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TRADE AND STRUCTURAL ADJUSTMENT POLICIES IN SELECTED DEVELOPING COUNTRIES

(A Joint Contribution of the Development Co-operation Directorate
and the Development Centre to the OECD Horizontal
Programme on Trade and Structural Adjustment)

by

Jens Andersson, Federico Bonaglia,
Kiichiro Fukasaku and Caroline Lesser

Research programme on:
Policy Coherence and Productive Capacity Building



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FOREWORD

The Development Co-operation Directorate (DCD) and the Development Centre (DEV) were invited to contribute to the OECD Trade and Structural Adjustment Project (TASAP) presented at the 2005 OECD Ministerial Council Meeting. Following the terms of reference for this special project, DCD and DEV were requested to examine five country- and sector-specific cases that represent successful examples of adjustment, achieved mainly through diversification of production and export bases, and to summarise lessons learned.

Parts of this contribution have been incorporated in the final TASAP Study and Brochure discussed at the 2005 OECD Ministerial Council Meeting.

This paper was jointly drafted by a task team comprised of Jens Andersson (external consultant), Federico Bonaglia (DEV), Kiichiro Fukasaku (DEV) and Caroline Lesser (DCD).

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The opinions expressed in this paper are, however, those of the authors alone and do not reflect those of the OECD, the Development Centre or their member countries.

PREFACE

The goal of this joint undertaking is to identify the requirements for successful trade-related structural adjustment in developing countries, in response to the major challenges they face today — shifts in comparative advantage, new sources of competition, accelerating technological change or shifting consumer preferences — as these impinge on particular sectors, their workers, and ultimately the economy as a whole.

The theme “trade and structural adjustment” has been studied previously, both within and outside the Organisation. Policy issues central to this theme generally remain the same, with recognition of the benefits of open markets and the need for flexible responses — by governments and industry — to emerging challenges.

Yet, the context of the present study is different in important respects from that which prevailed in the 1970s and 80s. The emergence of the world’s two most populous countries — China and India — as both competitive suppliers and large consumers of goods and services, including natural resources, is a notable change which poses important adjustment challenges and development opportunities for OECD and non-OECD economies. Shifting societal concerns also means that making the case for open markets requires paying greater attention to the impacts liberalisation might entail on the environment and on poor and vulnerable groups within societies.

The adoption of appropriate, coherent and well-sequenced domestic policies in the framework of a comprehensive national development strategy is at the heart of a successful adjustment process, yet this requires political leadership, efficient institutional and governance frameworks as well as adequate infrastructure facilities. As part of the lessons learned, the authors also stress the important role development co-operation can play in supporting the adjustment process in developing countries. Yet, a full treatment of this topic is beyond the scope of this paper. A more comprehensive assessment of the role of development co-operation in supporting trade and structural adjustment is indeed an area in which further joint work may be warranted.

This paper — an example of ongoing collaborative work between the Development Co-operation Directorate and the Development Centre — provides many useful insights about trade and structural adjustment policies from development perspectives. It seeks to distil good practices and draw lessons from a comparative analysis of different case studies that might be useful for other developing countries.

Louka T. Katseli



Director
OECD Development Centre

Michael Roeskau



Director
OECD Development Co-operation
Directorate

7 July 2005

RÉSUMÉ

L'expérience des cinq filières étudiées (agro-alimentaire au Chili, fleurs au Kenya, vêtements au Lesotho et à Maurice, et fruits de mer en Thaïlande) démontre que des industries non traditionnelles peuvent naître et générer de solides taux de croissance dans les contextes les plus variés de géographie ou de fondamentaux économiques et sociaux. Dans la plupart de ces cas, les pouvoirs publics ont adopté une approche relativement favorable à l'exportation et aux affaires, et adapté leurs politiques au développement de ces activités.

Partant, le facteur clé d'un ajustement structurel bénéfique a été la détermination des gouvernements à adapter leur économie et le cadre politique pour permettre aux entreprises d'opérer à un stade approprié et de renforcer leurs avantages comparatifs sur les marchés internationaux. Ce qui souligne l'importance d'inscrire la politique commerciale dans le cadre des stratégies de développement global et de mettre en place, pour assurer une approche cohérente de l'ajustement commercial et structurel, une procédure consultative nationale d'adoption des politiques. Les études de cas soulignent aussi que les pays (pouvoirs publics et entreprises) sont condamnés à *s'adapter constamment* en fonction des nouvelles sources de concurrence, de la charge salariale croissante, des contraintes de l'environnement, des avancées technologiques, et des exigences de la demande et des progrès. Les décideurs politiques de la plupart des pays passés en revue sont conscients de ce défi. Et c'est pourquoi plusieurs d'entre eux ont pris l'initiative de mettre en œuvre des mécanismes ou des programmes spécifiques pour renforcer la compétitivité des actuelles filières d'export et/ou pour favoriser l'émergence d'activités exportatrices non traditionnelles.

