to encourage the development of wood-based industries by various means, including a ban on the export of first-class species in round-wood, and by granting a 40 per cent reduction on forest fees for all logs processed domestically. Legal exportation of round-wood has since decreased drastically, while exports of processed wood have slightly increased. This notwithstanding, wood exports captured by official statistics indicate a value of only US\$ 30 million per year. A considerable increase in licence fees over recent years has brought government revenue from forest exploitation close to efficient levels of rent pricing, but mechanisms for transferring some of the benefits to the local level remain to be operationalised (World Bank 2005c).

Fishery

Fishery (essentially shrimp) used to account for between 35 and 40 per cent of exports in the 1990s, prior to the current mega-project-led growth. While catch volumes and exports of shrimp have remained relatively stable at approximately 9,000 tons annually (except for periods of import restrictions to key European markets due to problems with SPS compliance), the share in exports has declined to around 10 to 15 per cent. The value of the annual catch is currently around US\$ 70 million, while total rent is estimated at US\$ 24 million. Shrimp fisheries are dominated by three large industrial companies, which together hold more than one half of the total shrimp quota. The rest is shared by some 200 smaller companies operating jointly with a parastatal. The sector has suffered from lack of transparency in license and quota allocation, while collection and use of different taxes and fees seems to be unclear (World Bank 2005c).

Another major export oriented sub-sector is industrial tuna fishery, which consists of purse-seiners fishing for low-value tuna species which are sold to canneries operating in Indian Ocean island states, and commercial long-line vessels fishing for higher-value tuna species sold to international markets for fresh and frozen consumption. The industrial fleets fishing for both shrimp and tuna have on-board processing facilities and/or export directly (USAID 2004a).

It has been estimated that the fishing effort has increased by a factor of three since the late 1970s, while the total catch has remained more or less constant (World Bank 2005c). This is a clear indication that the level of sustainable catches has been reached. The new PRSP 2006-2009 document acknowledges the fact, and new development initiatives for the sector concentrate mainly on establishing more efficient mechanisms to control over-fishing (especially in small-scale fisheries) and increasing value-added to existing products. New opportunities for increasing production can, however, be found in aquaculture (Republic of Mozambique 2006). Central and northern Mozambique offer excellent conditions for shrimp aquaculture, and in re-

cent years the industry has attracted substantial foreign FDI and know-how (USAID 2004a).

4.7.2 Access to agricultural land

According to government statistics, less than 13 per cent of the 36 million hectares of potentially arable land is currently cultivated. In 2003, there were approximately 3.2 million farm households cultivating some 4.25 million hectares (Hughes 2005). According to a government agricultural survey, the number of farm households had increased by 1.3 per cent since 2000, while total cultivated land area had increased by more than 15 per cent (Table 4.7.1). In Mozambique, medium- and large-scale farmers are relatively insignificant in terms of land area and number of farms. Two thirds of agricultural production is for home consumption and only five per cent is generated by large-scale farms. Most of the agricultural land area for small (less than 10 ha) and medium farms (10-50 ha) is cultivated for basic food crops, while large farm enterprises (more than 50 ha) produce mostly cash crops.

Table 4.7.1 Distribution of farms by cultivated area and type, 2000

	Size of farm			All farms
	0-10 ha	10-50 ha	Over 50 ha	
Number of households	3,054,100	10,200	400	3,064,700
Total cultivated area (ha)	3,736,600	67,700	121,000	3,925,300
Average cultivated area/farm (ha)	1.22	6.65	282	1.26
Area under food crops (%)	84.4	74.2	7.6	84.7

Source: World Bank 2006e.

This rather unusual land tenure situation in the context of sub-Saharan Africa is a result of Mozambique's post-colonial history. Since independence in 1975, all land in Mozambique is the property of the state. While small-scale peasant farmers enjoy use rights to land they have traditionally cultivated, the government policy after independence was to concentrate agricultural activity on collectivised state farms and agricultural co-operatives, while cultivation by individual households was discouraged. In this context smallholder land rights continued to be insecure, as the government (like its colonial predecessor) could – and often did – take over prime agricultural land from small-scale farmers and allocate it to state farms and co-operatives (Myers 1994; O'Laughlin 1996).

During the privatisation process implemented in conjunction with the structural adjustment programme since 1987, most state farms and co-operatives were privatised. However, contrary to the aspirations of local peasant farmers, the land was allocated to outsiders. In the case of medium-size farms and enterprises the beneficiaries

were mainly members of the national political elite, military officers or re-emerging businessmen. Most of the large agricultural enterprises such as state farms were handed over to joint venture enterprises between international companies and the state (Bowen 1992; Myers 1994; West and Myers 1996).

After a successful transition to multi-party democracy in 1994 and the subsequent period of political stability, the interest of foreign investors grew rapidly, leading to increasing pressure on land. The government's focus on private investment as the motor of rural development made it necessary to guarantee secure rights to investors and allow for transfer of rights between third parties. At the same time, however, the concern to safeguard existing rights of local small-scale farmers to land, which in practice was still largely governed by customary systems, created different demands for land tenure reform. The result was the 1997 Land Law, which seeks to integrate both customary and formal land administration within a single policy and legal framework. A key characteristic of the law is that land in Mozambique is not divided into distinct community/subsistence and private/commercial categories. In theory, at least, the law gives customarily allocated rights full legal equivalence to a land title allocated under the formal system (Tanner 2005; cf. Virtanen 2004).

The new law seeks to promote rural development by allowing the private sector access to customarily acquired land. It provides clear mechanisms and conditions for private investors who seek new land rights from the state, while empowering local people to participate in the allocation process as well as in land and natural resource management, including conflict resolution. The key mechanism for protecting the land rights of local populations is the delimitation process, whereby local communities secure and register their customarily acquired rights to currently cultivated land, but also to land used in longer term rotational cycles and forest land. On this basis new deals can be made between investors and locals over specific parcels of land. While the absence of title document does not undermine the statutory land use and benefit right acquired through customary occupation, delimitation and titling does provide substantial added security. In practice, however, commitment to community land rights identification and registration has been very weak on the part of the public sector land administration. Almost all delimitation exercises carried out so far have been initiated and supported by NGOs, often with financial support from bilateral donors (Tanner 2005; cf. Hughes 2005).

While the new PRSP 2006–2009 includes a somewhat contradictory objective to “*certify and/or deed the rights to land to small and medium-scale farmers for income crops*”, which implies separating rights to commercial land from the broader land rights guaranteed by law for small-scale farmers, the objective to “*inventory and map the occupation, use and exploitation of lands*” appears to be totally de-linked from the community land delimitation exercise, which has been left without resources (Repub-

lic of Mozambique 2006).

The private sector gains access to land through 50-year renewable leases (concessions), which are inheritable and may be transferred – subject to prior administrative authorisation. One condition for the award of such leases is the presentation of a land use or development plan; the lease can be cancelled if the lessor fails to comply with the plan. While technically, land cannot be sold, investments in infrastructure and improvements in leased land can be bought and sold. Administrative authorisation is still required for transfer of the land lease associated with the sale (Hughes 2005).

The system has been criticised on two grounds: for being too complicated and not providing strong enough security for private investors to become interested, and for encouraging speculation in land. Various Western donors with neo-liberal views continue to insist on full privatisation of land (e.g. USAID 2004a), but it is increasingly acknowledged that the current legal framework actually provides a relatively good basis for rural development. Some minor modifications will probably be needed to reduce excessive state intervention in lease management, while linking the transfer of leases more closely to land development would provide adequate security for investors. The key problem is the lax and inconsistent enforcement of the existing Land Law and Regulations (Hanlon 2004; Hughes 2005). Complaints that the statutory consultation with local communities constitutes a barrier to investment probably reflect the marginal interest of state authorities in developing the system and carrying out community delimitations, which would clarify the tenure rights of communities and thus strengthen their position in negotiations with the private sector. Speeding up the consultation process by limiting the rights of local communities would probably only increase conflicts and create even more opportunities for corrupt practices (Hanlon 2004a; Tanner 2005).

In Mozambique large areas have been leased by influential individuals and companies, who ultimately cultivate or otherwise efficiently use only a small portion of the land, being primarily interested in profiting by trading their land rights to others (Bowen 1992; West and Myers 1996). This practice is encouraged by the current low level of land tax and related fees, which makes speculative investment without immediate profits economically feasible. The prevalent practice of selective exemption from or ‘amnesty’ of taxes and fees, and more generally the lack of enforcement, is another contributing factor. According to a World Bank report, one approach in addressing these problems is to reduce the extent of administrative discretionary power over land allocation and monitoring, increase land tax to a level which would effectively discourage passive speculation in land while contributing to government revenue, simplify the land tax system to a manageable level and enforce it in a transparent manner (Hughes 2005). The proposal would seem to provide a workable basis from which implementation of the ‘land reform’ in Mozambique might finally be launched.

4.7.3 Public investment in agricultural services and rural infrastructure

As noted by Hanlon (2004a), the current belief seems to be that ‘development’ – especially in agriculture – is something which comes from the outside: foreign investors, the market or the IFIs make development happen, while the Mozambican government and the private sector are merely spectators. The government sectoral programmes for agriculture have turned out to be highly inefficient, as most of the resources have been dissipated in central administration costs (Weimer et al. 2004). The new Proagri II would not appear to be much better, and its launching has already suffered repeated delays (Birgegård 2006). At the same time representatives of the private sector have stated explicitly that without much stronger government investment in supporting institutions, there is little prospect for increased private sector investment in agriculture, as most factors of production are more expensive than in the neighbouring countries (Hanlon 2004a).

We have discussed above (chapters 4.4.5-6), the problems of agricultural credit and rural transport. While private investment in agriculture expanded by 23 per cent between 1990 and 2002, it was highly concentrated in a few provinces (Sofala and Maputo) with somewhat better infrastructure and economic incentives, including access to credit (USAID 2004a). Other weaknesses undermining the potential of Mozambique’s agriculture assets include low coverage of extension services, the absence of SPS controls, weak agro-processing capacity, and the absence of effective producer organisations.

Extension services are provided by at least one institution in 117 of the 128 administrative districts of Mozambique. In 65 districts services were provided by the Ministry of Agriculture (sometimes in collaboration with NGO or private sector), and in 52 districts only by NGOs or the private sector. Less than one third of the 2,276 extension workers were employed by the Ministry of Agriculture. In practice the coverage is very low: more than 43 per cent of households must travel 200 kilometres or more to visit an office, and consequently only 14 per cent of farmers had received advice from an extension worker during 2002-03. The government extension policy focuses on support to high-potential areas. However, extension staff do not always have the technical knowledge required to promote the production of high-value crops or adding value to commodities – not to mention information on world market prices, grades and standards. While seed development and distribution are generally weak, there have been some successes especially in food crops. Applied research carried out by national agricultural research institutions has resulted in a substantial improvement for example in the development of drought-resistant maize and high-yield cassava varieties. The resources available for the agricultural research network, which was recently reformed and consolidated under one institute (*Instituto de Investigação Agrária de Moçambique*, IIAM), are among the lowest in Africa and are totally insufficient (Coughlin 2006).

Worldwide, and especially in the EU and North America, the regulations and technical standards governing agricultural imports (especially food) are becoming more stringent. At the same time producer countries in sub-Saharan Africa face increasing problems in meeting these requirements. A recent study indicates that sanitary and phytosanitary (SPS) measures are considered the most significant impediment to African food exports to the EU, followed by technical requirements concerning labelling and composition standards. Transport and other direct export costs were also considered more important in restricting food and agricultural trade than tariffs and quantitative restrictions (Henson et al. 2004). A growing proportion of SPS measures are process standards, which comprise an important component of risk management programmes such as the Hazard Analysis and Critical Control Point (HACCP) regulations, which have become mandatory for food products in a large number of developed countries (Roberts et al. 2004).

Along with many other LDC countries in Africa, Mozambique is in a particularly weak position to comply with the new regulations. The National Institute for Normalisation and Quality was only created in 1993, and currently Mozambique has only a very rudimentary system of standardisation, quality assurance or accreditation, and no subsystem of certification. Most sectors lack standardised procedures, and awareness of standard SPS measures such as the HACCP system is minimal. Lack of effective domestic SPS services and infrastructure to protect agriculture from the risk of pests and disease exposes the sector to considerable pre- and post-harvest losses each year. The problem is even more serious in respect of export possibilities. For example, exports of banana and citrus fruits to South Africa have suffered serious losses due to problems in meeting SPS standards, and the new EU laws on food safety and traceability will place an even greater burden on the government's SPS services. Failure to comply will inevitably lead to exclusion from these regional and world market opportunities (Coughlin 2006; USAID 2004a).

Agro-industrial activity in Mozambique is minimal. The productivity of small-scale farmers is low and farms are geographically dispersed, rendering investments in processing costly and frequently non-viable. Except for sugar and more recently tobacco, processing industries are weakly developed and use mostly old technology, which makes them uncompetitive on the world markets. A number of existing local industries using domestic raw materials, for example beverages, canned vegetables and some meat-processing activities, have closed down, while many of the new industries such as milk products and juices use imported raw materials (milk powder and fruit pulp) and thus contribute very little to the national economy. Only a small portion of raw cashews are processed, mostly for domestic consumption, the rest being exported to India, where they are processed. In many core products the processing of side-products such as seed oil and cake in the case of cotton, is not fully integrated

in the domestic value chain. Effective producer organisations are absent in most of Mozambique's non-state sectors. Without such associations producers cannot enjoy economies of scale in input supply, technology transfer, value-adding, transport, logistics and storage, and produce marketing (Castel-Branco 2003; USAID 2004a).

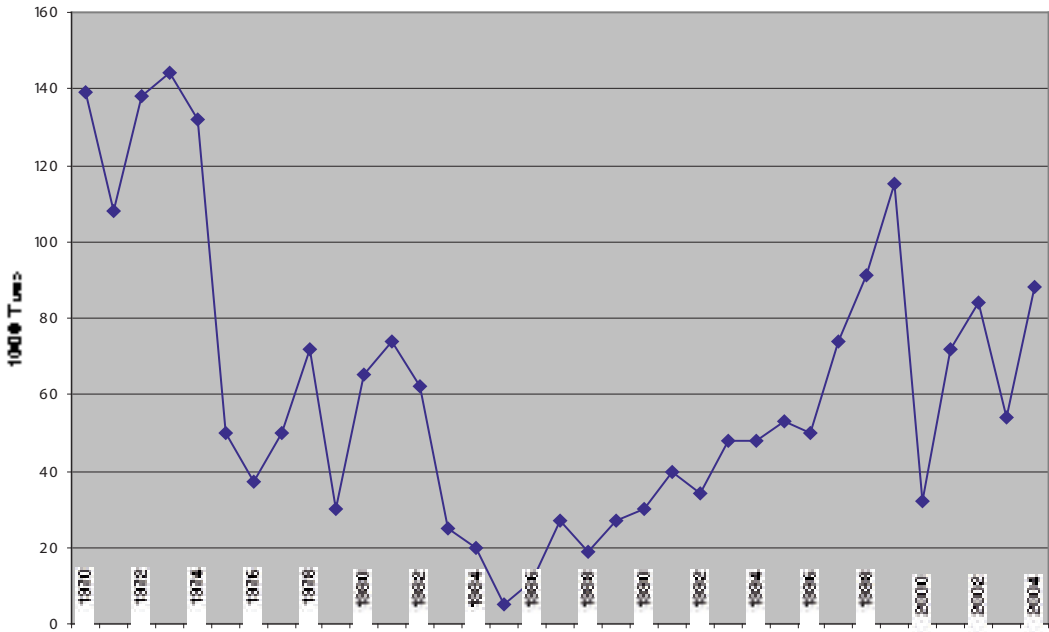
4.7.4 Case study: cotton sector reform

Cotton was effectively promoted by the colonial government in Mozambique from the 1930s, and had become an important cash crop by the 1960s. Between 1960 and 1974 production of raw cotton oscillated between 100 and 140 thousand tons, and in 1973 cotton made up 20 per cent of total export revenue. After independence cotton production fell to 5,200 tons in 1985 (Figure 4.7.2).

As a result of the new strategy, seed cotton production increased to over 50,000 tons in 1995, due primarily to area expansion. On the other hand, output per hectare has not improved over average figures in the colonial period. For low-input producers (who were the majority), returns to family labour were often substantially lower than wage rates paid to unskilled agricultural workers (Oliveira et al. 1997). Economic benefits to the public sector from the privatisation of state farms has also been negligible. The increase in government revenue has been minimal due to the joint venture basis of the operations and generous tax and customs duty exemptions involved. While cash crop production by smallholders increased, the vague and unstable institutional framework has become a source of insecurity and recurrent conflicts (Pitcher 1996; West and Myers 1996).

The agreement between the state and the JVCs stipulates that the government establishes a minimum producer price each year. Various observers have criticised the government for a largely unsuccessful price policy resulting in internationally low prices which were less than one half of the export price in the early 1990s. The private companies have also been accused of failing to provide quality inputs and extension services to all interested small-scale growers in the unrealistically extensive concession areas granted by the state (Oliveira et al. 1997; Pitcher 1996; Pitoro et al. 2001).

Figure 4.7.2 Seed cotton production in Mozambique, 1970–2004



Source: IAM 2006.

By the mid 1990s fully private companies began to appear along with the JVCs. The latter operated in the traditional ‘cotton belt’ in the north, while the former focused mainly on the central provinces. Production increased rapidly, reaching a post-independence peak of 116,000 tons of seed cotton in 1999. In the following year, however, production collapsed to 40,000 tons, this mainly due to institutional failure in the JVC region, where falling prices and entry of new independent buyers had put severe stress on the old concession system since 1994. The independent buyers attracted production from the concession areas by offering better prices, leading to widespread credit default. In 1995, the government decided to grant the principal new buyer a concession area. This provided no solution to the broader problem, however, as other buyers entered the arena while farmers grew increasingly discontent due to continuing low prices and inadequate services. In 1998, the government decided to encourage the formation of farmer associations, who were then allowed to deal with the company of their choice irrespective of concession borders. The model was, however, exploited by some buyers who created large ‘virtual’ associations to legitimise purchases inside concession areas without providing any support services (Pitcher 1998; Tschirley et al. 2006).

In late 2000, an 'open concession' model was formally introduced. This allowed farmer groups within concession areas to opt out of their implicit contract with the concession company and deal with a company of their choice. Production in the following year increased to 71,000 tons, but pressure from the established ginning companies led to revocation of the model and a return to the 'closed concession' model in the following year. This model is still the basis of official policy. For the second time, the government sought to placate discontent by offering the largest independent buyer a concession area of its own. Since then both total production and productivity levels in the traditional northern production area have stagnated at relatively low levels. Entry of new companies in the central region, however, has brought more encouraging results. Unlike the old companies, these have invested in seed quality and ginning technology, and provide support to farmer organisations (Boughton et al. 2002; Tschirley et al. 2006).

Lack of social capital – again

Cotton involves in Mozambique well over 200,000 small-scale growers, generates significant export revenue, and has a strong potential for upstream and downstream linkages through input use and technology, initial processing, value-adding, marketing and international trade. At the same time, cotton companies operating in Mozambique pay the lowest average producer share of sub-Saharan Africa, despite the advantage of coastal access, and have achieved the second lowest average export value per hectare. Cotton continues, therefore, to be a low-input, low-output cash crop whose growers live in poverty much like their colonial era predecessors (Poulton et al. 2004; Tschirley et al. 2006).

According to Boughton and associates (2002), there are two key dimensions which determine the performance of an agricultural commodity chain, notably the levels of productivity and quality achieved throughout the chain, and the extent to which it pays farmers a competitive share of the export value achieved. Producer prices depend essentially on competition among firms for the raw product. In addition to the world commodity price, the export value, on the other hand, depends on the volume and quality of the product exported. Processed commodities such as cotton require a great deal of co-ordination to be produced, processed and marketed competitively. Since most farmers in Mozambique require credit to access the needed inputs, one of the key co-ordination challenges is to ensure timely access to and use of appropriate inputs, and subsequently to recover the credit. Due to widespread credit market failure experienced during the last ten years, a combination of public and private action is needed to resolve this endemic problem, acquire and diffuse technical innovations, and ensure the co-ordination necessary to meet the quality requirements of global markets (Boughton et al. 2002; Tschirley et al. 2006).

4.8 Poverty, inequality and alternative strategies of growth

At the time of the first national household survey in 1996–97, Mozambique was considered one of the world's poorest countries (UNDP 2000). The mean consumption per capita was actually below the absolute poverty line, making the need for economic growth indisputable as redistribution alone would not suffice to reduce the levels of poverty. In the period 1996 to 2002, the economy grew by a cumulative 62 per cent while consumption per capita grew by a cumulative 50 per cent. The poverty headcount figure fell from 69 per cent in 1996–97 to 54 per cent in 2002–03, representing a reduction of about 15 percentage points (Table 4.8.1).⁵⁷ Whilst the trend is encouraging, it is important to note that over one half of the population (nearly ten million people) continue to live in absolute poverty. This highlights the continuing importance of poverty reduction in Mozambique's development policy (James et al. 2005; Massingarella et al. 2004).

While the provincial surveys involve some problems with respect to data reliability and consistency⁵⁸, they are indicative of general geographical trends. Poverty incidence has declined markedly (28 percentage points) in the central region, but also considerably in the north (11 percentage points). In the south, there has been very little change (less than one percentage point): poverty measured by headcount has actually increased in Maputo City and Province, while there was a marginal reduction in Inhambane and Gaza provinces. The poverty gap index, which measures the magnitude of poverty⁵⁹, brings out these regional differences even more clearly. Except for Gaza, which shows a slight improvement, all the southern provinces have suffered from a substantial increase in poverty. The results are consistent with other research findings using different welfare indicators such as quality of habitation and possession of durable goods (bicycles and radios), as well as locally perceived changes in welfare (Massingarella et al. 2004; Mate et al. 2005).

⁵⁷ The poverty analysis is based on two nationally representative surveys (1996–97 and 2002–03) containing detailed information on expenditure for 8,274 and 8,700 households, respectively. A cost of basic needs approach was employed to construct time- and region-specific poverty lines for each survey, with the same spatial regions used in both studies. A change in the definition of urban and rural areas between the two surveys, however, makes interpretation of the rural-urban aspect somewhat more complicated (Datt et al. 1998a; Massingarella et al. 2004).

⁵⁸ The main problems relate to Sofala and Cabo Delgado. It is generally agreed that the 1996–97 data from Sofala reflect the effects of the unusually destructive seasonal floods which occurred during those years, and are thus not representative of the overall situation in the province. Cabo Delgado, on the other hand, has suffered from serious sampling problems in both surveys (Massingarella et al. 2004).

⁵⁹ This measure of the magnitude of poverty considers both the number of poor people, and how poor they are. The poverty gap index is the combined measurement of incidence of poverty and depth of poverty.

Table 4.8.1 Incidence and magnitude of poverty in Mozambique, 1996–97 and 2002–03

	Incidence of poverty (%)			Poverty gap index		
	1996–07	2002–03	Change	1996–97	2002–03	Change
National average	69.4	54.1	-15.3	29.3	20.5	-8.8
<i>North</i>	66.3	55.3	-11.0	26.2	19.5	-7.1
<i>Centre</i>	73.8	45.5	-28.3	32.7	16.0	-16.7
<i>South</i>	65.8	66.5	+0.7	26.8	29.1	+2.3
<i>Niassa</i>	70.6	52.1	-18.5	30.1	15.8	-14.3
Cabo Delgado	57.4	63.2	+5.8	19.8	21.6	+1.8
Nampula	68.9	52.6	-16.3	28.6	19.5	-9.1
Zambézia	68.1	44.6	-23.5	26.0	14.0	-12.0
Tete	82.3	59.8	-22.5	39.0	26.3	-12.7
Manica	62.6	43.6	-19.0	24.2	16.8	-7.4
Sofala	87.9	36.1	-51.8	49.2	10.7	-38.5
Inhambane	82.6	80.7	-1.9	38.6	42.2	+3.6
Gaza	64.6	60.1	-4.5	23.0	20.6	-2.4
Maputo Province	65.6	69.3	+3.7	27.8	31.1	+3.3
Maputo City	47.8	53.6	+5.8	16.5	20.9	+4.4

Source: Massingarela et al. 2004.

4.8.1 The changing regional pattern of poverty in Mozambique

The geographical pattern of the growth process has contributed to a reduction in regional disparities in Mozambique (Boughton et al. 2006; James et al. 2005). In 1998, the national human development index (HDI) was 0.285, ranging from 0.605 in Maputo City to 0.176 in Zambézia Province. The difference between the south (0.427) and centre (0.267) and north (0.212) in the immediate post-war period was indeed substantial (UNDP 2000).⁶⁰ At the same time, however, intra-regional inequality has increased in all provinces except for Nampula and Manica (Table 4.8.2).

In 2002–03, inequality was lowest in the north and centre, with estimated Gini coefficients of approximately 0.39. The level was much higher in the southern region (Gini coefficient 0.47), driven in part by the increase in inequality within Maputo City from 0.44 in 1996–97 to 0.52 in 2002–03. This is a cause for concern, especially considering that the poverty headcount has remained essentially flat in the capital city between the two sample periods despite the increase in mean consumption. Moreover, the Theil entropy measure value for the City increased from 0.41 to 0.60. The results show a sharp rise in the consumption growth of the richest households in the midst of a large impoverished population. This would seem to indicate that the benefits of economic growth in the city in recent years are not reaching the poorer sections of society (James et al. 2005; cf. World Bank 2005c).

⁶⁰ While caution is needed when using development indicators (notably GDP per capita) calculated at the level of sub-national units such as provinces (Rolim 2002), they do provide indicative figures on general trends.

Table 4.8.2 Regional changes in inequality between 1996–97 and 2002–03

	Mean consumption ¹	Increase in consumption ²	Gini ³		GE(1) ³	
			1996-97	2002-03	1996-97	2002-03
National average	1.28	32	0.40	0.42	0.31	0.37
North	1.22	20	0.38	0.39	0.29	0.35
Centre	1.40	63	0.37	0.39	0.27	0.31
South	1.15	4	0.43	0.47	0.37	0.50
Niassa	1.29	45	0.35	0.36	0.22	0.26
Cabo Delgado	1.27	8	0.37	0.44	0.27	0.62
Nampula	1.18	20	0.39	0.36	0.30	0.24
Zambézia	1.35	44	0.32	0.35	0.20	0.23
Tete	1.06	49	0.35	0.40	0.21	0.30
Manica	1.41	22	0.41	0.40	0.36	0.30
Sofala	1.81	207	0.40	0.43	0.32	0.41
Inhambane	0.77	-1	0.38	0.44	0.31	0.40
Gaza	1.24	12	0.38	0.41	0.27	0.38
Maputo Province	1.01	-6	0.42	0.43	0.35	0.36
Maputo City	1.69	10	0.44	0.52	0.41	0.60

¹Proportion of poverty line, 2002-03; ²From 1996-97, per cent; ³The Gini and GE(1) (General Entropy or Theil entropy measure) reflect the dispersion of a distribution, 0=absence of inequality. *Source:* James et al. 2005.

On the national scale the level of inequality measured by the Gini coefficient increased moderately from 0.40 in 1996–97 to 0.42 in 2002–03, still a low level in the regional context of Southern Africa (Table 4.8.2). This reflects the fact that the rapid economic growth has been relatively broad-based, with consumption per capita in all percentiles of the population growing at least three per cent per year. However, even though the mean consumption per capita for the entire population increased from 97 per cent of the poverty line in 1996–97 to 128 per cent in 2002–03, the mean consumption in the poorest quintile was still less than 40 per cent of what is required to meet basic needs. This is because average consumption in the highest quintile was eight times that in the poorest quintile, while the growth rate in the highest quintile was 36 per cent, compared with 23 per cent in the lowest. In absolute terms this means that 57 per cent of the total increase in consumption took place in the richest quintile, against only eight per cent in the poorest (James et al. 2005; World Bank 2005c). Data from household income surveys reflect an even more skewed distribution of growth in rural areas: over 70 per cent went to the top income quintile, while less than three per cent went to the poorest (Boughton et al. 2006). Using the definition given by Kakwani and Pernia (2000), the recent economic growth in Mozambique cannot, therefore, be considered pro-poor.

4.8.2 Foreign capital investment and poverty alleviation

During the last decade there has been a rapid increase in FDI capital, especially in manufacturing, mining and energy, contributing to a very rapid rise in exports and deepening integration in global markets. However, if we look at the regional pattern of poverty incidence and compare it with the distribution of productive investment in Mozambique, we note a negative correlation. Between 1990 and 2003 the City and Province of Maputo absorbed 75 per cent of FDI and 60 per cent of total private investment in the country. The other two southern provinces of Gaza and Inhambane together absorbed another 15 per cent of total FDI and 17 per cent of total private investment (Castel-Branco 2004). But while the southern region has thus consumed approximately 90 per cent of FDI and 77 per cent of total private investment, it is the only region where the incidence of poverty has actually increased, especially in Maputo City and Province – precisely where the majority of the new investments were made (Table 4.8.1). We also note that the two provinces with the highest head-count poverty ratios (81% in Inhambane and 70% in Maputo Province) are in the south, while even in Maputo City the poverty ratio is just barely below the national average.⁶¹

This apparent paradox can be explained by the current pattern of economic growth and the changing role of Mozambique in the regional economy. As noted above (chapter 4.2.1), the southern part of Mozambique was historically integrated in the South African economy, and especially in the MEC, as a labour reserve and transport corridor. After independence the volume of these key activities decreased rapidly. The number of migrant labourers working in South Africa fell by more than 60 per cent between 1975 and 1977, while railway transport through the port of Maputo decreased initially more gradually, but then fell drastically by 70 per cent (in volume) between 1982 and 1984 as the civil war intensified. While the reduction in railway traffic was not reflected directly in employment figures as the state-owned ports and rail corporation (*Caminhos de Ferro de Moçambique*, CFM) did not lay off workers, the reduction in migrant labour was immediately visible in the increasing number of unemployed, and indirectly in radically decreasing investment in agriculture and other productive activities. However, even with reduced employment potential these sectors constituted at least up to the late 1990s the major mechanism whereby the Mozambican economy benefited from the South African MEC, notably as an impor-

⁶¹ While an increase in inequality in the main urban centres is common in the process of economic transition, it does not automatically cause an increase in poverty. For example in Dar es Salaam (Tanzania) recent rapid growth has resulted in a greater than average reduction in the incidence of poverty (United Republic of Tanzania 2005).

tant source of investment capital for the small-scale agricultural sector in the southern part of the country (Castel-Branco 2002; Nhabinde 1999).

The system suffered a further setback in the late 1990s as a result of structural changes in the South African and Mozambican economies. In South Africa the restructuring and increasing mechanisation of the gold mines, including the closure of some, caused a further reduction in migrant labour, which was reflected in a 40 per cent decline in migrant workers' remittances to Mozambique between 1997 and 1999.⁶² At about the same time the privatisation process in Mozambique had moved to utilities with a focus on the management of port and railway services. While the privatisation of CFM had some positive economic effects such as an increase in transport revenue (in foreign currency) from less than US\$ 60 million in 1998 to US\$ 100 million in 1999, it also implied a substantial decrease in the labour force. Diversion to an increasingly efficient and flexible road transport, which is largely dominated by South African companies, poses another threat to the Mozambican railroad network, which continues to suffer from severe security problems (Castel-Branco 2001; 2002; Nhabinde 1999).

While the MEC continues to dominate the economic linkages between South Africa and Mozambique, it has undergone some major changes as a result of the globalisation process. The key issue is that trade and FDI have become South Africa's main instruments for regional domination. Regional control over production sites, trade and capital flows – typically in the context of SDIs and other joint public-private strategies – has become more important than access to cheap migrant labour and transport services. However, while South Africa has been conspicuously successful in attracting international finance capital and know-how to mega-projects located in neighbouring countries conveniently close to major export outlets, and in tying host government resources to supporting physical infrastructure, the concrete local development impact of these highly capital-intensive projects has been minimal. With the exception of sugar, none of the major South Africa-driven mega-projects located in Mozambique has provided substantial numbers of job opportunities beyond the initial construction period. While a few projects have stimulated the emergence and growth of small and medium enterprises in South African regions bordering on Mozambique, linkages between South African and Mozambican firms are few and tenuous. Overall, the mega-project-based development strategy relying on market opening has lost more jobs than it has created (Castel-Branco 2002; Söderbaum and Taylor 2004).

While the change in South African industrial strategy, which lies behind the current pattern of investment in southern Mozambique, has created a small number of highly

⁶² While the number of legal migrant workers outside the MEC is insignificant (less than 2 %), most of the illegal migrant workers are found outside of the MEC, mainly in agriculture (Castel-Branco 2002).

productive and relatively well-paid jobs, its overall impact on the poverty situation has arguably been negative.⁶³ Most observers agree that the contribution of mega-projects to local employment has been at best marginal, while the tax contribution has also been very limited, about 0.4 per cent of revenues in the case of Mozal (see e.g. USAID 2004a; World Bank 2005c). Replacement of migrant labour with FDI has, therefore, practically eliminated the key mechanism for distributing the benefits from Mozambique's participation in the MEC to those effected by the change. On the other hand, the concentration of private and public investment in large capital-intensive projects with little impact on poverty alleviation has drained financing from other, potentially more labour-intensive projects. Increased demand has also created localised pressure on market prices, which – in the context of increasing economic inequality – has driven more and more of the poorer inhabitants of the capital and surrounding provinces into poverty (Castel-Branco 2004; Söderbaum and Taylor 2001).

The poverty situation is especially drastic in Maputo and Inhambane provinces, but also in Gaza. Except for a few localised spots of high productivity such as parts of the Lebombo highlands and the Chokwe irrigation scheme, the agricultural potential in the southern provinces is very low (UNICEF 1994). To a great extent this has historically been compensated by access to remittances from migrant labour to South Africa, which was the main source of investment capital and livelihood support for the rural population (Roesch 1991). The radical decline of this revenue, and failure to compensate it with salaried work in Mozambique, has drastically increased the incidence of poverty and vulnerability to drought in the region. In the predominantly rural provinces of the south, increasing poverty is closely linked to falling agricultural production. In Inhambane, for example, large-scale capital investment in the natural gas project and tourism industry in Bazaruto Islands has brought relatively few benefits to the local population (G20 2005), while the production of basic food crops (maize and other traditional cereals, beans and groundnuts) decreased by 33 to 73 per cent between 1998 and 2003, except for cassava (a traditional famine food), which increased by 17 per cent (DAPSA 2006; Mate et al. 2005).

4.8.3 Agriculture as a source of pro-poor growth

Agriculture provided the second most important sectoral contribution to economic growth (after manufacturing) between 1996 and 2003, accounting for 1.7 percentage points out of 8.6. It was also the sector with the largest contribution to poverty reduction when weighted by the share in population. The change in poverty of households

⁶³ Similar conclusions have been reached on the basis of East Asian data, which indicate that reliance on FDI has an adverse effect on income distribution (You 1998).

whose heads work in agriculture accounted for a full 11 percentage points of the total reduction in poverty, amounting to 15 percentage points (World Bank 2005c). The prominent role of agriculture in poverty alleviation is due to its dominant position in the economy: some 70 per cent of the entire population have agriculture as their main occupation. As noted above (chapter 4.7.2), small-scale farmers (with an average farm size of 1.4 ha) constitute 99 per cent of the farming community and cultivate 95 per cent of the total cultivated area, which means that no significant increase in agricultural output and no significant reduction in poverty can be achieved unless the small-scale sector is made a priority (Birgegård 2006).

Agriculture is important also from the gender perspective: in 2003 more than 88 per cent of women worked as unskilled labour in agriculture. They made up 59 per cent of all unskilled labour in the sector, while men accounted for about 75 per cent of skilled agricultural labour (Table 4.8.3). This unequal division has a direct implication for gender differences in the incidence of poverty, since unskilled agricultural labour has by far the lowest wage index.

Reseachers and policy analysts broadly agree that the post-war growth in agriculture in Mozambique resulted mainly from the recovery of smallholder subsistence food crop production through an expansion of the area under cultivation and a higher labour input.⁶⁴ The area under cultivation expanded by 3.3 per cent annually during the period 1992-2001, while the labour input grew by 1.7 per cent. The increase in factor inputs was particularly substantial in the central region, where the cultivated area expanded by seven per cent and labour input grew by four per cent annually (Birgegård 2006).

Table 4.8.3 Skill and gender composition of the Mozambican labour force, 2003

	Gender shares by skill		Skill shares by gender			Wage index
	Female	Male	Female	Male	Total	
Unskilled agricultural labour	59.0%	41.0%	88.2%	67.0%	78.1%	100
Skilled agricultural labour	25.3%	74.7%	2.4%	7.8%	5.0%	164
Unskilled non-agric. labour	30.1%	69.9%	7.1%	18.0%	12.3%	430
Skilled non-agric. labour	25.2%	74.8%	1.8%	5.8%	3.7%	1,474
Highly-skilled non-agric. lab.	25.3%	74.7%	0.4%	1.4%	0.9%	3,509
Average/Total	52.2%	47.8%	100	100	100	225

Source: AfDB/ADF 2006.

A 45 per cent increase in the mean cultivated area per capita (adult equivalent) in the central region was recorded between 1996 and 2002. The growth in cultivated

⁶⁴ See e.g. Republic of Mozambique 2006; World Bank 2006e. Labour input in agriculture increased despite virtual stagnation in the total number of people active in agriculture, forestry and fisheries. This was probably due to more intensive use of available labour.

area was only ten per cent in the north, while the southern provinces (excluding Maputo City) suffered an eight per cent decline (Boughton et al. 2006).

At the same time, there was little increase in market integration and the use of productivity-enhancing inputs. For example, about 90 per cent of farmers still prepare their land by hoe. Consequently, yields for basic food crops in the smallholder sector have remained essentially flat over the last decade. In rural areas, subsistence agriculture provides about half of total income, the rest coming primarily from sales of agricultural products and animal produce, supplemented by non-agricultural activities, mainly natural resource extraction. Being better able to feed the family and even to grow a small surplus for sale has made a major impact in a society where 70 per cent of the population live below the poverty line (Boughton et al. 2006; Coughlin 2006).

The problem is that the ‘bounce-back’ effect in agriculture cannot be repeated. The growth rates of the production of such staple food crops as maize, sorghum and cassava have fallen from their 1990s levels, and the same is visible in traditional cash crops such as cashew and cotton (DAPSA 2006; World Bank 2005c). Recovering pre-war production levels with well-known and previously applied technology did not demand too much innovative capacity or external support, but now this option for growth has largely been exhausted. The new challenge is to transform the present system of subsistence agriculture, which is characterised by geographical dispersion, small units and low productivity, to an efficient commercially oriented system (Birgegård 2006). According to the national poverty alleviation strategy PARPA, *“the agricultural development program must be oriented toward: (i) assistance to small family farms during their gradual transition to commercial operation; and (ii) assistance to commercial farmers, encouraging them to boost their production, productivity, and competitiveness, thus ensuring satisfaction of basic needs and higher incomes in rural areas, coupled with the establishment of agroindustries that will add value to farm products for both the domestic and export markets”* (Republic of Mozambique 2006, p. 128).

Transition to commercial agriculture

Most observers agree that achieving the transition to a commercially oriented agriculture sector depends on investment in rural trade networks, agricultural extension, micro-credit, transport, and processing services. All these services benefit from effective producer organisations. Currently credit is available to only three per cent of rural households, less than five per cent participate in farmers’ associations, and extension services reach only 14 per cent of farmers. Lack of infrastructure (especially rural roads and electricity), combined with the geographical dispersal of producers, creates a strong disincentive to expansion of the private service network and process-

ing industries in rural areas remote from the main markets and/or transport corridors. As a result, commercial margins for agricultural products are very high, especially for primary products (27-111%), while access to improved agricultural inputs (seeds, fertilizers, pesticides) is limited and prices elevated (Coughlin 2006; cf. Kydd and Dorward 2004). With the ongoing high rate of investment in construction and rehabilitation of rural and district roads and expansion of the electricity network, the coverage of the commercial network is likely to expand in the near future. The question is: which of the alternative rural development strategies (or combinations thereof) would most likely contribute to pro-poor growth which is also sustainable?

In order to benefit from global markets, rural producers must have access to improved inputs and technology, value-adding, transport and storage, and produce marketing. The government cannot realistically be expected to provide these services on a nation-wide scale: at present, for example, less than one third of extension agents are in government service, the rest being NGO and private sector employees (Coughlin 2006). Low economic activity, thin markets, high transaction costs and risk, however, imply that unit costs are high and thus unattractive for private sector operators (Kydd and Dorward 2004). Some kind of joint public-private approach is thus called for.

In collaboration with the private sector, improvement in agricultural service delivery can be achieved by either vertical integration of the agro-industry or through contract farming arrangements. In the period 2000 to 2004, five major agricultural products (cotton, tobacco, sugar, cashew and timber) accounted for approximately 40 per cent (in value) of agricultural exports. Of these, tobacco and sugar have grown rapidly with the support of foreign investment and know-how, while the production of cotton and cashew has stagnated or even declined as a result of inconsistent government policies and conflicts within the sector (see chapter 4.7). Timber exports have grown rapidly but suffer from inconsistent government policy and a relatively high incidence of illegal (unsustainable) harvesting and contraband. A sixth product group with good export potential is horticultural products (Republica de Moçambique 2006). It should, however, be kept in mind that traditional food crops such as maize, millet, cassava, beans and fruits still constitute the bulk of national and even regional – though often informal and thus unregistered – trade, which provides a third alternative (Boughton et al. 2006; USAID 2004a).

Contract farming

Contract farming provides a strategy which can, at least in theory, stabilise the rural population within the smallholder framework by creating remunerative agricultural self-employment through product-specific contracts with private enterprises, who provide the necessary inputs and services (credit, extension, seeds and tools) to

smallholders against the right to buy the produce (Kirsten and Sartorius 2002). The problems encountered in implementing the system in cotton and tobacco sectors in Mozambique has been discussed above (chapter 4.7.4), and here we will concentrate on the potential effect on poverty alleviation.

A number of studies have shown that contract farming tends to favour the more affluent farmers who have a better resource base – including education and social capital – and higher risk-bearing capacity (Humphrey et al. 2004; Kirsten and Sartorius 2002). The latter is an important factor, for due to low farm-gate prices for crops, the application of expensive modern inputs is risky and not always lucrative, especially for the poorest farmers. In the cotton and tobacco sectors, for example, contract farming has proved profitable for those farmers who have been able to plant on a relatively large scale, while those with small areas under cultivation have actually incurred losses. In a study made in the Zambézi Valley it was also noted that cotton and tobacco growing has benefited disproportionately few female-headed households: only four to five per cent of growers against 10 to 15 per cent of non-growers were female (Benfica et al. 2005; cf. Boughton et al. 2006). Contract farming tends to operate most efficiently in relatively concentrated high-potential agricultural areas, and thus it rather increases than reduces regional and sub-regional inequality in terms of service accessibility. Nor does the state extension service provide a balancing factor, as it concentrates its efforts in high-potential areas (Coughlin 2006).

The impact of contract farming on the poorest groups is, therefore, at best indirect. However, in the context of the widespread poverty characterising Mozambique, where well over one half of the rural population live below the poverty line, improving the income-generating capacity of even the middle strata can make a major difference in poverty.

Wage labour

The policy option focusing on the provision of equal basic services to a supposedly homogeneous smallholder population has been criticised for its failure to recognise that rural areas are characterised by substantial differences in household income both within and between regions. One common factor, however, is the presence of wage labour relations at all levels, including the poorest segment of the rural population (Cramer and Pontara 1998; Weimer et al. 2004). It has been argued that in the context of a high incidence of poverty, decently remunerated rural wage-earning opportunities can have a dramatic effect in reducing poverty, especially among poor women such as widows without access to sufficient land (Sender et al. 2006; World Bank 2006e). In the classical growth model the increase in wage labour (either farm or non-farm) is the main factor creating a link between growth and poverty alleviation, and

there are some indications that such growth has taken place in a few African countries which have managed to gain access to international food markets, for example Kenya in European horticultural markets (Humphrey et al. 2004).

However, in Mozambique agricultural wage labour currently represents a decreasing source of income for the rural poor. While the share of wage labour in total rural household income increased rapidly from two per cent in 1995–96 to nine per cent in 2001–02, the increase took place in the highest income quintile while its share among the poorest groups actually decreased. Even though seasonal agricultural wage labour is (along with much more important natural resource extraction) one component of a typical diversified survival strategy of the poor, its role remains secondary (Boughton et al. 2006). Therefore, as the colonial experience demonstrates, a credible set of policies and institutional arrangements which link smallholder development with the advancement of large commercial farming operations – including a substantial employment effect biased in favour of the rural poor – must be in place in order to ensure that the impact of the operation is pro-poor (Birgegård 2006).

Marketing food crops

Among the rural poor, agricultural production is concentrated in traditional food crops (see 4.7.1). According to the agricultural sample survey, crop production contributed 80 per cent of income for the poorest 60 per cent of rural households in 2001–02 (Boughton et al. 2006). Even though only about one fifth of the maize crop is sold on formal markets, informal trade with Malawi is actually an important source of revenue for smallholders especially in the border districts. In the centre-north smallholders produce rice as a cash crop by rain-fed methods on low-lying land. Smallholders also grow fruit and cultivate various horticultural crops using traditional techniques, partly for cash and partly to complement their own food supply. Some of these products have already found markets in neighbouring countries, notably South Africa and Malawi. In the food crop sector, where the national research effort on seeds and pest control has been relatively strong, active dissemination of higher-yielding, drought-tolerant and disease-resistant crop varieties could make a major impact on food security and cash earning opportunities for the majority of semi-subsistence smallholders even in the context of otherwise weak service provision (Boughton et al. 2006; World Bank 2004b).

While the current debate on agricultural development in Mozambique has tended to be structured around ideological themes such as defense of the independence of the small-scale peasant producer or promotion of ‘modern’ large-scale export-oriented agriculture (see e.g. Birgegård 2006; Cramer and Pontara 1998; Sender et al. 2006), it is important to note that the related production and trade strategies (contract farm-

ing or wage-labour-based production for export markets, independent production of food crops for local and regional markets) are by nature complementary. While market development services such as post-harvest management, enterprise development, market linkages, access to finance, and compliance with quality regulations are – to a varying degree – needed to strengthen all rural development strategies, they must be adapted to the respective production chains and socio-economic conditions. Mozambique is well endowed resourcewise and positioned geographically to export agricultural products to surrounding markets, including the Middle East and South Asia in addition to Southern Africa. This comparative advantage should be used effectively both to guarantee national-level food security and to develop an increasingly competitive commercial agricultural export capacity. In the medium term Southern African and neighbouring region markets and related production linkages can serve as a springboard for integration in global supply chains of high-value agroindustrial products, which are likely to provide the most promising means to access the lucrative global markets in the long term.

4.9 Aid, trade and growth in Mozambique

After rising most years between 1960 and 1990, total official development assistance (ODA) to sub-Saharan Africa started to fall in the early 1990s, decreasing from US\$ 16,900 million in 1994 to US\$ 11,600 million in 1999. In the ten-year period after 1987, 12 of the 19 main bilateral donors providing aid to the region reduced their aid. France, which is by far the largest provider of aid to sub-Saharan Africa, but also the EC, Belgium and the Nordic countries all cut their aid to the region by ten per cent or more. This trend was again reversed in 2000, with ODA to the region reaching a new high point of US\$ 17,700 million in 2002. The increase is primarily driven by France and the USA (Addison et al. 2005).

In sub-Saharan Africa, the share of ODA in total official and private financial flows is much higher than in developing countries overall. During the period between 1991 to 2002, ODA accounted for almost 90 per cent of total financial flows to sub-Saharan Africa, while its share was less than 50 per cent for the whole group (Table 4.9.1).

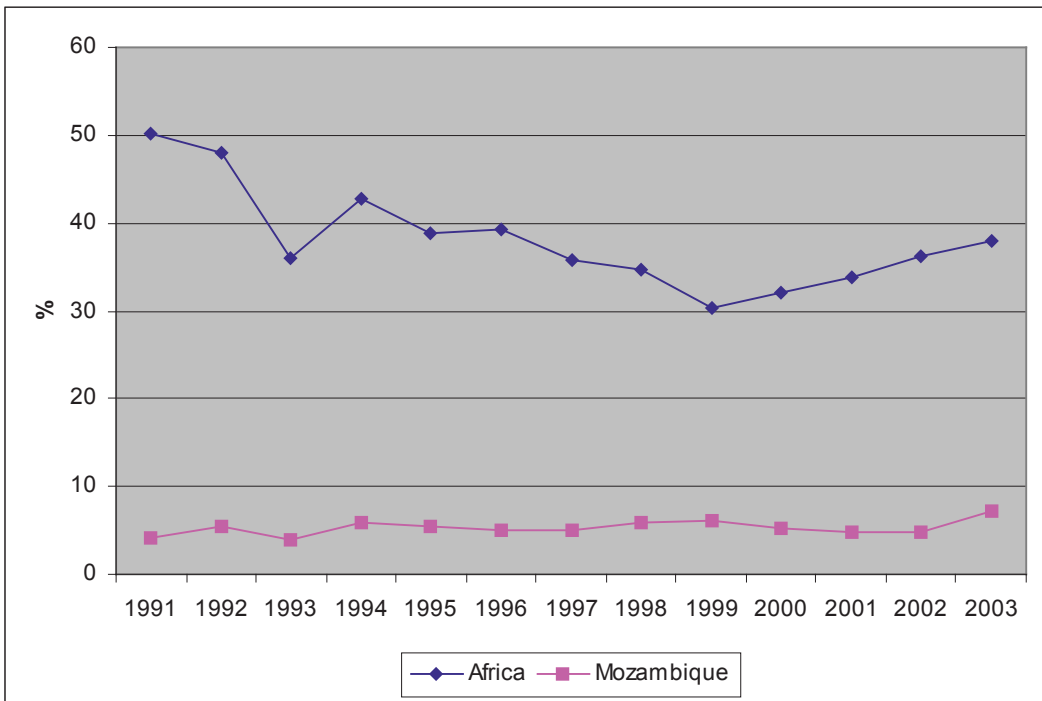
Table 4.9.1 Share of ODA and private flows in total financial flows in developing countries and sub-Saharan Africa, 1971–2002 (%)

	1971–80	1981–90	1991–2002
ODA to developing countries	36.7	50.8	43.6
Private flows to developing countries	50.7	38.2	47.7
ODA to sub-Saharan Africa	59.5	77.8	88.3
Private flows to sub-Saharan Africa	29.3	7.9	11.5

Source: Addison et al. 2005.

As described above (chapter 4.4.3), ODA to Mozambique increased substantially after the mid-1980s. The country's share in net ODA disbursements to sub-Saharan Africa increased from 5.3 per cent in 1986–87, to 6.8 per cent in 1991–92, and remained at about 6.7 per cent in 1999–2000 (Addison et al. 2005). Mozambique is one of Finland's five long-term development partners in sub-Saharan Africa, where its share has remained relatively steadily at around five per cent since 1991 (Figure 4.9.1). During the same period, the share of sub-Saharan Africa in Finnish ODA has fallen from approximately 50 per cent in 1991 to 30 per cent in 1999, but is again currently close to 40 per cent. In Mozambique Finnish aid has concentrated mainly on primary education, health care and rural development.

Figure 4.9.1 Finnish ODA to Africa and Mozambique, 1991–2003
 (per cent of total bilateral assistance)



Source: MFA 2006.

4.9.1 The relationship between aid and economic growth

Sub-Saharan Africa currently receives a historically unprecedented volume of aid, which is even likely to increase in the future. At the same time critical discussion on the potential negative economic and institutional impacts of increasing volumes of

aid has pointed out that the proposed increase might be better spent on other types of assistance than traditional bilateral aid (Moss et al. 2006).

The basic critical macroeconomic argument is that large volumes of aid can affect the real exchange rate and thus undermine the competitiveness of the export sector, leading to so-called 'Dutch disease'. While an active central bank can manage exchange rate appreciations and mitigate pernicious effects on competitiveness, a number of cases suggest that a large volume of ODA can lower exports and economic growth, leading to increasing unemployment and dependence on external assistance. The management of the real exchange rate is arguably rendered more difficult by ODA volatility, which can cause serious distortions. This is because aid is less predictable than domestic fiscal revenues, and its volatility lessens any potential positive effects of aid on recipients. It contributes to macroeconomic instability, which complicates public policy-making, and directs public spending toward consumption rather than investment (Aiyar et al. 2005; Foster and Killick 2006; Moss et al. 2006).

On the other hand, various studies show that aid has contributed positively to growth in sub-Saharan Africa due to its positive effect on the volume of investment and related income and employment benefits. However, even those who maintain that ODA has had a positive impact on economic growth note that the volatility and uncertainty of aid receipts reduce its effectiveness (Addison et al. 2005; Lensink and Morrissey 2000). In the case of Mozambique, increased ODA appears to have had a positive effect on growth while it has not appreciated the real exchange rate. The criticism that aid generates 'Dutch disease' and leads to structural distortions seems, therefore, to be unfounded in the case of Mozambique, at least hitherto (Foster and Killick 2006; Haaparanta and Kerkelä 2006). Some observers even see the Mozambican experience as a shift from a vicious to a virtuous cycle, marked by the end of civil war and the emergence of sustained growth supported by external aid. According to this view, sustained aid at a high level was crucial for managing the transition process: establishing peace smoothly, managing the challenge of post-war stabilisation, and carrying out widespread reconstruction (Arndt et al. 2006).

It is, however, important to note that even in the case of a 'virtuous cycle' the aid-growth relation is not likely to be stable, and upsurges of ODA can be a major source of growth volatility. Externally financed investments in the public and social infrastructure tend to generate fiscal pressures. In Mozambique, the rate of return from such investment was particularly high in the early post-war period due to the very low base from which they were made. Nevertheless, problems in meeting recurrent costs without prejudicing the quality of the services offered makes sustenance of such high rates unlikely. As constraints on absorptive capacity reduce marginal returns to increases in public investment, the feared structural distortions may appear in the future (Arndt et al. 2006; cf. Foster and Killick 2006).

4.9.2 The impact of ODA on public institutions

According to recent studies, out of 22 low-income countries with ODA inflows equivalent to at least one half of total government expenditure, 16 are in sub-Saharan Africa. Out of 12 poor countries where the ratio of ODA to government expenditure is 75 per cent or more, ten are African. For example, in Malawi and Zambia aid has funded more than 40 per cent of government expenditure for nearly 20 years (Bräutigam and Knack 2004; Moss et al. 2006). Statistical data show that higher aid levels are associated with lower tax effort. In the mid-1970s tax revenue in both middle-income and low-income countries was about 17 per cent of the GDP, but by the late 1990s it had increased to 21 per cent in the middle-income countries while in the low-income countries it had fallen to 14 per cent. The latter receive much higher levels of ODA (Bräutigam and Knack 2004). As noted above (chapter 4.4.2), in the case of Mozambique the level of tax revenue has stagnated at a level of 12 per cent of the GDP.

The basic critical argument is that a large and sustained volume of aid tends to structure accountability as something between the executive branch of government and aid donors rather than between state and society, thus weakening the role of domestic political institutions in governance. Various studies show that countries which rely on a substantial proportion of unearned income from natural resources such as oil will tend to be less democratic and have less effective institutional mechanisms providing accountability. Aid can have many of the same dysfunctional effects as natural resources, as in both cases governing elites can dispense with ensuring the support of citizens and the assent of their legislatures in order to raise revenues. According to this argument, reliance on the citizenry for raising public revenues, as opposed to unearned income via offshore extraction or ODA, is an essential ingredient in the establishment of accountability between state and society (Moss et al. 2006).

In Mozambique, foreign aid currently finances approximately 50 per cent of the government budget (AfDB/OECD 2006). Combined with very high reliance on FDI in the private sector, the high level of aid dependence has facilitated the persistence of a highly centralised development approach. Following in the footsteps of centralised colonial administration and the subsequent Marxist-Leninist party/state apparatus, the government continues to operate through mega-projects put together by the top political leadership and respective donors and/or private investors with very little public consultation or transparency. The post-war period has been characterised by a long list of failed centrally initiated mega-projects in agriculture and tourism, for example the Mozagrius project in Niassa Province, the Blanchard project in Maputo Province, and arguably the cotton JVCs in Nampula Province (see e.g. Pitcher 1996; Walker 1999). The current SDI approach and related industrial mega-projects seem to follow the same approach, even though their economic sustainability (at least for the foreign owners) is likely to be better. According to

Söderbaum and Taylor (2001, p. 687), *“what is emerging is not a partnership between state and capital in the service of public good, but rather a deal between political elite and transnational capital, supported by the IFIs and the donor community”*.

4.9.3 Trade capacity building and foreign aid

According to OECD (2003) guidelines, trade capacity building seeks to enhance the ability of policymakers, enterprises and civil society in developing countries to (i) collaborate in formulating and implementing a trade development strategy embedded in a broader national development strategy; (ii) increase the volume and value-added of exports, diversify export products and markets and increase foreign investment to generate jobs and exports, and (iii) participate in, and benefit from the institutions, negotiations and processes which shape national trade policy and the rules and practices of international commerce.

While trade capacity building is typically presented as a technical exercise, it should be noted that especially the first and third of the above activity areas are essentially political processes which should be driven by developing country institutions. The OECD guidelines emphasise that ensuring local ownership of trade and development strategies is a key objective of trade capacity building (OECD 2003). The role of possible technical assistance from donor organisations should be limited to strengthening domestic policy analysis and formulation, and elaborating the technical rules and regulations needed to operationalise the trade policy choices made by domestic political authorities. Instead of imposing selected trade policies as the only possible or rational options available for developing countries, trade capacity building should encourage domestic political debate over trade issues (Arndt et al. 2006; cf. Hunsmann 2006).

Michael Friis Jensen (2005) has noted that in the case of sub-Saharan Africa, it is not the negotiation capacity that has prevented gains from multilateral trade talks from materialising, but rather the comparatively small size of African economies, which leaves them with little say at the negotiation table. In Mozambique, trade capacity building should arguably focus on addressing the numerous supply constraints the economy faces. The cost of financing capital accumulation is generally identified as a major constraint to growth. While capital accumulation, which has recently taken place mainly through FDI, has had a significant positive effect on growth, it has failed to create any major spillover effects. At the same time credit availability to domestic firms, especially to SMEs, appears to be a major problem limiting investment in export production. Resolving the problem requires a large-scale mobilisation of domestic savings and efficient mediation of those savings, i.e. improved financial services especially in rural areas. The problem is linked to a lack of trust in public institutions and the rule of law, which is manifested for example in the limited use of bank and

trade credit. The government can have a positive role to play in these circumstances by solving the problems of co-ordination and asymmetric information, and especially in strengthening the judicial system and contract enforcement (Coughlin 2006; Haaparanta and Kerkelä 2006; IFAD 2003; World Bank 2005c).

While commercial agriculture and agroprocessing are widely identified as the sectors in which Mozambique has comparative advantage on the global markets due to favourable agro-ecological conditions, low demographic pressure and relatively cheap labour, investment in agriculture remains extremely low. This can at least partly be attributed to weak government performance in the sector. Despite years of preparation, no comprehensive national rural development programme is in place (AfDB/OECD 2006). Various observers have noted that little effective change can be observed in the Ministry of Agriculture despite considerable investment. The ministry remains heavily overstaffed on the central level, but suffers from lack of human and financial resources at district and lower levels (see e.g. Birgegård 2006; Coughlin 2006; Weimer et al. 2004). According to one critical report, *“continued support to Proagri without substantial structural changes of its delivery machinery would amount to subsidising a ministerial bureaucracy and its public consumption, at the cost of much needed support for the production and productivity increases in agriculture and related processing”* (Weimer et al. 2004, p. 20). The same problems seem to persist in the new sectoral programme, Proagri II, which lacks a concrete strategy as to how input and output markets and financial services (particularly for smallholders) should actually be implemented (Birgegård 2006).

With dozens of sub-sectoral strategies and no overarching development vision or adequate mechanism to prioritise, link and coordinate activities, the government’s approach to rural development has been fragmented and based on poorly integrated analyses. Examples of inchoate government policy – often made more confused by donor interventions – which has discouraged investment and caused stagnation in producer prices can be cited from a number of key export sectors such as cotton (Tschirley et al. 2006), cashew (McMillan et al. 2003), and tobacco (Benfica et al. 2004). In terms of economic growth and poverty reduction, the results have clearly been far from optimal, especially for agriculture and agro-processing (Coughlin 2006).

Investment of ODA resources in the infrastructure, which is important to smallholders and rural entrepreneurs, as well as in basic health care and primary education services, can do much to promote growth and reduce poverty in that it creates livelihoods for the poor and enhances their labour productivity (Addison et al. 2005; Arimah 2004; McPherson 2002). However, the atomistic supply structure and the length of supply chains from dispersed smallholder producers and artisan fishermen creates a major obstacle to the creation and maintenance of cost-efficient linkages with export markets (Jensen 2005; Kirsten and Sartorius 2002). In these sectors weak

absorption capacity in the public sector, combined with relatively low public revenue collection capacity, seem to set the limits to further cost-effective investment of ODA (Arndt et al. 2006; McPherson 2002).

Significant advances in packaging and transport technology over the past two decades have opened up new opportunities for agricultural trade, with fresh food products becoming a significant part of the global agro-food trade (OECD 2003). At the same time, however, the global value chains have become increasingly buyer-driven. The new agro-food chains are characterised by the dominance of strict process-based quality conventions, which transfer the quality control function upstream to the producing company or exporting country government (Gibbon and Ponte 2005; Kirsten and Sartorius 2002). Increasing focus must thus be centred on different kinds of non-tariff barriers to trade, for example SPS regulations in the importing countries. With regard to agricultural exports to the EU, for example, SPS requirements were ranked in a recent study as the most significant impediment by respondents from low- and middle-income countries. Once internationally approved rules define specific SPS regulations, private and public investment in exporting countries are required to ensure that exported commodities meet the specified health and safety standards. This means that also in developing countries domestic (usually public) regulatory agencies must set up adequate norms and monitoring systems which enable companies to prove that they comply with the regulations (Henson et al. 2004; Roberts et al. 2004).

For a country like Mozambique, which suffers from a serious lack of both human and social capital, increasing demands with respect to quality control systems operated by the public sector and covering most of the highly dispersed smallholder producers can quickly become an insurmountable barrier. The problem becomes even more obvious if we include the provision of other services crucial for creating or even simply maintaining a globally competitive agricultural production capacity, for example agricultural research, extension and marketing services, which have traditionally been provided by the public sector (Coughlin 2006; Jensen 2005; McPherson 2002). For example, the WTO Agreement on the Application of Sanitary and Phytosanitary Measures contains specific provisions targeted to developing countries, including a recommendation that technical assistance be provided to help them establish production and monitoring systems which meet international health and environmental standards. Such technical assistance would serve the interests of both the public and private sectors as well as the rural population at large, provided that the planning and implementation is carried out jointly with all key stakeholders (Roberts et al. 2004).

Support to public-private partnerships (PPPs) in quality assurance and other currently neglected areas of basic support to commercial agriculture, forestry and fisheries, namely research and extension services, would arguably provide the most efficient way to build trade capacity in the agriculture and fisheries sector.

5. Conclusions

5.1 *Pro-poor growth in Vietnam and Mozambique*

In the introduction we posed three questions which we have sought to answer in this paper. The first question was: *What type of growth is best for poverty reduction in each country-specific context, and which policies will help bring about more equitable patterns of growth?* While Mozambique and Vietnam embraced independence and national unification with high hopes of rapid industrialisation and economic growth with high levels of equality following the socialist model, both ended up involved in civil or regional wars linked to Cold War conflicts, while the socialist experiments in economic development proved to be drastic failures. While their level of economic development had been close to average regional level (or in the case of Mozambique even somewhat higher) at the end of the colonial period, by the 1980s they were among the poorest countries in their respective regions and even in the world. As a result, by the mid-1980s both countries were forced to adopt at least some elements of market economy in order to find a way out of their economic crisis. There are, however, important differences in the way Mozambique and Vietnam addressed economic reform.

5.1.1 What can we learn from the case of Vietnam?

Vietnam started the renovation process with a gradual liberalisation of small-scale agriculture, thus reversing the earlier collectivisation policy. Family business was encouraged in agriculture, forestry and fishery as early as 1986, while households were made the basic unit of agriculture in 1988, and finally a new land law was passed in 1993. Restrictions on trade in the major staple crop rice were removed in 1997, making direct exports possible. In addition to invigoration of the commercial production of rice, new cash crops such as coffee and cashew were effectively introduced, while aquaculture was also promoted. This made possible a broad-based increase in rural household incomes before wholesale market liberalisation and privatisation of the large state-owned sector was addressed – the last phase of this process is taking place currently following Vietnam's joining the WTO in 2006.

A parallel gradual reform in the systems of trade, private enterprise and ownership was carried out. Contrary to the socialist industrialisation strategy, focus moved away from the heavy industries. The government encouraged controlled privatisation of light manufacturing industries, for example textiles, garment and furniture, making use of a wide range of investment sources ranging from domestic and regional to international financial institutions (IFIs) and private international capital. These

labour-intensive industries have had an important role in absorbing the workforce released by the agricultural sector, which has gained in productivity, thus providing an important mechanism for wider distribution of the benefits of economic growth. However, a large number of uncompetitive state-owned enterprises (SOEs) still remain, even though some have been successfully privatised under the joint venture modality. In any case, substantial reductions in the remaining labour force are expected in this sub-sector.

In Vietnam foreign aid has constantly been slightly above the average for developing countries. During the 1960s and 1970s it reflected the Cold War alignments as the North was heavily supported by the Soviet Union and the South by the USA, and after unification by the Soviet Union alone. Overseas development assistance (ODA) has again increased since 1990, and with a current value of about four per cent of the GDP it makes a crucial contribution to covering the balance of payment deficit. It does not, however, dominate investments or the government budget, except in the case of agricultural development.

Investment has been crucial in the structural change in the industrial sector, and increased foreign direct investment (FDI) has made an important contribution especially to export-oriented industries. Investment has come from a number of different sources with no single dominant investor: Asian investment covers about one half of the foreign investments, and they are widely spread across different export sectors. Domestic savings still represent an important source of investment.

The success of Vietnam's economic transition has relied on a number of favourable initial conditions linked to both natural resources and location, and to intangible capital. High population density and relatively small geographical size, combined with coastal location, create favourable conditions for the efficient production, transport and marketing of agricultural produce. This is supported by favourable agro-climatical conditions and considerable mineral wealth. A relatively high initial level of human capital (e.g. a functioning educational system and over 90 per cent literacy rate), combined with long-established social institutions which have largely survived the socialist period, have created a good starting-point for controlled economic liberalisation.

5.1.2 Does Mozambique provide an example of sustainable pro-poor growth?

Mozambique is one of the few Southern African countries which have experienced a decade-long period of sustained economic growth, i.e. since the ending of the civil war in 1992 and the first multi-party elections in 1994. The growth has been based on two sectors, agriculture and industry, and has been accompanied by a relatively rapid

reduction in absolute poverty.

The main factor in the reduction of poverty since the mid-1990s has been increased production in agriculture, which is overwhelmingly the main source of livelihood in the country. The problem with the growth is, however, that it represents a 'bounce-back' from the catastrophic war years to previous levels of agricultural production without any substantial improvement in productivity, which remains particularly low even when compared regionally. While an important development potential exists for various cash crops such as cashew, sugar, cotton, tea and tobacco, as well as for aquaculture and wood plantations, except for tobacco and sugar the production is currently even marginally competitive on the international markets only by merit of the very low prices paid to producers. Production of food crops (maize, rice, horticulture) for local and regional markets is also potentially an important source of rural income, but remains underdeveloped. If the constraints on agricultural productivity are not efficiently addressed in the next few years, the growth which has already slowed down is likely to stagnate.

Small-scale agriculture was practically neglected by the government even after the official reversal of the collectivisation policy in the mid-1980s. While the post-war agricultural development programmes have repeatedly emphasised the need to invigorate commercial agriculture and linkages between small-scale farmers and the private sector, on the ground very little has been achieved. The government policy remains top-down, inefficient and confused, and does not encourage and facilitate investment in the sector. Public services such as extension, quality control and research are under-capacitated and their coverage is very limited. At the same time collaboration with the private sector and NGOs is sporadic and lacks transparent rules. The new land law passed in 1997 makes strengthening the position and tenure rights of small-scale farmers possible while providing for long-term leasehold for private enterprises, but has not been implemented. This contributes to the current confusion in terms of land tenure, which is often erroneously blamed on lack of private (freehold) tenure.

Growth in industrial production has been the main driving force behind Mozambique's rapidly growing exports. This growth has, however, contributed very little to poverty reduction. It has created only few jobs, and its contribution to public revenue is marginal when compared to the value of production. The new industries rely on imported inputs or export products with very low value-added, and are closely linked to the South African mining and energy complex (MEC). Due to the enclave character of such industries, the spillover effect in terms of technology transfer or skills development has been minimal. The new industries have been financed almost entirely with FDI, which implies that a large part of the profits leave the country. In the medium term the impact on international competitiveness can even be negative due to the 'Dutch disease' problem. While market liberalisation and privatisation of

SOEs have improved access to foreign consumer and capital goods and reduced public spending on subsidies to unviable industries, the process has led to a decrease in industrial employment and closure of various domestic industries processing locally produced raw materials.

Mozambique continues to be highly dependent on ODA. Advisers and loans from the Soviet Union and its East European allies, as well as the Nordic countries, were prominent already before joining the Bretton Woods institutions in the mid-1980s. Thereafter growing amounts of aid from the IFIs and bilateral Western donors have more than compensated for the ending of Soviet aid with the collapse of the Soviet Union, reaching a peak of over 90 per cent of GNI during the peace process in 1992. During that period a large part of public revenue went to paying the heavy loan burden, but at the end of the 1990s the loan situation was considerably relieved through the Heavily Indebted Poor Countries (HIPC) initiative. However, ODA continues to be very high, covering a substantial trade balance deficit. Foreign aid also covers a large part of the government budget in various sectors, especially education, health and transport.

Compared to Vietnam, Mozambique suffers from three crucial handicaps. Market-oriented agricultural production is hampered by sparse population and infrastructure, which was largely destroyed by the civil war. Monopsonistic markets and high transport costs make inputs expensive and keep producer prices low, which discourages investment in agriculture. However, an even more severe constraint is the extremely low level of human capital: at independence the literacy level was below ten per cent, and despite considerable improvements after independence and especially since 1994 it is still below 50 per cent. Combined with a drastic lack of social capital, which is crucial for effective markets, the competitiveness of export production outside of the recently established enclave sectors remains very low. The domestic level of savings is likewise particularly low, which is reflected in inefficient financial institutions and a lack of national direct investment. Government services are generally perceived as inefficient and corrupt.

5.2 The role of trade liberalisation and correct sequencing

Our second question was: *What is the correct sequencing of policies and how much priority should deep trade liberalisation receive early in the reform process?*

In Vietnam trade liberalisation has been gradual, starting with the agricultural sector, and tightly controlled by the government. Opening of international trade was carried out in the context of the ASEAN free trade area, where Vietnam benefited initially from special and differential treatment due to its less developed economy. The process was supported by preferential treatment agreements in a few key markets such

as the EU and Japan. Gradual economic reforms in the ASEAN framework paved the way for the long process of WTO negotiations, which gave Vietnam sufficient time to adapt its economy to the imminent full trade liberalisation demanded by the WTO legislation. While it suffered some setbacks in terms of its initial objectives, the government has largely been able to keep the liberalisation process under its own control, gaining exceptions in areas it has considered crucial. It has also managed to keep foreign trade relatively well balanced between three major blocks, the ASEAN, the EU and the USA, thus avoiding excessive dependence.

The liberalisation process has not, however, proceeded without problems. The reduction of trade tariffs has seriously undermined the basis of government revenue, and threatens continuing provision of public services. The problem is aggravated by the influx of migrant workers from rural areas to industrial growth points, these being often left without access to social services provided by the municipalities. In the industrial sector SOEs are still important especially in the heavy industries. Discontinuation of government subsidies and their eventual privatisation will cause a major reduction in the labour force, and may even cause closure of entire industries. In light industries the Vietnamese contribution to the value chain tends to be relatively limited, as most of the key sectors (e.g. textiles and garments, furniture) rely on imported raw materials. Also in the agricultural sector there is ample room for development in agricultural processing and agroindustries, even though in a few sectors such as fish products considerable progress has been made during the last decade.

In Mozambique market liberalisation and privatisation were implemented under considerable external pressure as practically the only remaining option after the failure to obtaining more support from the Soviet Union and its allies in the mid-1980s. The urgency to end the civil war became even more pressing after the virtual collapse of the Soviet bloc in the late 1980s. Rapid transition was, therefore, accepted in return for Western aid. As the state structures had practically disappeared in many rural areas of Mozambique, the country was entirely unprepared to carry out the rapid and thorough market liberalisation and privatisation process demanded by the major IFIs and bilateral donors. Similarly to many other transition economies facing rapid liberalisation without adequate institutional control and guidance mechanisms (e.g. Russia), the process was confused and often delayed, and little transparent. In Mozambique the privatisation process was rendered even more complicated by the political situation, which prompted the political leadership to 'sell' the peace process to political and military elite groups. This obviously essentially undermined the transparency of the process as well as the viability of the resulting private enterprises.

While most state farms were divested during the first phase of privatisation, the process did not benefit the small-scale producer, while the established joint ventures and speculative privatisations to members of the national elite did little to improve

productivity. Subsequent government policies with respect to specific cash crops have often been incoherent and unstable, reflecting donor pressure rather than the interest of the producers (e.g. cashew and cotton). Effective development towards crop diversification, more efficient commercial production and agroprocessing has not, therefore, taken place in Mozambique. The national research capacity in agriculture is totally inadequate, while extension services rely mainly on NGOs and the private sector. The agricultural budget is consumed by administration on central and provincial levels. Without an effective government policy and support structures serving the producers, investors avoid agriculture, preferring less risky and more lucrative investment which bring rapid returns (e.g. in commerce and services), while small-scale producers rely on risk aversion by minimising monetary input.

At the same time Mozambique has failed to develop competitive labour-intensive industries such as textiles or footwear under the special transition periods granting least developed countries (LDCs) differential access to developed country markets (notably the EU and the USA). Instead these sectors have actually declined, as they have failed to compete with more efficient Asian producers after the Multi Fibre Agreement (MFA) ended. Due to its underdeveloped human and social capital Mozambique is unlikely to be able to benefit substantially through technology and know-how transfer from the capital-intensive MEC-related projects funded by FDI. Especially selling the rights to non-renewable natural resources such as minerals and fuels without adequate capacity to benefit from spillover effects and foregoing a large part of the potential public revenue benefits (e.g. taxes and royalties) due to over-generous 'tax holidays' to lure FDI may have been inappropriately timed.

5.3 Trade capacity building and pro-poor growth

The final question we posed was: *On what conditions can strengthening trade capacity contribute to pro-poor growth?*

Increasing openness and participation in global trade can contribute directly to pro-poor growth if it takes place in sectors which either increase the income of the poorest groups, or create sufficient public revenue to improve and maintain essential public services (e.g. education, health and social security) benefiting the poor. Economic growth through increased trade capacity can also benefit the poor indirectly if it increases the demand for the services they offer or the goods they produce, and thus improve their income. This linkage is, however, often merely presumed. It should be noted that growth is pro-poor only if the total benefits accruing to the poorest sections of society are proportionally higher than those benefiting the better-off, i.e. if inequality is reduced. If economic growth substantially reduces the overall prevalence of absolute poverty, but at the same time increases inequality, it can be seen as broad based but not pro-poor.

In Vietnam and Mozambique efforts to strengthen trade capacity should focus primarily on the supply side of the agricultural sector. Agriculture provides the livelihood for the majority in both countries, and is pursued in the areas where most of the poor live. In Mozambique institutional development is needed to build social capital, especially in sectors relevant to the rural development of such rural credit systems, government extension and quality control services, and agricultural research. In the context of insufficient government revenue and the related problem of absorption capacity, new solutions should be sought from the public-private partnership (PPP) approach. At the same time it is important to strengthen support for the traditional small-scale production of foodcrops, which is essential for both food security and income creation through growing regional trade. In the long run the improved commercial production of traditional food crops can serve as a stepping-stone to more lucrative global markets.

In Vietnam the government has been able to control the transition process more efficiently, but especially in the agricultural sector it remains dependent on ODA, which still contributes about half of the government agricultural budget. Benefits from global trade can most effectively be increased by extending the domestic production chain, e.g. producing raw material for the furniture industry in forest plantations, and by strengthening government services in agricultural research and quality control to ensure access to increasingly demanding developed country markets.

Support to the above supply-side activities in the agricultural sector would complement the current key sectors of Finnish aid to Vietnam (rural development, forestry, health and national poverty programmes) and Mozambique (rural development, health and education), and thus provide an efficient means of promoting the pro-poor growth target both directly and indirectly. There are, however, certain specific issues which must be considered, for example the limits set by absorption capacity in education and health sectors in Mozambique. In Vietnam it is evident that the current model of economic growth has not been able to address the threat of marginalisation faced by ethnic minority groups (except for the Hoa people), while the problems faced by the migrant populations with temporary status in urban areas constitutes a further distinct problem area to be addressed.

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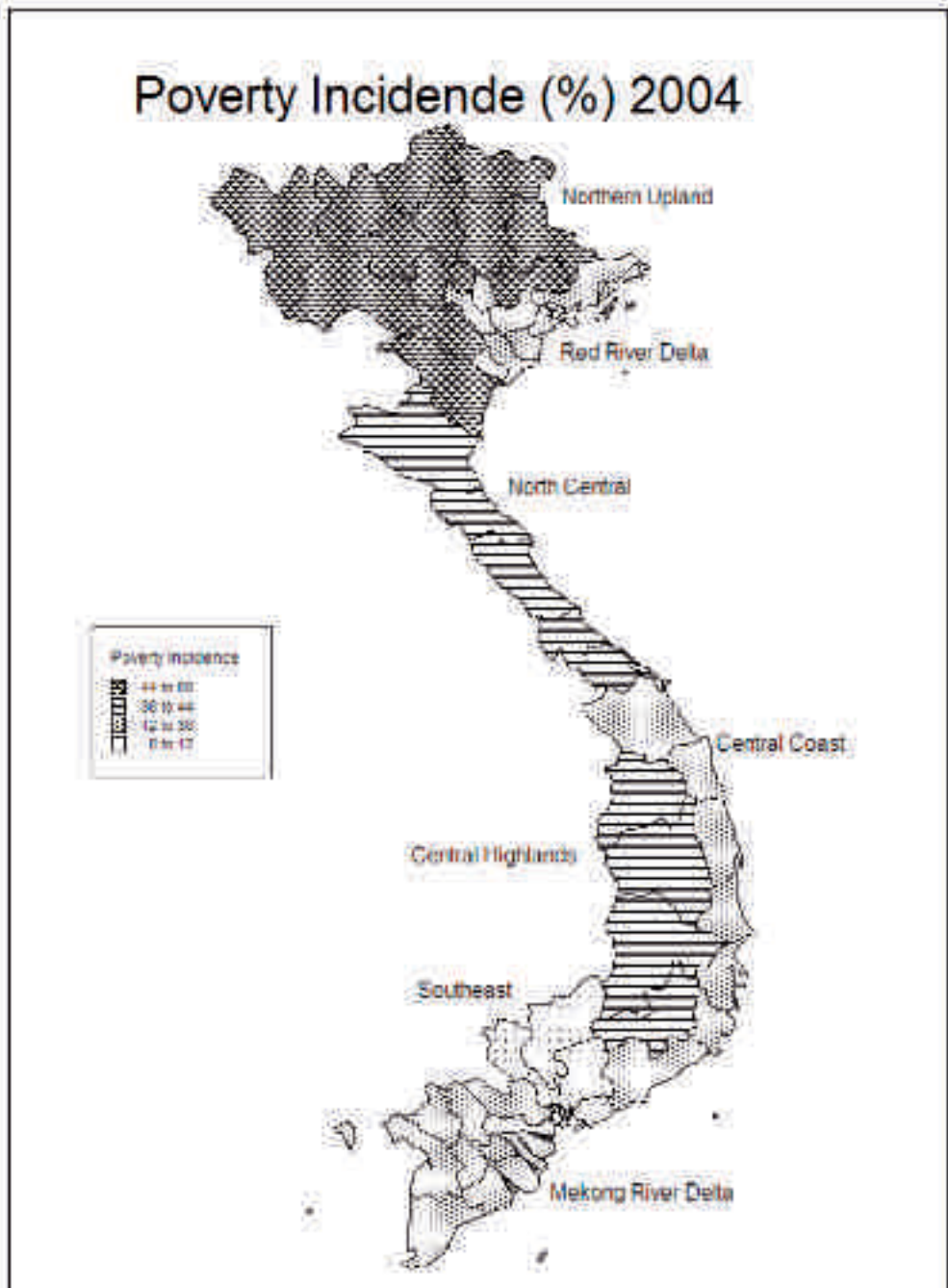
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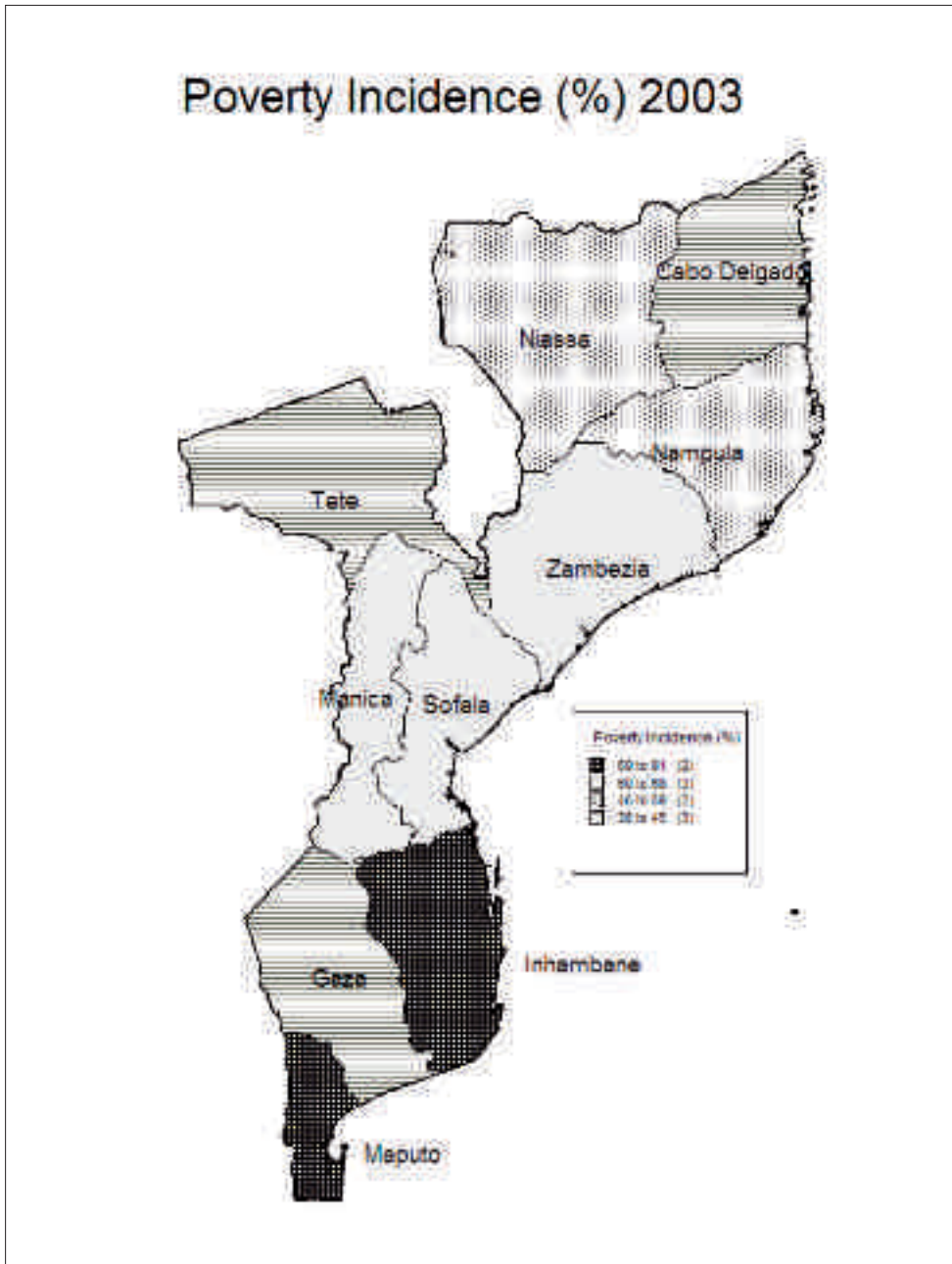
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MAP 1. POVERTY INCIDENCE PER REGION IN VIETNAM

MAP 2. POVERTY INCIDENCE PER PROVINCE IN MOZAMBIQUE



Climbing the Value Chain out of Poverty?

Aid for Trade and Its
Uses in Tanzania and Zambia

by

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Laetitia Kinunda-Rutashobya

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List of Acronyms

ACF	Agricultural Consultative Forum
ACP	African, Caribbean and Pacific countries
AfT	Aid for Trade
AGOA	African Growth and Opportunity Act
AIDS	Acquired Immune Deficiency Syndrome
ASIP	Agricultural Sector Investment Programme
ATI	African Trade Insurance Agency
BEST	Business Environment Strengthening for Tanzania
BRELA	Business Registrations and Licensing Agency
CBT	Cashewnut Board of Tanzania

CIDA	Canadian International Development Agency
CIDA-INC	Canadian Agency for International Development's Industrial Co-operation Program
CLUSA	Cooperative League of the U.S.A
CNSL	Cashew nut shell liquid
COMESA	Common Market for Eastern and Southern Africa
CSO	Central Statistical Office
CTCP	Central Transport Corridor Project
DDA	Doha Development Agenda
DFID	(UK) Department for International Development
DTIS	Diagnostic Trade Integration Study
EAC	East African Community
EBA	Everything but Arms
EBZ	Export Board of Zambia
EC	European Commission
EC	European Community
EDF	European Development Fund
EDP	Export Development Programme
EEP	The Enabling Environment Project (DFID)
EESM	Enhanced Export Support for Marketing
EPA	Economic Partnership Agreement
EU	European Union
EUR	Euro
EUREP	Euro-Retailer Working Group
ETI	Ethical Trading Initiative
FDI	Foreign Direct Investment
FNDP	Fifth National Development Plan (Zambia)
FOPIS	Forest Policy Implementation Support
FRA	Food Reserve Agency
FTA	Free Trade Agreement
GAP	Good agricultural practice
GATT	General Agreement for Trade and Tariffs
GCC	Global commodity chain
GPN	Global production networks
GVC	Global value chain
GDP	Gross Domestic Product
GRZ	Government of the Republic of Zambia
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HIPC	Heavily Indebted Poor Country

HTTI	Tanzanian Hotel and Tourism Training Institute
IDA	International Development Association
IF	Integrated Framework
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
INDECO	Industrial Development Corporation of Zambia
ITC	International Trade Center
JITAP	Joint Integrated Technical Assistance Programme
LDC	Least Developed Country
MAC	Ministry of Agriculture and Cooperatives
MFN	Most-favoured-nation
MATEP	Market Access, Trade & Enabling Policies Project
MCTI	Ministry of Commerce, Trade and Industry (Zambia)
MTS	Multilateral Trading System
NAMBOARD	National Agricultural Marketing Board
NGO	Non Governmental Organization
NSGRP	National Strategy for Growth and Reduction of Povert (MKUKUTA)
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OECD/DAC	OECD Development Assistance Committee
OEM	Original Equipment Manufacturing
PRSP	Poverty Reduction Strategy Paper
PSCAP	Public Service Capacity Building Project
PSRP	Public Service Reform Programme
PSD	Private Sector Development Plan
RITES	Rail India Technical and Economic Services Ltd.
RTFP	Regional Trade Facilitation Project
SADC	South African Development Community
SAP	Structural Adjustment Programme
SHAMBA	Southern Highlands Agricultural and Business Acceleration Programme
SEED	Support for Economic Expansion and Diversification
SEZ	Special Economic Zone
SME	Small and Middle-sized Enterprises
SPS	Sanitary and Phytosanitary
TACRI	Tanzania Coffee Research Institute
TANROADS	Tanzania Roads Agency
TAZARA	Tanzania Zambia Railway Authority
TBS	Tanzanian Bureau of Standards

TBT	Technical Barriers to Trade
TCB	Tanzania Coffee Board
TCB	Trade Capacity Building
TD	Trade Development
TFDA	Tanzania Food and Drug Authority
TNDP	Transitional National Development Plan
TPR	Trade Policy and Regulations
TRALAC	Trade Law Center for Southern Africa
TRC	Tanzania Railway Corporation
TRTA/CB	Trade Related Technical Assistance/Capacity Building
TTB	Tanzania Tourist Board
TWN	Third World Network
UNCTAD	United Nations Conference for Trade and Development
UNDP	United Nations Development Programme
UNIP	United National Independence Party
USAID	United States Agency for International Development
WTO	World Trade Organization
ZACCI	Zambia Confederation of Chambers of Commerce and Industry
ZAMTIE	Zambia Trade and Investment Enhancement Activity
ZATAC	Zambia Agribusiness Technical Centre
ZBF	Zambia Business Forum
ZCF	Zambia Cooperative Federation
ZEGA	Zambia Export Growers Association
ZIC	Zambia Investment Centre
ZNFU	Zambian National Farmers' Union

The notion that developing countries should trade their way out of poverty has gained increasing currency. The old Fair Trade slogan “trade not aid” was based on the conviction that developing countries should not live on alms but the results of their labour. This call has now been joined by those who believe that free markets are the best means of development intervention. There is a broad consensus emerging that strengthening the trade capacity of poor countries, and providing them with an enabling international environment in which to trade, is the best way to facilitate their development. Yet many open issues and internal contradictions remain within this endeavour. A new international trade regime, based on the World Trade Organization WTO, is predicated on the principles of free trade; but there is much doubt about these principles, and they are interpreted very selectively. And aid, far from going away, has made a comeback. Trade-Related Technical Assistance has been broadened to Aid for Trade.

The present study looks at these issues in the context of the Aid for Trade initiative based on the WTO, and discusses some issues faced by donors like Finland and the European Union when trying to make Aid for Trade operational. This is done both at a more general level and through case studies of two major partner countries: Tanzania and Zambia. The study then discusses the Aid for Trade initiative in the historical context of trade-related aid generally. A value chain analysis is then employed to provide a better picture of the conditions in which the traded commodities are produced, and how different stages along the chain add value to the consumed product. The big question raised in this study is how Aid for Trade has been and can be used, and whether it has the potential to counteract those tendencies that make the trade system work to the disadvantage of the poor countries.

The main argument underlying the study is that all ideas of the relationship between aid, trade and development are based on more general and theoretical assumptions of how economies work in general, and how economies of poor countries work more particularly. Such assumptions should be made explicit when discussing the policy options. The presently dominant Aid for Trade initiative represents only one, “WTO-compatible” approach, relying on the virtues of free trade. This context should be recognized when discussing it. We believe that there are alternatives - different ways of promoting trade and building the trading capacity of poor countries through aid. We also argue that too much concentration on trade and trade liberalisation may be unhealthy: what count are policies that develop the productive capacities of developing countries.