SUMMARY

The experience of the five examined industries (agro-food in Chile, cut flowers in Kenya, garment in Lesotho and in Mauritius and seafood in Thailand) demonstrates that non-traditional industries can emerge and achieved strong growth rates in very diverse settings in terms of geography and initial economic and social conditions. In most of these cases, the government adopted a relatively export-oriented, business-friendly attitude and adapted its policies as the industries developed.

Hence, a key factor for successful structural adjustment has been the pro-active role of government in establishing an enabling economic and policy environment that allows local firms to operate on a level-playing field and strengthen their competitive edge in international markets. This highlights the importance of implementing trade policies in the framework of comprehensive development strategies and establishing a consultative national policy-making process for ensuring a coherent approach to trade and structural adjustment. The case studies also underscore that countries (government and industry) are compelled to *constantly adapt* in light of new sources of competition, growing wage levels, environmental constraints, technological advances and demanding product and process standards. Policy-makers in most countries under review are aware of this challenge. As a consequence, some of them have taken the initiative to set up specific mechanisms or programmes for further enhancing the competitiveness of existing export sectors and/or promoting emerging non-traditional export industries.

I. INTRODUCTION

This paper examines five cases of trade and structural adjustment achieved through production and export diversification in developing economies and draws policy lessons for future adjustment challenges. The case studies focus on the expansion or emergence of: *i*) the agro-food industry in Chile; *ii*) the cut flowers industry in Kenya; *iii*) the garments industry in Lesotho and *iv*) in Mauritius; and *v*) the seafood industry in Thailand¹. They all represent notable examples of trade and structural adjustment, which have resulted in the emergence of non-traditional, dynamic export sectors.

The paper is organised as follows. Section II summarises the major lessons learned from adjustment experiences in the countries under review. Section III presents the five case studies. Each case study briefly examines: *i*) the major economic and social developments during the last three decades; *ii*) the performance, structure and impact of the examined industry on the economy; *iii*) the role of government policies and parastatal institutions and *iv*) future economic, social and environmental challenges and opportunities.

Initial conditions in the five countries under examination varied markedly in terms of geography, resource endowments and the level of economic and social development. Yet, all these countries underwent a period of macroeconomic imbalance, stagnation or even crisis in the 1970s — most notably in Chile (1972-73)— and again in the early 1980s, before experiencing the growth spurts of non-traditional exports in the late 1980s.

Adjustment occurred under different circumstances. Three of the five case studies (Chile, Kenya and Thailand) examine the growth of natural resource-based export sectors for which the world demand has been strong and increasing². The other two case studies (Lesotho and Mauritius) examine the emergence of the garment industry, which was mainly driven by the ability to combine domestic and foreign investment with preferential market access. The new export dynamism in Chile, Mauritius and Thailand coincided with strong overall growth and diversification since the late 1980s. In Kenya, a very dynamic industry has flourished in a setting of weak domestic growth and poor governance. Lesotho, a land-locked country heavily dependent

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1. In terms of the Standard International Trade Classification, Revision 3 (SITC, Rev. 3), these sectors are defined as including the following export categories: agro-food (codes 00-09, including seafood, code 03), cut flowers (code 292.7), garments or clothing (code 84).
 2. For an analysis of most dynamic export products see UNCTAD (2002, chapter 3) and WTO (2004, chapter 1); Bonaglia and Fukasaku (2003) provides an analysis of export diversification patterns for low-income countries.

on workers' remittances, embarked on export-oriented garment production since the early 1980s, with the initial investment of South African firms that wanted to avoid international sanctions.

While the underlying forces that prompt economies to adjust vary from one case to another, it can be argued that a number of critical requirements for successful structural adjustment are common to all. These include: *i*) macroeconomic stability; *ii*) trade and regulatory reforms that can stimulate exports, improve local business conditions and foster competition, thereby also promoting private domestic and foreign investment; *iii*) long-term investments in human resources and infrastructure; *iv*) adequate support structures or institutions that can assist firms to adapt, upgrade and connect to export markets and provide information and advice to potential investors, and *v*) a proper sequencing of reforms (both economy-wide and sector-specific) that can help sustain the structural adjustment process. As seen in the case of Kenya, it is difficult for the government to "pick winners" and target assistance to particular industries. Instead, the government should *facilitate* structural adjustment, by creating an enabling economic and policy environment which allows firms and other agents to respond to adjustment pressures, by shifting their resources to more productive uses.