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1. Aid for Trade Initiative

The term Aid for Trade (AfT) has become common currency since the Sixth WTO Ministerial Conference in Hong Kong in late 2005; but its origins lie in earlier efforts.

¹ The interviews were mainly on the Aid for Trade process, or the work done under the Integrated Framework, and general questions on technical assistance, e.g. what are the main issues of concern and what sort of problems were encountered.

During the run-up for that conference, in the G8 summit in July 2005 at Gleneagles, UK, it was proposed by the then British Chancellor of the Exchequer, Gordon Brown that “aid for trade” could be a key complement to WTO’s Doha trade liberalisation round, also known as the Doha Development Agenda (DDA). The proposal was based on a paper by the World Bank and the IMF, which argued that such aid would have a role in addressing supply-side constraints and adjustment costs from participation within the global markets (IMF, World Bank, 2005).²

The framework was taken up by the WTO in the Hong Kong Ministerial Declaration. It defined the aim of aid for trade as being “to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements”; but it was also recognised that aid for trade has value in itself in helping the poor countries more broadly to expand their trade. Thus Aid for Trade (AfT) was firmly connected to the WTO negotiations and agreements. Yet it was emphasised that “Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the DDA, particularly on market access” (WTO, 2005: 57).

At the time of writing of this report, a successful conclusion of the Doha round is not in sight, and many basic issues remain open to debate within the initiative. First, how much and what type of resources are going to be allocated to Aid for Trade? Second, and closely related, what is to be included under its umbrella, i.e., what will be its scope? Thirdly, there is the organisational question of how and by whom is the initiative to be operationalized and managed? Behind these issues, if only partially articulated, looms a question of more political nature about the basic rules of the game: must aid for trade necessarily be linked to WTO-led trade liberalisation? If it turns out that the latter will not work for the benefit of the poorer countries, what are the alternatives?

1.1 What is Aid for Trade?

A simple but crucial question is: what should be included in AfT? Donors are already assisting developing country economies in many ways that have trade-related components. What should a specific Aid for Trade project or programme include? An AfT Task Force was initiated in the WTO to make recommendations on how to operationalize AfT. The Task Force concluded its work in July 2006, and recommended an extremely broad scope for AfT, to include six items that they referred to as the AfT pillars: 1) trade policy and regulations, (2) trade development, (3) trade related

² In this paper “Aid for Trade” comprises of technical assistance; capacity building; institutional reform; investments in trade-related infrastructure; and assistance to offset adjustment costs, such as fiscal support to help countries make the transition from tariffs to other sources of revenue. (ibid: footnote 12).

infrastructure, (4) the building of productive capacity, (5) trade related adjustment and (6) other trade-related needs.

Hardly any of the activities referred to in these “pillars” are new as such, but only a part of them have previously been explicitly geared to trade and counted as “trade-related aid.” This traditional trade-related assistance includes the first 2 pillars, which have been called trade-related technical assistance/capacity building (TRTA/CB).

The first pillar, “trade policy and regulations”, includes the same activities that have been widespread in previous trade-related assistance since the 1990s, carried out to help countries negotiate and prepare for closer integration into the multilateral trading system. Such activities include the training of trade officials; analysis of proposals and positions and their impact; support for national stakeholders to articulate commercial interest and identify trade-offs; dispute issues; and institutional and technical support to facilitate implementation of trade agreements, and to facilitate adaptation to and compliance with rules and standards (WTO, 2006).

The second pillar, “trade development”, includes activities aimed at private sector development, in order to: help enterprises engage in trade, reinforce business support structures, and create a favourable business climate for traders. Such activities include: promotion of investments; analysis and institutional support for trade in services; provision of business support services; facilitation of public-private sector networking; help in establishing e-commerce; support to trade finance; assistance in trade promotion; market analysis and market development (<http://tcbdb.wto.org/>).

The WTO Task Force definition of AfT widened the notion of trade-relevant aid considerably, adding three new categories to the two ‘old’ ones just described. Pillar 4, trade-related adjustment, pertains specifically to trade, including as it does “supporting developing countries to put in place accompanying measures that assist them to benefit from liberalized trade.”

The remaining two specified categories, infrastructure and the building of productive capacity, are much broader categories. Previously, activities in these categories have figured prominently in bilateral and multilateral ODA. Here, for the first time, the categories have been specifically subsumed under ‘trade’. Trade-related infrastructure is defined as “physical infrastructure”, while productive capacity is not defined in any way, thus leaving it open to widely different interpretations. The final pillar ‘other trade related needs’ leaves open the possibility that trade related needs could be even further broadened as a meaningful category.

According to the Task Force, all Aid for Trade activities not falling into the categories representing the old trade-related technical assistance and capacity building definition (Categories 1 and 2): “should be reported as Aid for Trade when these activities have been explicitly identified as trade-related priorities in the recipient country’s national development strategies, such as the PRSP.” (WTO, 2006)

Such a definition is very broad indeed, and verges on the arbitrary. As noted by the DAC Report 2006, “in fact, there are few economically rational criteria to ring-fence Aid for Trade activities off from the overall economic growth agenda.” DAC proposes that what is counted as Aid for Trade, should depend more on the objective of the action than on its type or category (OECD, 2006).³ It should not be forgotten that monitoring current AfT spending, and pushing the WTO member countries to make good on the AfT pledges they have made, both hinge crucially on how AfT is defined.

Whether or not Aid for Trade entails more aid, in overall quantitative terms, is also a tricky question. The original G8 statement referred to “additionality” of AfT funds, something which has resulted in a great deal of misunderstanding. It has become clear that any funds allocated for Aid for Trade, will have to be mobilised as part of the more general Official Development Assistance (ODA). The current interpretation endorsed by the WTO AfT Secretary is that there will be no projected, proportionate increase in AfT funds within the total ODA. The additionality of pledged funding then relates to the pledged increase in total ODA spending, which will thus also increase the available funds for AfT.

An OECD/WTO database was built for monitoring AfT funding. Its figures have to be taken with a pinch of salt, because donors have used varying criteria for reporting their commitments. It indicates that there is a huge gap between the total quantity of funding for narrowly defined trade-related aid (the first two ‘pillars’ only), and the total for Aid for Trade using the newer, broader definition (all six ‘pillars’). In 2004, according to the OECD/WTO database, TRTA/CB accounted for \$2.6 billion (2.7% of total ODA), whereas all Aid for Trade activities totalled \$22.7 billion (in 2003 constant prices), which is 24.4% of total ODA, excluding debt relief. Of this figure, \$12.9 billion was spent on infrastructure (13.8% of total ODA), and \$7.3 billion in productive capacity building (7.8%) (Garcia et. al.: 2006). Garcia et. al. envisage the following scenarios for AfT spending by the year 2010, the first if spending commitments remain constant, and the second if these commitments expand:

³ OECD Journal on Development. Development-Co-operation Report 2006, p. 43

Table 1. Aid for Trade as a Net Percentage Share of ODA: Different Scenarios

	Status-Quo		Constant share		Doubling the volume	
	2001-04	2004	2010		2010	
	% Share	USD bn.	% Share	USD bn.	% Share	USD bn.
TRTA/CB	2.8	2.0	2.8	4.3	3.4	5.1
TRTA/CB & Infrastructure	14.5	15.5	14.5	21.0	20.5	30.0
Broader Aid for Trade	22.4	22.0	22.4	30.7	30.2	40.0

Note: Share as % of net ODA.

Source: Garcia et. al.: 2006: 22

1.2 Political and institutional context

The rationale for Aid for Trade arises from different roots. There is a genuine recognition arising on the donor side that the supply-side capacity of especially poorer developing countries is weak. Aid is perceived as one of the obvious means to try to build up trade capacity, so that poorer countries would be better positioned to compete in a liberalised and globalised world economy.

But, this is not the whole story. Trade liberalisation is the name of the game in town now, and the Aid for Trade initiative in its present form is being harnessed to prop it up. Although it is officially emphasised that Aid for Trade is a complement to trade liberalisation efforts, and not a condition, it is also acknowledged that the basic aim of AfT is to facilitate further integration of developing countries into the new international trade regime and cushion them from its worst immediate effects. Yet there is increasing doubt and speculation about the assumed benefits of trade liberalisation for the poor – even among some of the main actors engaged in the process.

As any such initiative, also Aid for Trade can and must be seen as part of international institutional politics. In the interviews conducted in Geneva, the origins for the initiative were commonly connected with the slowing down of the Doha negotiations and the frustration developing in many countries as the result of unfulfilled aid promises. The WTO Doha Development round began with a huge “wave of enthusiasm” on the donor country side, but with more hesitation from developing countries. The latter had begun to realise that development might not materialise, learning from their experiences of the lack of donor deliverance of funds pledged during earlier negotiation rounds or aid initiatives. Thus the original AfT initiative, with its promise of additional funds, can be interpreted as an attempt to compensate developing countries for a weak WTO round; whether this attempt has succeeded is another question.

While the Doha negotiations have dragged on and AfT funds have remained limited, a major beneficiary of the AfT initiative has been the WTO itself. AfT has clearly enhanced the role of the WTO as an organisation. No direct development cooperation role for the WTO is envisaged, as some had hoped, but AfT does signify a sea change for the WTO in that it has now begun to coordinate its capacity building activities along with development agencies, within the AfT framework.

The formal structure for this cooperation between WTO and development agencies is found in the Coherence Mandate of the WTO, which “recognizes the WTO’s responsibility for promoting coherence in global economic policy making” (Lamy, 2006b). The WTO cannot take responsibility for the coordination and disbursement of aid itself, so it has to resort to cooperation with existing development agencies. The role envisaged for the WTO in relation to AfT, according to WTO Director-General Pascal Lamy, is “predominantly one of advocacy for additional resources and enhanced coordination both at the multilateral level and at the domestic level in the case of beneficiary countries” (Lamy, 2006).

One could argue that the definition given for AfT by the WTO Task Force is extremely broad and reflects the ‘trade imperialism’ typically ascribed to the WTO. The WTO labels as many categories as possible as ‘trade-related’; they thus fall under the purview of the WTO itself. The new AfT ‘pillars’ of trade-related infrastructure, productive capacity, adjustment costs and other trade related needs have been given definitions that leave considerable room for broad interpretation and application. No doubt proper infrastructure and effective productive capacity are of utmost importance to trade, but the relationship between trade and development is hardly that straightforward.

UNCTAD, which has traditionally had a major role in trade-related assistance, seems to be still searching for its proper role in the AfT agenda. Among our interviewees in Geneva, Deputy Secretary General Dirk Bruinsma of UNCTAD raised the question of the disjuncture between the development policy sector and the trade sector, as being the key problem in the AfT debate. Both sectors have argued that the other is trying to take over their agenda. UNCTAD sees the role of the WTO as primarily in making rules and providing a forum for settlement of disputes. The WTO as an organisation is built on trade expertise, not development expertise. This is why the role of the WTO is limited to monitoring of AfT funds, and to advocacy for additional funds for trade related-assistance from donor countries. The AfT discussion has brought the WTO into closer cooperation with the OECD, with the formation of a joint monitoring mechanism for AfT funds.

Among the Southern participants, many seem to regard Aid for Trade as simply another source of conditional funding. The Tanzanian envoy said that there are so many projects which are fit for funding and already seeking funds from amply funded

institutions like the EU's European Development Fund, the US Millennium Challenge Account or Japan's New Development Initiative for Trade, but which have still not received the total amounts of funding that were pledged earlier.

Many of the reasons for not getting funding could be found in the different conditionalities attached to each of the funding mechanisms; another problem is the lack of absorptive capacity in LDC ministries, which are burdened with the coordination of the many bilateral loaning schemes that are currently in place. Each of these separate funding institutions carries the further risk that the funding can be stopped at any time. This makes strategic project management even more difficult for recipient countries. The minister plenipotentiary saw that a single multilateral donor agency would be a more predictable and efficient source of funding.

1.3 EU's Aid for Trade: Regional twist

The European Union has been keen to promote Aid for Trade, but in doing so, it has also tweaked it to its own liking. The European Commission pledged €1 billion right away at the G8 Gleneagles Summit. In December 2005, the Member States promised to increase their contribution to €1 billion by the year 2010. This applies to the more narrowly defined trade-related assistance, which should thus be raised to €2 billion per year in 2010. No targets were given for aiding infrastructure or productive capacity, as "it is almost impossible to try to strictly separate the trade-related parts from the support directed to infrastructure and building productive capacity or, more generally, from the overall growth promoting ODA" (Garcia et. al.: 2006: 6-7).

In October 2006, under the Finnish Presidency, the EU trade and development ministers convened in the General Affairs and External Relations Council. Reaffirming the pledges, they emphasised what were termed as the "special needs" of the African, Caribbean and Pacific (ACP) countries currently negotiating Economic Partnership Agreements (EPAs) with the EU. The Council promised that "a substantial share" of the Community and Member States' increased trade-related assistance will be devoted to the ACP countries. This should be additional to what the ACP countries will be granted through the European Development Fund, which was being negotiated at the same time. In addition, trade-related economic adjustment should be "addressed" and "a considerable level" of support to productive capacities and infrastructure continued and strengthened.

Since then, the Union has been engaged in the preparation of a Joint EU Aid for Trade Strategy that should be completed during 2007. In it, the Union is to map out how it is going to fulfil its pledges for AfT, and what the Council's commitment to allocate a substantial share of the additional TRA to ACP countries will in practice mean. The AfT Strategy should include a political commitment on the part of the

EU to strengthen its support for trade-related infrastructure, productive capacity and trade-related adjustment, starting by supporting good coverage of such wider issues in trade needs assessments.

The EU has thus given a strong regionalist twist to Aid for Trade. It is now proposed that major delivery mechanisms should include “regionally owned financing mechanisms” such as regional EPA funds – something which does not exist so far. EPA-related Regional Preparatory Task Forces (RPTFs) should also be strengthened as monitoring mechanisms to follow the impact of EPAs in ACP countries and regions.

There is some ambiguity in these plans. On the one hand, it is stated that Aid for Trade is a complement to trade negotiations and must not be dependent or conditional on any trade agreement, EPA or otherwise. Some Member States are very particular about this. Yet the Commission has mobilised Aid for Trade to serve its regionalist version of economic integration and the successful completion of the EPA negotiations. As the Trade Commissioner, Peter Mandelson, told the European Parliament, which had criticized the Commission AfT package: development aid must be seen as “a means to an end – a way of translating policy reform into practice.”

Even delivering on the quantitative promises may turn out to be difficult, depending as it does at least on the political support that the AfT initiative can garner from the public. The Commission has traditionally been more active in this field and is approaching its target, but the Member States have a long way to go. While the average annual commitments of the Commission for the narrow TRTA/CB based assistance reached EUR 0.9 billion through 2001-2004, those of the EU Member States remained at a mere EUR 0.3. If the EU Member States’ commitment to achieve 0.56% ODA/GNI by 2010 comes to pass, there should be plenty of room for increasing funding, both for TRTA/CB and for the wider Aid for Trade agenda.

2. Trade-related Assistance

The Aid for Trade initiative has had several precursors, which have already been tried out in practice. In recent years, the donor community has significantly scaled up its efforts in trade-related technical assistance. The volume of commitments rose by 50% between 2001 and 2004, to a total of approximately USD 3 billion. Much of this has taken place in the form of widely scattered technical assistance projects. In addition, there have been more integrated programmes, the most important of which are the Integrated Framework (IF) and the Joint Integrated Technical Assistance Programme (JITAP). Their roots lie in the 1994 Marrakesh Ministerial Declaration of the General Agreement for Trade and Tariffs (GATT) that led to the establishment of the WTO (Martina et al.: 2006).

Aimed at the Least Developed Countries (LDCs), the IF is a collaborative effort of the IMF, ITC, UNCTAD, UNDP, the World Bank and the WTO, with the OECD/DAC having observer status. It began operating modestly in late 1997, and was enhanced in late 2001 and ‘revamped’ in 2007.

The enhanced IF has two objectives: to “mainstream” (integrate) trade into the national development plans such as the Poverty Reduction Strategy Papers (PRSPs) of least-developed countries; and to assist in the co-ordinated delivery of trade-related technical assistance in response to the needs identified by the LDC. The IF should be built on the principles of country ownership and partnership (IF, 2006). It has been applied on a case-by-case basis through round-table meetings with beneficiaries, donors and the international agencies.

The implementation of the IF goes through three broad stages: the preparatory phase, the diagnostic phase and follow-up activities. While the preparatory phase sorts out the funding, the diagnostic phase results in the elaboration of a Diagnostic Trade Integration Study (DTIS). The DTIS is expected to evaluate internal and external constraints on a country’s integration into the world economy, and recommend areas where technical assistance and policy actions can help the country overcome these barriers (World Bank, 2006).

The follow-up activities elaborate and validate an action plan, which serves as a basis for trade-related technical assistance delivery. Because of the limited budget available, prioritisation has to take place in order to decide the most strategically important sectors that require funding first. Cambodia has been the pioneering country and is now at the most advanced stage of the IF process.⁴ The IF is envisaged to be an ongoing dynamic process: once the first cycle has been completed, it is possible to apply for further IF participation.

JITAP is a joint technical assistance programme aimed at a limited number of African countries. Its basic aim is to make it easier for these countries to participate in the multilateral trade system that has emerged under the WTO. It brings together the WTO, United Nations Conference on Trade and Development (UNCTAD) and International Trade Centre (ITC), all based in Geneva.

JITAP’s initial declared objectives have been to: build national capacity to understand the evolving trade system and adapt their national trading systems to the obligations and disciplines of the new Multilateral Trade System (MTS); and seek maximum advantage from the new MTS by enhancing the readiness of exporters. The evolved JITAP II objectives are to build capacities of the selected African countries in the areas of: trade negotiations, implementation of WTO agreements, and

⁴ For more information on Cambodia’s experience on the IF see: http://www.intracen.org/wedf/ef2006/Global-Debate/Country-Team-Papers/Cambodia_Paper.pdf

related trade policy formulation; national knowledge base on MTS; and supply capacity and market knowledge of exporting and export-ready enterprises, in order to derive benefit from business opportunities presented by trade liberalisation under the emerging MTS. The budget of JITAP in 2006 has been \$10 million and the funds are provided by developed country donors and organised through the Common Trust Fund (JITAP, 2006).

2.1 Mixed results

The judgement of the effectiveness and longer-term impact of trade-related assistance has proved difficult, but it is obvious that the record is mixed. Several evaluations, conducted by both bilateral and multilateral donors, and summed up by a group of OECD researchers, point to a number of weaknesses (OECD, 2006). A major issue has been the lack of clear and measurable objectives and indicators within the programmes. This has made it difficult to attribute changes at the macro-level (e.g. changes in a country's export performance) to micro-level activities. This problem seemed particularly acute for "trade development" programmes.

In any case, the impact was seen to vary considerably. Many programmes were credited for having increased "partner country understanding" of the importance of trade for growth and poverty reduction, raising awareness and knowledge of trade policy matters and strengthening national dialogue on these issues. Yet often, regardless of this understanding, it was not translated into sustainable impact when programmes have been implemented within unfavourable domestic policy or regulatory environments.

The following weaknesses were identified in most evaluations:

- Unsystematic or incomplete needs assessments. Needs were often listed, if at all, in too broad terms, without prioritisation or consultation with all the relevant stakeholders, e.g. the private sector and donor field missions. Several Action Plan matrices prepared for the Integrated Framework (IF), for example, were not prioritised.
- Weak project management and project governance structures. Some programmes lacked information regarding costs, timing or outputs; were implemented without close consultation with relevant partner country stakeholders; or lacked a clear definition of the roles and responsibilities of each entity involved (on the donor and partner sides).
- Trade-related assistance was fragmented with insufficient synergies with broader development assistance programmes. Donors' trade-related activities were sometimes conducted in isolation from broader development assistance programmes, such as

private sector or rural development programmes.

- Weak explicit linkages to poverty reduction. Few programmes actually had direct links to poverty reduction, whether at the micro-level (i.e. households, individuals) or at the macro-level (i.e. UN Millennium Development Goals and national poverty reduction goals), or took account of poverty-distributional outcomes. This was, for example, the case with JITAP, which did not explicitly address the trade-poverty linkage.
- Insufficient donor co-ordination and complementarity at the headquarters and the field level. This also holds true for multi-donor schemes, such as the JITAP and the IF. These schemes nevertheless contributed to a more co-ordinated and consistent approach amongst donors and international organisations.
- Inadequate internal communications and donor expertise on trade-related matters. Field mission staff, in particular, often lack a good understanding of trade's potential role in poverty reduction, or on how to support the trade policy process in the partner country.

In the conclusion of the OECD researcher group, the evaluations show that improvements are required, in particular in aid programming, donor harmonisation and donor-recipient partnerships. The basic principles for effective aid delivery as set out in the 2005 Paris Declaration on Aid Effectiveness should also be taken seriously in trade-related assistance. Partner country “ownership” should be ensured, the OECD researchers say, and the means for this are wide stakeholder dialogue and activities based on a sound, consultative diagnosis. Collaboration with all relevant stakeholders in the partner country must be strengthened during design, delivery and review phases. An understanding of initial internal and external conditions is essential before implementing trade-related assistance programmes; also essential is the existence of both a favourable domestic business environment, and the political will to use trade as an engine for development. Other factors, such as adequate governance, market access and international competitiveness, also greatly influence the effectiveness and impact of AfT.

2.2 Enhancing the Integrated Framework

The above criticisms covered both bilateral and multilateral undertakings. For the Integrated Framework specifically, a WTO-led Task Force assessed the benefits and shortcomings of the IF and communicated the results of their study in late June 2006. The Task Force found that, although generally the IF has been “a good framework”, there are still “significant shortcomings” in the process. They were identified as:

- General failure to mainstream trade into the PRSP process;
- Lack of adequate financial and human resources provided to the LDCs to ensure delivery of the intended outcomes;
- Lack of LDC country ownership of the process;
- View that the process has been slow;
- View that the success in moving from the diagnostics and priority-setting of the IF to investments by the donors and agencies under their permanent programmes has been relatively low (WTO, 2006a).

Thus a main problem was seen in the gap between the recommendations made in the DTIS process and their implementation. As a result of the assessment, the IF is being revamped. This revamped IF has been dubbed the Enhanced Integrated Framework (EIF) for which Draft Guidelines were published in May 2007 (IF, 2007). These Guidelines include the *modus operandi* of financing arrangements, and the roles of the different bodies with the responsibility for implementation and governance of the EIF process.

Financing is divided into two “tiers”. The Tier 1 financing arrangement is meant for the core functions of the IF with the objective of facilitating greater in-country capacity and ownership. Its aim is to build the human resource capacity of the IF National Implementation Arrangements (NIAs) and provide operational support to them; as well as prepare and/or update the LDCs’ DTIS and facilitate and support trade mainstreaming actions (into national PRSPs). The Tier 2 financing arrangement is “aimed at providing bridging funding to jump start project related activities identified in the DTIS, its update, and its Action Matrix, such as small priority projects, project development activities, feasibility studies and seed projects.” It is emphasised that funding for large infrastructural projects is to be sought by other means.

The Tier 1 arrangement is budgeted for an estimated amount of US\$77 million with a US\$2 million ceiling per LDC country. The money is allocated for a 5 year period. This period includes the money allocated for the DTIS process (up to US\$0.65 million) and the National Implementation Arrangements (up to US\$0.3 million) per year. For Tier 2 interventions, the IF Task Force estimates that a total amount of US\$320 million would be available for all LDCs. The Integrated Framework Trust Fund (IFTF) would fund approximately US\$160 million with a US\$12 million price ceiling per country. The bilateral donors are expected to meet the other half of the total. The hope is that in the future the donors’ commitments to the IF would involve an increasing share of the costs of the interventions.

Both Tier 1 and Tier 2 are to be executed either by the Government (Option 1) or by one of six core agencies (Option 2). For Tier 2 other relevant NGOs are also included for Option 2. For both Tier 1 and Tier 2 financing, the day to day monitoring

agency responsible is the National Implementation Unit or Focal Point (most likely the government of the LDC), which reports twice a year to the National Steering Committee, the Donor Facilitator and the Executive Secretariat.

Although some of the modalities of the EIF are still being discussed, it is now clear that the IF process will have a more influential role for the provision of trade-related aid for LDCs.

3. Discourse on trade and development

Although controversy surrounds the relationship between international trade and economic development, one suggestion seems safe: trade is a necessary, but not sufficient condition for development. Every country has engaged in trade; but not all have grown rich from it. The question is not “to trade or not to trade”, but “what to trade” and “how to trade?” Much of the controversy is about trade policy and in particular trade liberalisation: to what extent should trade be left “free”, i.e. entrusted to the market forces unencumbered by state restrictions, and how much and what type of state intervention is feasible or desirable? Views on this have been, and continue to be, widely disparate; and there is no consensus in sight.

The discussion necessarily circles around economics and economic models, as economics as a discipline is one of the staunchest champions of free trade. It is one of the basic tenets of modern economics that free trade is welfare-enhancing. Yet this has been disputed on several grounds, both within and outside economics. The theoretical bases of this assertion are complex and contested; and when applied to the real world, empirical evidence for it is at best inconclusive. Mainstream economics operates with models with more or less simplified assumptions. In practice the choice facing most countries is not the binary one between completely free trade and autarky (no trade). Rather, the choice is along a spectrum of trade regimes with varying mixes of market forces and state intervention, something that is more difficult to capture by modelling. This also provides room for more heterodox approaches.

3.1 Free trade and its changing theoretical basis

Voluntary exchange is at the heart of economic theory. It is axiomatic in economics that economic behaviour consists of exchange, and any voluntary exchange is beneficial to all parts – otherwise rational actors would not engage in it. When people exchange something that they have more than enough of, for something that they need, but do not have, everybody ends up in a better position than before (Kanbur, 2002). When this idea is extended to the international level, it provides the normative case for free trade. Yet this simple argument hides a host of the most perennial problems

in economics. There has been much disagreement as to what exactly the benefits of free trade are supposed to be; and the presumed benefits have been seen differently in different times and by different people.

The origins of the mainstream theory of international trade are usually credited to Adam Smith (*The Wealth of Nations*, 1776) and David Ricardo (*The Principles of Political Economy and Taxation*, 1817), although they saw some basic issues quite differently and the theory has since then undergone several transformations. For Smith, the decisive factors were the spread of the division of labour and the extension of the market. When mercantilist restrictions were done away with and trading goods moved freely, everybody could produce and sell what was best suited to him. The market grew, the division of labour progressed, endogenous technological change advanced and increasing returns to scale set in. This applied both internally, in Britain, and internationally. But Smith did not work out a more systematic model to buttress his insights.

Modelling was left for Ricardo, who was more pessimistic and more methodological. He believed that economic returns to scale will necessarily diminish in the long run. However, this could be counteracted by specialising production internationally, by following what he termed the comparative advantage of each country. Ricardo took England's cloth and Portugal's wine as examples. He calculated that it was beneficial to specialise in both the production and export of those goods for which a country's labour force and its technology were best suited. The point was that such specialisation was beneficial for trade, even if the other country would have been more efficient in absolute terms in the production of all goods. Believing, like Smith, that labour was the source of value embodied in commodities, Ricardo calculated the returns in terms of labour time used in the production of the goods traded. Trade made it possible to exploit the differences in the countries' labour productivity using different technologies. Thus the same amount of labour produced a larger total output.

The neoclassical economists retained the notions of comparative advantage and mutual benefit under free trade, but they transformed its theoretical basis. The labour theory of value was abandoned and price – the actual market price – was taken as the guiding concept. People were understood as Benthamite utilitarians maximizing their pleasure or utility. The act of exchange was seen to take place in equilibrium, where demand at a given price equals supply at the same price. The concepts of marginal utility and opportunity costs were brought in, and the assumption of the variation in technology was removed. Diminishing returns were changed into constant returns; i.e. it was assumed that if inputs were doubled, output would double as well. These operations demolished almost every basic notion of Ricardo except comparative advantage, and left the existing resource endowments as the basis of economic theory, instead of labour costs.

In the neoclassical view, it is beneficial for each country to specialise in the production and export of a good (product) for which it has the best endowments: a land-rich country should produce agricultural goods and a labour-rich country should specialise in the production of industrial goods. If each country would follow its comparative advantage, production and consumption would be optimized at the global level. This will result in what is called Pareto-optimum – a situation where nobody's position can be improved without somebody else's position deteriorating. This was the core of what became known as the Heckscher-Ohlin-Samuelson version of the neoclassical free trade doctrine.

Whereas all this could be logically proved with elegant mathematical models, it soon turned out that the models worked only under assumptions that were overtly restrictive, and seldom, if ever, were fulfilled in the real world. The proofs operated with a few basic goods. It was assumed, for instance, that resources such as labour and capital were fully employed and internally mobile within a country, but they were internationally immobile. Additionally, this all happens under the conditions of perfect competition and perfect information. By changing some of the main assumptions, the opposite could also be proved: that free trade was Pareto-inferior to autarky. Everybody is thus made worse off (Stiglitz and Charlton, 2005: 26).

From the early 1980s onwards, a new generation of models of international trade, which became known collectively as the New Trade Theory (NTT), set out to seek more realistic assumptions. The models allowed for imperfect competition and imperfect information, and product differentiation, i.e. the process of the modification of a product to make it differ from other similar or comparable products. Some models even tried to accommodate international capital mobility, which began to increase in the 1970s. When these models were applied to intermediate goods, they could be used to tackle newly emerging phenomena such as the increased outsourcing and geographical fragmentation of production.

Perhaps the most significant change brought by the new wave was the abandonment of the assumption of constant returns, and the insight that international trade creates scale economies leading to increasing returns. This was a return to the spirit of the original Smithian idea of trade advantages being additional and dynamic rather than comparative and static. So when the market expands, it provides opportunities for all involved to gain from the specialisation and exchange of knowledge. Thus the total production rises and everybody wins. International trade is especially beneficial for small countries, which would not be able to enjoy economies of scale on their own. The location of the activities is determined more by historical forces or sheer accident, and less by relative comparative advantages (Krugman and Obstfeld, 2006: Ch. 6).

The new “revisionist” models can be used to support free trade, but interestingly they can also be, and have been, used to challenge it. They no longer assume that the gains from trade liberalisation accrue automatically through economies of scale. They

also depend on whether the resources within a country are shifted from sectors of low productivity to sectors of higher productivity. It is conceivable, and empirically validated, that trade liberalisation can block the production of a poor country in lower-productivity sectors, where the short-term comparative advantage seems to lay.

In spite of such theoretical advances, most of the general equilibrium models that are used to estimate the impacts of trade liberalisation continue to rely on the general neo-classical assumptions of e.g. full employment of resources, perfect competition, perfect information and well-functioning markets. As argued by Sunanda Sen (2005), it seems that old neoclassical thinking continues to inform the promotion of the cause of free trade. This especially pertains to the influential institutions such as the WTO, the IMF, the World Bank; such thinking and such promotion of free trade is applied in the developing countries. On the other hand, variants of NTT models are called in to advocate more interventionist trade policies in the developed countries. These interventionist policies include subsidies, and research and investment in emerging infant industries of the future such as clean energy.

Yet, as revisionist economists like Joseph Stiglitz have noted, the neoclassical assumptions are of questionable validity for any country, and they are particularly problematic for developing countries. If unemployment and underemployment are high, the sectors of higher productivity are not just waiting for labour to be released from low-productivity sectors. In practice, trade liberalisation often leads to the opposite result: it harms competing local importing industries and transfers labour from low productivity sectors to the no-productivity sector – i.e. it causes unemployment. Liberalisation also increases risks, as the international markets are much more volatile than the internal ones, and means to hedge against them do not exist. Stiglitz is by no means against liberalisation, but he speaks for a slow pace and careful sequencing (Stiglitz and Charlton, 2005: 71, 25-26).

One of the simplifying assumptions in most of the above models is that the price is all that matters, and the price mechanism encapsulates the required information about a product. This obviously is not what happens in real economies; indeed current economic dynamics can be seen to be “based on an obsession with quality” (Gibbon and Ponte, 2005: 168). Attempts to correct this and bring quality considerations into economic analysis have been made within the neoclassical approach by introducing information asymmetries, but a frontal attack has been left to a very different body of work called convention theory. It goes outside the realm of “pure” economics and introduces broader social considerations into economic research, using quality as a fundamental concept in its endeavours (Wilkinson 1997; Renard 2003; and Gibbon and Ponte 2005: Ch. 6).

In convention theory, quality is seen as a key for understanding the emerging competitive strategies as markets function on the basis of principles of “product qualification.” But there are no universal standards of quality. This is where the idea of

convention – i.e. mutual social expectations – comes in. Quality is seen as a social construct, which is constructed by means of differing conventions and related forms of coordination. Only when there is no uncertainty about the quality of a product, does price function as the main management form by reflecting quality. This is called *market* coordination. But if price alone cannot be used to evaluate quality, economic actors adopt differing conventions that are linked to other forms of coordination. In *domestic* coordination, uncertainty about quality is solved through face-to-face relations, trust, and private brands; in *industrial* coordination, an outside party steps in to determine common norms or standards and enforces them through testing, inspection and certification; and *civic* coordination relies on the adherence of a group of actors to collective principles (such as in Fair Trade).

3.2 Trade, development and history

Most of the models in economics, especially the standard neoclassical one, are static – they ignore time and history. They compare one “steady equilibrium state” with another, but do not deal with the mechanisms and processes of transition from one state to another. In other words, they treat trade as a one-time exchange which may, or may not, leave the participants better off in terms of short-term utility. But, they have little or nothing to say of the contribution of trade to long-term processes of growth and development, which trade transactions are implicitly based upon, as well as occurring within. And those who have dealt with this question, such as the classical political economists, Smith and Ricardo, have assumed that international trade leads to convergence rather than divergence.

As this patently has not happened, a different set of notions has been brought forward to explain why not. They range from wild scenarios of world history to strictly focused mathematical models. All have in common the acknowledgement of the fundamental asymmetry in the starting points of the North and South, which go beyond mere resource endowments. This makes them see the role of international trade in a different light from mainstream economics. Many of them postulate that if trade is conducted from very unequal starting points, it tends to reinforce the inequalities rather than wipe them out, although they differ in their views of the possible causes for this. Such ideas went out of intellectual fashion in the 1980s, but now there are signs of a comeback.

The causal mechanism most commonly offered to produce and upkeep such inequalities, is the terms of trade argument, which relates to the relationship between a country’s export and import prices. It received its most famous expression in the Prebisch-Singer thesis, developed independently by Raúl Prebisch and Hans Singer in the late 1940s. It states that the terms of trade between primary products and manu-

factured goods tend to deteriorate over time, which means that countries that export primary commodities will be able to import less and less for a given level of exports.

This argument is contested. Some new empirical support for the theory has been found in recent research, yet some modifications have been made. The deterioration in the terms of trade for primary products is probably more selective, bumpy and discontinuous rather than all-encompassing and linear. But it is far from theoretically clear why this should be so. The reason usually mentioned is differing “income elasticity” of industrial and agricultural goods. With the increase of incomes, the demand for the former (e.g. cars) grows more than that for the latter (e.g. food).

Another early notion of the possible negative effects of terms of trade was the idea of “immiserising growth,” presented by Jagdish Bhagwati in 1958. Here trade-led growth may result in a country being worse off than it was before. This would be the case if growth is heavily export biased and leads to a fall in the terms of trade large enough that it outweighs the gains from growth. The theory presupposes that the growing country is able to influence world prices.

In addition to terms of trade, other mechanisms upholding global inequality have been proposed. Ragnar Nurkse stressed, in the 1950s, the role of agricultural protectionism in industrial economies as a factor contributing to the vicious circle of underdevelopment. In addition to deteriorating terms of trade, Singer added the outflow of funds to repay foreign investment. Gunnar Myrdal formulated his suggestive theory of cumulative causation – that is, of poverty creating poverty – in his work on the American black population, and extended it later to development economics. He warned that the “backwash effects” of development investment often overruled the “spread effects,” if any, without really explaining why.

There have also been attempts to more rigorously model trade and growth even in the North-South tradition (for an overview, see Darity and Davis, pp. 150-154). The pioneer here was Arthur Lewis, who in 1954 presented his famous model of growth with surplus labour. He later complemented it with a Ricardian trade model, where the higher productivity of the North twists the terms of trade in its favour. The Cambridge economist Nicholas Kaldor developed a world economy model which has since been given a variety of mathematical formulations. It is predicated on a structural asymmetry with respect to returns of scale. The North is seen as a manufacturing region featuring increasing returns, while the South is the primary goods producing region with decreasing returns. Although the region with falling costs, the North, should face deteriorating terms of trade, it has been shown that under quite plausible conditions a world with Kaldor’s features will generate persistent relative poverty in the South.

At the other end, the work of Prebisch and Singer spawned a dependency approach. This approach sees the world divided into a rich core and a poor periphery, and explains both the wealth of the former and the poverty of the latter, as the histori-

cal result of global exploitation. Basically, what is meant by exploitation is the long-term transfer of resources from the South to the North, due to the different ways the countries have integrated into the world system. Trade and terms of trade are high on the list of assumed vehicles of transfer, but it is also seen as taking place in many other forms. Potential vehicles span from outright plunder and end with the most subtle accounting mechanisms within multinational corporations such as the use of transfer pricing. This approach quickly divided into diverse schools. Some lean towards revolutionary neo-Marxism (Andre Gunder Frank), and others keep the possibility of liberal reform open (Fernando Henrique Cardoso). Some, like Samir Amin, went as far as to advocate the “delinking” of poor countries from the world economy.

Theoretically the most ambitious notion stemming from this tradition is that of unequal exchange. The evocative concept was coined in the early 1960s by the Greco-French economist Arghiri Emmanuel. It is akin to the well-known principle of “buying cheap and selling dear,” but extends this idea to the South-North trade as a whole, and relies on the concept of value instead of price. The theory brings back the labour theory of value, now in its Marxian form, where labour power is seen as a commodity having value. A commodity, or a set of commodities, is seen to be bought below its value in the South and exchanged with something that is sold above its value in the North. In this way, an exploitative relationship is formed as “value” is transferred from the South to the North through trade.

Emmanuel himself argued that capital was mobile and the rate of profit tended to equalise internationally, whereas wage levels continued to vary nationally as labour stayed immobile across the borders. In the mainstream, and in most Marxist economic thinking, differences in wages were seen to reflect differences in productivity, but Emmanuel disagreed with this notion. Instead, he saw differential productivity as a “conjunction of Western productivity with ‘exotic’ wages” (Emmanuel 1972, 70). In his view, it must have been the politically and historically set wage levels that determined relative prices, and not the other way around. This was a politically explosive idea in particular for the left as it put much of the blame for exploitative unequal exchange squarely on the Northern trade unions, which have been driving the Northern wage levels relatively higher from the South. Most of the subsequent versions of the theory preferred to keep to a more Ricardian line, and saw the higher productivity in the North as the cause (and thereby justification) of higher wages. In this case, the blame for any unequal exchange falls on the machinations of the multinationals.

3.3 Trade openness, growth and poverty

As the above, very selective and highly condensed, overview shows, theoretical arguments abound both for and against free trade. The problem for policy makers is that

they have to choose whom to believe: which of the arguments carries enough weight to be acted upon? If everything can be logically shown, does it mean that nothing can be empirically believed and acted upon? (Srinivasan and Bhagwati, quoted in Stiglitz and Charlton, 2005: 33) We obviously need to turn to empirical evidence in order get some more elucidation on the effect of trade and trade liberalisation on growth and poverty reduction. But, hardly surprisingly, here again the record is mixed – empirical studies cannot be left unaffected by their theoretical basis.

In studies undertaken in neoclassical fashion, the case for a positive relationship between trade and growth seems to be well established. A number of influential papers (such as Dollar 1992; Sachs and Warner 1995; Edwards 1998; and Frankel and Romer 1999 – see the overview by Darity and Davis, 2005: 145) purportedly showing the connection, are repeatedly referred to. Later studies by the World Bank economists, especially David Dollar, seem to have confirmed the relationship. Yet, there is a lot of doubt about the conclusions of these studies, especially among the revisionists, but also among the more mainstream economists, lately within the World Bank itself. As Stiglitz and Carlton state: “it is difficult to establish the evidentiary source of the bullishness for unqualified trade liberalisation” (Stiglitz and Charlton, 2005: 34).

The evidence that trade openness would lead to sustained poverty reduction, which has been taken as the prime goal of global development policy, is even thinner. Martin Ravallion (2006), a World Bank economist, has recently investigated this using both macro- and micro evidence, mainly from China and Morocco. His overall conclusion is that whatever approach is used, it “casts doubt on any presumption that greater openness to external trade is the key to rapid poverty reduction.” However, he does not find any more evidence for the opposite view that trade openness hurts more poor people than it helps. Rather the impacts seem to be varied. Rural families tend to lose and urban households tend to gain; and the impacts are much more pronounced in some geographical areas than others.

The long-term historical record is also mixed. As is well known in economic history, and as Ha-Joon Chang has recently reminded us, almost all today’s developed countries grew behind tariff walls and used other extra-economic means when creating a competitive environment for industry at home, before championing trade liberalisation globally. In Chang’s words, when the current developed countries were in catching-up positions, they

“protected infant industries, poached skilled workers and smuggled contraband machines from more developed countries, engaged in industrial espionage, and wilfully violated patents and trademarks. However once they joined the league of the most developed nations, they began to advocate free trade and prevent the outflow of skilled workers and technologies; they also became strong protectors of patents and trademarks” (Chang, 2002: 64).

The theoretical basis for historical protection was provided by the 19th century German economist Friedrich List, with his infant industry argument. He saw broadly three developmental stages of trade integration, which depend upon the level of industrial development of a country. A predominantly agrarian society will initially benefit from free trade, due to it being exposed to new technologies and goods from a relatively more developed nation. At the second stage however, to improve its terms of trade, the agrarian country will want to develop its own industrial capacity. The development of this new industrial capacity, now known as the “infant industry” stage, necessitates protective measures from foreign competition and the importation of the means of production and know-how from abroad. At the third stage, as the home industry has matured from domestic competition, it is beneficial for that country’s further industrial development to seek new markets from abroad via freer trade.

This was an appealing argument for many Third World policy-makers, and attempts to build up infant industries were widely taken in the 1950s and 1960s to form import-substituting industries. Most of these infant industries collapsed sooner or later, at the latest from the oil shocks of the 1970s and the subsequent debt crisis. Much has been made out of their failure: it seemed to show that the drive to modernization through industrialization had reached a dead end. Yet it should be noticed that orthodox free trade prescriptions did not fare much better. Few if any of the actual success stories of economic development that was able to move into the export industry phase ever followed them. As stated by Stiglitz and Charlton, there can “be no doubt that the successful cases of development over the last fifty years have pursued inventive and idiosyncratic economic policies. To date, not one successful developing country has pursued a purely free market approach to development.” (Stiglitz and Charlton, 2005: 17)

The East Asian tiger countries followed a two-track policy of protecting industries not ready to compete internationally and promoting industries ready for export. Countries like Vietnam and China have also pursued active industrialization policies and liberalised trade and investment much more cautiously than demanded by free market advocacy.

The counterargument here is that Vietnam and China nevertheless *have* liberalised and there is nothing to show that the blatantly interventionist policies historically adapted by the Northern and East Asian countries would have been the best possible policies for rapid economic development – perhaps they developed in spite rather than because of them. But at least the evidence shows that public action and state intervention is not only compatible but even conducive to economic development, when it is properly mixed with regulation and the promotion of markets. This evidence suggests that much more discussion should be devoted to the forms and pre-conditions of such intervention.

4. Modelling the Economic Impact of Doha Trade Liberalisation

A group of economic Applied General Equilibrium (AGE) or Computational General Equilibrium (CGE) studies have recently been done in order to assess the potential economic impact of the WTO Doha round, trade liberalisation. The AGE and CGE models are based on neo-classical 'marginalist' economics. They are generally used as heuristic devices in order to capture and isolate the impact of tariffs and subsidies on trade, while leaving out other economic phenomena.

The results of these exercises vary greatly. Common to these models is that the biggest gains stem from the complete global liberalisation of agriculture. Anderson and Martin estimate a boost of nearly \$300 billion to global welfare by 2015, when all trade in merchandise and agricultural subsidies are freed. The high income countries gain the most in absolute terms, but developing countries gain disproportionately more in relation to their share of world trade. This World Bank model has been criticised for using overtly optimistic assumptions, which overstate potential gains. An IFPRI study estimates a much lower \$100 billion net gain from global agricultural liberalisation (Bouët, 2005). The current Doha discussions however, do not involve such an ambitious scope.

Vyborny (2006) summarizes the recent AGE-contributions assessing the more realistic Doha policy outcomes (including the above models). This study cites net global gains in the range of \$32-\$55 billion. The consensus among these models is that the developed countries gain the most, the middle-income countries gain second, while some of the least developed economies come out as net losers.⁵ Tanzania and Zambia are either in the modest winner or net loser groups. The IFPRI model, which specifically includes Tanzania, and Zambia, indicates a slight welfare increase of between \$20-\$100 million (0.2%-0.5% of GDP) for Tanzania. For Zambia the welfare increase is less evident, being between \$0-\$40 million (-0.1%-0.7%). (Vyborny, 2006: 6).

Vyborny argues that, due to these modest gains and in some cases losses for LDCs, there needs to be a comprehensive development package in order for the round to be a global win-win-win solution. The reasoning is that the Least Developed Countries will nevertheless lose out, if they do not get access to the most sensitive agricultural markets in developed countries. This argument coincides with the official justification for the need for Aft.