Managing successfully the structural adjustment process poses a major challenge for many low-income countries whose economies heavily depend on commodity exports. Despite major efforts at reform and market-opening initiatives since the 1980s, many of the world's poorest countries have not been able to reap the full benefits of global trading opportunities and hence participate in the growth-inducing and poverty-reducing benefits of trade. However, "unfavourable" initial conditions, such as dependence on natural resources, are not insurmountable. Other factors, such as knowledge, quality of institutions and infrastructure, are all crucial in determining trade volumes and diversification. These countries need to develop their own strategies for trade and investment promotion, with the input of relevant state and non-state stakeholders in their countries.

II. LESSONS LEARNED

The main purpose of the five case studies is to identify the government policies that have helped to facilitate and sustain the structural adjustment process in developing economies. These policies are typically a mixture of both economy-wide and sector-specific support policies. While the case studies focus on the performance of particular sectors and the policies affecting them directly, experience in fact suggests that the impact of economy-wide policies, aimed at improving overall economic efficiency, is often more important to the performance of particular sectors than the impact of any sector-specific policy measure. Indeed, with the exception of Kenya, the sectors under examination have evolved in a context of strong overall economic growth. This highlights the importance of creating an enabling policy framework as a prerequisite for successful structural adjustment.

Enabling Policy Framework

All five countries pursued import-substitution strategies prior to, or in parallel to, conducting outward oriented strategies in some sectors. In addition to securing macroeconomic stability, removing the anti-export bias and restoring realistic exchange rates played a key role in the initial efforts to put economies onto outward-oriented growth paths. Complementary policy measures and initiatives — such as regulatory reform and the availability of adequate export and investment support services — were also implemented to improve domestic conditions for international business development and to encourage long-term investment in non-traditional export sectors.

The case studies point to the importance of sound public institutions for managing the services and incentives provided to exporters and investors, such as the Export Processing Zone (EPZ) in Mauritius and the investment incentives in Chile. However, the problem of defining “sound institutions” remains (Rodrik, 2003). Governance indicators highlight Chile’s good performance yet indicate that Lesotho and Kenya are lagging far behind³. In the case of Kenya, the cut flower industry has prospered in what seems to be an adverse governance environment, which has been an important factor behind the country’s disappointing overall economic performance.

3. See www.worldbank.org/wbi/governance/data.html.

Establishing a well-functioning consultative process between the government and the private sector is considered to be a key requirement for effective policy formulation, which is needed to manage and sustain an effective structural adjustment process (OECD 2002; Bonaglia and Fukasaku, 2002). For the consultative process to work, it must involve active and vocal business organisations. A variety of such organisations exists in all five industries reviewed (some have emerged with direct government support). These organisations play an important role both in promoting business interests to the government and in providing business services to members. Relevant sector-specific organisations include, for example, the Kenya Flower Council, the Lesotho Textile Exporters' Association, and the Thai Frozen Food Association. Beyond sector-specific organisations, there is also a range of more general industry organisations and chambers of commerce that represent and support the private sector. In addition to the associations, networks of private service providers have developed as well.

Trade Policy

Access to OECD markets — whether facilitated by multilateral, regional or bilateral trade agreements or by preferential trade schemes — has, in various ways, been of fundamental importance to the adjustment process in all five countries examined. It has stimulated exports, improved access to essential inputs (raw material and capital) and fostered competition and innovation.

Exports from Kenya, Lesotho and Mauritius have enjoyed preferential access to EU markets thanks to the European Economic Community (EEC) — African, Caribbean and Pacific group of states (ACP) Lomé Convention introduced in 1975 (and further revised in 1979, 1984 and 1989) and the Cotonou Agreement introduced in 2000⁴. In addition, the US Africa Growth and Opportunity Act (AGOA), introduced in 2000 and further revised in 2002 (AGOA II) and 2004 (AGOA III), helped both Lesotho and Kenya, and to some extent Mauritius, to increase textile and clothing (T&C) exports to the US (see Table 1)⁵.

4. Further information on EU-ACP agreements can be found at <http://europa.eu.int/comm/trade>.

5. In 2003, US imports from 37 African countries, beneficiaries of the scheme, rose by 43 per cent to nearly \$25 billion. Although 70 per cent of these imports originate from five oil-exporting countries, substantial increases are also reported for Kenya, Lesotho and Swaziland, which nearly doubled their exports to the US between 2001 and 2003 (WTO, 2004).