The reasons cited in the report for the small gains or net losses for LDCs were: the

⁵ The studies include: the World Bank's Anderson and Martin model; the French think tank's Centre d'Etudes Politiques et Informations Internationales (CEPII) model; the International Food Policy Research Institute IFPRI model; and the Carnegie Endowment's model.

small absolute size of the LDC economies, which limits the immediate amount of gains to be had from trade; the impact of preference erosion, as the LDCs lose preferences with respect to other developing countries; the uncompetitiveness of LDC economies with respect to other economies; the effect of the rise of world food prices on net importers of food when subsidies in developed countries are cut; and the fact that if the most sensitive agricultural products including meat, sugar, tea, coffee, cocoa, oilseeds, tobacco and beverages are not globally liberalised under the more realistic Doha projections, the majority of the gains are achieved through manufacturing (a capacity that LDC economies proportionately lack). With respect to the last point, the question is what would an appropriate development package consist of in order for the LDCs to reap benefits from the opening opportunities for manufactures trade? Would the solution be consistent with respect to globally liberalised markets? Vyborny's model summary does not offer any analytical solutions to these problems.

A recent paper not outlined in Vyborny's work but worth mentioning is Hertel et al's (2007) paper on the distributional impacts of WTO agricultural trade liberalisation. It relies on the latest GTAP 6.1 data, and household surveys done in developed and developing countries. The results of the research echo the above findings with more precision. Hertel points out that full agricultural liberalisation of only the rich countries improves welfare for developed countries, but decreases welfare for some net food importers such as Bangladesh or Zambia. In Zambia's case the lower income group within Zambia loses relatively more to the rich in Zambia with full liberalisation. This is because a relatively high proportion of Zambia's poor live in urban areas, and urban Zambia is a net food importer. A more limited Doha liberalisation would also be welfare decreasing for Zambia, but to a lesser extent.

Although the above problems cited are echoed by other findings, the results of these models should still be treated with caution. There are 'knowledge gaps' that practising modellers would readily accept, and more fundamental problems with neo-classical trade theory itself. The 'knowledge gaps' generally referred to in the literature are: the lack of appropriate accounting data in the GTAP database, the difficulties with modelling dynamic effects of foreign investment economies of scale and technology; the difficulties with choosing appropriate elasticities including the Armington assumption, the lack of proper assessment of adjustment costs and the lack of measuring the financial impact of trade liberalisation.

Although these are serious difficulties by themselves, there are even more fundamental problems with neo-classical trade theory that have sparked long-lasting discussion. These include the problem of the existence of equilibrium and restriction and assumptions needed for the convergence of supply and demand; the theoretical problems with using the capital concept, and the static nature of neoclassical economics. An acceptance of any of these more fundamental criticisms calls for a paradigmatic shift

from the basic methodological premises of ‘instrumentalist’ neo-classical economics, which either practising modellers do not accept or are unaware of.⁶ The CGE-models may provide figures that appear sound, but neo-classical economic theory does not necessarily provide comfort that the answers are built on a solid foundation.

5. Value chain approach

Much of the above discussion has been conducted in terms of “countries” trading among themselves with finished goods. If such an idea was accurate at any time, that time is long gone. Goods are designed, produced and marketed in long value chains, or networks, which commonly cross the borders. Such chains are coordinated and regulated primarily by business firms, mostly by large transnational corporations. A focus on value chains opens up new questions e.g.: how are such chains governed and controlled; whether they are driven more by producers or buyers; where the different stages in the production are geographically located and which factors affect the decisions concerning this; and above all, how much value each of the stages adds to the final product. The role of trade must also be seen in a different light. It cannot any longer be taken as an isolated, discrete and individually optimising activity. Rather, it is embedded in and to a considerable extent determined by, institutional structures (Raikes, Friis Jensen and Ponte, 2000: 394).

‘Value chain’ can be defined in a looser or stricter way. It can refer to a huge range of activities and transactions that are global in every sense of the word, to fairly restricted sets of production and distribution activities within one company or branch. In this report, we follow Kaplinsky and Morris, and take the term to refer to the “full range of activities which are required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use.” (Kaplinsky and Morris, 2000: 4). These activities include for example design, production, marketing, distribution, support to the final consumer, and governance of the whole process (Gibbon and Ponte, 2005: 77). Usually the value chain is depicted as a vertical chain with interlinking nodes of value added activity, but in reality the links between firms can be quite complex and do not necessarily take a vertical shape. For example a bank might influence and have transactions with all the economic agents in a given value chain.

There are different conceptions and traditions of value chain analysis. Global

⁶ For more on this type of literature and the search for economic alternatives, the reader is advised to begin by consulting: <http://www.paecon.net/>

value chain (GVC) analysis, pioneered by Gary Gereffi and his collaborators, and the global production networks (GPN) theories of the Manchester school, are analytical tools from the political economy strand of value chain theory. The main questions that these theories attempt to answer is how economic actors have integrated into the world economy, what are the distributional benefits that the economic actors are receiving, and how can the terms of integration be altered in a more equitable way (Kaplinsky and Morris, 2000: 1-2).

A much more managerial approach has been espoused by Michael Porter, whose focus is in analysing the determinants of competitive advantage at the level of a firm. Porter argues that “gaining competitive advantage requires that a firm’s value chain is managed as a system rather than a collection of separate parts. Reconfiguring the value chain, by relocating, reordering, regrouping, or even eliminating activities is often the root of a major improvement in competitive position.” (Porter, 1990: 42). This point of view, although limited from a social scientist’s perspective, has garnered a lot of influence in managerial circles.

The GVC and GPN theories offer a dynamic perspective for decomposing total value earnings into the rewards achieved by the different parties in the chain, or network. This is in contrast to the traditional static sector analysis, which has been bounded by a traditional state centric outlook. The GVC and GPN theories can be used for analysing the links of particular firms, regions and countries in the global economy (which provide the context for upgrading possibilities), and to identify normative levers which can be used to alter the existing distributive patterns.

GVCs and GPNs differ from traditional economic analysis in the sense that they throw more light on the determinants of income distribution and the systemic properties of each actor within the value chain. “It is only through a comprehensive view of the whole chain that the links in the chain or segments in product markets which are characterised by high or growing rent can be identified.” (Kaplinsky and Morris, 2000). Once the value of each component within the value chain or network is identified, one can begin to evaluate the reasons for its value. Then one can begin to identify ways of addressing the systemic properties of the value chain by looking at each actor’s place within the value chain and the options and requirements for upgrading to higher value added activities.

Common elements to both GVC and GPN theories are their focus on three principal conceptual dimensions. They include an *input-output structure*, *territoriality* and *governance* structure for the GVC, as well as concepts of *value*, *embeddedness* and *power* for the GPN.

An *input-output structure* for the GVC is defined as a set of products and services linked together in a sequence of value adding economic activities. For the GPN, *value* is conceptualised in terms of how value is created, enhanced and captured within

the production network. In methodological practice, accounting for a GVC involves a decision whether to completely account for all the items of value for a given commodity vs. a narrow accounting of only the elements of value that require some sort of overt coordination among the different stages of the chain (Wood, 2001: 3). The GPN is open to the usage of both mainstream economic and Marxist interpretations of value: in the former, value is practically equated with price; while in the latter, it is calculated in terms of labour time necessarily needed in production, and its costs.

Territoriality for the GVC is defined as the spatial dispersion or concentration of production and distribution networks, comprised of enterprises of different sizes and types. **Embeddedness** for the GPN is a more holistic concept extending out from the enterprise level to the societal sphere in which the enterprises are embedded, and which influence the strategies of the enterprises, and the values, priorities and expectations of managers, workers and communities. It is recognised that, globally, the nature of these arrangements vary (e.g. education, training, labour systems, sources of corporate financing, the nature of state policy and legal framework), and have influence over the forms that capitalism takes.

The **governance** structure in the GVC refers to the relationships of authority and power that determine how financial, material, and human resources are allocated and flow within a chain. Within the GPN framework, the three forms of **power** that are deemed significant are corporate, institutional, and collective spheres of power. Corporate power is understood as the capacity to influence decisions and resource allocations; this is power held by the lead firm over the other firms of the network. Institutional power refers to the multitude of local, state, and international institutional arrangements that exist and influence GPNs. Collective power is understood as the actions of collective agents who seek to influence companies at particular locations in GPNs, their respective governments and international agencies. Power is not a zero-sum game, but it is recognized that asymmetries exist (Gereffi, 1994 and 2005, and Henderson et al. 2002).

Kaplinsky and Morris of the GVC tradition also draw attention to the more familiar concepts of **economic rent**, and **barriers to entry** as additional conceptual tools to explain how the differences of the benefits in the value chain are accrued. This is another way of conceiving embeddedness and value. Rents arise through differential productive capacity, or the control of key knowledge or resources, which for competitors can act as a barrier to entry into the markets. In practise there can be a variety of areas where rents can be accrued including factor, human resource, technological, organisational, marketing, policy, financial rents etc. A focus on these rents, and the mechanisms or institutional relationships through which the rents are accrued, can be an important point of investigation for the GVC (Kaplinsky and Morris, 2000). This focus can identify for example, whether the relations are just, and whether they can

be manipulated through possible intervention. Naturally in practise different value chains will embed different combinations and strengths of economic rents or barriers to entry, and the importance of this distinction will thus vary.

The main difference between the Gereffi et al. inspired GVC and the Manchester school GPN is that the latter has a broader outlook. The GVC theory mainly stays on the firm (company or enterprise) level and tries to assess the dynamics of inter-firm relations. The GPN on the other hand explicitly attempts to focus on the global big picture. It tries to take into consideration all the relevant factors that are external to firms, but may have an effect on their behaviour and performance. The limitations of the GVC are that by only focusing on inter-firm relations, essential preconditions influencing firm behaviour grounded in society may be missed. The GPN suffers from diminishing conceptual clarity with increasing scope. Once the big picture is taken into consideration, it becomes increasingly complex to assess the interrelationship of all the conceptual components of the production network.

5.1 Value chain governance and international trade

The analysis of governance is a key component in value chain analysis. It is also a complex and controversial subject. Basically the issue is who coordinates the chain and on whose conditions it functions. In 1994, Gereffi et. al. originally used the term 'global commodity chain' (GCC) and divided it into producer- and buyer-driven chains to analyse their governance structure. When these terms were criticized, the term "commodity" was replaced with "value," which was thought to better encapsulate both tangible, and intangible value-adding activities. In addition, a more detailed and dynamic typological characterisation for types of value chains was also introduced by Gereffi. He conceptualised governance forms into market based, modular, relational, captive and hierarchy. The distinguishing factors were seen in the degrees of the complexity of transactions, ability to codify transactions, and the capabilities in the supply base (ranked either high or low). Still, many theorists have remained with the simple division of producer- and buyer-driven chains, as they seem to capture the most essential characteristics of the activities.

'Producer-driven value chains' refers to those industries where control of the production system is established by hi-tech transnational corporations or enterprises. This typically includes capital, and technologically intensive industries such as electrical machinery, automobiles, computers and aircraft, that operate within oligopolistic competitive environments. Control of the technology and business know-how is centralised in the administrative headquarters of the home country, and production of components is typically externalised to developing countries via sub-contracting agreements where competition is high and profits are low. The profits of the head-

quarters are garnered through the level of earnings received from scale economies and technological rents, and from the ability to exert control over backward linkages with raw material and component suppliers, as well as forward linkages into retailing. These are managerially and technologically highly sophisticated processes, which we do not have among our examples.

'Buyer-driven value chains' in Gereffi's analysis refers to industries where large retailers, brand-named merchandisers, and trading companies from developed countries, play the main role of setting up decentralized production networks in developing countries. Within this trade-led pattern of industrialisation, exercise of power is established through significant investments in brand advertising and product development, and through efficient computerised management of the delivery of goods. The division point of governance for the buyer-driven chain is exercised at the point of consumption, while for the producer-driven chain it is at the point of production.

The production of the consumer goods in buyer-driven chains is usually labour intensive, and decentralised and outsourced to developing countries. Typical goods in buyer-driven value chains would be garments, toys, footwear, consumer electronics, housewares and a wide range of hand-crafted items (like furniture, ornaments, and costume jewellery).

Whereas in producer-driven value chains only parts and components are subcontracted, in buyer-driven networks finished goods are subcontracted under original equipment manufacturer (OEM) arrangements. Within these arrangements the branded companies supply the specifications and design of the goods to the manufacturers. The chains are viewed as being run by lead firms for whom suppliers at different levels work.

Profits in buyer-driven chains are derived from unique combinations of high-value research, design, sales and marketing within their respective evolving niche markets. This gives the branded merchandisers a strategic role as brokers between the factories in developing countries and the consumers in developed countries. The branded merchandisers' role is to manage the production and trade networks to make sure that all the pieces of the business come together as an integrated whole (Gereffi, 1994: 97-104).

Global value chain analysis has its origins in Marxist-inspired world systems theory (Hopkins and Wallerstein, 1986); and one of its distinguishing qualities is its embeddedness in an institutional environment, and its inclusion of aspects of power in economic relations and transactions, which are commonly overlooked features in standard economics (Gibbon and Ponte, 2005: 84-85). Yet value chain analysis as such is by no means committed to one particular way of thinking and as an empirical tool it can be employed in connection with widely differing theoretical approaches. Porter's firm-level quest for specific competitive advantages, for instance, is quite far removed from global analysis by Gereffi et al.

From the point of view of this study a major question is: which of the trade theo-

ries reviewed above could best account for the emergence of global value chains, and could help provide policy guidance for developing countries? The theory of the comparative advantage of developing countries with an abundance of inexpensive labour might seem to make sense; but then the neoclassical assumptions of capital immobility and full employment must be dropped, because otherwise they will make a mockery of any predictive presumptions of the model. Similarly, the notion of comparative advantage will hardly be enough on its own.

Quality considerations play a decisive role in the functioning and control of value chains. Notions of different forms of coordination employed by convention theory have also become relevant, and have been employed in value chain analyses, although their immediate contribution might not always be evident.

Arguably there are reasons to take unequal exchange, or some version of it, out of the mothballs of trade theory. The sourcing decisions within the value chains are made largely, though not only, by considering wage differentials. When Northern multinational companies shift production from high-wage to low-wage countries and bring the goods back to the former to be marketed, they exploit the historically and socially set wage and price differentials between these countries. Branding endows them with oligopolistic rent-yielding market power, and as long as surplus labour exists globally, production can be relocated further. This weakens the negotiation power of subcontractors and workers (cf. Heintz). Evidently underlying all this is the big issue debated by Emmanuel and his critics back in the 1960s: are the persisting international wage (and price) differentials to be understood as reflections of the differences in productivity, or are they due to extra-economic social and political forces that have been historically active in the North?

6. Background on Tanzania and Zambia

Although Tanzania and Zambia are both counted among the Least Developed Countries (LDCs), they represent economies of a different type. Zambia's export economy continues to be heavily dependent on one basic commodity, copper. There was a time when the exports of even unprocessed copper provided a fairly handsome national income, but since those days Zambia's economy has stagnated. Copper production has recently revived and steeply rising world market prices have provided some windfall gains, but the set-up remains extremely vulnerable. Tanzania has never been able to carve a significant place for any of its major products in the world market. Having traditionally been an agricultural producer, its export economy is now increasingly based on gold mining and tourism.

Both countries gained independence in the early 1960s and followed what have been

generally regarded as socialist-inspired economic policies for the next two decades. In Tanzania, a combination of external shocks and internal inefficiencies led to a serious economic crisis in the early 1980s, triggering a change in the country's economic and trade policies. Zambia's over-reliance on copper exports became unsustainable with dwindling copper prices, beginning in the 1970s, and the government became heavily indebted to international donors and lenders. Both countries began embracing trade liberalisation, privatisation and diversification policies, as influenced and conditioned by the donors and the lending agencies IMF and World Bank. The main instruments of these policies were the Structural Adjustment Programmes (SAPs) of the 1980s and 1990s, and the current Poverty Reduction Strategy Papers (PRSPs).

As can be seen in Table 2 below, since the 1990s, Tanzania has experienced better GDP growth than Zambia. Tanzania began its economic reforms in the late 1980s, while Zambia began its reforms in 1991 when multiparty Democracy was established in the country. These reforms entailed: macroeconomic stabilization; trade liberalisation; privatization of state owned enterprises; liberalisation of the financial sector; implementation of a market oriented regulatory framework; and generally progressive improvement of the business environment. Following the reforms, Tanzania's economic growth accelerated from 3.6% in 1995 to 6.8% in 2005 and 6.2% in 2006. At a current estimated total population of some 37 million, Tanzania's GDP per capita in 2005 was USD 317.8, up from USD 177.1 in 1995.

Zambia continues to depend heavily on copper for its exports, while about 50% of Tanzania's export revenues are derived from gold and tourism. This may appear as being undiversified, but Zambia's exports of non-traditional agricultural products have increased substantially from 1990 onwards; and for Tanzania, tourism is a growing industry that has overtaken agriculture as a leading strategic export sector. Tanzania has even slightly increased its relative share of world trade from 1990 to 2001, to about 0.02%. Zambia's share of world trade between 1990 and 2003 on the other hand has declined from almost 0.038% to 0.014%. Both countries' share of exports and imports from GDP show modest integration into the world economy, being an average of 21.5% exp/GDP and 28.3% imp/GDP for Zambia, and 16.7% exp/GDP and 24.7% imp/GDP for Tanzania between 2000–2005.⁷

An interesting similarity between the two countries' trade patterns is that South Africa has become the major source of imports for both countries (and exports for Zambia). In Zambia's case this has coincided with a substantial decrease in the EU's and Japanese share of Zambia's trade.

Tanzania has implemented prudent monetary and fiscal policies which has reduced the inflation rate from 36% in 1990, to 27.4% in 1995 and 4.4% in 2003. Zambia had

⁷ World Bank 2007, WDI Data Query: <http://devdata.worldbank.org/data-query/>

managed to maintain the inflation rate at around 4% for the past three years, until it started pushing upward to 5.8% in 2006 on account of a persistent increase in oil prices and the decline of food supply and hydropower generation associated with drought.

Yet basic poverty seems to persist in Zambia. Despite the economic reforms, between 1991 and 2000 the proportion of people consuming less than a dollar a day increased from 48.5% to 57.8% according to the MDGI.

Zambia remains one of the poorest countries in the world with 75.8% of her people consuming less than a dollar a day. For Zambia the 1990s was a decade of economic reforms and turmoil. During this time Zambia was turned into one of the most liberalised economies in Africa with substantial donor support. The early part of the decade was especially turbulent. Economic growth varied between 6.8 and 8.8% during 1990–1996, and the yearly inflation rate for these six years averaged 93%. Between 1997–2005 inflation averaged 23%. The economy grew consistently from 1999 onwards, averaging 3.0% per capita during 2000–2005. This was a reverse of three decades of economic decline in the country.⁸

Table 2. Tanzania and Zambia: GDP Growth 1980–2005

	Gross domestic product growth (%)		
	1980–1990	1990–2003	2000–2005
Tanzania	–	3.7	6.9
Zambia	0.8	1.4	4.7
Population growth (%)			
	1980–1990	1990–2003	2000–2005
Tanzania	3.2	2.6	2.0
Zambia	3	2.2	1.7
GDP per capita (% change)			
	1980–1990	1990–2003	2000–2005
Tanzania	–	1.1	4.9
Zambia	-2.2	-0.8	3.0
Proportion of population below \$1 (1993PPP) per day			
	1991	2000	2003
Tanzania	48.5	57.8	
Zambia	64.6	–	75.8

Sources: World Bank Development Report: 1998/99, 2005 and 2007, and UN Millennium Development Goals Indicators: <http://mdgs.un.org/unsd/mdg/Data.aspx>⁹

While economic performance has improved, some primary social development indicators show regress. According to the Millennium Development Indicators, during 1993–2003 both countries' average population living below \$1 a day has increased,

⁸ World Bank, Zambia DTIS 2005, IMF, 2007: www.imf.org

⁹ The population figures should be thought of as indicative. The Tanzanian census, for example, records 2.9% population growth for the years 1988–2002. See: United Republic of Tanzania, 2007

while the proportion of people undernourished has stayed about the same. Literacy rates fell, although more recently in Tanzania the number of children in primary schools has greatly increased.¹⁰

An important difference in the economic makeup of Tanzania and Zambia is that, while Tanzania's population predominantly lives in rural areas with 80% of the population involved in agricultural activities, Zambia is substantially urbanized.¹¹

6.1 Tanzania: Paving the way to trade openness

Tanzania has come a long way in liberalising its trade regime over the past two decades, as reflected by the decline of its IMF trade restrictiveness index rating to 5 (moderate) from 10 (restrictive).¹²

In the late 1960s, Tanzania embarked on a development strategy based on the afrosocialist ideology articulated in the 1967 Arusha Declaration. It was backed up by an import-substitution strategy, which had among its key economic objectives the promotion of heavy industry and achievement of self-sufficiency in food production. Two main instruments were employed in implementing the strategy. First, a series of ambitious investment programs, embodied in five-year plans, were mainly targeted at the expansion of the capital-intensive industrial sector, and infrastructural spending was undertaken. Second, a set of large state-owned enterprises (parastatals) were supported. They dominated most industries; had legal monopolies in the pricing, marketing, and processing of agricultural crops; and by the mid-1970s, had become the country's largest importers and exporters.

Throughout the 1970s, the government used trade restrictions as key tools for achieving its development priorities. Producers of export cash crops had to sell their products to marketing parastatals, which offered prices well below world prices. Ex-

¹⁰ <http://mdgs.un.org/unsd/mdg/Data.aspx>

¹¹ CIA World Fact Book (2007), <https://www.cia.gov/cia/publications/factbook/geos/tz.html>

¹² IMF (2005b), <http://www.imf.org/external/np/pp/eng/2005/021405r.pdf>: In comparison, it is interesting to note that economically successful Vietnam is the most trade restrictive country on the index. The IMF's Trade Restrictiveness Index (TRI) was first developed for use in the 1997 review of *Trade Liberalisation in IMF-Supported Programs*. The index was constructed to provide a baseline of each country's overall trade policy. The TRI consists of three components: The Overall Trade Restrictiveness Index, the Tariff Restrictiveness Rating, and the Nontariff Restrictiveness Rating. The tariff portion of the index consists of a 5-point scale, based on the simple unweighted average of a country's most-favoured-nation (MFN) applied tariff rates, plus any additional surcharges or fees which are applied only to imports. The nontariff component of the index consists of a three-point scale evaluating a country's use of nontariff trade restrictions (such as quotas, restrictive licensing requirements, bans, state trading, or exchange restrictions) based on the aggregate amount of trade or production affected. The overall trade restrictiveness rating is a ten-point scale arrived at by combining the Tariff Restrictiveness Rating with the Nontariff Rating (IMF, **Review of the IMF's Trade Restrictiveness Index**, 2005).

porters of other, non-traditional exports had to surrender most of their foreign exchange earnings and cope with a cumbersome and opaque system of export permits. Similarly, imports were regulated through administrative allocations of foreign exchange and an import-licensing system, both of which became increasingly restrictive towards the end of the 1970s as foreign exchange earnings declined.

By the mid-1980s, after the oil crises of the 1970s and other external shocks, it was generally recognized that Tanzania's overly restrictive economic policies were seriously undermining its economic performance. To address these issues, the government's 1986 Economic Recovery Program sought to reinvigorate the export sector by eliminating cost-price distortions and introducing import liberalisation measures.

Restrictions on the exports of non-traditional crops started easing during 1985/86. This commenced with a scheme allowing exporters to retain an increasing share of their export proceeds in order to finance their import requirements. By 1993/94, the system of export licensing was abolished; the requirement of registration of exporting companies eliminated and foreign exchange surrender requirements had been dropped. By the end of 1999, virtually all export restrictions had been eliminated.

The gradual recovery in Tanzania's exports led to a steady relaxation of foreign exchange constraints and facilitated the liberalisation of imports. An important step was the 1988 rationalization of import tariff rates, which reduced the trade-weighted average tariff rate to 23% from 35% in 1986. This reduction in the tariff burden was complemented during 1988–90 by two key liberalisation measures: the introduction of an open general license system under which import licenses were provided automatically for eligible imports; and the creation of the Own Funds Facility, under which import licenses were provided freely to importers that used their own foreign exchange holdings to pay for specified imports. The scope of these facilities remained limited, however, until a major intensification of liberalisation efforts in 1991–93 eliminated all administrative allocations of foreign exchange and abolished import licensing.

During 1980–86, non-tariff barriers in Tanzania covered more than 50% of imports, and the average simple tariff rate was about 40%; but by 1999, non-tariff barriers were largely confined to restrictions on imports of petroleum products (owing to physical constraints at port facilities), and the simple tariff rate was between 15–20%. With the removal of all non-tariff barriers, which is still in progress, the country's IMF trade restrictiveness index rating is expected to decline further to '3'.

The relaxation of trade restrictions was supported by strong macroeconomic stabilization measures, which brought about a substantial fall in inflation, as well as by steps taken to correct the exchange rate misalignment, reflected in a sharp depreciation of the real effective exchange rate.

Tanzania is still continuing with its trade liberalisation policy. As a founding mem-

ber of the WTO, Tanzania grants at least most-favoured-nation (MFN) treatment to its trading partners. Furthermore, as a member of the EAC Customs Union, Tanzania abandoned its previous 4-band escalatory tariff structure of 0,10,15, and 25% (on capital goods and unprocessed materials; semi-processed inputs; fully processed inputs; and final consumer goods respectively) and has adopted the EAC Common External Tariff, which has 3-bands of 0, 10 and 25% (on raw materials, capital goods, and meritorious goods such as medical, pharmaceutical, educational supplies; intermediate goods and finished goods, respectively). Tanzania has subsequently gradually eliminated quantitative restrictions as well as taxes on most exports; and its import duties have fallen below the regional average.

Relaxation of trade restrictions has enabled Tanzania to increase its export earnings as well as import volume. Both its export to GDP ratio, and import to GDP ratio, have continued to grow. Between 1980 and 1997, Tanzania's economy has become more open than that of Uganda, but less open than Kenya (see Table 3 below). The recent increase in Tanzania exports is mainly attributed to increased gold production and tourism receipts. On the other hand, the rate of import growth has been higher than that of exports, due to increased imports of capital, and intermediate and consumer goods. As a result, since 1997 Tanzania has for many years recorded a negative current account balance (see Table 4 below).

Table 3. Tanzania, Kenya, Uganda: Trade as a Share of GDP

	Tanzania		Kenya		Uganda	
	1988–90	1990–96	1980–90	1990–97	1980–90	1990–97
Exports/GDP	0.13	0.15	0.25	0.32	0.11	0.11
Imports/GDP	0.31	0.39	0.29	0.34	0.18	0.24
Total Trade/GDP	0.44	0.54	0.54	0.65	0.29	0.35

Source: TIC, Bank of Tanzania, ZIPA "Tanzania Investment Report" 2004

Table 4. Tanzania: Trade and Ratio of Current Account Balance to GDP

	1997	1999	2000	2001	2002	2003
Exports/GDP	0.2	0.1	0.1	0.2	0.2	0.2
Imports/GDP	0.4	0.3	0.3	0.2	0.2	0.3
Current Account Balance/GDP	-3.1	-9.6	-5.5	-5.1	-2.2	-4.4

Source: TIC, Bank of Tanzania, ZIPA "Tanzania Investment Report" 2004

Despite the adoption of the trade liberalisation policy, and the many existing preferential treatment agreements within the WTO, EU, EAC, SADC, and bilateral trade preferences with countries such as the US (AGOA), Canada, China, South Korea, Australia and others, Tanzania's external trade performance has not been satisfactory.

Its current account balance has continued to be negative, and its share of GDP has continued to be low, as shown in the tables above. It has also continued to record a deficit balance of trade with its major trading partners (See Table 4 above).

6.1.1 Main exports

Travel (mainly tourism) and gold have become dominant export categories, accounting for about 50% of total exports of goods and services. During 2005/06 Tanzania exported goods and services worth UD\$ 3,092.6 million, an increase of 8.8% from the level recorded during the previous year. Traditional and manufactured exports accounted for 12% and 6%, respectively, of total exports of goods and services. As for the export of goods, gold remained the dominant export category, accounting for 39.7%, while manufactured exports accounted for 10.4%. The share of traditional exports to total goods exports was 20.5% down from 57.6% in 1995/96. Amongst the traditional exports, cotton was the major export crop, accounting for 33.4% during 2005/06, followed by tobacco (22.3%), cashews (17.5%), coffee (17.0%), tea (5.3%), cloves (2.7%) and sisal (1.8%).

Most Tanzanian commodities are exported in raw form. For example, almost all cashew nuts produced in Tanzania are exported raw to India, where they are processed and sold onwards to the world kernel market. Most Tanzanian coffee is also auctioned in raw form at the Moshi Coffee Auction in Northern Tanzania. Previous attempts to add value especially in the case of cashew nuts have met with a number of problems (see below).

In the same vein, value addition in coffee has been very insignificant. Almost all coffee is sold raw (cured) at the Moshi Auction. Tanzania Tea Blenders has for a number of years been packaging processed coffee from Tanganyika Coffee Company (Tanica) in the West Lake Region, although the product has not secured a reliable export market. Recently, the Mbinga Coffee Curing Company Ltd has attempted to process coffee on a pilot basis.

Table 5. Tanzania: Contribution of Selected Items to Total Exports of Goods and Services (In Million US\$ 2003–2006)

Goods/Services	2003	2004	2005	2006
Travel and Tourism	640	689.6	806.5	854.0
Gold	386.9	583.1	668.9	688.9
Traditional Exports	221.6	220.5	327.3	356.3
Manufactured Exports	71.0	94.2	129.7	181.4

Table 6. Tanzania: Contribution of Selected Items to Total Exports of Goods (%)

Export Good	%	Export Good	%
Gold	39.7	Tobacco	4.6
Manufactured Goods	10.4	Cashew nuts	3.6
Re-Exports	8.1	Coffee	3.5
Fish and Fish products	7.9	Vegetable and Oil Seeds	3.2
Other Non-Traditional Products	7.0	Other Minerals	3.2
Cotton	6.9	Other Traditional Products	2.0

6.1.2 Tanzania's regional, bilateral and multilateral trade agreements

Tanzania is a signatory to the Uruguay Round that established the WTO. This makes Tanzania one of the founding members of the world trade body. Tanzanian trade policy is thus guided by the rules and obligations of the Multilateral Trading System. Apart from its membership in the WTO, Tanzania enjoys preferential market access offers from regional, bilateral and other multilateral trading system arrangements. Its regional membership includes the East African Community (EAC), and the Southern African Development Community (SADC). It is also currently considering re-entering the Common Market for Eastern and Southern Africa (COMESA), from which it withdrew in the year 2000.

Tanzania also enjoys preferential treatment from the European Union (EU) under the Everything but Arms (EBA) initiative for LDC countries. It is also part of the EPA (Economic Partnership Agreement) negotiations between the EU and ACP countries, where Tanzania is included in the Southern African (SADC) negotiating group. The Cotonou Agreement signed in 2000 by the EU and the 77 ACP countries calls for establishing economic partnership agreements between the EU and the regional groupings of the ACP members.

EBA enables duty-quota free access to the EU market for all LDC products except arms and ammunition. Under EBA product coverage has also expanded. EBA has brought significant improvements in market access for Tanzania's exports, as can be most clearly seen in the growth of exports of Tanzanian fish to the EU market. Market access under EBA is much better than the preferences granted under the Cotonou/Lome and previous EU Generalized Systems of Preferences (GSP). What remain cumbersome are the rules of origin. There is also a slight uncertainty about its continuation, because EBA is granted unilaterally by the EU for an indefinite period of time, rather than being agreed upon contractually.

Tanzania is also eligible for preferential market access offered by the United States under the African Growth Opportunities Act (AGOA). It is among 37 sub-Saharan African countries which are eligible to export more than 6,000 items to the US duty-free under AGOA. The previous GSP programme of the US expired in September

2001 and contained several limitations in terms of product coverage. AGOA is an enhanced GSP: it provides duty-free treatment for a longer period of time and for a wider range of products. The list of items includes agricultural commodities, handicrafts, manufactured goods, etc. There exist however some specific rules of origin and customs requirements. A special provision of AGOA encourages exports of apparel from less developed AGOA beneficiaries, with more favourable rules of origin requirements over an initial four year period.

Other ongoing bilateral agreements exist with Canada, China, Australia, Comoro, and South Korea. Under the Tanzania/China bilateral trade agreement, for instance, Tanzania is eligible to export 445 products to China duty free. Tanzania is also eligible to export 87 products to South Korea duty free.

6.1.3 Tanzania's trading partners

Tanzania's major trading partners include the UK, South Africa, India, Kenya, China, Japan, United Arab Emirates, and some European countries such as the Netherlands, Germany and Belgium. While the UK is the major export destination of Tanzanian goods, South Africa has for the past ten years been the major source of imports into Tanzania.

Except for trade with the UK, Tanzania has consistently maintained a deficit trade balance with its major trading partners, despite the existence of preferential market access. For example, Tanzania has not adequately taken advantage of preferential treatment under the AGOA. Bilateral trade flows between Tanzania and the US have remained small and fairly constant. Likewise, Tanzania has not adequately exploited the preferential market access granted by the EU (Everything but Arms). Clearly, a number of 'behind-the-border' (supply side) constraints are limiting Tanzania's effective participation in foreign trade.

6.2 Zambia: Copper and the emergence of non-traditional exports

Since independence in 1964, the Zambian economy has been dominated by the copper mining industry, despite efforts to diversify the economy. **Nonetheless, there has been growth in the contribution of non-traditional exports.** The **principle non-traditional exports** are fresh fruits and vegetables, cut flowers, cotton yarn, cotton lint, gemstones, stock-feed, sugar, cement, processed foods and textiles. The country's **main trading partners** are South Africa, the European Union, China, Zimbabwe, South Korea, United Arab Emirates, Tanzania and the Democratic Republic of Congo.

Zambia's trade regime is considered one of the most open in Africa, yet Zambia's share of world exports declined from 0.038% to 0.014% through the period

1990 to 2003. This is an indication of Zambia's failure to take advantage of the trade opportunities created by rapid globalisation since the 1980s. These trade patterns have been influenced by economic and political relationships with neighbouring countries, because Zambia is a landlocked country. Historically, Zambia's trade has been oriented towards the south, mainly Zimbabwe and South Africa; however routes through Tanzania have also been established for access to the sea. Stability in the region is particularly important for the country to maintain its trade routes.

6.2.1 International trade performance

Trade performance has been greatly influenced by the performance of the copper mining industry. The favourable performance of the Zambian economy in recent years, growing at an average of 4% per annum, is seen as evidence of a recovering economy following the privatisation of the copper mining industry. At the same time though, the price of copper on the international market has risen to historically unprecedented levels. Although the non-traditional export sector performed well, this sector has suffered from the appreciation of the Kwacha. From December 2004 to September 2005, the real effective exchange rate appreciated by 26%. Apart from the improvement in the terms of trade attributed largely to copper exports, the improved debt position created by the Multilateral Debt Reduction Initiative is said to have contributed to the currency appreciation.

In the 1990s, significant changes took place in Zambia's trade in both the commodity composition and the relative importance of trading partners. Exports of non-traditional products increased substantially from 1995 onwards. The share of non-traditional exports increased from 8% of total merchandise exports in 1990 to 38% in 2003. Most of this growth took place in the floriculture and horticultural sectors, which increased in value from US\$9.1 million and US\$2.4 million in 1994 to US\$34.1 million and US\$36.4 million, respectively.

Zambia's external balances have improved slightly in recent years. According to IMF statistics, the merchandise trade balance went from a deficit of 9.5% of GDP in 2001 to 1.5% in 2004. The current account deficit narrowed from 21% of GDP to 11% of GDP during the same period (IMF, 2006, 35).

The major export markets are South Africa, China, Korea and the European Union. The main destinations for non-traditional exports are DRC, Zimbabwe, Malawi and Tanzania. Floricultural and horticultural products go to the European Union, more specifically to the United Kingdom, Germany and the Netherlands. Most of Zambia's imports come from South Africa and the European Union.

In recent years, South Africa has emerged as the most important trading partner for both imports and exports, as shares of the EU and Japan have declined considera-

bly (World Bank, 2005a), indicating a resumption of historical ties with South Africa following the end of apartheid. This is also due to its geographical proximity.

Zambia's trade regime is considered one of the most open in Africa, following the government's implementation of an extensive economic reform programme that included the liberalisation of trade.¹³ The country had a rating of 2 on the IMF's restrictiveness scale (ranging from 0 to 10, with 10 being the most restrictive). The simple average MNF tariff in Zambia was 13.4% with a coefficient of variation of 0.7, indicating modest dispersion of tariff rates.

Zambia's current tariff structure comprises four bands. The 0% rate applies to raw materials and 'merit' goods, the 5% to 15% rates apply to intermediate rates, and the 25% rate applies to finished products. However, specific rates apply to a few items. For example, although steel, plastics in primary form and rubber are internationally classified as intermediate goods, they are given duty-free status because they are not produced in the country (ZNFU/GRZ, 2005). The industries facing the highest duties are fishing and light manufactures such as wood products, manufactured food, beverages and tobacco, textiles and leather (World Bank, 2005a, viii). Duty exemptions are also granted to items used in donor projects and programmes.

In spite of the high degree of 'openness' of the economy, there is no guarantee that this will translate into faster rates of growth and poverty reduction. UNCTAD (2004) suggests that, although the national economies of most LDCs are highly integrated into the world through trade, the lives and the livelihoods of most people are not directly linked to the international economy. There is a danger of 'enclave-led' growth, unless measures are taken to promote developmental linkages between growing export activities and the rest of the economy (UNCTAD, 2004: 7-8).

6.2.2 Trade protocols and regional agreements

Zambia is a signatory to a number of multilateral and regional trade agreements. The country is a member of the World Trade Organisation, the Common Market for Eastern and Southern Africa (COMESA), and the Southern Africa Development Community (SADC), and a signatory to the Cotonou Agreement. It also benefits from the US African Growth and Opportunity Act (AGOA), the EU's Everything But Arms Initiative (EBA) and the Canadian Initiative. The country's ability to benefit from

¹³ One of the problems facing researchers is the lack of a clear definition of what is meant by 'openness'. Yanikkaya (2002) identifies five categories of measurement: trade shares, which is exports plus imports divided by GDP; measures of trade barriers that include average tariff rates, export taxes, total taxes on international trade, and indices of non-tariff barriers (NTBs); bilateral payments arrangements (BPAs); black market premium; indices of trade orientation such as Leamer's, 1988 openness index, Dollar's, 1992 price distortion and variability index, and Sachs and Warner's, 1995 openness index).

these agreements is dependent on its ability to effectively negotiate its position. Trade negotiations are complex; and the institutions responsible, the Ministry of Commerce, Trade and Industry and Zambian trade missions (in e.g. Geneva and Brussels), lack capacity and resources to negotiate effectively. Presently there are important trade issues still open for Zambia: to make decisions as to whether to conclude an EPA with the EU and/or to participate in regional customs unions, and to consider how to effectively engage in the on-going WTO multilateral trade negotiations.

According to the Diagnostic Trade Integration Study (DTIS) for Zambia: ‘in order to support export diversification, the key priority areas in trade policy were to: (i) make export incentives work for exporters; (ii) improve trade facilitation; and (iii) enhance the authorities’ capacity to formulate, coordinate, and implement trade policy, and negotiate trade agreements.’ It also concluded that further liberalisation of imports was a lesser priority, although duties on imported capital goods should be removed to stimulate private sector investment. The Study suggested that market access was not a limiting constraint on export growth, as most of Zambia’s exports face zero or low tariffs, and Zambia also qualifies for preferential access to the major developed country and regional markets (World Bank, 2005a: 43). These issues require careful consideration in the country’s engagement in the various trade agreements and negotiations which are, are presented in brief below:

COMESA. Common Market for Eastern and Southern Africa (COMESA) was established in 1994 as the successor organisation to the Preferential Trade Area (PTA) which had been established in 1981. Members include Angola, Djibouti, Burundi, Comoros, Eritrea, Ethiopia, Democratic Republic of the Congo (DRC), Egypt, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. COMESA implemented a free trade area (FTA) on 31st October, 2000 when nine member countries removed all tariffs on products originating from their countries. One of the objectives was to move to a customs union by 2005, but this was postponed. The additional benefits that Zambia would gain from a customs union are unclear (World Bank, 2005b). Nonetheless, regional markets remain important, accounting for 15% of merchandise exports. COMESA accounts for about 16% of imports and 9% of exports (ibid).

SADC. Zambia’s direction of intra-regional trade is mainly south, within the Southern Africa Development Community or SADC countries which account for about 52% of total imports and 35% of exports (excluding the DRC, Zimbabwe, Mauritius and Malawi). The member states of SADC are Angola, Botswana, the Democratic Republic of the Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia, and

Zimbabwe. The SADC Protocol on Trade was signed by Zambia in 1996. The implementation of the protocol commenced in September 2000, leading to the establishment of a free trade area by 2008. Concern has been raised that the implementation of the SADC FTA would result in a substantial loss of revenue, if tariffs on imports from South Africa were phased out.

According to UNCTAD (2006) data, since 1995 SADC has increased its share of Zambian exports and imports significantly. This is especially apparent within merchandise trade, where Zambian exports/imports between 1995-1997 averaged 12.0/48.0% of totals, while in 2004 this share was 48.1/58.9%. The change of direction for exports seems to have come at the cost of export trade with Asia, while imports from the EU have fallen during this time period (UNCTAD, 2006b: 7).

The country's dual membership in both COMESA and SADC does complicate its regional trade relations. Each regional body has different rules of origin; and policies regarding common external tariffs, and the treatment of intra-regional trade in agricultural products, are subject to varying approaches to non-trade barriers.

The impact of belonging to COMESA does not threaten primary agricultural products directly, but it has a negative effect on agro-processed goods. Producers in COMESA that benefit from subsidies and export incentives are able to exploit COMESA rules of origin and export to Zambia at more competitive prices.

The dominant position of South Africa in SADC poses the biggest challenge. For example, after 2012, Zambia will be expected to grant duty free access to most South African agricultural imports. It is unlikely that local producers will be able to compete. As things stand, South Africa already enforces a number of stiff technical barriers and quantitative restrictions that limit market access for Zambian exporters. Given the gaps in the levels of development between Zambia and South Africa, some trade agreements between the two countries may be reviewed in the national interest (Weeks et al, 2006, 79).

Cotonou Agreement. Zambia is one of the 77 countries in Africa, Caribbean, and Pacific (ACP) which signed the Cotonou Agreement with the EU in June 2000 when the Lome Convention IV expired. The Cotonou Agreement provides for the negotiation of Economic Partnership Agreements (EPA) between the EU and the ACP countries as regional groupings or individually.

Zambia also has unilateral access, as an LDC, to the EU market under the EU's Everything But Arms (EBA) Initiative, which offers duty free, quota-free access for an unlimited period to all products excepting arms.

AGOA. The US African Growth and Opportunity Act (AGOA) was enacted by the US Congress in 2000. It provides preferential access, duty and quota free, to the Unit-

ed States markets for eligible goods between 2000 and 2008. Nonetheless, Zambia exports to the United States remain modest at about 2%. Zambia has benefited indirectly by exporting cotton yarn to South Africa and more directly by exporting wood panels and leather. According to Mudenda (2005), the reasons for the low volumes of exports to the United States include the inability of local firms to ensure constant supply to potential buyers, high cost of transportation, lack of information among producers, the high cost of transportation, and technical barriers such as sanitary and phytosanitary requirements.

The Canadian Initiative. As an LDC, Zambia is eligible to benefit from the Canadian Initiative, which provides duty free and free access of most goods into the Canadian Market. Qualifying countries are required to provide legal documentation pertaining to rules of origin, certification and direct shipment. The objective of the initiative is to stimulate investment in and export of agricultural produce.

6.3 Domestic trade and infrastructure in Tanzania and Zambia

The development of domestic trade is important for the expansion of international trade. For Tanzania, locally produced goods include cement, aluminium roofing sheets, steel, cooking oil, soft drinks, beer, cigarettes, printed textiles, soap, plastic products, wheat and maize flour, bread, etc. Wholesale outlets are prevalent in larger towns and cities, while individually owned vendors and smaller retail shops are common in smaller communities and remote areas. For Zambia, domestic goods traded include food, beverages, textiles and leather products, chemicals and pharmaceuticals, and rubber products.

For both Tanzania and Zambia, transport, energy, and telecommunications infrastructure are key bottlenecks hindering growth in domestic trading activity. For Zambia, this is apparent in the fact that trading activity is concentrated in the main towns along the main rail line. In Tanzania, the poor transport network and market infrastructure has often led to price escalation in some food insecure regions. The market for domestic products is characterized by a large number of small scale producers and traders, thus the building of infrastructure could have substantial benefits for pro-poor growth. Additionally, industrial production in Tanzania has for a long time been hampered by inadequate electricity and water supplies, while large scale production and trading is hampered by the lack of capital.

According to quantitative estimates by UNCTAD (2006), there is a clear correlation between developed infrastructure and economic growth, even among LDCs. The cluster of fastest growing LDCs had relatively good or average infrastructure, while the poorest or regressing economies had relatively poor infrastructure (UNCTAD,

2006a: 201). According to interviews by Eskola, in Tanzania total transport costs depend upon road condition, distance, and possibility to ship to Dar es Salaam. Fuel prices depend upon the remoteness of the location, time of the year and international fuel prices, which have been on the rise in the recent years. Transport costs could vary up to four-fold for comparable distances from Dar es Salaam to other regions in Tanzania. There is almost no regional market for perishable food products, due to the lack of storage facilities and the problems that lengthy trips pose for perishable products in tropical climates (Eskola, 2005).

While there is a clear correlation between the provision of infrastructure and economic development, Porter (1990), makes the point that it is not only the stock of existing infrastructure that is important for competitive advantage, but the capacity to maintain and improve upon existing infrastructure. Therefore, a lasting solution for infrastructural development must not simply constitute the supply of infrastructure. It must also provide for institutions with the capacity to maintain and build upon existing infrastructure.

The Tanzanian government has recognized the vital role of infrastructural development, but the effects of a number of policy initiatives leave a great deal to be desired. So far, through the Agricultural Marketing Systems Development Programme, the government has only rehabilitated 106 kilometres of rural roads in 8 districts. Tanzania has a land area of 886,037 sq km and an estimated 78,891 km of roads, of which 72,083 km are unpaved, and 3,690 km of railroads. By comparison, Finland has 78,189 km of roads, of which 50,633 km are paved, and 5,741 km of railroads, but only 1/3 of Tanzania's land area.¹⁴

International donors are giving relatively substantial assistance to solve the infrastructure problem. The International Development Agency is assisting Tanzania with its \$122 million Central Transport Corridor Project (CTCP). The CTCP comprises assistance for both the roads and the railway network. It also has a trade development component, geared towards capacity building activities for local authorities for improving the maintenance capacity of the current transport infrastructure.

The Tanzanian railroad infrastructure mainly consists of the 2,715 kms in the Tanzania Railway Corporation (TRC) and the 960 kms of the Tanzania Zambia Railway Authority (TAZARA). The TRC has been blamed for inefficiency, run-down infrastructure, and repeated derailments. For example the TRC is partly blamed for the currently 8-day waiting line for goods in the Dar es Salaam port. Consequently, ships have been diverted to Kenya.

The solution for the railroad problem has been concessional privatisation for foreign owned companies. After lengthy negotiations, the unprofitable TRC has been conces-

¹⁴ <https://www.cia.gov/cia/publications/factbook/>

sioned for 25 years to Rail India Technical and Economic Services Ltd. (RITES). It is hoped that RITES will invest in electrifying and rehabilitating the rail infrastructure to handle heavier cargo (Railways of Africa, 2007).

6.4 Markets and institutional framework

For the provision of efficient markets, some state intervention is needed. For example, the Zambian government played a significant role in agricultural marketing prior to 1991, with varying success. Yet when the agricultural sector was liberalised, the private sector was unable to take over the marketing role effectively, and therefore many farmers, particularly in rural areas, were unable to bring their produce to market.

‘To take full advantage of any gains in access, domestic action is necessary to improve farmers’ linkages to markets. Although market participation has begun to rise, less than half of farmers are selling to markets. Farmers should be helped to manage farming as a business and base production decisions on market information and trends. Interventions focusing on export markets and also domestic marketing have the potential to offer employment to a relatively large number of people in the rural areas, both directly and indirectly. Outgrower schemes, for example, offer low cost opportunities in the production of cotton.’ (Nair, 2004: 1).

The Tanzanian government has taken an active role in order to counter market inefficiencies through the Agricultural Marketing Policy. It has also made efforts in improving the business environment in Tanzania. Currently the Business Environment Strengthening for Tanzania (BEST) programme is being implemented. A Business Registrations and Licensing Agency (BRELA), which undertakes industrial licensing and company registration, as well as patents, trademarks and copyrights registration, was established in the year 2000. The establishment of BRELA as an Executive Agency has significantly reduced bureaucracy in the approval procedures, and the number of days it takes for businesses to be registered has been reduced from 90 to as low as 3 days. A Fair Competition Commission has also been formed.

According to Eskola (2005) these basically good efforts by government to improve business institutions have yet to take hold in regional municipalities and localities. She points to the lack of credibility of politically appointed crop boards at the regional level, and the poor negotiation capacity of the farmers associations and lack of business skills of the farmers at the grass roots level. This power asymmetry leads to the farmers receiving lower prices for their crops than might otherwise be the case.

Another institutional barrier for economic development is the lack of state capacity to enforce contracts between suppliers and buyers. Because the state cannot enforce contracts, supplying and buying is organised through unnecessarily complex informal middle-men networks, which operate on a personal level and frequently involve fam-

ily ties. This arguably increases transaction costs between the supplier and the buyer, and many consumers in urban areas have expressed hope for government intervention in order to keep food prices down.

A related problem is the lack of state capacity to ensure order, especially in the more remote rural areas. The regulatory administration is inefficient and corrupt. Transportation of goods is made unnecessarily difficult as both bribe-seeking members of the police and armed bandits stop trucks with road blocks. According to a quote by one of Eskola's interviewees, the transporters have to be wary of the "flies (policemen) in the day and mosquitos (robbers) in the night." (Eskola, 2005: 35).

In Zambia the functioning of the domestic legislative and institutional framework also has a significant impact on commodities' competitiveness on the international market, and on levels of productivity within the country. According to a study undertaken for the Zambia National Farmer's Union and the government, one of the main challenges facing the agricultural sector is the mixed signals created by policy reversals and changes made by the government (ZNFU/GRZ JC, 2005).

The short term approach, and selective offers of investment incentives (particularly to the mining sector) has created uncertainty and acted as a disincentive to long-term investment in agriculture. The ZNFU/GRZ JC study argues that, although it is government policy to disengage from being directly involved in agricultural input supply and crop marketing¹⁵, the introduction of the Fertiliser Subsidy Programme to smallholder farmers has crowded out private sector input suppliers and distorted markets. Additionally, it has promoted rent seeking behaviour without establishing substantial improvements in productivity.¹⁶ Productive investments in agriculture have been hampered by difficulty in accessing affordable finance, as government borrowing has been driving up lending base rates of commercial banks, which were around 30% at the time of the study (ZNFU/GRZ JC, 2005: 5-7). The volatility of the Kwacha in 2005/2006 in relation to international currencies was destabilising for the export sector, and the absence of a clear policy statement on the implications of the rapid appreciation of the Kwacha created further uncertainty.

The key recommendations made were that the government should establish predictable and stable policies with commodity specific targets. Incentives proposed include a zero tariff rate for all agricultural outputs and supplies, and government guarantees for the protection of local producers, so that commodity value chains would not be distorted. Additional recommendations for measures to support the productive sectors include improved research and development, provision of extension services,

¹⁵ 'Government will focus on proving public goods that are needed for efficient sector growth, such as rural infrastructure, research, extension, pest and disease control (FNDP, 2006: 54)'.
¹⁶ Other studies have supported the introduction of this subsidy.

and infrastructural development including irrigation, feeder roads and telecommunications.

Zim's loss – Zam's loss. Lessons from the plight of the Zimbabwean farmers operating in Zambia

A few interesting lessons may be learned from the persecuted white farmers that moved to Zambia from neighbouring Zimbabwe. The case highlights the potential and risks associated with an export strategy for a poor undiversified economy such as that of Zambia.

Since the year 2000, about two hundred white farmers from Zimbabwe have fled to Zambia. The Zimbabwean farmers' move to Zambia was caused by the aggressive land reform programme of Zimbabwe's President, Robert Mugabe, which turned into violence and theft in early 2000.

The Zimbabwean farmers in Zambia started farming tobacco, seed corn, soybeans, wheat, cattle, sorghum, vegetables and flowers from scratch. Their opportunities in Zambia were based on access to land, capital, and labour, and silent political support from the Zambian government.

The Zambian government provided the Zimbabweans with leases for the ample agricultural land that has lain untapped. It hoped that the Zimbabweans would provide impetus and direction for Zambia's diversification strategy. According to African Business, only 10% of Zambia's arable land is actively being farmed, and in 2004 there were only 450 large commercial farmers. Many of the Zimbabwean farmers were able to get access to land near Lusaka, a strategic location for export orientated farming. With donor assistance, the Zambian government also devised supportive policy measures. It provided zero tax for the importation of farming machinery, and capped power tariffs (Hobbs Gama, 2004).

The Zimbabwean farmers could offer their farming expertise, finances and contacts to obtain loans from abroad for inputs and equipment. The main funding partner for many farmers has been the Universal Leaf Tobacco Company of Virginia, USA. In 2004 it had reportedly invested USD\$42 million in 48 big farms and 1,200 smallholdings. Of this total amount, USD\$11 million was also given to Zambian nationals to offset allegations that the loans were racially motivated (Economist, 2004). The loans were used for the inputs required for mechanised agricultural production.

Initially the Zimbabweans were very successful in Zambia. The Zambian to-

bacco industry boomed. Tobacco production increased from 3 million kilos in 2001 to 24 million kilos in 2005. Over 20,000 new jobs had been created. Farmers reported 50% profit on their crop. On the other hand, Zimbabwe's share of tobacco had shrunk from 240 million kilos in 2000 to 65 million kilos in 2004 (Zimbabwe Information Centre, 2007).

The initial success of the white farmers begged questions of why the blacks in Zambia had not done this before. The lesson learned according to African Business was that "commercial success on a larger scale is possible everywhere in Africa as long as the capital and markets are available" (Milan Vesely, 2004). In other words, the lack of access to international capital markets has acted as a powerful barrier to entry for commercial farming in Zambia.

In early 2006 however, there were reports that the apparent gains of the farmers seemed to be short lived. The reasons for the dwindling profits were due to the vagaries of the international economy: a strong kwacha, rising oil prices, and a steady international price.

7. Aid for trade in Tanzania and Zambia

Both Tanzania and Zambia are heavily aid-dependent countries. In the case of Zambia, Chisala et al. succinctly point out that:

"Overall, the relationship between the Zambian governments and external agencies from the 1980s into the new century was one of 'donorship'. The relationship was one in which donors and lenders collectively acted as setters of policy priorities, designers of economic programmes, active participants in the implementation of policy, and assessors of the outcome of the policy; in other words, a case of profound aid dependency that went beyond dependency on funding." (Chisala et. al. 2006: 7)

This being the case, the donors must share the blame for the turbulence of the Zambian economy over the past two decades. For Zambia, ODA as a percentage of GNI averaged 23.4% during 1990–2004.¹⁷ Zambia's economy has recently benefited from massive debt relief as a consequence of the G8 meeting at Gleneagles in 2005. Zambia's external debt was then lowered from \$7.1 billion to \$0.5 billion.

¹⁷ UNMDGI (2007): <http://mdgs.un.org/unsd/mdg/Data.aspx>

Tanzania is similarly heavily aid dependent. According to OECD figures, during 2003–2005, ODA/GNI averaged 15.5%.¹⁸ Approximately 40% of the Tanzanian government's budget, and consequently 80% of the government's development budget, has been financed by donors during 2005/2006¹⁹. The Mkukuta development strategy is predicated on the predictable flow of aid funding: obviously with such major dependency on foreign aid, aligning donor spending to government development strategy is a key issue.

With the limited government funding available, donors do have a key influence on government spending priorities; and thus a potential relative shift in donor aid preferences, from the social sector to trade capacity building, will be reflected on the ground. Chisala et al. argue that for Zambia the influence of donor bargaining power vis-a-vis the recipient government, has been underestimated by donors. The availability of funding for a donor-designated area of intervention compromises government policy at the cost of areas that the recipient government may deem to be more crucial. The donors and lenders have also reserved the right to be judgemental on whether the recipient government has shown enough dedication in the fulfillment of the associated conditionalities for donor funding. According to some critics, this is what the whole talk about "ownership" is about: partner governments should "own" those policies that the donors prefer them to "own."

7.1 IF and JITAP

Tanzania and Zambia have been involved in both the Integrated Framework and JITAP. Both have carried out the Diagnostic Trade Integration Study (DTIS) of the IF to evaluate the internal and external constraints on their integration into the world economy. Both are also participating in the JITAP: Zambia benefits from the Foundation Track, which aims at building basic institutional capacity to respond effectively to the requirements, challenges and advantages made possible by participation within the MTS. Tanzania is part of the Advanced Track under JITAP II, which builds on the work of the Foundation Track and goes further into building national participatory networks to formulate negotiation strategies in order to benefit more fully from the rights granted by the MTS (JITAP, 2007b). The experiences of Tanzania and Zambia are not very encouraging, at least not at the national level. In Geneva, Zambia headed the LDC mission for the WTO AfT Task Force, and the Tanzanian envoy commended the strategic partnerships that the LDCs had formed amongst themselves.

DTIS studies include topics on macroeconomic environment and competitive-

¹⁸ OECD (2007), <http://www.oecd.org/dataoecd/24/21/1882894.gif>

¹⁹ Tanzania Development Partners Group (2007), www.tzdp.org.or.tz/uploads/media/Tanzania_FINAL_December_5_2006.doc

ness, trade policy, market access and trade preferences, institutions for trade policy and export development, export processing zones, sanitary and phytosanitary standards, transport, and customs, as well as sectoral studies on e.g. agricultural export crops, horticulture and floriculture, tourism, spices, and fish (in the case of Tanzania). The DTIS studies are followed by an Action Plan (matrix), with recommendations for each of the above topics on what types of changes are needed and whether or not legislation reform and/or new investments in technical assistance are required. A DTIS also details a time frame for the changes and the agencies that should be involved in the process of change. Neither Tanzania nor Zambia have been able to move much beyond the study phase. Zambia awaits the implementation of the Window II phase, where money is to be distributed by the IF Trust Fund to kickstart projects recommended by the Action Plan.

It is hoped that the JITAP work will lead to a more regionally integrated, networked and strategically aligned approach to the MTS. Assessments have found that a lack of country ownership and commitment are clear problems in most countries. In Tanzania, the lack of interest displayed by high-level officials, combined with a lack of resources for implementation, turned the JITAP I into a “hollow shell” perceived as being inflexible and donor-driven. The lack of human and financial resources for implementing the ambitious plans was also a key obstacle. For these reasons JITAP was badly delayed, and consequently it neither created better informed positions for WTO negotiations, nor increased WTO-related administrative capacity for the implementation of WTO rules. A study commissioned by the Netherlands found that the most positive results in the Tanzanian experience were the two development strategies for textiles and clothing, and for spices, which were developed with the assistance of JITAP. The Tanzanian Board of External Trade had independently produced similar strategies for ‘horticulture and mushrooms’ and for fisheries (IOB, 2005).

The feeling in Geneva has been that those countries willing to involve themselves in the IF and JITAP have also been those that felt the most that they had gained from the processes. The most critically minded countries have also been the most reluctant to commit themselves to the processes. On the other hand, it is important to ask what is the appropriate level of commitment to trade-related issues to expect from underfunded government ministries, when weighed alongside other issues pertinent to development policy? It has also been asked why there has not been more coordination between the JITAP and the IF.

7.2 Bilateral Aid for Trade in Tanzania

In principle, all Aid for Trade efforts for Tanzania should be aligned with the Government of Tanzania’s development strategies. This is to ensure country ownership in line

with the 2005 Paris Declaration on Aid Effectiveness. The main development strategies are spelled out in Vision 2025, and in the second generation PRSP, i.e. the National Strategy for Growth and Reduction of Poverty (locally known as Mkukuta).²⁰ The aim of these strategies is to transform Tanzania into “a strong, diversified, resilient, and competitive economy, which can effectively cope with the challenges of development and which can also easily and confidently adapt to changing markets and technological conditions in the regional and global economy.”²¹

Donor alignment with these government-owned national development strategies is to be done within the context of the Development Partners’ Joint Assistance Strategy (JAS).²² The JAS articulates ways to implement the aims of the Paris Declaration. According to Temu (2006), in the case of Tanzania’s private sector agriculture development, there is still a lot of work to be done with aligning the donor initiatives with the national development strategies and budgets. In actual fact, bilateral Aid for Trade in Tanzania consists of a raft of scattered projects.

According to the latest figures from the WTO/OECD Doha Development Database²³ on trade-related commitments made as grants and loans, during 2001–2005 \$17.8 million was committed to trade policy and regulations, and \$110.3 million to trade development. This represented 2.4% of sector allocable ODA²⁴ – i.e. ODA that excludes all administration costs, debt forgiveness, emergency aid & etc., which do not directly support a recipient country’s sectors (agriculture, education, health etc.). Infrastructure commitments for this period reached \$932.9 million, which represented 17.5 % of sector allocable ODA. The table below summarises the latest figures on aid commitments to Tanzania, according to data provided by OECD/WTO.

²⁰ Supporting Vision 2025, more specific strategies and programmes for addressing the major constraints to economic growth include the following: Rural Development Strategy; Agricultural Sector Development Strategy and its Programme Framework and Process (ASDS and ASDP-F&P); the National Trade Policy; Business Environment Strengthening for Tanzania (BEST) Programme; the National Micro Finance Policy; and the SME Development Policy. (Temu, 2006), also see: <http://www.tanzania.go.tz/economicsurveyf.html> and NSGRP, 2005

²¹ Vision 2025: <http://www.tanzania.go.tz/vision.htm>

²² <http://www.tzdac.or.tz/JAS/JAS%20Main.html>

²³ The Doha Development Database’s results should be viewed with an element of caution. All of the reporters are not operating under similar reporting requirements, and some could not report the costs of their activities at all. See: http://www.oecd.org/document/52/0,2340,en_2649_34665_2488035_1_1_1,00.html

²⁴ Sector allocable ODA excludes action relating to debt, emergency assistance and reconstruction, administrative costs of donors, support to NGO’s and unallocated/unspecified ODA.

Table 7. Tanzania: Aid Commitments to Tanzania in Current \$US thousands

	2001	2002	2003	2004	2005	2001–2005
TD Total	19 891	9 619	9 174	47 303	24 281	110 268
TPR Total	8 586	885	607	6 724	971	17 773
Grand Total TCB	28 477	10 503	9 781	54 027	25 252	128 041
Total ODA	1 636 609	1 226 697	1 559 567	2 032 300	1 789 747	8 244 920
Sector Allocable ODA	967 822	653 657	958 191	1 356 601	1 389 673	5 325 944
Total TCB/Total ODA	1.7%	0.9%	0.6%	2.7%	1.4%	1.6%
Total TCB/Sector allocable ODA	2.9%	1.6%	1.0%	4.0%	1.8%	2.4%
Infrastructure	364 309	24 246	38 137	301 796	204 365	932 853
Inf/Total ODA	22.3%	2.0%	0.4%	14.8%	11.4%	11.3%
Inf/Sector allocable ODA	37.6%	3.7%	4.0%	22.2%	14.7%	17.5%
TCB and INF/Total ODA	24.0%	2.8%	3.1%	17.5%	12.8%	12.9%
TCB and INF/Sector allocable ODA	40.6%	5.3%	5.0%	26.2%	16.5%	19.9%

Source: WTO/OECD Doha Development Database, and OECD CRS database

The above Table 8 gives the TCB commitments breakdown for 2001–2004 using (the now revised) 2006 WTO/OECD Doha Development Database figures. Almost all major programmes of the top donors were involved with either public institution building/support or infrastructural development. Only one, relatively significantly, funded programme states that it benefits the value chain upgrading efforts of private business-oriented stakeholders at the pro-poor grassroots level: this is the Southern Highlands Agricultural and Business Acceleration Programme (SHAMBA).

Table 8. Tanzania: TCB Commitments for 2001–2004: Breakdown by Implementing Country/Agency, in Current \$US thousands

TCB Category	Implementing Country/Agency	2001	2002	2003	2004	2001–2004	As Share of Total TCB
TD	EC		329.8		38 514.1	38 843.9	31.5%
	IDA	15 000.0		100.0	2 684.0	17 784.0	14.4%
	United States	3 000.0	7 695.0	1 137.0	562.5	12 394.5	10.0%
	Switzerland		1 108.0	6 319.7	1 242.0	8 669.7	7.0%
	Germany	626.9	4 102.4	1 236.0	2 512.1	8 477.4	6.9%
	France		46.7	5 349.4	6.2	5 402.3	4.4%
	ITC	597.4	197.8	784.0	148.2	1 727.4	1.4%
	UNDP				1 038.7	1 038.7	0.8%
	Norway	86.2	196.1	315.7	51.9	649.9	0.5%
	Finland	132.6	399.6			532.1	0.4%
	FAO	93.0			363.0	456.0	0.4%
	UNIDO		61.0	98.0	281.9	450.9	0.4%
	Japan	84.1	177.2	82.8	102.0	446.2	0.4%
	Belgium	29.4		135.6	236.1	401.0	0.3%
New Zealand				108.0	108.0	0.1%	
TD Total		19 649.5	14 313.7	15 558.2	47 850.8	97 382.2	78.9%
TPR	United Kingdom	6 023.3				6 023.3	4.9%
	Switzerland	381.8	5 260.8			5 642.6	4.6%
	IDA			140.0	5 368.0	5 508.0	4.5%
	Germany		867.0	176.3	2 503.4	3 546.7	2.9%
	US	2 422.0	417.0	100.0	31.2	2 969.2	2.4%
	UNIDO			209.0	1 154.0	1 363.0	1.1%
	WTO	56.9	112.1	144.2	129.6	442.8	0.4%
	FAO		223.0			223.0	0.2%
	Belgium	52.9	68.1			121.0	0.1%
	WCO			46.8	51.0	97.9	0.1%
	ITC			65.4	20.4	85.8	0.1%
	IMF		51.9			51.9	>0.1%
	Korea				34.0	34.0	>0.1%
Canada		5.7	6.4		12.2	>0.1%	
TPR Total		8 936.9	7 005.6	888.1	9 291.7	26 121.3	21.2%
Grand Total TCB		28 586.5	21 319.3	16 446.3	57 142.4	123 494.5	100.0%

Source: WTO/OECD Doha Development Database, and OECD/DAC database (2006 figures)

7.2.1 Main Trade Development (TD) Projects Implemented in Tanzania 2001–2004

The next section is a brief discussion by implementing country or agency of the main trade development (TD) projects in Tanzania that have been implemented between 2001–2004. All of the TD/TPR projects were financed by grants, except for the **International Development Agency (IDA)**, which provided loans. All quotes are from the WTO/OECD Doha Development Database, unless otherwise stated.

The European Commission's (EC) share in Trade Development in Tanzania was almost solely bound up in the Malindi Wharves Rehabilitation Project, in the Port of Zanzibar. The Project was funded by a grant of \$38.5 million. Its trade relevance lies in the fact that the Malindi Wharves form the main port for Zanzibar, handling more than 90% of Zanzibar's trade.

This is a typical infrastructure project and it can be asked why is it found under TD in the database? The Project has a long and difficult history. The reconstruction and expansion of the Malindi Wharves was originally funded by the European Union in the early nineties. It suffered from significant faults in the original construction of the wharves themselves, which resulted in legal disputes against the Italian contractor. The costs of the rehabilitation, undertaken by a Dutch company, were underestimated, resulting in further delays (EC, 2006, and Afrol //Afro? Afroil?/// News, 2007).²⁵

The International Development Agency (IDA) has two large projects under the Trade Development category: the Regional Trade Facilitation Project (RTFP) (\$15.0 million under the Trade Finance category), and the Central Transport Corridor Project mentioned above (\$2.7 million under Trade Promotion Strategy Design and Implementation). Both projects are financed by development loans.

The RTFP's objective is to enable the Africa Trade Insurance Agency (ATI)²⁶ to become "Africa's Export Credit Agency". The IDA's role is largely to offer long-term credit to back-up the insurance policies, and to supervise and monitor ATI's operations. This back-up and the related partnership with Atradius, a European insurer, has enabled ATI to issue short-term coverage for the first time to a Tanzanian company operating in Africa, in January 2007. Prior to this, insurance was only used to cover

²⁵ The EU has not hesitated to use the Project funding as long-running political leverage against the Government of Zanzibar. In 1995, funding for the Project was suspended due to political unrest, and the EU issued a warning regarding a similar suspension of funding in 2004. See: Mwamunyange, 2004

²⁶ ATI, 2007

African exporters exporting to OECD countries, and supply was only available for long-term coverage.²⁷

The IDA had two projects related to trade policy and trade regulations: Global Markets (\$0.14 million grant) and the Central Transport Corridor Project (\$5.37 million loan). The Global Markets Project provides trade related training and education, including training of trainers. The Central Transport Corridor Project (CTCP) is part of a larger \$122 million project, of which 4% is reported as trade-related. The development objective of the CTCP is to “(a) upgrade strategic road links; (b) enhance road management capacity; and (c) improve operations of Tanzanian Railways.” The trade policy and regulations related component is related to the support of the Tanzania Roads Agency TANROADS, a new Tanzanian institution responsible for the management of trunk road construction, rehabilitation and maintenance.²⁸

The World Bank Group reports that as a whole it is Tanzania’s biggest donor. Currently it has 23 active projects in Tanzania totalling \$1.8 billion in commitments. The largest project is the Songo Songo gas project, with a total estimated cost of \$296 million. The gas project aims to develop Tanzania’s natural gas reserves, “to produce least-cost power generation for domestic, and industrial use, in an environmentally sustainable manner.” (World Bank, 2007).

The United States has 35 entries under the TD category, the majority of which are USAID projects. A substantial share of the USAID TD money, 69%, went into labour rights and child labour related programmes (Human Resources and Labour Standards) leaving \$3.8 million for the other USAID programmes under Trade Development.

The second biggest programme, Southern Highlands Agricultural and Business Acceleration Programme (SHAMBA), attracted over \$1.1 million from the US (and \$2.2 million from Switzerland). SHAMBA focuses primarily on improved coffee production and yield for the export market. This Cooperative Agreement was awarded to TechnoServe, Tanzania in December 2001. It plans to strengthen 30 small-scale coffee businesses linked to 2,250 smallholder farmers.

TechnoServe is a US-based non-profit NGO that provides business consultation and networking services for developing countries. It seeks to provide market-based solutions for combating poverty. In 2005, it reported a budget of \$21.6 million.²⁹ Its Tanzanian

²⁷ The information on this project is based on World Bank Report 38144 issued in December 2006, which can be found at the worldbank.org site and on the website for ATI, 2007

²⁸ World Bank (2007), CTCP and United Republic of Tanzania (2007), Transport

²⁹ TechnoServe, 2007: <http://www.technoserve.org/about-who.html>; interviews in Tanzania, July 2007

operations were established in 1990. TechnoServe has established a local farmers' umbrella association called Kilicafe, and brought Kilicafe together with major overseas buyers such as Starbucks, Peet's Coffee, and Procter & Gamble. Kilicafe presently consists of 117 "farmers' business groups" with a total of some 10,000 members. It has succeeded in providing higher revenues and more income for its members through credit access, improved marketing and development of central pulper processing.³⁰

The US also has 11 projects for trade policy and regulations: 9 were funded by US-AID and 2 via the U.S. Department of Agriculture (USDA). The projects fall under the categories of Trade Mainstreaming in PRSP's development plans, Trade and Environment, RTAs, Services, Trade-related Training and Education, and Sanitary and Phytosanitary Measures. The most expensive project provided a grant of \$2.4 million dollars to mainstream trade into PRSPs.

Germany had 12 entries for Trade Development between the years 2001-2004. A total of \$4.1 million was spent on capacity building projects to strengthen the SADC Secretariat: \$2.2 million of this was budgeted for implementation and provided by the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), while the remaining amount was provided by InWEnt. The capacity-building projects were e.g.: Program for Strengthening the SADC Secretariat, Business IT, Enterprise-based Environmental Management, Regional Linking of Freight Transport and Logistics in the SADC Region, Quality Management, SADC Productivity Network.

One of the main areas of funding in the category of trade policy and regulations is support to restructure SADC in order to centralise all Sector Coordination Units within the SADC Headquarters (GTZ 2007).

Another, major, German-funded capacity-building initiative has been the Forest Policy Implementation Support (FOPIS) of \$1.9 million implemented by the GTZ. This again shows the flexibility of the category 'Aid for Trade (AfT)'. FOPIS is being implemented between 1995-2008 with a total budget of 9.25 million Euros. The aim of the project is to contribute to the sustainable use of Tanzanian natural resources. The project assists with the development of national policies, strategies and instruments for managing natural resources. This work has contributed to a revised National Forest Policy, which was formulated and approved by the Cabinet in 1998, and the Forest

³⁰ Interestingly, TechnoServe has also made a contribution to the AfT discussion. In a paper published in May 2006, TechnoServe argues that market access does not guarantee market entry. It highlights the importance of other factors, such as access to credit, power, and transport, as well as development of human resources, technical assistance for streamlining of business registry and export processes, and strengthening of institutions by training officials, simplifying taxation procedures, and supporting the building of marketing networks to strengthen bargaining power of producers and workers. (See: TechnoServe 2007: <http://www.technoserve.org/news/AidForTradeCoffeeCaseMay06.pdf>)

Act approved by Parliament in 2002. Finland was also involved in the preparation of the plan, without accounting it as Aft.

France budgeted just about the whole of her grant contribution of over \$5.3 million for a project to repair and upgrade the Tanzanian Hotel and Tourism Training Institute (HTTI) in Dar es Salaam, the only government-owned hotel training institute in Tanzania. The HTTI operates under the Tanzania Tourist Board (TTB), which was established in 1962. The HTTI has also been supported by the Canadian Agency for International Development's Industrial Co-operation Program (CIDA-INC) (Christie and Crompton, 2001).

According to a (UK) DFID paper (Bennel et al. 1999), government funding for HTTI had been cut back with a resulting negative impact on the quality of the education it provided. The DFID paper states that "while economic liberalisation has created a more conducive environment for private sector tourist development, there is a pervasive concern that, with respect to human resources development, government has become too laissez-faire with a corresponding lack of government control and strategic direction." A Tanzanian Daily News column however casts doubt on the "lack of quality education" thesis. It lamented the number of expatriates working in the Tanzanian hotel industry, and argued that it is the government that had failed to promote Tanzanian staff and hotel managers to work in Tanzanian hotels (Kapembwa J., 2006).

The **UK's** \$6.0 million grant consisted of one project, a grant to the Tanzanian Revenue Authority, to strengthen management and improve the performance of the Customs Department. The purpose is to increase revenue collection via better information systems, which have a specific emphasis on revenue accounting (<http://tcbdb.wto.org>).

Switzerland's grant was part of a multilateral project to establish the Trade Law Center for Southern Africa (TRALAC), whose mission is to "build capacity in various aspects of international trade law in order to allow Southern African states and societies to engage in the multilateral trade system more effectively. It assists governments, civil society, the business sector and universities by providing training and finding solutions to the many practical legal problems related to the implementation of the international (WTO, SADC, SACU) and bilateral agreements."

UNIDO lists 8 projects for trade policy and regulations. They are listed under the categories of SPS Measures, and Technical Barriers to Trade. The most important of these projects is the Trade Capacity project with a total budget of \$3.0 million to be disbursed in the years 2004–2006. This project is part of the UNIDO IP2, which aims at "enhancing the capacities of the Tanzanian quality infrastructure – with em-

phasis on the Tanzanian Bureau of Standards (TBS) – to ensure compliance with TBT/SPS systems requirements, and to deliver globally accepted metrology, testing, quality and certification services in order to facilitate exports in selected sectors with important trade potential.” (UNIDO, 2007a).

The selected sectors in this case are the value chains for coffee and cashew nuts. Within Tanzania the project works with the Weights and Measure Agency, and the Tanzania Food and Drug Authority (TFDA), to improve infrastructure and capacity to provide metrology, and calibration services, including maintenance and accreditation, certification and testing services. Activities to achieve international recognition of tests, certificates and products will also be pursued to ensure access to export markets for Tanzanian goods and overcome potential barriers to trade. According to the UNIDO web-site, UNIDO has spent \$6.0 million during 2000–2006 on various capacity-building projects in Tanzania (UNIDO, 2007b).

Finland has two projects under trade development in Tanzania. The larger project is the long-running National Forest Programme that began in 1989 and is geared towards building technical capacity related to forest management in Tanzania, Zambia and Malawi. The project funds educational activities related to forests and forestry: some \$400,000 was committed to developing course content in forestry schools and other educational facilities. The second project is in the area of ‘ethical privatisation’. A budget of \$38,000 was committed for the purpose of privatizing a tea and coffee processing centre, “to improve the income channels of producers and expand their businesses, to help them export their produce.” This project is described in more detail later on in this report.

7.3 Bilateral Aid for Trade in Zambia

The structure of bilateral Aid for Trade (AfT) in Zambia is to a great extent similar to that in Tanzania. In order to build capacity for trade related activities, both bilateral and multilateral agencies have provided support to the Government of Zambia (GoZ), primarily the Zambian Ministry of Commerce, Trade and Industry, and to the private sector. As discussed earlier, Zambia has undertaken extensive reforms to create a market-oriented economy that should contribute to growth. Aid is commonly seen as having a role to play in supporting areas that will complement the objectives of these reforms. Trade-related capacity building has accounted for approximately less than 3% of the total aid received as is shown in Table 9.

Table 9. Aid for Trade-Related Capacity Building in Zambia, in US\$ thousands (2001–2005)

TBC Category	Funding Country/Agency	2001	2002	2003	2004	2005	2001–05	As Share of Total TBC (%)
TD	EC	1 401.5				10 887.9	15 779	21.51
	Germany	0.0	4 102.3	1 243.9	623.7		5 970	4.44
	IDA	15 261.0	150.0		13 000.0		27 411	20.47
	Japan	74.5	240.0	321.3	250.9		886	0.60
	Norway	893.5		579.2			1 473	1.09
	Switzerland	0.0	1 150.0				1 150	0.85
	United Kingdom	0.0	1 510.4			13 437.0	14 947	10.79
	United States	4 783.9	2 617.0	1 205.1	2 087.3		10 513	7.65
	Netherlands	1 584.3	154.6	3 727.0	2 151.7	1 259	7 744	5.76
	Finland	100.7	64.1				170	0.13
FAO	200.0					200	0.15	
	Italy		3.9				4	0.00
	New Zealand				85.0		85	0.06
TD Total		40 489.3	10 166.3	7 076.5	17 066.5	31 431.9	108 840	79.41
TFR	EC	0.0				1 050.0	1 050	0.81
	Germany	0.0	857.0	63.3	2 387.9		3 308	2.47
	IDA	0.0		1.0			1.0	0.01
	Japan	3.0	6.7	9.3	9.4		29	0.02
	Norway	33.4					33	0.02
	Switzerland	381.8	3 012.6				3 394	2.52
	United Kingdom	173.9			366.5	102.0	642	0.48
	United States	912.0	1 81.0	350.9	919.3		2 716	2.01
	WTO	514.8	3 779.1	4 355.9	3 831.1	3 939.4	16 431	12.01
TFR Total		2 184.1	6 073.2	4 874.6	7 514.2	5 131.5	27 696	20.59
Grand Total		42 673.4	16 239.6	11 951.1	24 580.7	37 113.3	136 536	100.0
	Net ODA	349 000.0	641 000.0	581 000.0	1 000 000.0	n.a.	n.a.	
	Total TBC as Share of ODA	12.3	2.5	2.1	2.3	n.a.	n.a.	

Source: WTO/OECD Database; Chiwele, 2006: 13

A number of donors have made a particular commitment to support trade-related activities and private sector development as follows:

The EU has provided over 40 million Euros for two export development support programmes, namely, the Export Development Programme II, 2003–2007 (EDP II) and the Mining Sector Diversification Programme. The Export Board of Zambia is coordinating both programmes. The first Export Development Programme (1993–1999) provided lines of credit to producer organizations involved in non-traditional exports: over €18 million was disbursed. The successor programme, Enhanced Export Sup-

port for Marketing (EESM) provided €5 million to the Zambia Export Growers Association (ZEGA), as well as export support to the tobacco and coffee sectors. During this period, coffee production trebled and tobacco production doubled. The EU also provides support to Zambia through the Common Market for Eastern and Southern Africa (COMESA) Secretariat under the Regional Integration Programme. This support will continue into the near future under the 9th European Development Fund (EDF) as part of the Cotonou Agreement.

The ZAMTIE Project (2001 – May 2005) supported by **USAID** provided for a trade advisor on an ongoing basis to the Zambian Ministry of Commerce, Trade and Industry (MCTI), and supported the Zambia Business Forum (ZBF) and other private sector associations in capacity building. The project was established to improve the trade and investment environment; advise the government and the private sector on negotiations within WTO, EU-ACP, SADC and COMESA; assist with legislative instruments to effect appropriate trade remedies (safeguards); assist with identifying trade and investment opportunities and barriers to Zambian exports; and strengthen the technical capacity within MCTI through the provision of practical training and short courses. The ZAMTIE Project provided technical support for the implementation of the new ‘Safeguards’ legislation, including drafting and training courses, a review of the agricultural sector, opportunities for exporting under the African Growth and Opportunity Act (AGOA), and a study of the textile and clothing sector.

The Market Access, Trade and Enabling Policies Project (MATEP) began activities in 2005 designed to increase penetration of Zambia’s exports of agricultural and natural resources products into regional and international markets. The Project is initially focusing on tourism and eight value chains: horticulture, paprika, honey, coffee, livestock, cotton, maize, and cassava. The project is USAID’s main vehicle for contributing to the Government of Zambia’s (GoZ) Private Sector Development (PSD) Plan. The project consists of 4 parts: a trade and enabling policy component; market access component; finance; and tourism.

The UK’s DFID has two Private Sector Development interventions which commenced in 2005. These included facilitating policy dialogue amongst stakeholders within defined agricultural sub-sectors or thematic areas (The Enabling Environment Project, EEP), enhancing financial sector market intelligence, and supporting the implementation of the Financial Sector Development Plan (Financial Services Enabling Environment Project). DFID is currently the Lead Donor Advisor for the Integrated Framework (IF) and has signalled its intention to support priority activities. The EEP aims to improve the policy frameworks for pro-private sector growth by identifying and delivering specific strategic policy interventions aimed at strengthening demand and supply-side capabilities. DFID previously financed technical assistance for the

trade in services negotiations sponsored by the ZAMTIE project.

The **World Bank** has two active projects supporting diversification and exports: Enterprise Development Project (EDP) of \$ 45 million, and Support for Economic Expansion and Diversification (SEED) of US\$ 24 million. The Bank also provides technical and advisory support as needed. Joint Integrated Technical Assistance Project (JITAP) is a coordinated programme of assistance financed by the ITC, UNCTAD and WTO. The programme was prepared during 2003, and implementation began in 2004.

The **Commonwealth Secretariat** provides technical assistance on trade negotiation and regional trade issues to Zambia through its 'Hub-and-Spoke' Project. Participating countries are required to appoint a counterpart trade fellow, who is provided with technical and research assistance from the Commonwealth Secretariat. A trade fellow ('spoke') has currently been assigned to MCTI (2003-2005), with a regional advisor ('hub') also in place at the COMESA Secretariat in Lusaka (2003-2005). In addition to technical assistance, the initiative also provides modest financial resources to support research projects undertaken by the national trade fellow and the regional advisor. **Sweden, the Netherlands, Norway, UNDP, UNCTAD and ITC** all provide advisory services or funding for training and capacity building of Zambians in trade-related areas.

Finland began its involvement with the Integrated Framework (IF) in Zambia starting as of February 2007. Finland's role has been to participate as the IF Facilitator in order to incorporate the recommendations of the DTIS action matrix into the Zambian national development plans. For this purpose, Finland has committed 4-5 million Euros on the condition of the overall development of the IF in Zambia. Similarly, Finland also participates in the Private Sector Development Reform Programme in Zambia, with a commitment of 2.25 million Euros.

7.4 Concluding thoughts on AfT in Tanzania and Zambia

As the above breakdown of AfT projects demonstrates to some extent, the general tendency of official AfT funding is to be either used in larger multilateral, to a great extent donor-driven programmes, or dispersed in a great multitude of isolated bilateral projects involving a great deal of technical assistance and support infrastructure, institutions, and policy. Little AfT funding is provided for business enterprise support and manufacturing. When stating this, it must be remembered that the WTO/OECD TRTA/CB consulted as a primary source was operating under the more limited definition of AfT as 'trade-related capacity building'. Efforts to look outside the

framework by spot-checking the main donor countries' current portfolios, in the case of Tanzania, did not markedly change this conclusion, however. The portfolios of the regional development banks and trust funds were not inspected even casually.

This is not to argue that technical assistance is not needed, or that infrastructure, policies and institutions are not essential, but as was noted above in Section 2, it has become clear that this kind of assistance tends to suffer from a number of problems of a structural nature, such as the lack of harmonization between donors, and weak sustainability of the projects. A general problem with the sustainability of isolated, scattered projects is that their success may be constrained by factors outside the project sphere. Such factors could include changes in the price of inputs or demand for outputs, deterioration of necessary infrastructure or energy supply, environmental conditions, administrative capacity, human capabilities, foreign exchange swings, financial security and political stability.

Some historical changes, such as the oil crisis in the early 1970s and its impact on oil dependent infant industries in Africa, may have been difficult to anticipate. Other problems, including the underutilization of processing plants due to the technical biases of the donor countries, could have been foreseen. Necessary inputs may be tied to overpriced donor technology. Interest rates may be too high in the recipient country to finance the operations. When the price of labour is low, modern capital and energy intensive technology with associated input requirements to be supplied from abroad may be inappropriate. Sustainability of industrial or agricultural projects requires some guaranteed demand in the recipient country, as well as readily accessible input requirements that are competitively priced, and/or have some kickback effects on the recipient country's economy (scale economies, industrial clustering). Of course, the present tendency in mainstream ODA away from individual projects and towards sectoral aid and budget support is meant to tackle these issues.

In writing this report, we were unable to go more deeply into the bilateral projects currently being implemented under the banner of AfT. Some of them, such as the EC's EESM project being implemented in Zambia, and TechnoServe's approach with coffee and cashew value chains in Tanzania (to be discussed in more detail below) could be worth investigating further. There are also projects, such as the EC's Zanzibar Wharves rehabilitation, which would be problematic under any banner. What is clear is that the amount of funding available for AfT, at the moment, does not match the potential needs that have been identified. For example the grandiose SADC regional development programme, the Mtwara Development Corridor, has been budgeted to cost \$7.9 billion in Tanzania alone, but thus far only a \$100 000 investment has been secured (Edwin, 2007). No costs have so far been placed on the DTIS action matrices, but the \$320 million commitment for all LDCs is still clearly below the needs.

8. Value chains at work in Tanzania and Zambia

In order to provide a better understanding of how value chains work in countries such as Tanzania and Zambia, a few value chains are presented here in some detail: cashew nuts and coffee in Tanzania, and fresh vegetables and cotton in Zambia. None of the chains works particularly well for the moment. In Tanzania, cashew and coffee are among the traditional export crops. Their importance in the national economy has greatly diminished; but from the poverty point of view, they continue to be highly relevant, as they provide the main cash income for several hundreds of thousands of people. The value chains they form are genuinely global. Their end products are consumed everywhere in the world and mediated by numerous and nebulous middlemen.. The Zambian examples are of a more recent provenance, much narrower and also more vigorous. They correspond more to the idea of business value chains. In the fresh vegetables sector, it is easy to identify British supermarket chains as lead firms with whom Zambian suppliers deal directly. There are still relatively few of these suppliers, less than 10,000. Cotton cultivation involves more than 200,000 people, most of whom are working within smallholder outgrower schemes run by large multinational ginning companies.

8.1 *Cashew nuts in Tanzania*

Cashew nut is called the poor man's crop and rich man's food: cultivated by some of the world's poorest farmers, with the help of even poorer casual labourers, and consumed by well-to-do customers ready to pay handsome prices for their small luxury. This makes cashew nut an obvious candidate for a product chain in which there is ample room for value-addition at different stages. Yet the way the global cashew value chain works leaves the common farmers in Tanzania with very limited possibilities to influence the incomes they get from cashew cultivation.

Cashew nuts are one of the many varieties of edible tree nuts traded and eaten globally, others are e.g. almond and pistachio. Cashew nut is mainly a luxury snack food, destined for markets in rich countries, although it is also consumed where it is produced. Cashew nut's popularity in the increasingly health-conscious Western markets has been enhanced by the facts that, despite its fairly high fat content, most of its fats are unsaturated, and the nuts contain no sugar. Cashews are to some extent used in cooking and for confectionary, but most of them are eaten out-of-hand. This makes a very large price differential between 'whole' and 'broken' nuts.

In Tanzania, cashew nut is harvested from trees that are grown primarily by smallholders. The trees have other uses and other valuable parts as well, but in global trade their main attraction is the nut, or its kernel. According to much quoted, but now

old (out of date) estimates, cashew is grown in Tanzania on 400,000 hectares and provides an important source of income for some 250,000 to 280,000 smallholder farmers in the country. There are a few large estate owners with many hundreds of trees, but most farmers have allocated from 0.5 to two ha to cashew, giving room for 20 to 100 trees.

Cashew cultivation is especially important in the South East, in the coastal regions of Mtwara and Lindi, and parts of Ruvuma, which among them account for some 80-90% of Tanzania's marketed cashew crop. These are among the poorer areas in Tanzania, and also areas of long-standing Finnish support for rural development. Cashew nuts are commonly the main source of cash income for rural people in these areas, estimated as accounting for more than three-quarters of total cash incomes of farmers. Some of the nuts are consumed locally as food, but most of them are marketed for export.

Historically, the marketed production of cashew in Tanzania has fluctuated wildly. From the modest beginnings in the 1930s, it rose to some 145,000 tonnes //tons?// in the early 1970s, only to almost collapse in the 1980s. Production revived after trade liberalisation in the early 1990s, but has failed to regain its former glory. The recovery took the marketed production to 122,000 tonnes in 2000/01, from an all-time low of 16,400 tonnes in 1986/87, but the next year it plummeted to 65,000 tonnes. Since then, the annual figures have remained slightly below 100,000 tonnes: in the 2005/06 season, it was some 80,000 tonnes and may slightly exceed this in 2006/07.

The outlook for the Tanzanian cashew industry is not particularly bright. Production suffers from low productivity. Most trees are aged, having been planted in the 1950s and 1960s. In addition the old trees are infested with pests and disease, and many produce only some 3 to 5 kg of raw nuts, although there are trees that still produce 10 kg and more. Average production per tree can only be guessed, but it must be nearer the lower end of the scale. The farmers complain that the whole cultivation system has changed. Previously it was possible to get an ample crop without any purchased inputs. Nowadays constant application of pesticides and insecticides is a must; but these chemicals are expensive, and their supply is erratic.