Table 1. Leading Textile and Clothing Exporters under AGOA (\$ million)

		2001	2002	2003	2004	2005 Jan-Mar
Kenya	T&C exports under AGOA	52	122	176	272	58
	Total exports under AGOA	59	129	184	287	60
	Total exports to the US	129	189	249	352	93
Lesotho	T&C exports under AGOA	130	318	373	448	72
	Total exports under AGOA	130	318	373	448	72
	Total exports to the US	217	321	393	467	107
Madagascar	T&C exports under AGOA	92	76	186	314	42
	Total exports under AGOA	97	80	188	317	43
	Total exports to the US	272	216	384	469	70
Mauritius	T&C exports under AGOA	39	107	135	148	27
	Total exports under AGOA	54	114	143	160	28
	Total exports to the US	275	280	298	270	58
South Africa	T&C exports under AGOA	31	85	127	115	15
	Total exports under AGOA	923	1342	1669	1781	374
	Total exports to the US	4 430	4 236	4 888	5 926	1 347
Swaziland	T&C exports under AGOA	8	74	126	176	33
	Total exports under AGOA	15	81	134	177	40
	Total exports to the US	65	114	162	199	58

Source: US International Trade Commission [http://reportweb.usitc.gov/africa/trade_data.jsp (see Table 1)] and www.agoa.gov.

Yet, as the partnership between the EU and ACP countries is currently being revised, through the negotiation of the Economic Partnership Agreements (EPAs), and as EU tariffs might be further reduced through multilateral trade negotiations, ACP countries are likely to face increasing competitive pressures⁶. In addition, the dismantling of the Multifibre Arrangement (MFA) quota system as of 1 January 2005 has intensified adjustment pressures on African garment exporters⁷.

While trade preferences can sustain exports and investments in specific industries, and as such support the export diversification and adjustment process, they cannot substitute for domestic efforts at policy reform, nor remedy by themselves to supply-side shortcomings. In fact, there is substantial evidence that “trade preferences have not transformed the export and growth

6. Many in the ACP group fear the introduction of free trade with the EU, negotiated under the EPA, could undermine their economic development possibilities as local industries collapse under pressure from competition from imported EU goods. Yet, EPAs will include developmental protocols, i.e. measures to promote the structural transformation of ACP economies, so that they produce more value added goods. Negotiations of the EPAs have started in September 2002 and will come to a close at the end of 2007.

7. In fact, these countries are mainly exporting in standardised, low-price and low-to-medium quality product segments, such as trousers and knit shirts, where competition is most likely to heat up in the post-quota world. See Manchester Trade Team (2005) for an analysis of the impact of the phasing out of the MFA on Easter and Southern African countries.

performance of most developing country beneficiaries, although performance may have been worse without them and a few countries may have benefited substantially" (Brenton and Ikezuki, 2005, p. 4). In a nutshell, preferential market access can provide a window of opportunity for uplifting a country's export profile, but it can only have a long lasting impact if it does not distort the allocation of resources with respect to the country's comparative advantage. It is therefore of foremost importance that the granting of such access is time-bounded and bundled with multilateral liberalisation, to ensure it does not encourage the emergence of inefficient industries.

Chile and Kenya have been able to take advantage of the fact that their agricultural production is off-seasonal for their major export markets. Increasingly, however, their exports have been subject to strict technical requirements and health and quality standards. Thailand has also faced Sanitary and Phyto-Sanitary measures (SPS) and other non-tariff measures in OECD markets. The policy response of the governments and industries has been to set up specialised agencies to enhance quality control and certification and raise awareness of standards amongst producers (e.g. Thailand's National Food Institute). To boost trade, Thailand and Chile are now pursuing a bilateral and regional Free Trade Agreement (FTA) strategy, involving a number of OECD and non-OECD countries.

Trade reform is part and parcel of the requirements for successful structural adjustment. The five countries under review have taken different approaches to trade reform. In the early stage of reform, Mauritius undertook a policy of partial opening, by instituting an EPZ in the protected domestic economy. Similarly, the Thai economy has been liberalised only gradually. Among the five countries, Chile is the only case in which the government pursued a policy of full import liberalisation. This policy, together with a range of other measures that further opened up the economy and promoted exports, contributed to the development of fresh fruit, wine and other agro-food export industries. It was however not until the mid-1980s, after adopting a set of corrective regulatory measures which promoted product market competition and innovation, that these exports became a source of (economy-wide) growth. This last point highlights the importance of adequate sequencing of complementary reforms.

Like many other developing economies, the five countries under study also introduced various forms of export incentives, such as duty-drawback schemes (reimbursement of import levies charged on parts and components used for export production), tax holidays and other fiscal measures provided for export firms in the EPZ. It is worth emphasising that export incentive packages need to be managed by well-functioning public institutions, in order to avoid delays and other inefficiencies. In addition, these incentive packages must be part of an overall export and investment promotion strategy of the government, such as the EPZ in Mauritius. The absence of such overall strategies may explain the difficulty of establishing successful EPZs in other Sub-Saharan countries (Bost, 2001). Inefficiencies in the protected sector may also weaken the linkages with the dynamic export sector. Lesotho is a case in point, as the country faces a major challenge to strengthen linkages between the foreign-owned garment sector and the rest of the economy.