8.1.1 Global cashew trade

When speaking of cashew cultivation and trade, it is important to distinguish between the raw nut and the kernel. What is usually called cashew nut – the part that is eaten – is actually the kernel that is found inside the nut shell. The raw nut must be processed – fumigated, roasted and decorticated - in order to produce the kernel. These are sold in different grades – white or scorched wholes, pieces, splits, etc., depending on their shape, size, and colour. The prices vary according to the grade and

trade conjuncture. The most valuable are the big, white, whole kernels which are available in different sizes.

Both raw cashew nuts and kernels are traded world-wide. Much of the raw nut trade has traditionally focused on India, which was the first country to build up a processing industry. Nuts processed there have been both consumed locally and exported. India continues to be the world's largest producer and processor of cashew nuts by far. Its prices and quality set the standards for the industry as a whole. Its yearly production of raw nuts is almost one million tonnes. Following India are Vietnam, with a yearly production of 350,000 tonnes of raw nuts, and Brazil with 200,000 tonnes. They are also increasingly important processors and exporters.

Although India has lost its near-monopoly position in the raw cashew trade, due to the rise of Brazil and Vietnam, it continues to be the largest producer and exporter of kernels. Its annual kernel production is some 200,000 tonnes of which more than 100,000 tonnes are exported. Among the consuming countries, the United States is largest, followed by India. Europe, especially the Netherlands and the central European countries, and Japan, are also major markets. Lately, consumption and imports in China and the United Arab Emirates has been increasing.

Thus India is the only country that is important both as a producer and a consumer. India has always been an importer of raw nuts and exporter of kernels. The hundreds of small-to-medium-scale processing factories in India have to rely on importing raw nuts, especially from Africa. The seasonality of cultivation has affected the pattern. The imports to India fall mostly into the period from December to May, since India's own harvest starts in May and continues until July. Indian processors can thus operate over an extended period without having to maintain very large stocks of raw nuts.

Exports from East Africa, especially Tanzania and Mozambique, to India accelerated during the 1950s and 1960s. Peak levels of raw nut exports were reached in the early 1970s, but the trade subsequently declined. When it revived again, production had been expanded in Southeast Asia and West Africa. Guinea-Bissau, traditionally a strong producer, and Ivory Coast, have already overtaken Tanzania in exports of cashew nut. Mozambique, which was a major producer in the 1970s, but whose production collapsed in the 1980s, has also been making a slow recovery.

8.1.2 Value chain in the cashew industry

If we look at cashew nut as a global commodity, its value chain starts with a tree on the farm of the primary producer, and moves through several steps from harvesting to trade, and further through different stages of processing until it reaches a vendor's tray or the shelves of a supermarket where it is purchased by the final consumer.

8.1.2.1 Production

The cashew tree has several qualities that make it easy for even the smallest farmers to enter into its cultivation. Entry costs are minimal; and cultivation and maintenance require little intensive effort. Cashews can even spread through natural cross-pollination, but commonly they are cultivated from selected or unselected seeds, or from seedlings. Few, if any, specialized production inputs are required to start cashew cultivation. Tree maintenance, involving weeding and pruning, is less demanding than for most other tree crops. Cashews can be intercropped with food crops.

As any cultivation, that of cashew needs land and labour. In Southern Tanzania, land is seldom a limiting factor, although there are places where land scarcity is a fact of life. Economically a more important factor is labour. Some researchers believe that a shortage of labour has been one of the most important factors limiting the rehabilitation of abandoned farms, particularly those that were lying untouched for many years.

Cashew trees are sown or planted, tended and harvested and the nuts are graded after harvesting. Weeding – rather by hoeing than slashing – is practiced around the trees. Harvesting consists of reaping the nuts that have dropped to the ground after maturity. The apples are detached from the nuts and kept, if they are used for further processing. Harvesting is time-consuming and labour-intensive but not as heavy as weeding. Women and children can participate as well.

Cashew is not only a poor man's crop but to a great extent an old man's crop. Crops are controlled by the heads of households, who tend to be the elders. Division of labour is clearly gendered. Labour is obtained both within and outside the household. Adult males carry out most cashew activities, particularly the heavy work of rehabilitation of abandoned fields; adult females are engaged in weeding; and harvesting is frequently a family activity.

According to available agro-economic studies, the average size of cashew households varies with the environment and farming system from 3.3 to 7.1 persons, but less than half of these contribute to farm labour. The smallest farmers can make do with their own labour and that of their household, but most farmers need to obtain some outside labour. This can take place through traditional labour exchange arrangements, or more commonly by hiring labour, usually from among the poorer local people. Despite the limited availability of cash, a considerable number of farmers hire labour.

Wages may seem low from the outside, but they are not insignificant by local standards. During fieldwork in December 2006, a common day wage was estimated at TSh 2,000 (€ 1.30), and one worker could weed four trees and harvest eight trees in one day. Costs for grading naturally varied with production. For a relatively well-producing tree (8 kg), they were estimated at TSh 250 per tree. According to these estimates, labour costs per tree would be some TSh 2,000, that is TSh 250 per kg of

raw nuts if the tree produces 8 kg of nuts.

Production costs have increased, because it has become practically impossible to produce a commercially viable amount of nuts without resorting to bought inputs. During the time of neglect of the cashew fields in the 1980s, they were attacked by diseases, notably powdery mildew, and sucking pests of different kinds. These affect both yield and quality and may cause a total yield loss. It has become mandatory to use agrochemicals for prevention and/or control of diseases and pests, although their availability is restricted by untimely distribution and unaffordable prices. The trees have to be dusted with sulphur, or sprayed with pesticides and insecticides in liquid form.

Sulphur is the cheapest of fungicides, but dusting is a complicated operation in which outside blowers have to be employed. Liquid pesticides and insecticides are easier to use but are more expensive. The costs of disease and pest control for the farmer varies from case to case, depending on the mix of inputs and whether they have been available at subsidized prices or not. A fairly detailed estimate put the cost of application of a pesticide and five rounds of sulphur dusting at a little less than TSh 1,000 per tree.

The above estimates, together with the costs of packaging and transport to the selling point would make the production costs of one kg of raw cashew nuts almost TSh 400. Other estimates, without detailed breakdowns, range from TSh 300 to 500. It is clear that the production costs must vary greatly, in direct relation to the intensity of labour and the application of inputs, as well as to the productivity of the trees. It is a fair guess, however, that at present the production costs of one kg of raw cashew nuts in Tanzania must be at least in the region of TSh 300, if outside labour is used, with some two-thirds of this going to the labourers. This is much more than the costs quoted in studies undertaken in the early 1990s, when the estimates remained below TSh 100 per one kg of raw nuts.

On the other hand, what appears as a labour cost for the farmer is income for the labourer. Casual work on cashew shambas provides some cash income for thousands of poorer people in South Eastern Tanzania. In this way, cashew cultivation is a significant source of cash income, not only for the owners of the trees and their households, but for broader sections of the people as well.

8.1.2.2 Trading of raw nuts

To obtain the amount of profit to the producer, production costs must be compared with the price of raw cashew nuts. The price offered to farmers has varied greatly over the years. It was low during the years of low production and started to rise in the early 1990s, from about TSh 150 per one kg of raw nuts of standard (i.e. high) quality in the early 1990s, up to 750-600 TSh. in 1999/00. Then it collapsed and began to rise again, settling at around 500-600 in 2005/06 and 2006/07. Even though the rise in

a decade may sound high, the above calculations of costs suggest that the farmers' margins are bound to have remained small.

Table 10. Tanzania: Price of raw cashew nuts 2002–2007

	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007
CIF/C & F	USD 650	725	1045.6	833.3	750
FOB/Tonne	USD 579.63	648	950	788.92	664.5
Farmgate Price/kg (Standard)	TSh. 360/=	462/=	750/=	600/=	600/=

Source: Cashew Board of Tanzania, December 2006

Price formation is neither simple nor very transparent. The price paid to the farmer in Mtwara or Lindi obviously depends on the world market price, which again depends on the global supply and demand. These factors are beyond the influence of a producer of Tanzania's magnitude. There has been a dramatic increase in world production of raw cashew nuts in the last few years. It has jumped from less than one million tonnes in 2001 to 1.35 million tonnes in 2003, and 1.65 million tonnes in 2006, with the largest increases coming from Vietnam and West Africa. While there is no clear trend in world market prices, they have lately been in decline (Table 10).

Within Tanzania, cashew trade has been liberalised, but it is far from unregulated. Every year the Cashew Board sets what is called the 'indicative' price. In practice, it has become both the minimum price demanded and the maximum price paid. The price is supposed to be set in consultation with all the stakeholders from buyers to farmers, but there is much confusion and dissatisfaction with both the opaque way of setting the price and the determination of the price level. In the last two years, many buyers regarded the indicative price as being too high, and were reluctant to start buying.

This is a market with a large number of small producers/sellers, and relatively few small to medium-size buyers. The scene is dominated by private buyers, and the marketing channels have been reduced to only a few. A number of small local buyers procure nuts for local use and processing. A much smaller number of big buyers, with much higher financial buying power, look mainly for nuts to be exported raw to be processed in India. These intermediaries are either integrated into the corporate structure of the exporter, or are working more independently, yet with close financial and cultural ties with processing factories in India. Most of the larger traders and the prominent exporter buying agents are long-established, Tanzanian-Asian trading companies which are also involved in wider commodity trading and transport, and serve as cashew buying agents for exporters based in Dar es Salaam.

The actual buying takes place in the villages. The buyers do not deal directly with the farmers. They work through what is left of local cooperatives, actually small groups of local people working as the buyers' local agents. The farmers take their nuts in gunny sacks to trading pots maintained by these "cooperatives." The buyers give money to the people running the posts, who deduct their own commission, TSh 30 per kg in 2006/07, and pass the rest to the farmer. The nuts may be stored for a short period before the buyer takes them in a lorry to Mtwara to be further shipped to India.

The buying season begins in October and goes on till January, and unofficially a little longer. The farm gate prices often approach the indicative prices in the early season and then go down. The big buyers operate largely as a monopsony, and in the absence of an alternative market the Tanzanian producer has little choice but to accept the price offered. This was particularly evident in 2000/07, when the buying mostly started late, and most companies first bought just the amount that was needed to avoid losing their license.

In the 1980s, when buying and export of cashew nut in Tanzania was monopolised by the parastatal Cashew Marketing Board, the different middlemen accounted for more than one-half of the world market price. This ratio has improved under liberalisation, and farm gate prices are now more than 70% of the export price. Yet both the farmers and the buyers continue to pay different local taxes and to make other contributions. The buyers also have to pay for transport to Mtwara port, and for storage.

In such a set-up, the farmer's profit is unpredictable and varies widely from year to year. It can be fairly handsome in a good year, but lately such years have been few and far between. What a cashew nut farmer earns depends on a number of factors, such as the age and productivity of his trees, the extent to which he can rely on family labour, and on how much he has to employ outsiders. A large farmer who produces tonnes of nuts can make a profit even with small margins, but an average Southern Tanzanian cultivator with only a few dozen trees and nut production of a few hundred kilos can, with a margin of say 200 TSh, only make some TSh 100,000 to 200,000 per year. This is not much more than a primary school teacher makes in two months.

8.1.2.3 Processing

Most of the trading is conducted in raw nuts, as cashew nut processing is somewhat too complicated to be easily undertaken on each individual farm. The outer shell of a cashew nut is hard and difficult to break, and requires conditioning, via humidification and roasting, before the kernel can be removed through what is called decortication. Inside there is also a leathery coating. Both the shell and the coating must be removed to obtain the kernel. Extra trouble is caused by the fact that the outer shell contains a toxic liquid (cashew nut shell liquid, CNSL) that blisters the human skin

and spoils the kernel on contact. The trick is to remove the shell and skin without breaking or contaminating the kernel.

There are a range of technologies available for cashew nut processing, but the basic choices are between small-scale and large scale operations, and between manual and machine technology. The smallest processors, such as a few individual farmers, or women's groups, roast the nuts on a pan or a larger metal sheet and spread them on sand beds to dry. Then they crack the shells with a wooden hammer and leave the nuts to cool off after which the outer layer of the nut is removed by a kitchen knife.

Even in large scale processing, most functions have traditionally been performed manually, using semi-skilled experienced workers, but the process is rather different from the small-scale one and involves some use of simple machinery. Hundreds of workers, predominantly women, undertake these operations in large factories. This remains the case in India. Since the 1960s, various mechanized processes and equipment have been introduced in several countries, most particularly for roasting, liquid extraction, and decortication. Mechanization has been most thoroughly and successfully undertaken in Brazil. In most countries, manual technology still dominates. In any case, raw material cleaning, and sizing and kernel grading, have remained very labour-intensive manual operations.

Between the Indian, largely manual technology and the various types of mechanical and semi-mechanical operations, there are significant differences in investment requirements, labour skills and health requirements, as well as in levels of efficiency. In general, the Indian processing system involves lower investment and variable costs, and achieves far greater efficiency in terms of kernel material yield and the proportion of whole kernels. That system does, however, require large numbers of experienced workers who will be exposed to a health hazard because of the toxic liquid. The mechanized systems have much higher fixed costs and are more vulnerable to breakdown (due to shortages of spare parts, lubricating oils, etc.). They also require large quantities of nuts for efficient operation, and operate well below their theoretical capacity wherever strict grading and sizing activities are not in place prior to the decortication process.

Processing is a phase which could be assumed to add considerable value to the product, but this obviously depends on the international kernel price. The price for cashew kernels has of late averaged some \$4,500 per tonne, compared with some \$750 per tonne for raw cashew nuts. But these cannot be compared directly. A rule of thumb is that it requires four kilos of raw nuts to produce one kilo of kernels. The Indian processor of imported nuts must add to this the export taxes, sea freight and other costs which are estimated in Tanzania at TSh 200 per kg of raw nuts, i.e. 800 per one kg of kernels-to-be.

The processing costs proper consist of financing and management, labour, electricity, and etc. They vary according to the method. The available estimates are broad and

range from TSh 1,250 per one kg (mechanized processing in Tanzania) to almost TSh 2,000 (large-scale semi-manual processing inside Tanzania). If these estimates are correct, and they may well be exaggerated, processing to the kernel stage may not be that lucrative an operation at present kernel prices, averaging around \$4.5 (less than TSh 6,000). One major producer claims to operate at a five percent margin.

In late 2007, the actual Tanzanian processing capacity is expected to somewhat exceed 20,000 tonnes of raw nuts. There are a few large, a larger number of small, and some micro-sized privately owned factories employing manual technology, located in Dar es Salaam, Kibaha, Tanga, and Mtwara; and there is one mechanized factory in Masasi (see below). The first, and major, processing factory is Premier Cashew in Dar es Salaam, a Tanzanian-Indian company with a background in agricultural marketing. It has been in business since 1999, although it closed temporarily in 2004, and now produces more than 5,000 tonnes of kernels annually. It has developed its own brand and started an ambitious extension plan in order to reach a capacity of 12,000 tonnes in 2008.

A major new development has been started by Olam, the big Singapore-based multinational. Although it continues to take most of the raw cashew nuts it buys in Tanzania to India for processing, it has also started processing some of them in southern Tanzania. It has established a processing factory in an old grain warehouse at Mtwara harbour, using manual technology backed up with simple machinery. With a work force of more than 3,000 labourers, mostly local women, the company boasts that this is the largest hand-driven cashew processing factory in the world. Its annual capacity is some 14,000 tonnes. Olam has also opened another, much smaller facility in Newala, which basically feeds half-processed nuts to Mtwara.

Local processing has been much encouraged by a Memorandum of Understanding signed in 2005 between the Government of Tanzania (GoT) and the major local processors, with some mediation from TechnoServe, a US based NGO funded by USAID and Switzerland. GoT agreed to suspend the export levy on processed cashew nuts, and to transfer to exporters of raw nuts some of the levies now being paid by buyers in villages; the levies will be paid by the exporters at the Tanzanian port of export. On their part, the processors promised to increase their capacity so that within five years all the nuts cultivated in Tanzania would be processed in the country – a tall order, even if the newly privatized, mechanised plants start producing soon (see below).

The processing chain extends beyond the Tanzanian borders and merges with the marketing chain. While cashew nuts processed on a small or medium scale in Tanzania can be obtained on the street in Dar es Salaam or Mtwara at TSh 5,000 (some €) per kg and roasted or salted ones with some thousands more, a visit to any well-stocked American, Dutch or British supermarket reveals that roasted and salted cashew nuts in small tins sell at prices that approach €0 per kilo or even more – a least double or

triple the price paid on the street in Tanzania.³¹ This is because the nuts processed in India, Tanzania or elsewhere, are exported as plain cashew kernels in bulk packaging. They are imported by wholesalers who repack them in tins after further processing (roasting and salting) them: the processed nuts are then sold under the wholesaler's own brands. As in so many other products, the final phases – the finishing stages of processing and marketing that are located in rich consumer countries – are apparently those where the real jump in value-addition takes place.

8.1.2.4 Some attempts at intervening in the Tanzanian cashew industry

Few, if any, of the participants in the Tanzania-based cashew chain are happy with the way the chain works. While the consumer considers the final price to be on the high side, the farmer thinks he is getting short shrift, and the processor complains about the high taxes and the low profitability of his enterprise. Access to market information is very uneven and practically non-existent at the small producer end of the chain. Prices have become a highly politicized issue, and deep suspicion and distrust pervade the whole industry – as is soon experienced by an outside researcher intruding to collect data on the prices and profitabilities. There have been many attempts to intervene in the Tanzanian cashew industry. Some have focused on the cultivation system, others on processing.

The basic problem of ageing, pest-ridden trees, and their low productivity, has been tackled by intensifying cashew research for development and dissemination of new higher-yielding, disease and pest resistant varieties. This is the task taken up by the Agricultural Research Institute at Naliendele outside Mtwara, one of the few research stations in the world where cashew is given precedence. The Naliendele Institute has been supported by outside aid, notably from the Italians, and by two major projects funded by the World Bank.

Until recently, cashew breeding at Naliendele was limited to a selection programme, trying to find what is best from local material and foreign introductions. A breeding programme to generate new cashew clones started in 1996. New polyclonal seeds are now available for local farmers from six Cashew Development Centres (CDCs) scattered throughout cashew growing areas. Their adoption has been somewhat slow, but is by no means non-existent. Meanwhile, hopes of producing seedlings immune to disease have faded; what is aimed at now is maximum resistance.

Another approach to intervention is to help a limited number of hand-picked farmers to make the maximum use of their existing resources. This has been pioneered by

³¹ Packages of 200 g of whole white cashew nuts were sold in April 2007 in Helsinki at Stockmann for €3 per kg.

the business-minded NGO TechnoServe. The approach has been tried with a number of crops in a number of countries, e.g. with cashew processing in Mozambique. In Tanzania, TechnoServe is involved in coffee in Kilimanjaro and in the South West. In these regions, TechnoServe developed a business group model for coffee which it is now trying to apply to cashew cultivation. Some 12 villages with about one hundred “progressive” farmers in each of them have been selected for the pilot phase of this project. For these farmers, TechnoServe has arranged a supply of inputs and the guaranteed sale of their production. In coffee, it has embarked on niche marketing abroad on behalf of these groups; in cashew no such export scheme exists so far. In Tanzania, TechnoServe has teamed up with Olam. The farmers sell their nuts to Olam which pays them the indicative price – in the 2006/07 season somewhat grudgingly.

This is a pilot project whose success remains to be seen. In an environment like that of Southern Tanzania, such schemes inevitably run into numerous problems to do with timely delivery inputs, repayment of loans, etc. Even if it the pilot project would work with the selected farmers, the big question is whether it can be sustained and replicated so that most if not all the cashew farmers would be embraced by it. So far the number of beneficiaries is very small, and the scheme works on the strength of heavy intervention by TechnoServe.

Moving up in the value chain by increasing processing of nuts inside Tanzania would be an obvious way of reaping more benefits to the Tanzanian national economy. The macro economic advantages of processing, both in terms of value added and job creation, have indeed been clear for a long time; and there have been many attempts to raise the processing capacity in Tanzania. The success of these efforts has been much less than hoped for.

The most ambitious attempt was made in the late 1970s and 1980s. With two rather expensive World Bank loans, Tanzania built 12 highly mechanised cashew processing factories in the southern parts of the country. They were equipped with machinery from Italy or Japan. These became probably the most notorious white elephants on the Tanzanian aid scene. Even at their best, they worked for only a few years and then were shut down. As the marketed production of cashew nuts collapsed at the time the factories were finished they did not have enough raw material. They were also producing a high degree of broken, i.e. less valuable, kernels. Despite a few unsuccessful spurts in between now and then, most of them have been laying idle. These factories have now been privatized in an effort to revive them. So far only one of them, that in Masasi run by Buco Ltd, a Tanzanian private company, is regularly producing. Its installed capacity is 10,000 tonnes per year: it should be in practice be able to process several thousands of tonnes, but production has reportedly so far remained much below this.

A major reason for the slow restart is that the choice of technology is fixed. As the

factories are highly mechanised, profitable running requires large amounts of capital, to which the small entrepreneurs have no access. The defunct factories were sold cheaply to local Tanzanian entrepreneurs in order to keep them in domestic ownership. Few of the new owners have the capital to rehabilitate them. Business skills are in short supply. For those factories that are technically in order, the entrepreneurs lack money to buy the quantities of nuts needed for profitable mechanised production. The interest rates charged by Tanzanian banks are high, approaching 20%, and the banks are not used to financing any productive activities, let alone making analyses of business risk. Thus, the value addition that takes place in processing happens mainly in manually operated, Tanzanian-Indian (Premier, Mohammed Enterprises), or foreign owned installations (Olam).

The Fair Trade approach has not been tried for cashew in Tanzania; and the thin profit margins and the current working conditions in the factories would hardly allow any serious attempts in the near future. However, there have been some moves towards organic farming. Premier Cashew has a few villages in the Mkuranga District south of Dar es Salaam, where it has contracted some 500 farmers to produce cashew nuts without artificial fertiliser or chemical pesticides (sulphur is allowed though): the organically produced nuts are processed and stored separately. Premier Cashew pays the cultivators a premium price of 10 to 15% above its normal price for cashew nuts, and gets 20 to 25% more for these nuts when exporting. The nuts produced have been internationally certified, but it is not yet clear whether the difference will be enough to cover all the paperwork and other extra costs involved. In Masasi, a project has begun that is setting up farmer groups for production of organic cashew nuts.

8.2 Coffee in Tanzania

Coffee is one of Tanzania's traditional cash crops. It is still among the largest, together with cotton, tobacco, cashew nuts and tea. However, its contribution to total value of goods exported (including non-traditional goods) has come down drastically from around 20%, as recently as the 1990s, to reach the current 3.5%. The bulk of Tanzanian coffee production output is destined for export markets. Just a few percent of the coffee beans grown are fully processed and consumed locally. At the global level, Tanzania is a smallish producer, providing less than 1% of total world output.

The world market prices of coffee are notoriously volatile. At the moment, coffee prices are high: they have roughly doubled from the bottom price of the early 2000s. This means that recently the value of Tanzania's coffee exports has been growing, even though production has been fluctuating at low levels: in 1995/96 coffee production stood at 52,000 tonnes; it dropped to 37,500 tonnes in 2001/02, and 32,500 tonnes in 2003/04, recovering to 55,000 tonnes in 2006/07.

Coffee plays an import role in poverty reduction in Tanzania. More than 7% of the Tanzanian population depends directly on coffee for their income. The bulk of coffee production (variously estimated at 90-95%) is grown by small holder farmers, on a farm whose average size is only 1-2 acres, providing employment for some 400,000 families. Less than 10% is grown in estates. Small holder coffee farmers are mostly elderly folk, and perhaps one in four are women. Cultivation is mainly based on family labour, but many farmers also use temporary day labourers. Much of the work, especially picking and pruning, is traditionally done by women. For regions such as Kilimanjaro and Kagera, coffee constitutes a major source of employment. Out of the some 400,000 families that depend on coffee at the national level, most are based in these two regions.

Tanzania produces three types of coffee: mild Arabica, hard Arabica and Robusta coffee. About two-thirds of the coffee is mild Arabica, and the rest is hard Arabica and Robusta. Mild Arabica is regarded as the best coffee, used for quality blends in Northern Europe: it also fetches the best price. It is grown mainly in Arusha and Kilimanjaro in the north, and Mbeya and Ruvuma in the south, and a little in Kigoma in western Tanzania. Robusta is considered inferior in quality. It is mainly used for the espresso blends and darker roasts consumed in Southern Europe, as well as for instant coffee. Kagera produces about two-thirds of total Tanzanian Robusta coffee.

Production fluctuations follow changes in prices; but drought also plays a part. Trees are very old, and cultivation technology remains traditional. More than 90% of the smallholder coffee farmers in Tanzania use hand hoes. Even in the plateau environment where modern agriculture could be appropriate, the application of modern methods is negligible.

OECD countries, especially Europe, constitute the bulk of the markets for Tanzania's coffee exports. For the past five years, Germany has been the leading buyer of Tanzanian coffee, followed by Japan, Italy, USA and Belgium. Last year, Germany bought some 34% of all coffee exported from Tanzania, while Japan accounted for 13%.

The present high prices are not expected to remain high for long. World demand is currently lower than production. Recently Vietnam has emerged as a prominent coffee producer, second only to Brazil. Brazil has also increased production, hence flooding the coffee market. The coffee market is also gloomy because of declining per capita consumption in Western Europe and North America. Yet this is not simply an overproduction crisis. While markets for bulk coffee are becoming saturated, demand for speciality coffee is growing. However, in the composition of the consumer price of speciality coffee, the raw material itself plays a dwindling role.³²

Much hope is presently being put in these specialty coffees, and some successes have

³² An insightful analysis of the international trends is provided by Daviron and Ponte 2005.

been recently gained. Fair Trade and organic coffee farming is practiced in Tanzania, although such farming is still at an introductory stage. For example, in Kilimanjaro, certain cooperatives produce Fair Trade labelled coffee and sell it abroad directly. The Kagera Cooperative Union Ltd (KCU) has gone into what is understood as organic production, with some help from the Utz Kapeh foundation. KCU already has registered two farms at Ibwela and Kashwezi as pilots and plans to register twelve more.

8.2.1 Developments in Tanzanian coffee chain

The coffee industry has gone through tremendous internal changes in the past decade. It underwent a thorough marketing liberalisation in the mid-1990s. Despite the changes, the basic trend of stagnating output has persisted and the quality of most of the crop has even worsened.

Before liberalisation, coffee buying and processing was dominated by cooperative unions. For the first time, during 1994/95 private buyers were allowed to participate in the buying and processing of coffee, and Government control of pricing was reduced. The major motivation for the reforms was to raise the price paid to farmers by reversing their declining share of the export price, and to cut the delays in payments to farmers. By the end of the 1990s, private traders had captured a market share of two-thirds. Many private buyers evolved into vertically integrated exporters that bought coffee directly from the farmers, processed it in their own factories, and exported it themselves. Such an arrangement has now been forbidden, but it may continue under different guises.

As a result of the marketing liberalisation of the industry, the trend in the share of export price received by farmers was temporarily reversed. For Arabica coffee, it rose from 60% in 1985/86–1993/94 to 73% in 1994/95–1998/99; and for robusta coffee from 56% in 1985/86–1993/94 to 69% in 1994/95–1998/99. Supposedly this figure has not gone below 75%, but what has happened to the trend in recent years is not quite clear.³³ The reforms also substantially reduced delays in the payment to growers.

Yet the overall supply response has been disappointing. Between 1985–1999, there was an average 13% decline in production; this was not, however, uniform. While mild Arabica coffee production declined by 20%, hard Arabica and robusta coffee production increased by 10%. Declines in Arabica production were blamed on old coffee trees, especially in the Arusha and Kilimanjaro areas, the El Nino rains in 1997/98, and coffee berry diseases which mainly affected mild Arabica. Low use of fertilizer is seen as a further reason for the decline in production.

Use of fertilizers went down after the sector was liberalised in 1994/95. Previ-

³³ TechnoServe estimated it to have been only 43% in Southern Tanzania in 2003 (Piper 2007).

ously inputs were supplied to growers on credit by the Cooperative Unions. After the liberalisation, credit was cut and the subsidy was removed. In a survey conducted in Kagera in 1998/99, 41% of the respondents said that it was difficult to get fertilizer, and 39% complained about its price. A survey by the Economic Research Bureau discovered that nationally only about a quarter of coffee growers used purchased inputs after 1994. Since 2003/04 GoT has been providing a fertilizer subsidy to farmers, with coffee farmers among its beneficiaries, but the size of the subsidy is very small in comparison to the needs.

Following the fall in the world coffee price in the early 2000s, most coffee farms were either destroyed by cutting coffee trees, or left unattended. The current yield of coffee farmers in Kagera region is about 320 kg per hectare. This is a very low output compared to the normal coffee production of 1500-3000 kg per hectare. As for Arabica coffee, yield has fallen from 270 kg per hectare parchment in the 1970s to 170 kg per hectare parchment currently (Piper, 2007).

Measures to revive coffee production in the region, taken for example by the Kilimanjaro regional authorities, have met with disappointment. The coffee revival campaign in the Kilimanjaro region started 10 years ago. Among the efforts made was the replacement of old coffee trees with new, high yielding and disease resistant seedlings. The campaign to replace old trees has now spread throughout the country, but the response is still low.

Apart from the quantity, the quality of coffee produced in Tanzania has been declining. This is commonly blamed on declining input utilization. Another major reason that has been suggested is the change in buying practices. Before liberalisation, there was an incentive to deliver higher quality produce. The cooperatives paid farmers in instalments. The last instalment depended on quality: larger beans with a lower defect count fetched a higher price. After liberalisation, in practice, only one price is paid by private traders for any parchment/dry cherry bought at the primary level. Most coffee is now bought by the private traders, and the cooperatives often emulate their business practices. Thus there is little direct incentive for farmers to deliver better-quality coffee (Daviron and Ponte, 133-134, interviews).

The Tanzania Coffee Board (TCB) continues to regulate the industry. All actors including private buyers have to obtain a license from it. The Board guides private companies on how the whole business of buying coffee should be conducted. Some of the important parts of the permit are the emphasis on buying quality coffee at the displayed price and within the prescribed geographical area.

Although it has become possible to export coffee directly, this only applies to the highest quality and value coffee. Most primary processors (Cooperative Unions and private processors) still sell their coffee through the Moshi Auction. Coffee owners store their coffee at the TCB-certified warehouses, deliver samples to the Auction and

have a representative to repossess the coffee. The auction is conducted weekly. Prices basically depend on the world markets, but the Moshi auction usually has a higher price during the months of July to September. After September the price goes down until November to December. Much of the auctioning consists of formalising deals already agreed upon in practice, and involves extensive paperwork. It usually takes up to eight weeks to complete this paperwork, which means considerable costs for coffee owners. The late release of bank loans to cooperatives places cooperatives at a disadvantage.

8.2.1.1 Coffee value chain in Tanzania and beyond

Coffee can be considered a truly global product. It is produced in more than 50 countries. Even small producers like Tanzania export their coffee all over the world. The Coffee Chain begins with a cherry produced by a coffee tree in a warm country and ends as a drink in a cup at home or in a trendy café somewhere in the North. Tanzania is still a tea-drinking country and very little coffee is consumed locally.

Inside Tanzania, the main stakeholders of the coffee industry are the producers (larger and smaller), primary societies, Cooperative Unions, private traders and processors, R&D institutions and the regulator, the Tanzania Coffee Board (TCB). Almost all of Tanzania's coffee production is exported through the Moshi auction, a statutory body run and managed by TCB. International traders take the coffee primarily to consuming countries for further industrial processing. Processing includes roasting, grinding and packing. The later handling of mass market coffee is dominated by big multinationals, whereas fashionable specialty coffees sustain a great number of small companies.

But internal relationships in global coffee value chains keep changing. Global coffee production was regulated from the early 1960s onwards by voluntary quotas agreed upon between the producing and consuming countries in International Coffee Agreements. Due to disagreements among the producers this regime collapsed in 1989, after which production has been *laissez faire* and grown out of control. At the same time, the producer price has shown a secular decline even if it has fluctuated wildly and risen considerably at times. The share of the price which remains in the producer countries has also been in steady decline. While it was almost 20% in the 1980s, it fell to some 13-14% after liberalisation in the 1990s, and has probably fallen still further since then. Correspondingly, the consumer countries have gained: especially the Northern roasters seem to have increased their share. (Daviron and Ponte, 2005: 204-205, see also Table 11 below.)

Inside Tanzania, the farmers sell their coffee either to cooperatives or to private buyers. The coffee can be sold within a few days as cherries (notably robusta) or as processed coffee. The phase from harvest to auction is called primary processing: its

main goal is the separation of the bean from the skin and pulp of the cherry. There are two basic methods for this, depending on the type of coffee. Arabica is usually processed “wet”, that is, the cherries are harvested, then pulped, fermented, washed and dried. The result is “parchment” coffee. This goes to a curing plant, where the parchment is removed and beans are cleaned and polished. For Robusta, and some Arabica coffees, the “dry” method is used. Dry-processed Arabica is known as Hard Arabica. Coffee is picked while ripe and dried in the sun until the coffee bean inside separates. Outer shells are then removed in a huller. The end result of both methods, wet and dry, is “green” coffee ready to be sold.

Arabica coffee is either hand pulped by smallholder growers or sent to central pulperies, owned by cooperative unions and GoT, for processing. Hand pulped coffee is of lower quality and fetches a lower price than the coffee processed by central pulperies. Primary societies then collect coffee which is now dry and clean, and stock it properly for later transferring to the cooperative union. Private buyers also buy ripe coffee and process it in their own plants. The cooperative unions, through their agents, clean, grade, label, bulk and pack sacks of coffee beans for shipping. For clean (i.e. processed) coffee, only re-cleaning and grading is done.

The price paid to farmers is calculated from the export value at the time of the auction. The middleman transaction costs are first deducted. Amounts payable to farmers are further reduced by taxes and other administrative costs, as traders transfer these to the farmer when calculating farm gate prices. Coffee buyers are charged VAT, a district cess of 5%, research costs of 0.75% and multiple other taxes. They are also forced by law to use sisal bags that are expensive compared to jute bags. At their best, the farmers used to receive some 70% of the export price, but this share has apparently gone down again as world market prices have risen.

In 2006/07, a 50 kg bag of coffee was fetching in Tanzania an average price of \$93.33, up from \$49.13 per 50kg in 2000/01. Based on this, and knowing the calculation for the buyer’s price paid to the average Tanzanian coffee farmer, one can estimate that the farmer was paid some TSh1,100 per kilo. For Arabica grown on Kilimanjaro, the common price was TSh1,500 per kilo. As a small farm of one to two hectares could produce yearly from 20 to 100 kg (Arabica in Kilimanjaro) or 200 kg or more (Robusta in Kagera), the farmer (some of whom are women) could earn during the time of high prices from some 20,000 to over 100,000 TSh per year, that is from a few dozen to more than 100 USD. As the production costs per kilo may range from TSh 500 to TSh 1,500 – the estimates vary enormously – even at the lowest production costs the farmer’s profit is small indeed.

There has also been some differentiation taking place among the producers. With the help of the Kilicafe association established by TechnoServe, some more “progressive” groups have been able to improve their cultivation methods and to bypass the

one compares the present, high, world market prices, of which the producing farmer is being paid almost USD\$1 per kilo, and compares what the farmer gets to prices for processed coffee on the supermarket shelves in Finland (from 2.5 to 5-6 per half a kilo package, i.e. c. USD\$6.50 – USD\$15.60 per kilo), one can guess that the difference cannot come only from the costs of transport, processing and marketing, meaning that the profit margins must be considerable. And in speciality markets, including Fair Trade, the margins must be even higher than in the strongly competitive mainstream.³⁴ In a cup of latte costing more than €3 in a trendy café, the share in total cost of the coffee itself, not to mention the price paid to the original coffee farmer, must be miniscule. As the calculations by Ponte (Table 11) graphically show, the cultivator's share is small in any chain. She or he earns relatively best from the mainstream coffee, but even there, by far the greatest amount is pocketed by the Northern roaster – except in the case of the Italian coffee bar, where the barkeeper takes the most.

Table 11. Some Tanzania-Italy/US coffee value chains 1999/2000
(% of retail price)

	Tanzania-Italy Home consumption	Tanzania-Italy Bar consumption	Tanzania-US Specialty
Farm gate	8.7	1.2	4.1
Auction	20.7	2.7	7.6
Export harbour fob	23.3	3.0	8.1
Import harbour cif	25.0	3.2	8.6
Roaster selling price	88.0	33.3	80.0
Retail consumer price	100.0	100.0	100.0

Source: Daviron and Ponte, 2005: 210, 212, 215

8.2.1.2. Challenges along the coffee value chain

Producers. With the exception of large estate growers, Tanzanian coffee farmers all use traditional means of production, and most of them cannot afford modern inputs. The fact that coffee has been grown for decades using traditional methods impedes the introduction and adoption of new production methods. Farmers have not kept abreast of changing consumer requirements: modern consumers insist on good agricultural practices, safety and quality assurance. Moreover, most of the harvest is taken from old coffee trees, since no serious initiatives have been made to encourage planting new coffee trees. The huge fall in the world market price for coffee that occurred in 2001/2002 demoralized farmers to the extent that some even cut down their coffee trees. In addition, coffee tree and coffee bean diseases and pests pose another challenge.

³⁴ See also the calculations on the value chain of instant coffee below.

Primary Societies. The primary societies are composed of the leaders from among the coffee farmers. In most primary societies, the leaders have a wide understanding of coffee from planting up to the farm gate. Very few, however, know and can explain the process beyond the gate. The facts that the members of the societies, and most coffee farmers, lack business management skills (often including basic accounting), and have little understanding of business transactions occurring outside and beyond the society, make the society system ineffective.

The primary society can finance neither its activities (collection of coffee) nor its administration. It has to borrow from the cooperative unions to buy coffee during the season. In turn, the society has to sell all coffee to the cooperative unions. In order to cover administration costs, the society takes an agreed-upon percentage of sales from each farmer. Most of the cooperative's loss takes place at the society level, sometimes as a result of mismanagement.

Cooperative Unions. The Board of Directors of a cooperative union is selected from among the members of the Primary Societies that make up the cooperative. As most societies have members with few or weak business skills, this means that the cooperative boards may have weak management. The cooperative unions are extremely dependent financially on banks and show no indication of becoming financially stable in the near future. Every season the cooperative unions borrow almost 100% of the money required for buying coffee. The interest rates for short-term loans is very high, i.e. more than 12% interest for a six-month loan. The banks loans are also credited to accounts very late, however early one applies. Consequently, the primary societies collect coffee on credit. This exercise forces most farmers to sell to private traders who pay farmers immediately in cash, although at a low price. As a result, the cooperative share of the coffee buying is squeezed by middlemen and a few licensed buyers. For example, in the Kagera region, where we conducted interviews, these licensed buyers, including KCU, buy coffee based on the previous year's average annual selling price at auction, which has no influence whatsoever on the outcome of the coming season's auction prices.

Private buyers and processors. The private buyers were introduced into the system following the marketing liberalisation of the coffee industry. The aim was to create competition at the farm gate that could give good returns to farmers. Initially, private buyers paid a higher price compared to the cooperatives. Later, although the cooperative unions' price combined with other cooperative benefits to farmers remained much higher, private buyers continued to win out in the market because most farmers are cash constrained and need the immediate cash payments of the private buyers.

The newly introduced 'one license' rule has succeeded in raising competition at the

auction, but it has stagnated competition at the farm gate level. The benefits being realized at the auction do not necessarily go back to the peasant farmers. Recently a group of wealthy farmers have emerged, who gamble and exploit peasants by buying coffee at their doorsteps in a system commonly known in Kagera as “Butura” (buying un-dry coffee). These gamblers accumulate and dry the coffee, and later sell it to either the unions or coffee smugglers. It is the unions who mostly benefit from the ‘second’ payments that result from the auction competition benefits. This system amounts to exploitation of the farmers.

Supporting Institutions and Regulators. The coffee regulator, Tanzania Coffee Board (TCB), provides licenses for buying coffee, and works to maintain coffee quality through awareness and sensitization. Achieving the latter objective, controlling coffee quality, is a great challenge. Some buyers misuse their license and go beyond the requested and approved geographical areas.

Tanzania Coffee Research Institute (TACRI), whose headquarters is in Lyamungo, Moshi, is in charge of coffee improvement and productivity. TACRI works particularly in two main areas: it conducts research on improved coffee tree seedlings, and trains farmers in good agricultural practice. It has recently developed an improved variety of Arabica that is highly productive and resistant to coffee berry diseases, which TACRI believes may revitalize the Tanzanian coffee industry and make it bloom again (*The Guardian*, Dar es Salaam, 5 July 2007).

TACRI has branches in various places in Tanzania, including the Kagera region. However, these branches, especially the one in Kagera, lack facilities and resources for carrying out their functions. The absence of a Quality and Tissues Culture Laboratory makes the cost of coffee research for improvement and productivity very expensive. Samples have to be sent to TACRI Headquarters in Moshi for testing.

Our recent visit to the Kagera TACRI revealed that it has only two officials, of whom one is a university graduate, to support 250,000 farmers scattered throughout the region. The proportion of farmers to extension officers is likewise high. The farmers that benefit most from the extension service are located close to urban areas and along the roads.

Africafe – What’s in a Brand?

Tanzanian instant coffee Africafe, in its red-brown-gold tins or plastic packages, used to be a well-known brand in Finland. It was promoted through intensive efforts by various well-wishers. Its main importer, ‘Tampereen kehityksmaakauppa’ (Tampere KMK, the Tampere Third World Shop), provided roasting and

packaging machinery to Africafe packers, Tanzania Tea Blenders, Ltd. At one time Africafe instant coffee was widely available in popular K-shops in Finland, and posh supermarkets. It is still all over the place in Tanzania, but the varieties sold as Africafe in Finland look somehow different, and its visibility has gone down. What has happened?

The story of Africafe is an interesting example of the economics and politics of coffee production in an African country. It involves forces and factors such as local and global coffee markets, politics of patronage, and international aid, and holds important lessons for Aid for Trade. In fact, the “ethical privatisation” that Finland has registered in its Aid for Trade statistics in Tanzania (see above: pp. 61) was related to the privatisation of Africafe’s packer, Tanzania Tea Company, Ltd. (TTBL).

Africafe continues to be the main TTBL brand: with its 75% market share it dominates the instant coffee market in Tanzania. But TTBL does not produce any coffee itself. It only packages it at its Dar es Salaam factory, and markets it domestically and internationally. The coffee inside the Africafe packets and tins is produced far inland, in Bukoba in Kagera region on the shore of Lake Victoria, by a company called Tanganyika Instant Coffee (Tanica).

Tanica’s factory in Bukoba is the only factory in Tanzania, and indeed in the whole of East Africa, which produces instant coffee. It buys the beans from local farmers, takes the water from the lake, and produces spray dried instant coffee powder in a process that consists of roasting green beans; grinding them; extracting coffee solubles by mixing them with water under high pressure; and drying this extract by spraying it into a hot air tower. It mixes Robusta and Arabica in differing blends for differing markets.

The factory has been running like this for the last 40 years, since it started operating in 1967. The Africafe brand also originates from those times. While Tanica has always been a state-owned company, it was initially under foreign management: Lyons 1967–1972 and Nestle 1972–1982. It has been under local management since 1982. A few changes were made in the machinery by Nestle, but fundamentally the factory remains as it was designed and built. Obviously it is now in need of a major overhaul.

The installed capacity of the plant is 500 tonnes of instant powder per year. This is very little by modern standards. World production of instant coffee – powder and granular together – is roughly 500,000 tonnes. However, the production of Tanica has never reached its designed capacity. The nearest it came was in 1980, when it was some 450 tonnes. In recent years it has been closer to

250 tonnes annually on average.

In addition to the old machinery, Tanica suffers from many other problems. For example, it often doesn't have enough money to buy green beans and fuel when they are most needed. Another major problem is its dependency on TTBL. Tanica provides more than a third of its instant coffee powder in bulk to TTBL, which transforms it into Africafe and sells up to 100 tonnes per year in the domestic market at a good price. Tanica has tried to develop its own brands on basically the same bulk (Tanica and Kilimanjaro Café), but it is unable to compete with the well-established Africafe, although it offers its brands at 30% lower prices.

As long as Tanzania pursued its ujamaa policies and both Tanica and TTBL were parastatal, i.e. majority government-owned companies, the working arrangement did not seem problematic. But when the market economy came to Tanzania in the late 1980s, not least because of the insistence of the donors, the coffee and tea companies were slated for privatisation and the old partners parted ways. At this point, Tampereen kehityksmaakauppa (Tampere KMK) became deeply involved in the process.

When TTBL was privatised, i.e. liquidated, Tampere KMK made a joint bid together with a number of cooperative unions and workers for the company, but they lost out to a Tanzanian company run by a well-connected family of Iranian origin. Tampere KMK had prepared themselves for such an occasion by declaring that in the case of possible privatisation the Africafe roasting and packaging machinery Tampere KMK had donated – financed mainly from the NGO funds of the Finnish Foreign Ministry – would not be included in the offer but could be handed over to the workers or claimed back. The successful bidder insisted they had bought the machinery as well. A long and acrimonious row over “Tampereen machinery” ensued and went to the court. The Tanzanian High Court gave a ruling favour of Tampere KMK, but the new owners of TTBL appealed. The case has been hovering in the Tanzanian legal space for years and is still pending.

Meanwhile, Tanica came up for privatisation. Tampere KMK backed a consortium of local cooperatives: Kagera Cooperative Union, Karagwe District Cooperative Union, and the Federation for Tanzanian Cooperatives, which won the bid. Old partners had now turned into rivals and Tanica is, with support from Tampere, trying to conquer the market share now held by TTBL. Tampere KMK plans a major rehabilitation of Tanica and is seeking support from, among others, Finnfund.