Investment Promotion and Other Support Policies

The range and depth of the support schemes implemented have varied, but in none of the five cases has the government intervened *directly* in production or sales. In other words, the government has primarily played a facilitating role. The private sector has been encouraged to innovate and stay competitive. This “non-interventionist, yet supportive” policy has been a particular success factor for the Kenyan horticulture and cut flower industries, as compared to an opposite tendency of state intervention in Africa. It is however important to recognise that a support framework cannot compensate for flaws in the fundamental enabling environment.

Investment capital primarily originated from *domestic* sources in all the sectors under study, except in Lesotho, where the garment sector is mainly in the hands of foreign investors. It is noteworthy that the capital often originated from the export sectors that had been dominant previously, such as the sugar sector in Mauritius, the agro-industry corporations in Thailand, and the horticulture industry in Kenya. In particular, the Mauritian experience highlights how important it is not to kill the “cash cow” and ensure that domestic sources of risk capital are adequately mobilised and complement foreign direct investment (Subramanian and Roy, 2001).

Even though the case studies do not elaborate at any length on the role of the domestic financial system in the growth of new export sectors, it is worth noting that the availability of short and long term finance is a key element for entrepreneurs. In Mauritius, for instance, the Development Bank of Mauritius played a key role in providing preferential credit to the EPZ sector, setting up a foreign exchange risk scheme and supporting SMEs. In other African countries, various efforts have also been undertaken to promote the financial market, but access to finance remains a serious bottleneck to trade development (Bonaglia and Fukasaku, 2002).

While domestic investments dominated in terms of quantity, foreign investments seem to have made an important “qualitative” contribution. FDI and expatriate expertise provided capital, managerial, and technological know-how, as well as access to foreign markets and buyers. The Dutch and Israelis helped to develop cut flower expertise in Kenya, East Asians the garment industry in Mauritius and Lesotho, Americans fruit packaging techniques in Chile and Japanese shrimp farming in Thailand. The governments also assisted in attracting FDI with fairly open and non-discriminatory investment regimes put in place in the 1980s.

Infrastructure and Human Resources Development

International transport facilities and other physical infrastructure played an important role in the development of the five surveyed industries, in particular for perishable products such as fresh fruit and cut flowers. The five case studies seem to indicate that adequate infrastructure facilities and services were already in place at the time of industry growth, though further investments were undertaken by the government, alongside deregulation of infrastructure services. In the Mauritian case, the Development Bank of Mauritius was directly involved in building and managing the industrial estates for the EPZ sector. In the case of Kenyan cut flowers, the industry was able to take advantage of the international air traffic created by tourism and early horticultural exports. In Thailand, companies co-operated to

negotiate lower international freight costs. In Lesotho, the Lesotho National Development Corporation provided factory space and utility services to investors, even though the recent rapid growth of the garment industry has created a shortage of facilities.

In terms of human resource development, the challenges facing the surveyed industries appear to be quite similar. When the industries first started to grow, they all had access to a pool of relatively well-educated and cheap labour. Literacy and primary education levels were all relatively high. As the industries developed, they were confronted with shortages of skilled labour and rising wage levels. Human resource development has thus become a major challenge to improve productivity and climb up the value-chain ladder, in the face of rising competition and market demands. Governments can help overcome this challenge by investing in secondary and tertiary education as well as in vocational training.

Social and Environmental Impacts

Industrial growth has brought about significant social and environmental impacts. Perhaps the most striking social impact can be found in the Mauritius' case, where unemployment was significantly reduced in the course of the 1980s (Anker *et al.*, 2001). A noteworthy social feature common to most case studies is the high dependence on female labour. While the jobs created tend to be precarious in some cases (e.g. peak and off-peak periods in agricultural production), the export sectors under review have provided women with opportunities and income they did not previously enjoy and thus contributed to poverty reduction.

The expansion of the examined industries has sometimes caused harmful environmental effects, such as water pollution, depletion of fish stocks and destruction of mangrove ecosystems, which have in turn raised concerns regarding the sustainability of some of these industries (shrimp farming in Thailand is probably a case in point). Buyers and consumers in importing countries are now adding pressures on producers to comply with a wide range of health, environmental and social standards. To deal with these issues, the governments in the surveyed countries are required to develop legislation, formulate good practices and put in place appropriate quality control systems in co-operation with the private sector and eventually with the support of external aid⁸.