TTBL has continued to market Africafe internationally, but it has lost some of its Fair Trade related markets. To be sure, Africafe has never been officially certified by the Free Trade Labelling Organization, but it has enjoyed a “fair” image because of its close relationship to European Fair Trade organisations such as Tampere KMK and Twin Trading in the UK. The Tanzanian cooperative unions were able to muster the capital for their bid for Tanica basically thanks to commitments from the Northern Fair Trade organisations.

Tampere KMK has discontinued any dealings with TTBL. Tampere KMK now buys instant coffee in bulk from Tanica through the Kagera Cooperative Union, packs it in Finland, and sells it under the name Africafe without using the elements of the original logo. It also imports Fair Trade certified coffee from cooperatives on Kilimanjaro.. Sales are fairly modest; but Tanzanian coffees fetch a good price at Finnish solidarity markets and keep Tampere KMK in business.

Over the whole period, more than €160,000 of Finnish development aid, and probably even more of Tampere KMK’s own funds, originating not least from its coffee business, have been used: first to deliver the machinery to TTBL; then, unsuccessfully, to try to rescue it from TTBL’s new owner’s custody (which was what “ethical privatisation” was all about). The machines are still at the TTBL compound in Gerezani in Dar es Salaam. The company boasts that it is doing well enough and does not need such antiquated machines and can even “donate them back”.

In principle, instant coffee could be a good business for all involved in Tanzania, if more value added could be created inside the country. One kilo, packaged in 100 g pouches, fetches almost €50 in Finland. It is sold by Tanica at less than €10. In very rough terms, the farmer may at best get some two euros for the raw coffee needed to produce 1 kg of instant coffee. The cooperative, which turns the cherries into clean coffee, takes perhaps another two euros. Taking the production costs into account, the margins for the value chain are small up to the exit door of Tanica. Inside Tanzania, TTBL and the retailer add more to the value. In an upmarket supermarket in Dar es Salaam, a kilo of Africafe in tins of 250 g sells at around €15 while that of Tanica brand sells at around €10.

Tanzanian prices, however, are high by international standards and competition outside the solidarity markets is stiff. Brazil’s big factories can churn out instant coffee perhaps with one third of the costs of Tanica and sell it correspondingly cheaper to the world market. Also the world demand in instant coffee seems to be shifting from powder to granular form. It is hard to see how

any conceivable Tanzanian producer of the size of Tanica could be competitive in the open world markets. Important questions include: how long are the solidarity customers willing to pay the premium, and how will the home market for coffee in Tanzania develop.

8.3 Value Chain Case Studies in Zambia

In Zambia, this report investigated the value chains for fresh vegetables and for the cotton industry. The value chain for international fresh fruit and vegetables is made of retailers, importers, exporters, and growers; it can be seen as buyer-led and increasingly concentrated. The market shares of the traditional outlets have declined, with major supermarket chains dominating the market in the retailing sector. In the growing sector, the share of small farmers producing for export has declined, while the shares of exporter-owned farms and large commercial farms have increased. In cotton, the market is much less concentrated, although even here there are a few dominant players. Cotton is grown for both the local textile industry and for the export market. Most of the cotton in Zambia is grown in outgrower schemes organized by the large cotton mills. More than 200,000 smallholder farmers are involved in these schemes, producing more than 90% of the crop. Improving and upgrading the cotton industry therefore has the potential to strongly influence an increase in pro-poor growth, and thus on the reduction of poverty.

8.3.1 Value chain for fresh vegetables

Zambia's fastest growing export sector has been in non-traditional agricultural products³⁵. This basically means fresh vegetables and cut flowers. Vegetables grown include baby corn, snap beans, garden peas and mange tout, while roses are the most commonly grown flowers for export. The United Kingdom is the major target market for fresh vegetables, with approximately 80% of the exports, followed by South Africa (10%) and other European countries (10%) (EBZ, 2001). Consumer demand for out-of-season fruits and vegetables has increased in recent years. The demand for organic fruits and vegetables has created a potential niche market for producers in African countries like Zambia. South Africa, Cote D'Ivoire and Kenya are the leaders

³⁵ These are usually defined as crops that do not form the customary diet of the local population but are grown primarily for export (Temu and Temu, 2005). However, the term 'non-traditional exports' (NTE), within the Zambian context, refers to commodities other than copper or cobalt.

with Zambia, and Zimbabwe has seen rapid growth in this sector in recent years.

Fresh vegetables for export are grown mainly by commercial farmers, with some growing contracted out to smallholder farmers in the Lusaka area. In a few cases, smaller farmers in established cooperatives can work towards certification through training. For example, the Lubulima cooperative was provided with training through the Zambia Export Growers Association (ZEGA) Training Trust and is now able to provide vegetables to larger farmers like York Farm. These include baby corn, fine beans, green peas, mange tout and sugar snaps.

Singh (2002) provides an analysis of the value chain for non-traditional crops in Africa. The structure of this chain is detailed below:

Retailers include (1) traditional greengrocers and vegetable markets, (2) supermarkets and major retail chains like Sainsbury's and Tesco in the UK. The market shares of the traditional outlets have declined, with major supermarkets now dominating the market. Due to the volume of produce that supermarkets require, they tend to bypass wholesalers and deal directly with suppliers and importers. Multiple supermarkets invest heavily in the development of the supply chain to identify and retain suppliers who repeatedly deliver contracted produce of high quality in a timely manner. Functions of multiples in the supply chain of non-traditional crops are as follows: make produce available for consumer use; advertise the product to increase sales; supply value added products; keep track of consumer preference; monitor suppliers; and set the retail price for the fresh produce based on the supply and demand factors and on market competition.

Products with most value added in this case include vegetables that are washed, chopped, and mixed so that they are ready-to-use as salads or stir-fry. Different fruits are also washed, peeled, mixed and packed as ready-to-eat servings.

The procurement of fresh fruits and vegetables by the EU from Africa is handled through **importers**. Once multiples and wholesalers decide on the items, their quantity, and the delivery schedule of imports, then procurement orders are placed with the appropriate importers. Importers share in the responsibility of enforcing standards established by the retailers.

Exporters do not just ship produce, but are also the primary party in Africa responsible for meeting the supply chain requirements set by retailers. Due to the perishable nature of the produce, it has to be air freighted. Logistics is a core competence required by exporters, who must invest in computerised supply chain management. These firms need the capability to work closely with European importers; an organization competent to deal with growers to meet volume and quality requirements; capital to invest in transportation and post-harvest facilities; ability to benefit from

governmental incentives; and connections to bypass bureaucratic hurdles. Only a few large firms can meet such requirements.

Growers are divided into three main categories:

(1) **Exporter-owned or exporter-leased farms:** To increase the profit margin, exporters have entered into on-farm crop production. This way they gain control of all operations on the export side of the supply chain. It also makes the phase from harvesting to value added processing an integrated operation, which also makes it easier to ensure compliance with labour laws, pesticide regulations, and safety regulations. Growing crops on their own farms guarantees exporters continuity of supply and reduces risk of losing suppliers to the competition.

(2) **Large commercial farms:** Large exporters prefer dealing with commercial farms because they can supply different products, meet large volume requirements for export transactions, and are managed professionally. Larger commercial farms are better able to guarantee consistency and reliability of delivery. Yet even they can face financial difficulties and go out of business, as happened with Agriflora, which was one of Zambia's biggest exporters of high-value fresh vegetables.³⁶ Some of its outgrowers were inherited by York Farm, another big producer.

(3) **Small Farms:** The number of small farms producing crops for export has been steadily declining in "older" producer countries like Kenya; and the tendency towards the concentration of production and processing in the hands of a few large commercial farms is likely to continue (Dolan and Humphrey, 200X). Variations in crop quality due to non-uniform agronomic practices from farm to farm; logistic problems with overseeing compliance with pesticide use, child labour, and worker safety regulations; and the difficulty of communicating with large number of growers, combine to make small growers less attractive (Singh, 2002, 87-89). Many of the "smallholders" involved are in fact educated, former civil servants and parastatal employees who have settled in the immediate and periurban area of the capital.

8.3.1.1 Governance and value chains for fresh vegetables

The value chains for fresh vegetables are buyer-led in the sense that European supermarkets exercise a considerable degree of control over what happens far down the chain, even though they only take ownership of the product when it arrives at the distribution centres (Dolan and Humphrey, 200X, 3). Power is exercised through the requirement that producers must meet established standards. For vegetables, UK

³⁶ The appreciation of the Kwacha in late 2005 and early 2006 had a devastating effect on the agricultural export sector.

supermarkets have introduced codes to protect themselves from a variety of consumer concerns including food safety, the natural environment, and social concerns. Standards include EUREP-GAP, Ethical Trading Initiative (ETI), and social accountability. Due to the high quality control standards required by supermarkets in the UK and Europe, most smallholder farmers are not in a position to participate in this sector as they are not EUREP-GAP certified.

In addition to the external standards, the members of the Zambia Export Grower's Association (dominated by large commercial farms) have also established their own standards. This is mainly to protect the sector's reputation in the highly competitive international market. The inability of smaller farmers to comply with the multiple standards required acts as an effective barrier to entry into the sector. In a few cases, smallholder farmers in established cooperatives can work towards certification through training. For example the Lubulima cooperative was provided with training through the Zambia Export Growers Association (ZEGA) Training Trust. It is now able to provide vegetables to larger farmers like York Farm.³⁷ These include baby corn, fine beans, green peas, mange tout and sugar snaps.

However, although the lead supermarkets demand compliance with codes, they offer no guarantee that they will buy from producers in developing countries even when the latter bear the additional costs of such compliance. A study of the Zambian horticultural sector found that costs such as clinics and chemical storage facilities, protective clothing and medical check-ups for all pesticide sprayers, were borne by the supermarkets' suppliers (Freidberg, 2003: 39).

8.3.1.2 Process of production

The process of growing vegetables from planting to harvest takes 8-16 weeks depending on the crop. The vegetables are stored in cool before going to the packing sheds where they are washed and packaged. The produce is loaded in refrigerated trucks and transported either to Lusaka International Airport or Durban, South Africa where it is airfreighted. Although South Africa is further, the cold chain is more efficient. Ideally, vegetables should be kept at 2°C throughout transportation. The vegetables are stored and processed by the importers in their facilities and then distributed to supermarkets, including those in the Tesco chain in the UK.

³⁷ It should be noted here that many of the smallholders able to do this are mostly educated former civil servants and parastatal employees who have settled in the immediate and periurban area of the capital. This is not representative of the smallholder population.

Figure 2. Value chain for Fresh Vegetables

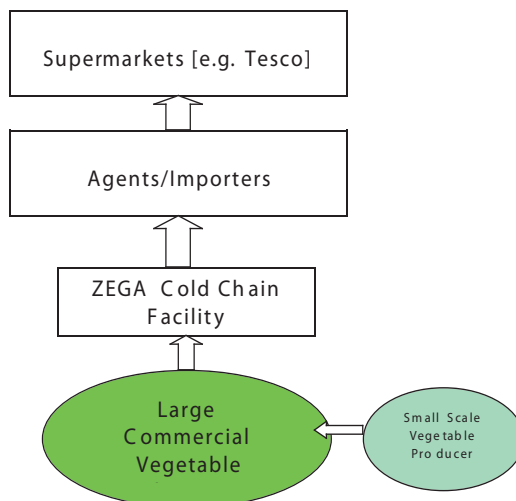
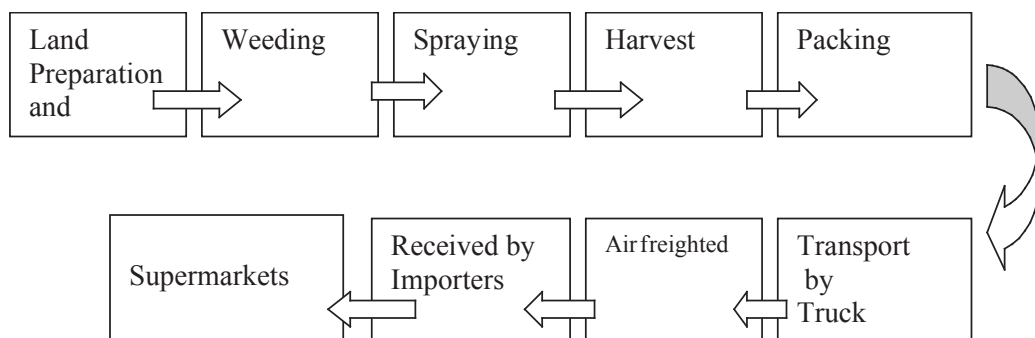


Figure 3. Process of Production of Fresh Vegetables



8.3.1.3 Cost and pricing

Prices paid to producers for fresh vegetables were difficult to establish during fieldwork. However, research has shown that producers receive only a small proportion of the final price paid by consumers. For example, producers in Kenya and Zimbabwe received 14.1% and 11.9% of the final price, while supermarkets received 45.5% and 45.9% respectively (Harris-Pascal, Humphrey and Dolan, 1998). An interview with a smallholder revealed that he received £1 per kilogram for his baby corn, while 250 grams of baby corn in Tesco were priced at £1.49 in store in February 2007.

8.3.1.4 Employment and wages

The expansion of the horticultural sector in Zambia has created employment, particularly in and around Lusaka. Employment in this sector was estimated at 8,000 persons, although it fluctuates (Barrientos, Dolan and Tallontire, 2001).³⁸ Women comprise approximately 70% of workers producing fresh vegetables and are typically concentrated in labour-intensive work such as packing and harvesting. Wages on commercial farms exporting fresh vegetables are above the minimum wage and quite competitive in relation to other agricultural producers. Additionally, standards required by EU consumers means that conditions of employment are considerably better. However, much of the work is seasonal and casual (Barrientos, Dolan and Tallontire, 2001).

8.3.1.5 Challenges and issues

In order to increase the income of the largest number of people, the Zambian government has sought to increase the participation of smallscale farmers as outgrowers in the production of non-traditional crops for the export market. However, one of the essential requirements of this sector is proximity to Lusaka International Airport, or a good road connection to South Africa.

Export horticulture represents an opportunity for reducing poverty through income generation among smallholder farmers on outgrower schemes, and creation of employment on larger farms. The government and donors can facilitate the continued participation of smallholder farmers by dissemination of information on good agricultural practices, raising awareness of export standards, providing support for certification, and supporting producer cooperatives.

There have been government and donor led efforts to raise the value added in Zambia in the vegetable and fruit market. Import substitution industries set up by the government prior to trade liberalisation have not survived competition, especially from South African products. One argument for this failure is that liberalisation of the sector was too hasty for the industries, which were unprepared for international competition. Currency fluctuations of the Kwacha distort prices farmers/ginners expect to receive, and also increase the risks of long-term financing.

Organic production is an area in which Zambian producers could potentially participate. This has been triggered by the increasing demand from UK supermarkets for organic products. However, this is by no means a risk-free enterprise as is shown by the fact that AgriFlora, which was one of the pioneers in this market, went out of

³⁸ Over 60% are seasonal and one farm indicated that employment dropped from 4,000 to 2,000 workers when the Kwacha appreciated.

business. York Farm has followed in Agriflora's footsteps, starting a small, trial organic plot in addition to its high-value/low-volume vegetable export production.

The suggestion has been made that one of the strategies of government should be to encourage agro-processing and upgrading within value chains (Weeks et al., 2006: 73). An example of such an attempt is presented in the box below.

Freshpikt Canning Factory

Officially opened in February 2006, Freshpikt is a new company processing vegetables and fruits at what used to be the Zamhort factory in Lusaka's industrial area. Products include canned tomatoes, beans, sweet corn, pineapples and guavas, as well as mango, pineapple and guava juice concentrate. USAID provided support for its establishment through the Market Access, Trade and Enabling Policy Project (MATEP) and the Production, Finance and Technology Project (PROFIT). MATEP provided financing to purchase the agricultural raw material inputs for production and helped the company to identify export markets. PROFIT is working with smallholder farmers to strengthen their capacity to supply the quantities of raw inputs required, at the quality standards necessary for Freshpikt operations.

Source: MATEP, 2006.

8.4 Value chain for cotton

The value chain for cotton is not quite as buyer-driven as that of fresh vegetables. Both producers and end users are many and dispersed. Cotton in Zambia is grown for both the local textile industry and for the export market. The sector has substantial smallholder participation.³⁹ Yet two dominant players have much to say. Most of the internationally traded crop is sold through international trading companies such as Dunavant and Cargill, which also control most of the ginning capacity. Production takes place on outgrower schemes run by ginneries that provide seed and pesticide as part of the credit package.

³⁹ Central Statistical Office Classification of Farmers: Small scale (0.5-9.0 hectares); emergent (10-20 hectares); medium scale (20-60 ha); large scale (60 ha and above).

8.4.1 Overview of the cotton industry

The quality of cotton produced in Zambia is relatively high because it is handpicked. It is therefore cleaner, and less damage is done to the cotton fibres. Zambia has the ability to more than double existing cotton seed production to become a major producer of both bulk cotton and cotton seed in the region.

Cotton production in Zambia has been growing since liberalisation as shown in Table 12. The growth in production has largely been achieved through an increased recruitment of farmers as the major growers invested to expand and improve the efficiency of their outgrower schemes (RATES, 2003). Total production of seed cotton was 180,000 metric tonnes in 2005, an increase of 23% from the previous year (Chiwele, 2006: 8). Estimated earnings from cotton exports increased nearly four times between 2000 and 2005, from \$10 million to \$36 million (ZNFU/GRZ 2005).

The Lint Company of Zambia (Lintco) was set up by the Government in 1976 to develop the cotton industry. After privatisation in 1994, the sector evolved from being monopolised by Lintco to having a number of established companies, including Dunavant Zambia Limited, Clark Cotton (now Cargill), Amaka Holdings Limited, Continental Ginneries Limited, Zambia-China Mulungushi Textiles, and Mukuba Textiles.

Table 12. Zambia: Cotton Production (1991–2002)

	1991–1992	1992–1993	1993–1994	1994–1995	1995–1996	1996–1997	1997–1998	1998–1999	1999–2000	2000–2001	2001–2002
Hectares (in thousands)	42	68	74	84	98	140	173	150	125	114	165
Raw Cotton (thousand tonnes)	26	32	37	42	49	84	104	88	75	80	116
Yield for SSF kg/h	500	500	500	500	500	600	600	600	600	700	700
No. Farmers (in thousands)	38	40	50	50	50	85	86	95	120	140	145
Average Production Costs/h USD\$	71	71	71	71	71	71	71	71	71	71	71
Raw Cotton Purchase Price USD\$/kg ???	.25	.25	.25	.25	.25	.25	.25	.25	.25	.25	.20

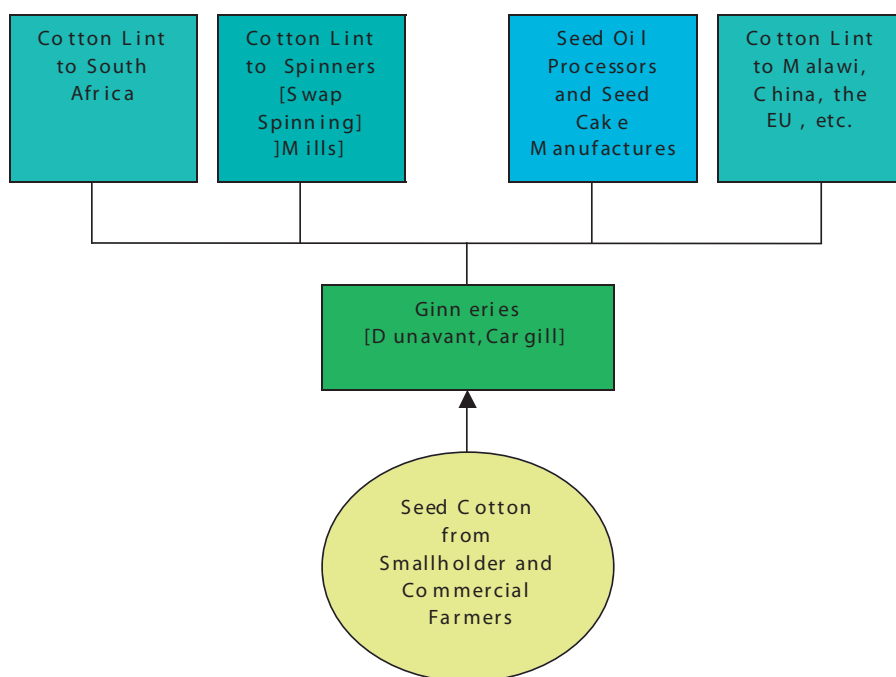
Source: RATES, 2003:12

8.4.2 Value chain for cotton

The cotton chain in the narrow sense begins with primary production and ends with lint or yarn exports to international markets and to domestic textile and clothing industries. The focus of this case study is on the seed cotton value chain. The major actors here are the ginning firms Dunavant Zambia Limited and Clark Cotton (now

Cargill), who accounted for 46% and 28% of the market, respectively. Dunavant established its operations in Zambia in 2001, after purchasing the Southern and Central Province operations of the former Lintco from Lonrho.⁴⁰ Dunavant has a ginnery capacity of 95,000 tonnes of seed cotton. Clark Cotton (Cargill) is based in Eastern Province with smaller operations in Southern Province, producing 38,000 tonnes in 2002.

Figure 4. Cotton Industry Structure



⁴⁰ Dunavant Enterprises, Inc. is the largest, privately owned, cotton merchandiser in the world, handling in excess of 6 million bales of U.S. and foreign cotton per year. Dunavant owns various real estate development companies, a truck brokerage company, cotton warehouses in the United States and Australia, ginning operations in Zambia, Uganda, Mozambique, and Australia, as well as a commodities trading company with locations in New York and Memphis, Tennessee.

Table 13: Cotton Trade Flow Leaders

Product	Producer	Buyer/Importer
Seed cotton	Outgrower schemes	Dunavant, ClarkCotton, ZCMT*, Continental Ginnery
Cotton lint	Dunavant, ClarkCotton, ZCMT, Continental Ginnery	Swarp Spinning (Local), Mukuba Textiles (Local), South Africa, EU, China
Cotton yarn	Swap Spinning, Mukuba Textiles and ZCMT	Mukuba Textiles (Local), ZCMT Local, South Africa (under SACU and AGOA), Mauritius (under AGOA), Botswana (under AGOA)
Woven Fabric	ZCMT	ZCMT Outlets (local) USA and EU
Garment	ZCMT, Unity Textiles	USA (under AGOA)

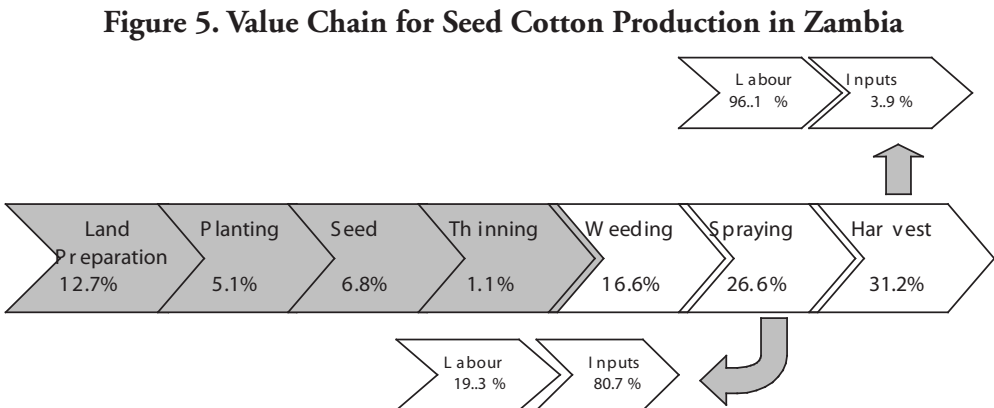
Source: RATES, 2003,37

* Zambia-China Mulungushi Textiles

8.4.2.1 Process of seed cotton production

Most of the cotton in Zambia is grown through outgrower schemes with approximately 227,000 smallholder farmers producing 90-95% of the crop on 254,000 hectares of land. Average yields are 530 kg per hectare, but these can be as high as 2,200 kg per hectare (GDS, 2006). The ginneries provide seed and pesticide as part of the credit package. Fertilizer is not usually provided, as it could also be used on other crops, such as maize. When the cotton is ready, it is handpicked and then delivered to a localised depot where the crop is weighed, graded (A, B or C) and recorded. Farmers are then given payment slips indicating the amount to be paid, minus the credit repayment for outstanding inputs.

The production of seed cotton goes through a number of production steps as indicated in Figure 5 below:



Source: Global Development Solutions, 2006, 8

The chain begins with land preparation and ends with harvest. According to an analysis by Global Development Solutions, harvesting represents the highest cost in producing seed cotton, at 31.2% of the cost. Reducing this cost would require an increase in labour productivity. Spraying accounts for 26.6% of the cost. This cost is so high because the crop has to be sprayed up to five times in the season. Cargill and Dunavant provide about 70% of the farmers' requirements. The smallholder uses local labour for weeding the crop, and the process accounts for 16.6% of the production cost. Although herbicides may be a more efficient way of controlling weeds, the cost of chemicals may be a constraint.

After the whole process is complete, cotton producers earn, after deducting all costs including their own labour, approximately US\$31.13 per hectare, given that the ginners were to pay them K1,000/kg of delivered seed cotton. This is a price lower than what was paid to producers in 2005, but slightly higher than what was offered in 2006. With cotton producers farming 1.5 – 2.0 hectares of cotton per year and receiving K1,000/kg for their seed cotton, they would earn an estimated income from cotton of US\$47 – US\$62 per year. This is after paying themselves an average labour rate for their time and that of their family.

One of the issues that came up during interviews with stakeholders was that of price. Farmers were sometimes unhappy with the price paid and believed that there should be more clarity and room for negotiation with ginners. On the other hand, ginners argue that the appreciation of the Kwacha in 2005/2006 meant that they could not pay the original estimated price.

8.4.2.2 Challenges and opportunities

Some of the constraints affecting the cotton seed outgrower schemes include: side selling by farmers; poor understanding and interpretation of contracts among distributors and farmers; ginners' tendency to push down producer prices to maximise margins; low output prices due to high transaction costs and low quality grades; lack of capacity to trace source of poor quality product; distributors' inability to verify delivery claims by farmers; low yields averaging about 600 kg per hectare; logistical problems and the impact of HIV/AIDS on farm households (RATES, 2003:15; Chiwele, 2006: 8).

As is the case with the rest of the agricultural sector in Zambia, small and medium scale farmers have limited access to longterm finance to invest in improving their levels of productivity. Firms managing outgrower schemes also face problems with borrowing to meet the demand for inputs and other activities, due to high interest rates on kwacha denominated lending facilities (Chiwele, 2006: 9). "The free or subsidised inputs, and centrally purchased outgrower programme inputs, seriously inhibited the

development of independent thinking, as well as an independent distribution chain for inputs (seed, fertiliser, pesticides, and advice) that could serve the farmers.” (GDS, 2006: 13).

Given the limited incomes and financing available to smallholders, the outgrower schemes will continue to be the only means of participating in cotton production. The Cotton Growers’ Association, together with the Cotton Development Trust have been considering the establishment of baby ginneries, initially on a pilot basis, to allow cooperatives to process their own cotton, particularly in more remote areas where ginners are currently unable to reach the cooperatives (interviews in Zambia, December 2006).

8.4.2.3 Improving cotton production

In cotton growing, one of the major problems is that of low yields. Poor agricultural practices (lack of timely planning, correct plant population, weed and pest control) were identified as a contributing factor. Government and private companies, like Dunavant, have provided training to farmers on outgrower schemes in order to increase productivity: this is an area where donors could provide support.

Farmers could achieve higher yields by adopting gravity feed irrigation, improving agricultural practices and managing the quality of the soil. Improving smallholders knowledge of business and agricultural management, and awareness of contractual obligations on both sides, as well as the maximisation of income through complementing existing farming, upgrading or moving to a different value chain, could also increase yields and smallholders’ incomes. Potentially more productive, genetically modified cotton is not produced, because of government restrictions. There are efforts being made by the Cotton Grower’s Association, together with the Cotton Development Trust, to increase the number of ginneries. Subsidies paid to Northern cotton growers e.g. in the USA, continue to push down international prices. (See also Section 9.1 below.)

The challenge of providing effective support to the cotton sector remains. While producers in countries like the United States continue to benefit from public support and subsidies, most of the smaller producers in developing countries have lost key public services such as provision of seed and other input supplies, credit and extension (Gibbon and Ponte, 2005: 113). Some of the recommended interventions include: expansion of extension services and outgrower schemes (training and finance); providing farmers with access to affordable farming inputs such as cottonseed; identifying areas suitable for irrigated cotton farming; and developing infrastructure accordingly (water distribution, electrification etc.) (RATES, 2003: 20).

Upgrading in the cotton industry would be helped by a revitalisation of the textile

industry. According to Situmbeko and Zulu (2004), textile manufacturing has been one sector particularly badly hit by trade liberalisation. The lowering of tariffs on textile products, and particularly the removal of all tariffs on used clothes, led to large increases in imports of cheap, second-hand clothing (called *Salaula*) from industrialised countries. The Zambian textile industry could not compete with these imports, and the sector has all but vanished. There were more than 140 textile manufacturing firms in 1991, but this had fallen to just eight by 2002. Employment in textile manufacturing fell by 30,000 from 34,000 to 4,000 (ibid: 32). Many of those textile mills still remaining are using outdated equipment and producing inferior quality fabric.

Under AGOA preferential arrangements, Zambia has the opportunity to access US markets until 2015 for exports of cotton and textile products; but the state of the Zambian textile industry is such that they are unable to benefit from this. In addition to the influx of cheaper fabrics and (new) clothing from Asia, regional competitors have benefited from the establishment of export processing zones and incentives such as duty exemptions. In terms of establishment of backward linkages, textiles mills have to pay export parity prices for cotton lint from ginnings: therefore there is no benefit to be derived from the use of local raw material.

8.4 Summing-up the Value Chain Studies

Our four value chain study examples covered cases of very different kinds. They show how the concept of 'value chain' can be used in different ways, in a looser or stricter sense. The term can be taken to refer to an entire industry on an international (global coffee market) or a national scale (Tanzanian coffee); or 'value chain' can refer only to the specific business relationships within a given industry (Tanzania's instant coffee). This makes it difficult to try to fit value chains into the existing models. It also indicates some of the limitations of the models.

Gereffi's original dichotomy of buyer-driven versus producer-driven chains is obviously coarse, but even its later elaborations and refinements are not of immediate help in our cases of agricultural value chains, as Gereffi's models seem to have been formulated with industrial value chains in mind. On the basis of our research, it rather seems necessary to add a further, basic, conceptual distinction: that between traditional, broad and all-encompassing global chains, and more recent and strictly focussed business-oriented chains. Yet this should not reduce the notion of value chains to a purely heuristic status. Some insights from the value chain discussion can be employed to make sense of our cases.

Our Tanzanian cases provide examples of well-established global chains where the requirements of the final consumer are mediated through a number of buying and selling middlemen, or nodes, at differing positions along the chain. Here the shape

of the “chain” rather resembles a network, and the myriads of final consumers are scattered across the world. What makes it possible to speak of them as value chains, and subject them to value chain analysis, is that they are managed and coordinated as such at both the national and international level. They are run by a larger or smaller number of lead firms whose approach is global. As in most agrofood commodities, seasonality plays an important part: to guarantee a smooth and steady supply they are bought in one part of the world at one time of the year, and another part of the world at another time.

Basic quality standards are set internationally and applied nationally. Nationally, **cashew** trade is regulated through the systems of licensing and indicative pricing, whereas (almost) all **coffee** is at least in principle bought in the national auction. At this level, the buyers are numerous and partly anonymous. The less the original producer’s crop contributes to the final product (coffee in a cup of latte), or, the further out at the margin the primary product is in the consumption patterns of the buyer (cashew as a snack), then the weaker the primary producer’s bargaining position is. This relationship puts the farmers in our case studies in very weak positions.

Our Zambian examples were very limited and tightly focussed chains: they have been specifically created to serve the business needs of the lead firms. The quality standards are extremely demanding and imposed by the top firms. The value chain for fresh vegetables is clearly propelled by the requirements of the retailers and importers in Europe, while the cotton cultivation and seed production businesses are run by a few multinational companies. In vegetables, the UK supermarkets exercise a considerable degree of power through their requirement that producers meet the established high standards imposed by European certificates. In cotton, two major ginning firms produce some three-fourths of Zambia’s lint cotton on their outgrower schemes, in which they provide most of the inputs and buy up the produce.

Entry: who can join? There are clear differences in the ease of entry to the chain at different stages. At the primary production level, the entry is easiest in cashew nut and coffee cultivation in Tanzania. The basic requirement is access to suitable land and labour. Participation in such chains is often determined regionally. The same applies to Zambian cotton producers, but in addition they need to make a deal with the ginneries. Those wishing to produce vegetables for export have to commit themselves to such high standards of production and monitoring that only the largest and best organized farmers will qualify. Small farmers, who are often educated ex-civil servants, can only enter as outgrowers for larger farms. Additional barriers to entry for small farms into the export market is the required capital needed for exporting fruits and vegetables, and the required close proximity to the Lusaka International Airport, or other transport outlet.

It is more difficult to enter as a supplier further up the chain, especially in the established chains. An independent supplier needs large volumes or extensive processing power; and in the liberalised environment, these are beyond the reach of most of the producers in Tanzania and Zambia. In the olden days, some cooperatives and major parastatals could enjoy such a position.

Governance, coordination and control: who calls the shots? Looking at the governance structure of the chains, it is obvious that in all our cases the primary producers have little power to affect the end product or the workings of the chain. The Zambian fresh vegetable chain, and the cotton chain, can be seen to approximate the ideal of buyer-drivenness; while in Tanzania the global chains can be seen as more supply than demand-led, although there are buyer-led business chains emerging within them. Buyers have to rely on the existing supply, which they have few means to affect except through the price they pay, and that is only partially under their control. These buyers are middlemen themselves, dependent on buyers further up the chain, where the transactions get more complicated. Our analysis supports the view that there can be several different drivers along the chain.

An essential part of the governance is access to and control of information. Many of the problems that primary producers have boil down to the fact that information is extremely unevenly spread along the chains and tends to get very scanty at the producer end. Quality standards are set at the buyer end of the chain; and the prices are determined by the forces of supply and demand, forces about which the primary producers know little, if anything at all. The need to control information may also work towards the concentration of production: monitoring supply is easier when dealing with only a few large suppliers.

Value addition: who benefits and how? Even the very rough figures that we were able to collect on the value addition along the chain seem to confirm the common understanding that the primary producers are not getting a 'fair share'. If the consumer price is taken as the "value" of the product, the primary producer tends to get a small share, while value addition increases as one moves up the chain, with the most addition taking place in those phases that are situated towards the end of the chain, that is, in final processing and marketing. Although our figures are very approximate, it appears that a particularly significant jump in value addition takes place when crossing the (literal as well as metaphorical) borderline from the primary producing country or activity to the finishing stages of processing and consuming which take place in other countries.

9. In search of policy options

If Tanzania and Zambia are poor countries in terms of GDP per capita, or number of people living under the poverty line, it is not because they have not traded, but because they have not benefited from the trade. Still, both are basically peaceful countries with plenty of tradable resources. They have swathes of arable land and ample labour. The climate varies, and may be changing, but there are places with enough rain and water available to be able to grow crops year round. Our value chain analysis suggests that the use of these resources adds relatively little value to the final price of the goods whose production starts in these countries. What the value chain analysis does not tell is why this is so and what should be done to change the current situation. In order to go into these issues, we need to recall some of our theoretical discussions above, and return to them in the context of value chain analysis.

9.1 Trading up or trading down?

If the global value chains work in a way that sees less value added by Third World producers than by First World processors, or marketers, one obvious way for developing country producers to improve their returns would be for them to move up the chain. It is a common lamentation in Tanzania and Zambia that they must finally stop being exporters of raw materials to the North, and must move up the chain to processing and selling the processed goods domestically and abroad, not least inside Africa.

Yet Gibbon and Ponte, in their innovative study of value chains in Africa, end up advocating “trading down” rather than “trading up.” They dismiss programmes promoting things like flexible production systems, high-value niche markets, or technological upgrading which have been “sold by consulting companies to one developing country government to another.” After examination of a limited number of successful African-based enterprises, they conclude that these had taken their point of departure in the realities of African resource endowments and put reliance on economies of scale, relatively high levels of specialization, and simple and labour-intensive technologies. In doing so they had consolidated roles down the value chains, as second- or even first-hand suppliers (Gibbon and Ponte, 2005: 92, 202-03) (as our Zambian fresh fruit suppliers).

The thrust of the recommendations by Gibbon and Ponte, however, does not rise from any particular inner logic of the value chain analysis, but from their empirical material. As we argued above, value chain analysis does not carry with it any theoretical baggage of its own; but it can be connected with, and adapted to, different approaches. Its value lies in its comprehensive, “embedded” approach, which makes it possible to see how the value, or price, of a product is formed and what are the piv-

otal points or nodes in which value addition takes place. One of the problems in the analysis of Gibbon and Ponte, which is insightful in many ways, is that they blur the conceptual distinction between what we have called ‘global’ chains, and the more familiar ‘business’ chains. Although they devote much discussion to global chains such as coffee, their conclusions are overwhelmingly based on analyses of a few successful business chains. Possibilities for moving up the chain, or upgrading, as it is called in value chain research, may well be different in chains of different types.

To be sure, elsewhere in their book Gibbon and Ponte do discuss possibilities and experiences of upgrading as well, and by no means exclude it. In an earlier paper, Gibbon makes a passionate case for value chain analysis being conducive to upgrading (Gibbon, 2000). In their book, they quote the typology of four categories of upgrading, as suggested by Humphrey and Smith (Gibbon and Ponte, 2005: 89):

1. *Process* upgrading: achieving a more efficient transformation of inputs into outputs through the reorganization of production;
2. *Product* upgrading: moving into more sophisticated products with increased unit value;
3. *Functional* upgrading: acquiring new functions (or abandoning old ones) that increase the skill content of activities;
4. *Intersectoral* upgrading: applying competences acquired in one function of a chain and using them in a different sector or chain.

Gibbon and Ponte are a little sceptical about the usefulness of this classification. As they point out, the distinction between product and process upgrading may not be that clear, as new processes may lead to new products. However, distinguishing between product and process may be a useful place to start. With its help one can see that what is called functional upgrading, e.g. going from primary production to processing, or from executing manual or technical tasks to own-brand manufacturing, is far from the only possible way of moving up a value chain. This is despite the fact that functional upgrading has been given the most attention in research literature so far. The idea of process upgrading also tackles the commonsensical point of criticism that not everybody can move up the value chain to new products and functions, as somebody must continue to produce the primary product. Even at the primary level, there is room to make attempts to capture more value.

Value chain analysis indicates where some of the problems lie. It shows that certain actors along the chain are more powerful than others, and makes it easy to identify them. Those who benefit from the way the chains presently work will not easily give up their privileges. In early value chain research, it was discovered that lead firms often explicitly seek to block their supplier from undertaking functional upgrading.

At the same time, lead firms encourage suppliers to undertake process and even product upgrading. When this tendency was linked to the governance of value chains, it was seen that in certain types of chains upgrading is possible only when the supplier breaks away from the chain and perhaps joins another type of chain. Yet the analyses also show that upgrading is possible even within the chains, if those who participate in them are willing to learn from the lead firms (ibid: 90-91).

In our Tanzanian – national – cases, at least three first ways of upgrading seem possible and have in fact been attempted. Both cashew and coffee production are plagued by low productivity and varying, mainly worsening, quality of the primary product. Much remains to be done in terms of “achieving a more efficient transformation of inputs into outputs through the reorganization of production” and arriving at new, better quality products. Trees need to be massively replanted and new, disease-resistant hybrid varieties introduced. Farming tools and methods can be much improved. Another way of going “into more sophisticated products with increased unit value” would be to aim an increasing part of the production to niche markets, where a premium is paid for a certain kind of production process (organic, fair trade, bird-friendly – see the discussion below). Functional upgrading has so far taken place in efforts to raise the processing capacity of the primary produce. There seems to be much room here to advance from primary production to processing, and from bulk processing to own-brand manufacturing.

The Zambian cases are again very different, being much more limited business chains. Process and product upgrading will obviously be of relevance there as well. In export horticulture, process upgrading could be advanced by: dissemination of information on good practice, raising awareness on export standards, and by providing support for certification and support to producer cooperatives. In the cotton value chain, GDS (2006) believes that a number of improvements could be made to increase farmers’ incomes. Farmers could achieve higher yields by adopting gravity feed irrigation, improving agricultural practices, and managing the quality of the soil. Even genetically modified varieties could be tried, if the government would allow them. Smallholders also need to develop their capacity to make management decisions on and about their farm, learn how to understand the importance of contracts, and develop the ability to maximise income by considering all production opportunities. The focus of intervention should be on increasing yields and volumes.

A major implication of our global value chain studies is that primary processing does not add nearly as much value to the final price of the product as do the activities of final processing, marketing etc. that take place in the consuming countries. This finding must be read with considerable caution, as our calculations are few and rough, and the situation must vary from product to product. But if confirmed, it seems to suggest that the recent globalisation drive has in no way obliterated the difference be-

tween countries with high wages and high prices, and those with low wages and low prices. The production costs of different phases of global goods are determined less by the nature of the activities than by the nature of the economy in which they are undertaken. This, it will be remembered, was the basic argument put forward by Emmanuel in the 1960s in his theory of unequal exchange. One does not have to accept all the theoretical underpinnings of Emmanuel's model to appreciate the continuing relevance of the proposition.

What would be the policy implications of such an 'unequal exchange' approach is not quite clear. In general, the policy conclusions from value chain studies do not seem particularly startling. Rather, they are commonplace to the point of anti-climax: Raise your productivity and make better products. Upgrade your production into those stages that add value, the more the better. Against this background, exhortations to try "trading down" can perhaps be read as a plea to be realistic in attempts at upgrading, and as advice to try to exploit whatever comparative advantage exists for the moment. If the human resources and other infrastructural preconditions for large-scale industrialization are missing – as they arguably are in today's Tanzania and Zambia – it is better to be content with positions lower down the chains. This does not mean precluding industrialization in the longer term, or building the indigenous processing capacity of the main agricultural products. Nonetheless, there is still a long way for Tanzania and Zambia to go before they have a considerable number of secured suppliers in global value chains, and before they get to the point where their primary producers can reasonably expect a proper price for their products. The main question may not be whether should this be the goal or not, but rather how could this goal be reached?

9.2 Trading free ...

Most of what has been done in Tanzania and Zambia in recent years to improve their trading capacity, and which has been discussed in this report, has been broadly informed by the dominant model of trade liberalisation, with its underlying ideal of free trade. As the regulated economies of the 1970s and 1980s turned out to work poorly, both governments started liberalising, and are continuing along this path. This has been greatly facilitated by the emergence of the new international trade regime following the birth of the WTO in 1995. However, increasing openness has not led to a substantially increased stake in the world economy, and in the case of Zambia nearly the reverse has occurred. Where does the problem lie? If trade liberalisation is not working, what are the alternatives?

For the advocates of liberalisation, the problem is that there has been too little of it. In Tanzania and Zambia there are still lots of non-market restrictions and levies

and taxes which should be done away with in order for market forces to do their job of allocating the available resources in the most efficient way. In Tanzania, both the cashew and coffee trades are still regulated and partly politicized as well. Although cashew cultivation has always been “free” and marketing was (re)liberalised more than ten years ago, indicative prices are set by the Cashew Nut Board, and politicians are eager to intervene on behalf of the farmers who are widely assumed to be exploited by shrewd buyers. The coffee regulator, Tanzania Coffee Board (TCB), fails to meet its objectives and may only serve to increase inefficiency. Why could jute bags not be used as well as sisal bags for coffee? Would it not be better to get rid of non-market interference, and free the market forces? If private buyers were allowed to participate in buying at farm gate level, would this not increase competition and reduce inefficiency and bureaucracy, to the benefit of the farmers?

It can also be argued that the way the international trade regime presently works is very selective, and allows too much of both protection and liberalisation. The principles of the WTO regime are applied differently in the North and the South. In the 2006 Third World Network (TWN) report, sponsored by the International Fund for Agricultural Development (IFAD), Khor argues that it is the combination of heavy agricultural subsidisation in the North – still in the region of USD 240 billion per year⁴¹ – and enforced trade liberalisation through the World Bank and IMF imposed structural adjustment programmes and associated conditionalities in the South, which in tandem impose heavy costs on developing countries’ agricultural commercial development and lock away potential gains from trade. Developed countries have been able to cling to domestic agricultural subsidies and erect non-tariff barriers that may have an even stronger effect in hindering trade and international competition, while the associated conditionalities have pushed many developing countries dependent on aid to liberalise – sometimes even further than the WTO rules would mandate alone. Such a drive also/ includes intellectual property rights over biological materials, including seeds, micro-organisms and genetic materials, (TWN, 2006).

Here the role of Aid for Trade becomes relevant. AfT is a WTO-inspired initiative and WTO is an organization aimed at further liberalisation of global trade both in the North and in the South. WTO’s justification is premised on the idea that, in the long run, trade liberalisation will be beneficial to all parties concerned, even though it may have both winners and losers in the short run. But it is now recognized that poorer developing countries may be among the short-term losers. Their domestic production, and production capacities, may suffer from a sudden influx of tariff free imports; and they may also lose their revenues from tariffs and customs. The justification for Aid for Trade can also be found here. It is relatively easy to provide aid as a

⁴¹ <http://www.oecd.org/dataoecd/63/8/32035391.pdf>

way to compensate for immediate losses and help the poor economies to accommodate themselves to the liberalised environment.