Conclusions

In brief, the experience of the five surveyed industries demonstrates that these non-traditional export industries have achieved strong growth in very diverse settings in terms of geography and initial economic and social conditions. In most of these cases, the government adopted a relatively export-oriented, business-friendly attitude and managed to adapt its policies as the industries developed. Hence, a key factor for successful adjustment has been the pro-active

8. Numerous donor agencies and regional bodies have already funded workshops to provide information on the SPS and TBT regulations in place in OECD countries, as well as advice on traceability, residue testing, food safety risk/conformity assessments and certification techniques. See the SPS and TBT categories in the WTO/OECD Trade Capacity Building Database at <http://tcbdb.wto.org>.

role of government in establishing an enabling economic and policy environment that allows local firms to operate on a level-playing field and strengthen their competitive edge in international markets. This highlights the importance of implementing trade policies in the framework of comprehensive development strategies and establishing a consultative national policy-making process, for ensuring a coherent approach to trade and structural adjustment.

In this respect, it is also important to see the growth of these industries in the context of a country's long-term economic transformation. Even though adjustment may have been triggered by identifiable policy choices on the part of the government, such as import liberalisation in Chile and the establishment of an EPZ in Mauritius, the potential outcome may have been somewhat influenced by other factors that were factored into the process *before* reforms, such as the skill level and cost of human resources and the quality of infrastructure⁹.

The case studies have also shown that in light of new sources of competition, growing wage levels, environmental constraints, technological advances and demanding product and process standards, countries (government and industry) are compelled to *constantly adapt*. Policy-makers in most countries under review are aware of this challenge. As a consequence, some of them have taken the initiative to set up specific mechanisms or programmes for further enhancing the competitiveness of existing export sectors and/or promoting emerging non-traditional export industries (e.g. the Economic Agenda for the New Millennium launched in 2000 in Mauritius; the National Competitiveness Committee established in 2003 in Thailand; the Consejo para la Innovacion Agraria in Chile). These initiatives often involve high-level policy-makers from a number of relevant Ministries (and sometimes the Prime Minister himself) as well as private sector representatives.

In addition, it is important to stress that bilateral donors, multilateral agencies and regional and international financial institutions have often provided valuable assistance to policy-makers, entrepreneurs, business associations and technical bodies in all five surveyed countries. Activities of direct relevance include, among others, road construction in Chile, support to the Horticultural Crops Development Authority and business associations in Kenya and technical assistance to shrimp farmers in Thailand. In Lesotho, the Integrated Framework for Trade-Related Technical Assistance, a multi-donor programme, aims to play an important role in strengthening the country's trade policy process and institution building¹⁰. To ensure aid effectiveness, donors should adapt to the changing circumstances and needs of partner countries, as identified in national strategies and development plans, and improve co-ordination and complementarity of their assistance programmes. Needless to say, development assistance cannot replace domestic processes, leadership and commitment.

9. Rodrik (2003) argues that economy-wide growth "spurts" may be initiated even by small policy changes if the economy operates below its potential and that "an attitudinal change on the part of the top political leadership towards a more market-oriented, private-sector-friendly framework often plays as large a role as the scope of reform itself (if not larger)" (p. 15).

10. The WTO/OECD Trade Capacity Building Database monitors since 2001 trade-related technical assistance and capacity building activities from approximately 45 "suppliers" (bilateral donor countries and multilateral agencies) to 146 recipient countries. See <http://tcbdb.wto.org>.

III. FIVE COUNTRY CASE STUDIES

A. CHILE

Introduction

Chile, the sixth largest country in terms of both GDP and population in Latin America, is one of the most open economies in the region with a volume of trade to GDP ratio above 50 per cent and the highest share of FDI to GDP in the 1990s. The country has experienced the highest per capita income growth in the region since the mid-1980s. Between 1984 and 1997, GDP per capita increased at an annual pace of 5-6 per cent, which is more than double the long-term trend of around 2.4 per cent per year over the last 40 years (OECD, 2003). Chile is considered a showcase of a country that has successfully followed an outward-oriented development path (Agosin, 2002; Ffrench-Davis, 2002). The neo-liberal economic policies initiated by the Pinochet regime from 1973 led to a switch in the policy stance from import substitution to export orientation and posed the basis for a major transformation of the economy. Chile has managed to exploit to the fullest extent its natural resource endowment to achieve vertical and horizontal diversification. Besides the copper cluster, which has also spurred a rise in engineering and consultancy services, the agro-food sector has played an important role in this transformation, with success stories such as fresh fruits, wine, and salmon (Fisher, 2001). This case study takes the agricultural and food industry as a starting point for a review of the Chilean experience.

Economic and Social Developments

The structure of the Chilean economy has changed dramatically since 1973. Economy-wide reforms curbed state intervention, deregulated input and output markets, opened the country to international trade and fundamentally altered the incentive structure in favour of the tradable sector. A large part of the import-competing traditional manufacturing sector (e.g. textiles and machine tools) declined. New natural resource-based, export-oriented industries, mainly agricultural products, became an engine of growth. Between 1973 and 2000, the share of exports to GDP grew more than 2.5 times (from 14 to 36 per cent), and the export basket was significantly diversified. Copper now represents less than 30 per cent of exports, while vegetables and fruits, fish, forestry products and wine are among the most important export items (see Statistical Annex). Export markets have also been significantly diversified.

By 1970, Chile had attained one of the highest levels of social development in Latin America (Ffrench-Davies, 2002). While life expectancy, infant mortality, and literacy continued to improve, unemployment and income inequality worsened considerably during the military

regime¹¹. The governments in place since 1990 made systematic efforts to strengthen macroeconomic stability while widening access to the benefits of growth to improve the social situation. These efforts have resulted in reductions in poverty and unemployment, but have only marginally reduced inequality¹².

Agro-food Industry Developments

Industry Performance, Structure and Impact on the Economy

Once a stagnant sector, the Chilean agro-food industry has become dynamic and diversified, accounting for around 11 per cent of GDP and 43 per cent of total exports¹³. It is estimated that approximately 14 per cent of the labour force is employed in agricultural and fishery activities. Thanks to its backward linkages (supply of inputs, including pesticides and machinery) and forward linkages (food-processing, distribution, and the service industry, including hotels), the agro-food cluster has a high employment creation potential, which has contributed to spread the benefits of growth and reduce poverty (Valdes and Foster, 2003b)¹⁴. At the same time, the jobs created in the expanding commercial agriculture, in particular the fruit sector, were often temporary and with lower wages, and attracted a growing number of women. Thus, the result of the structural adjustment seems to have been a shift from permanent rural employment to feminised temporary jobs (Belfor, 2000; Goldfrank, 2003). At the same time, the fruit sector offered women opportunities for employment, income and personal fulfilment that were previously lacking (Jarvis and Vera-Toscano, 2004).

Exports, which are mainly processed in nature, concentrate in three products — fresh fruit, wine and salmon — which make up half of agro-food exports (Brooks and Lucatelli, 2004; ODEPA, 2004a). Chile has been able to take advantage of the fact that its exports are to a large extent off-seasonal, or counter-seasonal *vis-à-vis* the major export markets (Ffrench-Davis, 2002).

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11. Major recessions contributed to dramatic increases in unemployment, which topped 24 per cent in 1982. Since then, the unemployment rate and mean duration have declined steadily to reach their historical levels in the 1990s (Edwards and Cox-Edwards, 2000).
 12. High growth, supported by targeted policies, led to a reduction in poverty from 45 to 21 per cent between 1987 and 2000. However, Chile still has one of the most uneven distributions of income among emerging market economies. The labour market is characterised by a dualistic structure, with a high share of informality and precarious contracts. Economic development is also split between the modern and dynamic metropolitan area of Santiago and several poor and relatively underdeveloped regions (OECD, 2003).
 13. Average for 1998-2000 (Brooks and Lucatelli, 2004).
 14. In their study of the impact of agriculture on poverty reduction in Chile, López and Anríquez (2003) conclude that agricultural expansion has a dramatic impact on poverty alleviation and such impact is larger than the impact of aggregate growth. They find that agricultural growth improves all measures of poverty significantly with the head-count poverty index falling by 8 to 11 per cent as a consequence of a 4.5 per cent increase in agricultural output (i.e. the elasticity of poverty reduction with respect to agricultural growth ranges between 1.8 and 2.4). The main driver of poverty reduction is the increased demand for labour, since the Chilean agricultural sector employs more unskilled labour than the rest of the economy.

The early reforms in land and water rights, labour regulation, import and export marketing, combined with tight macroeconomic policies and strategic exchange rate devaluation, unleashed the potential in the agricultural sector. Value-added in agriculture grew at more than 4 per cent per annum over 1973-90, a twenty-fold increase with respect to the dismal 0.2 rate of the 1960s (Valdes, 1993; Belfor, 2000).

The success of the agro-food industry also rests upon the active role played by a wide range of public institutions and private organisations that participate in policy making (thanks to consultative policy mechanisms), collect and disseminate market information, deliver technical assistance and take part in export promotion. These include the *Chilean Fresh Fruit Association* and the *Fruit Growers Federation of Chile*, which participate in the coordinating committee in the Ministry of Agriculture; the *Asociación de Exportadores y Embotelladores* (largest wine exporters) and the *Asociación de Productores de Vinos Finos de Exportación* (exporters of high quality wines); and the *Asociación de la Industria del Salmón de Chile* (SalmonChile). The Ministry of Agriculture co-ordinates an extensive network of public agencies related to the agro-food sector (ODEPA, 2003b; WTO, 2003b; Valdes and Foster, 2003a).

Fruits and Vegetables

Chile exports both unprocessed and processed (canned, frozen, dehydrated, juices) fruits and vegetables. Exports totalled \$1.6 billion in 2002, equivalent to over 10 per cent of total export earnings. The country is currently the leading world exporter of fresh grapes and the fifth largest exporter of apples.