This way of seeing the situation overlooks the possibility that what is taken as a prescription for a cure – trade liberalisation as it now undertaken under the WTO and in EU's EPAs – may actually be a part of the problem. Surely countries like Tanzania and Zambia have already done a substantial amount of liberalisation, and also benefited from it. Something could no doubt be added along the same lines, but arguably, the remaining main obstacles for a substantial increase in their exports lie more in the supply-side constraints such as low productivity, poor infrastructure and those institutional bottlenecks which cannot be tackled by trade liberalisation. As was argued in our theoretical discussion above, the case for free trade is hotly contested. It is increasingly recognized even in the mainstream economic literature that trade liberalisation and integration do not necessarily lead to economic development, or that they have such an effect only under certain conditions: it depends on what is traded and how. This is the perspective that “alternative” approaches have always shared.

Besides the theoretical considerations, there is some empirical evidence to support such a view. UNCTAD, in its *Least Developed Country Report 2006*, argues that the marginal position of the LDCs in world trade is due not to the lack of integration or openness, but to the low productivity and lack of productive diversity of the LDC economies. In 2000–2003, exports and imports of goods and services constituted 52% of the GDP of the LDC group as a whole. This was higher than the average 49% trade/GDP ratio of the OECD group. Thus, relative to the size of their own economies, the LDC group can generally be said to be highly integrated into the world economy, despite the fact that their share of world output is very low (0.5% share of exports, 0.7% share of exports) (UNCTAD, 2006: 140, see also Mshomba, 2000: 38).

Added to this there is the historical perspective referred to above. When the current developed countries were in the early stages of their own economic development, they protected their infant industries and frequently violated patents and trademarks. Only after they joined the league of the most developed nations, did they begin to advocate free trade and to protect intellectual property. Infringing intellectual property rights can still be an effective way of promoting economic growth, if a country can get away with it. One can ask, should the LDCs spend their scarce resources on establishing and maintaining institutions that are not suited to their current developmental concerns, if the greater part of the benefits from these arrangements accrue to parties that have the capacity to break the rules that the institutions are meant to maintain?

From the point of view of Tanzanian and Zambian small farmers, the problem with the free trade model is that, in order to benefit from it, further upgrading is necessary to achieve efficient, and internationally competitive, productive capacity. This

is where small farmers have failed under the existing conditions. With the exception of a few Zambian vegetable farmers, for Tanzanian and Zambian small farmers, the yields are low and cultivation practices are inefficient. Again here, some high-value business-type chains can probably be established, especially if aid is dished in from outside by “business-minded” NGOs. Whether such chains can ever benefit more than a small minority is doubtful. The question is, can one expect a comprehensive, competitive, and efficient production system to emerge once the prices have become “right” and the market forces have been allowed free reign? Or will this lead to a situation in which the majority of Tanzanian cashew and coffee producers must prepare to acknowledge that they are in a sunset business, and thus it is better to cut down their trees and plant flowers instead?

9.3 ...or trading fair?

One alternative line of argument is that trade liberalisation may be unavoidable and, in the end, best for everybody, but it must be made “development-friendly.” The Doha round and EU’s prospective EPAs, of course, claim to be development-friendly, but critics such as Stiglitz and Charlton (2005) demand more: the acceptance of non-reciprocity in issues of market access and trade concessions; careful sequencing of the reforms; and much longer timetables for the poor countries, to give them time to adjust to the competitive environment. “Special and differential treatment” should not be limited to a fixed transition period, but linked to the actual levels of development and the needs of the poor countries. The negotiations should be concentrated on the core trade issues; and any extra demands, such as protection of foreign investment, should at this stage be dropped. Despite the basic modesty of these suggestions and their compatibility with WTO’s ultimate mission, they have not found much resonance in the mainstream; the European Commission, on the contrary, seems ready to intensify the use of Aid for Trade to pursue its original negotiation line.

Another suggested alternative, to some extent supported by sympathetic donors, is to go increasingly into “sustainability” trading. This refers to the host of different trading arrangements such as fair, organic, ethical etc. trade, which have proliferated in the North during the last 20 years or so. What they have in common is that they are not only interested in the physical product that is traded, but also the *process* of its production. This approach involves consumers, who are prepared to pay a premium for a product whose production process has assuredly been socially, environmentally, ethically, or whatever is the specific interest of the consumer group in question, sustainable. In order to guarantee this, the product must be ‘decommodified’, in the sense that it must be made to seem transparent, regarding who produced it and how. Actual producers and the relations of production cannot be as anonymously hidden as

in a “normal” commodity. This can be achieved e.g. by a short production chain and traceability of those in the chain as well as the origin of raw ingredients (proximate food), or by a third party certification with concomitant justificatory narratives.⁴²

Sustainability trading is a hybrid, reflecting its multifarious origins. In Europe, its lineage springs from the alternative trade movement, whereas in the US efforts at organic agriculture and the search for consumer identities were more seminal. European Fair Trade was developed, under the slogan “trade not aid” by Oxfam and other charity organisations involved in the importation of handicrafts. Beginning this operation in the 1950s, they purchased goods directly from developing countries and sold them through the networks of ‘Third World’ shops. A major transformation took place in the late 1980s, when the labelling of Fair Trade products started, and these products were brought into the main marketing channels. The pioneer was the Dutch Max Havelaar coffee label. Since then the choice of product has been greatly extended, and the different labelling systems have come together in Fairtrade Labelling Organisations International (FLO), behind which is a coalition of NGOs from almost 20 countries. FLO officially sets international standards for Fair Trade. However, other sustainability products are sold under the producer’s own labels, and many are without any certifications at all, relying simply on the declarations of the seller.

As we have seen above, some such arrangements exist in Tanzania and Zambia. A few fair trade schemes exist for coffee (and tea) but not for cashew. In coffee, there are also other sustainability schemes. Fair Trade is the most demanding and the most rewarding of the schemes. For coffee, it requires that producers are smallholders who are democratically organised and who are guaranteed a price that will always include a social premium above the world market price. According to available studies, Fair Trade also gives the best return to the farmer, especially during the times of low prices (Daviron and Ponte, 175-176, 184). Other schemes are more interested in production processes that also raise the quality of the product. That way they add more value to it and the premiums they pay to farmers are smaller. Organic farming may sound an attractive alternative, since Tanzanian and Zambian peasants are often organic by default because after input subsidies were done away with they could not afford to procure fertilisers and pesticides. However, as we saw, there have been few attempts at systematic organic farming even in Tanzanian cashew. Organized organic farming involves a lot of planning and paperwork and commonly requires an outside input. In Zambia, the vegetable farmers have to conform to the ‘organic’ and other requirements for the labels the buyers have themselves created.

In Tanzania, one reason why it has been easier to start such arrangements in cof-

⁴² For insightful discussions on sustainability trading, see e.g.: Daviron and Ponte, Ch 5; Barham 2002; and Goodman 2004.

fee, rather than in cashew, is that it is easier to build organic farming and other 'sustainability' schemes upon existing cooperatives, and in the coffee-growing areas cooperatives have survived better. In the major cashew areas of the South East, genuine cooperatives collapsed or degenerated a long time ago. What are nowadays called cooperatives, are in fact a few people in a village who run the cashew trading post and pocket the commission. Fair Trade cashew would, at the very minimum, require the establishment of proper cooperatives or equivalent farmers' associations. In Zambia, in the case of vegetables, building the capacity of cooperatives and producer associations was also identified as one of the means of assisting small scale farmers. Aid to the cooperative movement is no panacea, however, and the popular nature of most Tanzanian cooperatives is open to some doubt. Local cooperatives have been massively shored up by Finnish and Nordic aid to Tanzania and Zambia in the past, with rather disappointing results.

The sustainability alternative, and especially Fair Trade, is fashionable, but it is hard to see how it could provide an overall solution. In spite of its radical origins and its image of "Robin Hood with latte at hand" (Goodman, 2004: 896), it is by no means inimical to markets and market forces. Rather it is increasingly ridden by an internal tension caused by being "in the market but not of the market" (Taylor, 2004): it cannot give up its original anti-market ambitions, but it also has to work within the market and accept market logic. It has reached a market share of a few per cent in some products in some countries, but it is doubtful whether it can significantly grow from that. Especially the market for Fair Trade coffee may already be getting saturated. Further, even though Fair Trade claims to bypass the unnecessary middlemen, its major benefits can be as easily hijacked by other middlemen as in other chains, as it is these middlemen who to benefit more than the primary producer from the additional price paid by the final consumer.

At best, Fair Trade can function as a redistributive mechanism among certain groups of producers and consumers. Some of the windfall that is now being reaped by wholesalers, processors and retailers in the North probably could be recycled to the Southern producers through the Fair Trade system. It is an open question, whether such 'sustainability' systems could also influence the location of the different stages of more value-adding production, better than the free trade model that relies purely on the market forces. It is also too soon to tell, whether sustainability trading, as a popularised concept, has yet matured to its full potential among consumers in the North, and producers in the South.

9.4 Role of policy and public action

Ultimately we come to the issues of policy and public action. If serious and compre-

hensive attempts at upgrading of production are going to take place in Tanzania and Zambia, they are something that have to be backed up by policy and public action. Many of the basic decisions have already been taken. Tanzanian producers are deeply involved in global value chains and cannot in the very short run escape from them – it is more likely they would prefer to become involved in new ones. The present trade regime in Tanzania and Zambia is a far cry from what is used to be, and there can be no going back to the old, heavily regulated, model. Moreover, the trend of the international regime is towards more liberalisation. But every trade regime needs some regulation and policy support. Even if completely free trade could be achieved, it would not work without the state continuously intervening to secure its basic conditions such as free competition and the rule of law. Neither do the value chains work in a vacuum: although they cross national borders, they are still embedded in national policy environments. Given our discussion of the way value chains presently work, we may have a rough idea what *should* be done. But given the policy conditions in Tanzania and Zambia, what *can* be done?

This is not the place to go into such a huge topic: it will suffice to insist that policy and public action do have a crucial role, and the donors must go on devising means to strengthen them and avoid undermining them. The structural and institutional weaknesses of Tanzanian and Zambian public institutions from the national level down to the cooperatives are deep, and widely known, and usually captured under the euphemism ‘weak governance’, meaning widespread corruption and mismanagement including perhaps partly serious, but toothless, attempts to deal with these issues. Yet the demands placed on any sort of upgrading in value chains call for such coordination and regulation that cannot be left to private actors only (who are by no means free of similar ‘governance’ problems).

Efforts at increasing the efficiency of production call for revamping farmers’ organisations and for changes in national incentive structures. Quality standards should be set, and quality control systems could and should be mediated by governments or other public institutions rather than merely left for private buyers to set and oversee. Clearly, there has to be a mix of public and private action; what their respective shares in the mix should be is one of the issues to be solved in domestic policy processes.

10. Conclusion: aid for trade or productive capacity?

This study set out to discover and describe the role of Aid for Trade: what should be funded, in what form, and through which institutional channels? Patently, there are no easy answers to such questions. Answers must depend both on the country, or the

value chain, concerned, and on the preferred policy model. Policy is something that must be left for the stakeholders on all levels within a country to decide upon themselves in their own policy processes. This is, of course, what all the parties have agreed to in the Paris Declaration, where country “ownership” is a governing principle, but it is also a practical necessity. What the outsiders can do is to support such processes and provide enough space for the processes to work.

The declared purpose of Aid for Trade is to facilitate the integration of poor countries into the new international trade regime, known as the Multilateral Trading System. This is something that can be done in different ways. Aid for Trade can be, and has been used for both technical facilitation and for policy advocacy. In the first respect, there are some worries about its effectiveness, due to its perceived weak sustainability, which is seen to stem from its nature as a multitude of scattered donor-driven projects. A main question here is, whether drastically reducing the number of bilateral projects and allocating more resources to common exercises (such as the Enhanced Integrated Framework) with substantial partner contribution, will suffice to improve the benefits to the recipients of Aid for Trade? It could also be asked, whether there is generally any optimal balance of trade related assistance vis-a-vis other ODA spending, or is Aid for Trade a meaningful category at all?

In respect to the policy advocacy role of Aid for Trade, the question marks are even larger. Providing policy space for developing countries such as Tanzania and Zambia means that they must have room to experiment with differing policy choices, including choices diverging from those preferred by the donor fashions of the day. Policy within the recipient countries is the responsibility of the governments and civil societies of the recipient countries themselves. Policy makers in donor countries need to concentrate on reforming their own institutions and instruments of aid delivery, and search for ways to effectively monitor effects and impacts of aid, and see to it that their own policies reach a degree of coherence such that policies do not work against what the donors are trying to achieve with aid. Now the question becomes, will the new international trade regime, based on the WTO rules and their enforcement, allow enough room to make Aid for Trade? Or will the new trade regime rather restrict policy, with demands for reciprocal market access, the introduction of new quality standards, and stricter protection of (Northern) intellectual property? And if AfT is used to promote such a regime, does this not work against achieving the desired goal of increasing liberalisation?

Aid for Trade could also be used for other purposes than merely propping up such a trade regime. It could be given a much more ambitious task than providing a ‘soft landing’ for poor countries entering the liberalised trade environment: AfT could be put to work to help build up productive capacity, thus enabling LDCs to better compete in the liberalised global markets, to whatever extent they finally liberalised.

This is one of the “pillars” explicitly mentioned by the AfT Task Force in 2006. It has also been advocated by other actors, such as UNCTAD, which in its *Least Developed Country Reports* of 2004 and 2006 has called for a “paradigm shift” in development policy and aid away from a consumption- and exchange-oriented approach to poverty reduction, and towards a production- and employment-oriented approach. Such a paradigm shift would also involve some serious rethinking of what is meant by the ‘overall poverty orientation’ of aid – by standard economic measures the poorest groups are seldom the most productive.

Defining productive capacities as the productive resources, entrepreneurial capabilities, and production linkages of a country, the LDC Report 2006 argues that the core processes through which productive capacities develop are capital accumulation, technological progress, and structural change. In the language of the value chain analysis, this means upgrading needs to be done in all ways and on all fronts. Three basic constraints on the development of productive capacities in the LDCs are seen in: poor physical infrastructure; weaknesses of the domestic private sector and in the supporting financial systems and knowledge systems; and insufficient demand. This leads to underutilization of domestic resources and capabilities, as well as to weak incentives to invest and innovate. These problems can be tackled with the mobilization of underutilized domestic potentials and a sectoral reallocation of aid. As stated by the Secretary General of UNCTAD, to the extent that Aid for Trade helps to create such capacities, it is a “move in the right direction.” (UNCTAD, 2006a: 2).

The preconditions for economic development, and the roles of trade and aid in it, are huge questions much beyond the scope of a report like this. There is no one single value chain out of poverty. In the global economy as it presently works, the odds are heavily stacked against producers in poor countries – especially, but not only, primary producers. We agree with those who maintain that economic development demands raising productive capacities and productivity, and the diversification of production at all levels. We also agree that trade has a role in all this, and that accomplishing it could be facilitated through aid. The question is how to perform the trick and achieve this in poor countries which have already experimented with what the best available policy advice has at various periods suggested. It may also be unhealthy to put too much emphasis on trade. Preoccupation with trade liberalisation may obscure the fact that what really count are policies that promote the development of productive capacities: it is the latter that the policy discourse should focus on. As Aid for Trade presently works, it seems to have the potential to both // reinforce and undermine such development.

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Aid for Trade: An Illusion or an Opportunity for Strengthening Competitiveness of Poor Economies

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1. Introduction

As the studies, for example, by Eronen et al. (2007) and Koponen et al. (2007) show many developing countries face competitiveness problems and are ill-equipped to fully benefit from external trade. Low value-added exports and unfavourable terms of trade have maintained the share of the poorest developing countries in world trade marginal for decades. The preferential trade arrangements granted by developed countries have not managed to curb this trend. The reasons for the difficulties faced by many poor countries willing to engage in the export business do not lie in limited formal market access but in these countries' incapacity to seize the opportunities arising from market opening. The international community has recognised the existence of these trade-related challenges troubling developing countries at least since the late 1940s, and the same issues have once again surfaced at the centre of international policy discussion during the last few years. This article discusses the recent Aid for Trade (AfT) initiative and its potential to bring added value to the international community's efforts to tackle the competitiveness challenges encountered by the developing countries, in particular the poorest ones.

2. Rebirth of aid in the multilateral trading system

The year 2005 gave the issue of trade-related development assistance strengthened political momentum. The theme "Aid for Trade" was first raised at the G8 meeting in June 2005, then in September the same year at the UN World Summit and finally at the December World Trade Organization (WTO) Hong Kong Ministerial Conference, where AfT was launched as a separate initiative alongside with the trade negotiations. The aim of AfT is to help developing countries, particularly the least-developed countries (LDCs), to increase their capacity to trade in world markets. The ongoing WTO round of negotiations was thus the context where AfT was born. A WTO AfT Task Force was established in February 2006 immediately after the Hong Kong Ministerial Conference. The Task Force submitted its report and recommendations to the WTO General Council in July 2006, and the General Council endorsed the report later in October. (WTO 2007; 2006b, 2005)

The year 2007 will be a crucial one for the operationalisation of AfT. The key issue to be resolved is how to make AfT an initiative with true added value to the international aid policies. To be able to deliver on the expectations created, much work will be required from the international trade and development community, from the WTO, but above all from the part of organisations such as the World Bank, regional development banks, United Nations Conference of Trade and Development

(UNCTAD) Organisation for Economic Cooperation and Development (OECD), as well as the European Union and other donors.

Despite the current enthusiasm about AfT, we should also note that, in fact, the idea of AfT has been present in the discussions of the multilateral trading system since its inception in the 1940s. At that time it was thought that since developing countries were structurally at a lower stage of development than the industrialised countries, they had to be accorded special treatment. This view was central for example in the thinking of the UN Economic Commission for Latin America and the Caribbean (ECLAC) and later in UNCTAD. The idea of AfT was quite explicitly and formally introduced to the GATT system² in 1966. In the Kennedy Round, a new chapter IV, entitled “Trade and Development”, was introduced to the GATT 1947 Agreement, which entered into force in 1966.³ It acknowledged that the less-developed contracting parties had an urgent need to use trade as one vehicle for attaining their development objectives. The need for AfT was also recognised, even if the phrasing was not exactly the same at that time. However, the themes were to a large extent the same as are discussed today. It was then decided that:

“the contracting parties shall collaborate in analysing the development plans and policies of individual less-developed contracting parties and in examining trade and aid relationships with a view to devising concrete measures to promote the development of export potential and to facilitate access to export markets for the products of the industries thus developed and, in this connection, seek appropriate collaboration with governments and international organizations, and in particular with organizations having competence in relation to financial assistance for economic development, in systematic studies of trade and aid relationships in individual less-developed contracting parties aimed at obtaining a clear analysis of export potential, market prospects and any further action that may be required;” (Article XXXVIII, GATT 1947)

At the same time when these issues were introduced to the GATT system, the other seedbeds of AfT, UNCTAD and the International Trade Centre (ITC), were created in 1964. The history of AfT is thus related with the development of the corpus of agreements that govern world trading systems and institutions providing trade-related technical assistance.

Developing countries’ need for trade-related assistance in the implementation of the agreements and associated adjustment costs was further re-affirmed as a result

² General Agreement on Tariffs and Trade, which has provided the basic legal framework for multilateral trading system since 1948.

³ The idea of adding Part IV was first proposed in the Harberler report of 1958. (ECLAC 2004)

of the Uruguay Round, and the issue became a cross-cutting theme in the GATT/WTO system. Accordingly, many provisions on technical assistance are found across the Uruguay Round agreements and ministerial decisions.⁴ Shortly after the Uruguay Round Agreements had been signed, the WTO, UNCTAD and the ITC established a Joint Integrated Technical Assistance Programme (JITAP) to support African countries to better integrate into the new multilateral trading system and world trade. Furthermore, the first WTO Ministerial Conference in 1996 also recognised the special difficulties LDCs faced in integrating into the world economy. The following year, WTO members launched an initiative to strengthen LDCs' trade capacities, known as the Integrated Framework for Trade-Related Technical Assistance to the Least Developed Countries (IF). (OECD 2006a)

Despite the fact that provisions on trade-related assistance were incorporated into the WTO system as a result of the Uruguay Round, many developing countries still felt that their needs had not been met and emphasised the need to reduce asymmetries between the rights and obligations resulting from the Uruguay Round. One key area of concern for developing countries was how trade-related assistance was treated in the Uruguay Round agreements. (ECLAC 2004) Accordingly, the need to improve the situation from developing countries' perspective was clearly manifested in the WTO Doha Ministerial Declaration paragraphs 38-41.⁵ The Uruguay Round provisions, however, focussed mostly on the implementation of agreements leading to further trade liberalization, leaving the broader "supply-side" issues mostly unaddressed.

According to the joint WTO/OECD database, the volume of trade-related technical assistance and capacity building (TRTA/CB)⁶ has increased considerably since the launch of the DDA negotiations. In 2004, commitments to TRTA/CB had increased 50 per cent from 2001 and amounted to USD 3.0 billion.⁷ Despite this significant increase, a broad consensus prevails that there are far more needs in developing coun-

⁴ Provisions on technical assistance and capacity building are found in the following agreements: 1) SPS, 2) TBT, 3) GATS, 4) TRIPS, 5) Agreement on Pre-shipment inspection, 6) Implementation of Article VII of GATT 1994, 6) Understanding on Rules and Procedures Governing the Settlement of Disputes and 7) Decision on measures concerning the possible negative effects of the reform programme on least-developed countries and net-food importing developing countries and 8) the Decision on measures in favour of least-developed countries.

⁵ In fact, technical assistance and capacity building is addressed in paragraphs 2, 16, 21, 24, 26, 27, 33, 38-43 of the Doha Declaration making the issue one of the key horizontal themes in the DDA. The issue is also important in the Decision on Implementation-Related Issues and Concerns and the WTO General Council Decision on 1 August 2004 ("July Package").

⁶ As reported by the OECD Development Assistance Committee and the WTO.

⁷ WTO/OECD 2005. The figure includes also contributions to Trust Funds (Integrated Framework, ITC, JITAP, WTO).

tries to be addressed and more AfT funds are needed.

This is the context in which led the key donors in the WTO Hong Kong Ministerial Conference to pledge to considerably increase their trade-related assistance by 2010. The EU Member States committed themselves to striving to increase their spending on trade-related assistance⁸ to EUR 1 billion per year by 2010 on top of the 1 billion annual Community contribution pledged by the EU Commission. The US announced grants of USD 2.7 billion a year by 2010 and Japan committed USD 10 billion over the next three years. (WTO 2006b) However, at the time of making these pledges there was no consensual definition on what AfT covers and therefore the amounts are not directly comparable.

2.1 The scope of Aid for Trade – an expanding agenda

One of the key issues for the AfT Task Force was to come up with a consensus on the scope of AfT, that is, what type of needs and support for them is considered as AfT. The Task Force concluded that the scope of AfT should be defined in a way that is both broad enough to reflect the diverse trade needs identified by countries and clear enough to distinguish between AfT and other development assistance of which it is a part. The Task Force established the following categories for AfT: 1) trade policy and regulations; 2) trade development; 3) trade-related infrastructure; 4) building productive capacity; and 5) trade-related adjustment. The Task Force recommended that categories 1 and 2 should follow the existing definition used in the Joint WTO/OECD Database. Projects and programmes considered for categories 3 to 5 can be reported as AfT, provided that these activities have been identified as trade-related development priorities in the recipient country's national development strategies – Poverty Reduction Strategies (PRS) or similar. (WTO 2006b).

This categorization has significantly broadened the scope of AfT from the earlier TRTA/CB (categories 1 and 2 above). There has been some confusion concerning the scope since these different categories seem to be conceptually overlapping. One example, is the definition of support for *trade-related adjustment costs*, which has been an integral part of the AfT discussion. It can be said that adjustment to new trading conditions or trade liberalization is largely about strengthening economic diversification, changing production patterns and bringing greater added value but also about managing public financial losses due to reduced tariff revenues. Many of the activities that are aimed to help economies to adjust fall under the different categories of AfT. Conceptually, adjustment support therefore partially overlaps with other categories of AfT and is thus not an entirely separate category of its own.

⁸ Defined as TRTA/CB.

However, this apparent conceptual overlap of different AfT categories must be eliminated in the statistical follow-up of AfT finance. For statistical monitoring delineating the boundaries of the different categories clearly and making categories mutually exclusive is essential. Without an unequivocal distinction between the AfT categories, the situation will get confusing and numerical representations will remain somewhat arbitrary and can be inflated or reduced depending on reporter's interests. This would seriously undermine the credibility of financial AfT commitments.

With the "new" category of *trade-related infrastructure*, the question has been how to distinguish the trade-related parts from the economic infrastructure in general, since infrastructure elements eventually contribute to productivity and to the ability to compete (OECD 2006a). In Spring 2007 it was decided that support for transport and storage, communications and energy could be used as a proxy for trade-related infrastructure.

The issue of overlapping categories relates mostly to the category of *building productive capacity*. The category of *trade development* has all along been as a sub-category of building productive capacity. The category was created at the beginning of the DDA to provide donors the opportunity to differentiate in their overall assistance to building productive capacity, the support targeted at the export sector. While activities under the category of *trade policy and regulations* can be considered to aim for the sole purpose of promoting external trade, the activities under trade development generally also have other major objectives, such as agricultural or industrial development (OECD 2006a).⁹ In continuation the aim is to treat trade development clearly as a subset of the category of building productive capacity.

Before TRTA/CB was largely observed in isolation and not in the broader context of total official development assistance (ODA) flows. When data relating to support for enhancing production in different economic sectors and infrastructure, as reported to the Creditor Reporting System (CRS) of the OECD, are taken to approximately correspond to the new broad definition of AfT, it can be seen that the volumes involved are considerably larger than the more narrow TRTA/CB. According to the OECD CRS data, the donors' total ODA commitments to support infrastructure were USD 12.9 billion in 2004. Support for productive capacity-building reached USD 7.3 billion in 2004. (OECD 2006a) Now when the scope of AfT has significantly increased there is a clear need to observe the different AfT categories in relation to each other and to overall ODA.

⁹ The OECD confirms that there are discrepancies in donors' reporting even now under the *trade development* category, and although some work to harmonise donors' approaches has been done, the total amount of assistance per donor in this category should be interpreted with caution. (WTO/OECD 2005 ; OECD 2006a).

3. Competitiveness in the PRS era – the rise of national development planning

The AfT initiative was born within the multilateral trading system, but international aid policies have also increasingly highlighted the importance of similar themes during recent years. In the 1990s major shifts in international aid policies have taken place that partly explain the increased focus on AfT and related issues in international aid. Their common denominator can be seen to be a reaction to the so-called Washington Consensus economic policies, strongly advocated by the Bretton Woods Institutions and with a strong emphasis on liberal market reforms and fiscal stabilisation. During the golden era of the Washington Consensus, it was believed that market forces alone would mostly resolve problems related to trade and productive capacities and that government intervention would lead to unfavourable distortions and should therefore be limited.¹⁰ However, this view has been questioned and the shift in thinking is now reflected in the PRS (Poverty Reduction Strategy) approach, which emphasizes the importance of national development planning in strengthening public investments in key areas such as education and health as well as building an enabling environment for private sector led economic growth.

There is an increasing consensus in the aid community that issues, such as productive capacities, private sector development and pro-poor growth in developing countries, which during the 1990s were left somewhat in the dark, should be given greater emphasis (See e.g. OECD 2006b; UNCTAD 2006). Between 1992–1995 and 2000–2003, ODA commitments to economic infrastructure and production-oriented sectors declined from 45 per cent to 26 per cent of the total commitments of all donors to LDCs. Aid commitments to production sectors alone (agriculture, industry, mining, construction, trade and tourism), constituted only 6.8 per cent of total aid commitments in the period 2000–2003. (UNCTAD 2006) This trend was due to a heavy focus on social sector financing in developing countries, which was an understandable counter-reaction to the structural adjustment policies of the Bretton Woods Institutions.

The role of the state in building the preconditions for economic development is nowadays seen in a very different light than during the 1990s. It is now understood that productive capacities and export competitiveness in developing countries do not evolve automatically, but that effective public policies and strategies are needed, complemented with international aid. In the aid policy context a discussion on the importance of pro-poor growth has been highlighted strongly during the last years. The

¹⁰ Issues related with mainstream thinking on trade liberalisation and poverty reduction are discussed by Eronen et al. 2007.

definition on pro-poor growth, quoted below, can also be seen to give the rationale and context for increased AfT financing:

“Rapid and sustained reduction of economic poverty requires pro-poor growth: a pace and pattern of growth that enhances the ability of poor women and men to participate in, contribute to and benefit from growth.”¹¹

3.1 The role of aid in building productive capacities

To date, international AfT discussion has, however been strongly biased. Financial pledges, such as the amount of finance, its additionality and delivery mechanisms, have received attention the most, but the real and most important question is another one: what should be done with the AfT finance made available to recipient countries? Since practically all AfT finance from donors to recipients is channelled through recipient governments and their different entities, this means that the key AfT question is how aid can support public institutions (in cooperation with the private sector or more broadly non-state actors) to enhance export competitiveness and productive capacities in the private sector at country-level? For example, will local governments be able to transform these development finance funds into enhanced export competitiveness of private sector enterprises?

If the AfT initiative is to fulfil the expectations attached to it, attention has to be paid to the question of needs from the point of view of specific economic sectors in the developing countries and how local productive processes in them are, or could be supported, when linked with international trading activities at various levels.

One fruitful approach to AfT is to see it from a value chain perspective as e.g. Koponen et al. (2007) have done. The key mission of the AfT initiative is to support national and international policies and institutions, which set the environment where firms and global value chains operate, in a way that contributes to the capacity of developing country firms to participate and compete successfully in international trade.

At the domestic level, developing country firms participating in international trade are influenced, above all, by the functioning of trade-related institutions that implement related policies, such as customs or export-promoting agencies. The area of trade facilitation, which generally means the simplification and harmonisation of import and export procedures, is an important area in this respect. Channelling AfT for the improvement of these institutions is in many cases a key priority. Another important area is support for upgrading human resources through different capacity-building programmes targeted at the managerial and operative levels.

¹¹ OECD 2006b.

Firms are obviously also influenced by the broader business environment, which is linked with the general national legislative and institutional framework. A good and improving business environment is a fundamental precondition for attracting and mobilizing both national and international investments. Many of the factors that determine investments are the same that determine the competitiveness of firms in a given economic sector in a country. Attractive conditions for competitive production, such as relatively low-cost skilled labour, encourage investors to set up new businesses, existing firms expand their operations or foreign companies open subsidiaries in another country. Viewed from this perspective, AfT can be seen as an effort to support the creation of favourable preconditions for investment decisions and competitiveness of firms located or willing to be located in particular countries.

Enhancing economic infrastructure is also important for increasing export competitiveness and attracting new investment. AfT support can therefore be directed, for example, at improving transport, energy and communications infrastructure. Poor transport infrastructure can thwart export-oriented investment and investments for energy-intensive manufacturing may be hindered by high prices and poor access to energy. Since infrastructure gaps and shortages are particularly severe in Africa, for example, it is not surprising that the issuance of additional AfT financing for infrastructure has been strongly urged by, for example, many African countries.

There are also many other important issues, such as those related to the building of national innovative systems, that need support, facilitation of technological upgrading, access to higher technology inputs used in the value-adding activities or development of policies for intellectual property rights.

Besides national policies and institutions, the AfT agenda obviously needs to look at the international and regional trade agreements, which lay the framework for many of the requirements within which national policies can be chosen: for example, the extent of market access, levels of allowed agricultural subsidies and an acceptable level of policy flexibility. An important function of AfT support is to help recipient governments to identify their national priorities and negotiate trade agreements based on national policy objectives as well as to support the implementation of international trade agreements.

It is also important to note that there can be many relevant AfT needs that are crucial for enhancing the export competitiveness of an economic sector but may not have an immediate or apparent connection with cross-border trade. There may be factors down in the value chain, which obstruct the evolution of competitive end-products. AfT should therefore not exclusively focus on the ultimate export activities. One must also consider the potential effects on poverty reduction in the poorest countries where a vast majority of the population works in the informal sector and sometimes at

the very beginning of the value chain.¹² The informal sector is in many ways present in the value chains related with foreign trade: In export-oriented value chains, the informal sector mainly participates in the primary production (agriculture and mining) whereas informal enterprises and workers are strongly present in import-oriented value chains, such as services; their presence is very significant especially in retail trade of consumer goods. In the manufacturing exports' sector, informal enterprises' presence is often minimal.

3.2 Modalities of Aid for Trade

This brief discussion on possible AfT needs in developing countries proves that trade-related needs are very widespread. This can also be seen by looking at some of the current in-country PRS processes where trade and other issues related to economic growth are getting increasing space. This can clearly be seen e.g. in the national developing strategies, NSGRP or MKUKUTA¹³ and PARPA II¹⁴, of Tanzania and Mozambique respectively. Both strategies present a long list of priorities in order to strengthen economic growth in the context of poverty reduction, and issues on trade and external competitiveness are an integral part of them. Both strategies prioritise the development of separate national trade policy strategies. Furthermore, issues on trade and productive capacities are also strongly linked with the many other priorities that are mentioned in them, such as: 1) strengthening the private sector, e.g. agro-based industries; 2) increasing investments, domestic and foreign; 3) strengthening infrastructure (transport, power, ICT); 4) strengthening agricultural productivity, technological change; and 5) human capital.

Eronen et al. (2007) also show that the challenge for countries like Mozambique is in terms of poverty reduction not only to increase trade, but to strengthen trade, which is linked to local growth processes that create employment and public revenues that can be used for poverty reducing investments. Eronen et al. found out that the growth of exports in Mozambique has contributed very little to the rather strong poverty reduction in Mozambique during the last years. The newly developed industries, financed almost totally by FDI, in Mozambique rely heavily on imported inputs and export products with low value added. They are also closely linked to the South African mining and energy complex. Eronen et al. note that these kind of enclave industrial production patterns have limited spill-over effects of technological transfer

¹² The effects of AfT on reduction of poverty are discussed by Eronen et al. 2007.

¹³ United Republic of Tanzania 2005.

¹⁴ Republic of Mozambique 2006.

and skills development.¹⁵

The above mentioned poverty reduction strategies of Mozambique and Tanzania are good examples of the importance and broadness and complexity of the economic growth agenda in poor countries. They also show the fact that trade is not a separate sector in these strategies but an integral part of their economic growth agenda, which requires increased and more effective aid. The agreed broad scope of the AfT initiative is thus very understandable from the point of view of needs expressed in strategies like the MKUKTA and PARPA II. Practically almost all priority policy areas in their growth chapters could be more or less included in the scope of the AfT initiative. However, this poses an implementation challenge for the AfT initiative, since the scope of AfT should be defined in a way that is both broad enough to reflect the diverse needs, but at the same time clear enough to distinguish between AfT and other development assistance of which it is a part.

How is this clarity going to be achieved given the inter-linkage between the agreed AfT agenda and the broader growth priorities in strategies like the MKUKTA and PARPA II? The aim to clearly establish a distinction between AfT and other development assistance is understandable for many reasons but, above all, relates to the pressures of showing that the international community is delivering additional AfT. These pressures have some of their origins in the environment where the AfT initiative has been born, that is, trade negotiations. From this context, it is logical to focus on clear and “visible” pledges, which can be referred to in negotiations.

But as has been shown above, in the real world, trade-related needs are often identified by governments as parts of broader national strategies implemented through various public policy programmes related to economic growth, such as private sector or sectoral (e.g. agricultural) programmes. The challenge is to strengthen the trade-related elements of these strategies. Therefore it is not always desirable or even possible that the parts of these strategies concerning trade could or should be extracted as separate programmes or projects. In terms of financing modalities the most effective way to support these national development programmes might in many cases be general and sectoral budget support mechanisms, in which case it is not statistically possible, or very difficult, to extract the AfT part from the overall support. In terms of AfT, the key issue in this case is rather what the trade-related objectives and indicators are, or should be, in the national programmes which are supported.

It goes without saying that there are investment needs (e.g. infrastructural projects) in LDCs that can be financed through separate “AfT projects”, but the key point that we want to make is that the AfT initiative should not lead to the creation of incentives that strengthen programmes and financing structures at the country level that are not

¹⁵ More on the issue of enclave led trade and economic growth see UNCTAD 2004.

in line with the objectives and priorities of ongoing government policy programmes in developing countries. It is important that the AfT initiative is implemented in such a way that it fosters incentives for donors and developing country governments to cooperate around priorities in national development strategies.

3. Policy conclusions

According to our analysis, the AfT initiative provides opportunities for strengthening competitiveness and productive capacities in poor and developing countries and regions. But in order to achieve these results and bring added value to international trade and development policies, different characteristics of AfT must be distinguished in order to be able draw right policy conclusions. As it was explained earlier, the AfT history is clearly related to negotiations on how trade-related assistance is treated in trade agreements. This part of AfT is related to implementation costs of trade agreements and adjustment costs. Another part of AfT responds to much longer-term trade capacity and competitiveness needs independent of the trade negotiations. (ECLAC 2006, UNDP 2006, Phillips et al. 2005) The view of the WTO Secretariat (2007) is very similar, they say that AfT needs to respond to two related concerns. One is assistance that some countries need to implement the results of the current multilateral trade negotiations and the to cope with certain adjustment costs. The second, broader, set of concerns is related with the lack of capacity to invest and expand production in order to benefit from multilateral trade in general.

Two policy conclusions are, in our view, of particular importance. Firstly, AfT has the potential to produce some added value in the WTO system as well as in regional trade agreements. Secondly, the AfT initiative, and particularly its global review mechanism, could be a vehicle to strengthen the effectiveness of international aid in supporting competitiveness and productive capacities in developing countries.

Policy conclusion 1. The AfT initiative and the implementation of trade agreements

It is clear that AfT was not born in the Hong Kong WTO Ministerial Conference but is an initiative which builds on half a century of ideas and intentions present in the GATT/WTO system and beyond. One can rightly argue that the main challenge in the integration of the poorest developing countries into the world trading system does not lie in the area of implementation of WTO agreements and related technical assistance. It is quite clear that the main challenges are related to much broader supply-side constraints, such as problems in trade-related infrastructure and poor productive capacity. This has been clearly noted in the developing countries' inputs to the AfT

process at the WTO and reflected in the conclusions the AfT Task Force. However, one should not underestimate the systemic effects that the changes in the provision of trade-related assistance in the WTO agreements across the system could have. The Aid for Trade initiative could thus also be seen as an effort to improve the effectiveness of aid related with the implementation of trade agreements. What could this mean in more concrete terms?

First, AfT could be particularly valuable for possible new multilateral trade agreements, such as Trade Facilitation. Financial commitments and agreed principles on Aid for Trade, will thus form the foundation on which the future Agreement on Trade Facilitation can be based upon. Key issues under discussion in the negotiations on Trade Facilitation have included, for example, needs assessments, notification of exceptions, aid matching, capacity-building plans and implementation as well as entry into force of obligations.

Second, in the WTO context, the parts of AfT that are related to the implementation of existing and new WTO agreements are conceptually a form of special and differential treatment (S&DT) and, through this dimension, closely related with the negotiations on S&DT across the board. Parts of the AfT initiative could also be seen as a contribution to the negotiations by providing a foundation on which a solution to the SD&T proposals that are related to technical assistance and capacity-building could be resolved. In fact, the phrasing concerning language on technical assistance in some of the WTO agreements is already quite strong, using the mandatory “shall” formulation instead of the non-mandatory “should”.¹⁶ However, the mandatory “shall” formulations have in practice remained as non-binding best endeavour clauses. The AfT architecture, including monitoring and evaluation mechanisms, could be used as a platform to move forward from current best endeavour clauses towards system truly based on mutual accountability and without leading to open-ended commitments to provide technical assistance and capacity-building and thus to function as a response to the needs expressed in the Doha mandate.

Therefore, a purely legalistic approach, which has characterised the SD&T negotiations so far, could be combined with a more pragmatic one, currently present in the AfT discussions. More concretely, a small part of existing financial AfT commitments and pledges could be ring-fenced for multi-year support for implementation of international trade agreements. This “core AfT”, combined with an international monitoring mechanism and where necessary legalistic fine-tuning of existing WTO agreements, could offer a way forward and produce some systemic added value. For example, in the case of the possible new agreement on Trade Facilitation donors could

¹⁶ According to the WTO Secretariat (2002), all S&DT provisions on technical assistance are mandatory.

make multi-year commitments to special facility under the DDA Global Trust Fund to which countries which need implementation support could resort.

Third, the issue of aid provision and trade agreements is not only present in the multilateral context, but concerns also various bilateral or regional trade negotiations between developed and developing countries currently taking place around the world. One example is the Economic Partnership Agreement (EPA) negotiations between the EU and the African, Caribbean and Pacific (ACP) countries.

Policy conclusion 2. The AfT initiative and long term strengthening of productive capacities

One of the key arguments behind the AfT initiative is that developing countries need to be able to build their societies on more self-sustained economic growth. Chronic trade imbalances only leave them to struggle with the option of further indebtedness and aid dependency. The AfT initiative can and should, from this point of view, be seen as an opportunity to increase ODA directed to support improved trade and productive capacities in developing countries, particularly in the poorest ones. The key question is how the initiative will achieve this.

In terms of international aid policies, the potential added value of the AfT initiative lies in its capacity to influence future aid allocations and priorities of the donors. From this point of view, the most promising part of the AfT initiative, something that is truly new, is its global review mechanism, which is to be convened by the WTO. The first WTO Global Review on AfT will be held in October 2007 preceded by regional events in Africa, Asia and Latin America.

This WTO AfT review process will consist of three monitoring levels: 1) an assessment of global AfT flows looking at whether additional resources are spent on AfT; 2) AfT progress reports and self assessments by donor agencies and organisations, looking at the scope and effectiveness of their AfT activities; 3) country assessments, looking at issues such as whether trade needs are being met, financial resources are being provided, and AfT is effective on the ground. From the aid-effectiveness point of view, it is particularly welcome that the WTO Secretariat emphasises the importance of qualitative, in parallel with quantitative, monitoring of AfT, such as its impact on trade growth, export diversification, economic development and poverty reduction. (WTO 2007; WTO 2006a)

The AfT monitoring systems by the WTO is an important and promising one, since it could become a kind of a continuous global external evaluation process of international aid policies and their effectiveness in supporting trade and productive capacities in developing countries. However, for reasons analysed earlier, it can be seriously questioned whether it is feasible or even meaningful to make explicit overall

financial AfT pledges beyond specific aid programmes as this could lead, for example, to re-labelling of up to one third of ODA as AfT (see for example OECD 2006a). The true added value to international aid policies, in the medium and long term, is that the global AfT review process would increase the focus of aid policies on strengthening trade and productive capacities in developing countries, based on their needs and priorities. Koponen et al. (2007) agree with UNCTAD (2006) that if AfT is part of a “paradigm shift” from a consumption and exchange oriented approach to poverty reduction towards a production and employment oriented approach, then it is a move to the right direction.

The AfT monitoring process could also establish a continuous dialogue between the trade and development communities within a WTO context. In the best case, this could have effects on international trade policies as well. It is very likely that the in-country assessments included in the AfT monitoring process will, in addition to trade capacity needs, also highlight key trade policy challenges for developing countries. This is because these two themes are very closely inter-linked at the country level. Both studies of Eronen et al. (2007) and Koponen et al. (2007) let to conclude that both national policy choices as well as the international trade policy framework are of paramount importance. The role of aid can only be complementary, and in right conditions it has an important potential role to play in enhancing pro-poor economic growth.

It can be said that AfT is a generic term for development assistance that is directed towards strengthening developing countries’ ability to produce and participate in external trade. It thus consists of a great variety of actors, programmes and delivery mechanisms. Because of this broadness and complexity it is sometimes difficult to approach AfT. What the WTO-based AfT initiative has done so far, is that it has increased political attention to these key development challenges faced by poorer developing countries in particular. The international community should now try to avoid making the AfT initiative a static funding mechanism where the primary focus is on developing strict criteria and borders on what can be funded under the heading of AfT and what cannot be done. Re-naming all national efforts aimed at increasing developing countries’ productivity and external competitiveness as “AfT programmes” will not change the world. Overemphasising “trade” alone at the expense of other factors influencing economic growth such as capital accumulation and technological change could lead us the wrong direction.¹⁷ The road to a successful AfT initiative is to upgrade and implement it more as a dynamic policy dialogue and monitoring process where AfT-related needs, implementation of activities and results are continuously and regularly assessed at various levels as a part of determined efforts and com-

¹⁷ This point was also highlighted by Koponen et al. 2007.

mitments to scale-up ODA. If achieved, the AfT initiative would clearly strengthen the current global trade and aid architecture from the development perspective.

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Many developing countries face problems of competitiveness and are ill-equipped to fully benefit from external trade. Low value-added exports and unfavourable terms of trade have depressed the share of the poorest countries in world trade for decades. It has now been acknowledged that the difficulties faced by poor countries do not lie in their limited formal market access but in their incapacity to seize the opportunities that arise from the opening of markets.

Since 2005 Aid for Trade has been the buzz-word in the field of trade and development policy. The effectiveness of around one third of official development assistance is a subject of discussion at the first global monitoring meeting of the WTO in November 2007. The EU is preparing a joint Aid for Trade strategy and these issues are being actively discussed by many other OECD donors and recipient countries.

However, many of the issues Aid for Trade aims to tackle have been on the agenda of development cooperation for decades, so what is new in Aid for Trade? What lies behind all the high-level Aid for Trade hype? Is it just an illusion or is it a serious opportunity for strengthening the trade and productive capacities of developing countries? What does Aid for Trade mean in practice? How can it be implemented in ways that create added value? These are some of the questions that the studies in this book try to answer by focusing on today's realities on the ground in Mozambique, Tanzania, Zambia and Vietnam.



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