The foundations of the industry can be traced back to the mid-1960s, but fruit exports took off only in 1975, after the reforms enforced by the new regime and the ensuing real exchange rate depreciation. Production doubled and export earnings increased by 19 per cent a year up to 1983, when the economy entered in deep recession. Since then, export growth slowed to around 10 per cent a year until 1989, and 4.6 per cent a year between 1990 and 2002. Technology upgrading was facilitated by agricultural research, which was compounded by availability of know-how, crops and technologies from abroad, notably from California. The transfer was facilitated by the *Corporación de Fomento de la Producción* (CORFO), which is the government agency responsible for developing national productivity. The Government favoured private investment in research and development. Private expenditure on agricultural research increased 19 times to about 13 per cent of total spending on agricultural research between 1973 and 1990.

Wine

Chile's wine industry dates back to the mid-19th century, when wealthy landowners created wine estates on the model of the French Bordeaux châteaux, importing French noble vines and French oenologists. The country has huge vineyards that are free from disease and enjoys ideal climatic conditions. After a good start, the industry floundered during the import substitution era, stymied by government regulations and taxes (Fischer, 2001).

At the beginning of the 1980s, product market regulations were eased and foreign investors were attracted by Chile's favourable environment. Investors brought capital and new

technologies to the sector, which were assimilated by an increasing number of local oenology students. Deregulation led to an initial increase in production, without a corresponding increase in demand, which caused a reduction in prices. Yields were lowered and growers started to produce higher quality wines for export, initially targeting the regional market. The industry went through a period of adjustment, with small producers disappearing and the remaining larger wineries modernising and becoming export-oriented (Torrealba, 1999).

Additional investment, mainly thanks to foreign capital, in modern technology and quality improvement of the vineyards, was needed to meet North American and European consumers' tastes. Substantial improvements in the quality of grapes and in methods of wine production, combined with increasing world demand for "new world wines" contributed to an impressive growth of exports. At the end of the 1980s, exports started to climb dramatically to reach \$610 million in 2002, making Chile the world's fifth largest wine exporter with a 4.2 per cent market share¹⁵.

Salmon

With \$1.2 billion exported, Chile qualified as the world's top exporter of farmed salmon in 2003. This result is all the more remarkable when considering that Chilean salmon farming only began in 1979 and that salmon is not a species native to this country (Bjørndal, 2002; Iizuka, 2004; SalmonChile, 2004a).

What factors explain the impressive development of this industry? Though the Southern regions of the country present suitable environmental conditions, many essential factors for building competitiveness (domestic markets and knowledge) did not exist from the outset. The attempt to start farming on a commercial basis dates back to the mid-1960s, led mainly by government agencies, with support from international cooperation. In the "experimental period" (1960s to 1973), donor agencies from Japan, USA and Canada lent financial and technical support to government agencies to survey areas and potentials for salmon farming. In the "learning period" (1974 to 1984) government agencies underwent structural change and local and foreign private initiatives for salmon and trout farming emerged. The "forming period" (1985 to 1989) witnessed a large increase in the number of local salmon farming firms and the first attempt at collective action from the local private sector (Iizuka, 2004).

Dedicated government agencies were established and charged with strategy formulation and implementation, providing loans to local firms and supporting aquaculture development (Fischer, 2001; Iizuka, 2004). The semi-public *Fundación Chile* played a particularly important role through the establishment in 1980 of the first modern farming centres — demonstrating the technical and commercial feasibility of large-scale salmon farming in the country — focusing on research and the implementation of new technology and by providing technical assistance to other firms.

Strong growth was accompanied in the 1990s by a phase of consolidation and market diversification. Government support to the industry decreased and became more indirect,

15. In 1984, only 2 per cent of the total production volume was exported, 7 per cent in 1989, and in 63 per cent 2002. This is the fastest growth recorded for New World wine producers during this period (Iizuka, 2004).

reflecting the strengthening of producers and producers' organisations. For instance, the private sector took the lead in promoting the establishment of quality certification, with support from a government agency (Maggi, 2002, quoted in Iizuka, 2004). Salmon producing firms had to specialise and outsource non-core processes to reduce costs. Some of these subsidiary firms became independent after a few years. At the same time, the industry is focussing – with success – on the production of higher value-added products, such as pre-prepared and processed products. Such specialisation has allowed companies to compensate for higher shipping costs¹⁶.

Government Policies

The rise of the export-oriented agro-food sector has been favoured by the shift in economic policy, which have altered the incentive structure and created the conditions for the tradable sector to become competitive and develop. Agro-food exports were initially boosted by real depreciation in exchange rates, improved access to imported inputs and export promotion measures, including duty drawbacks and public support through the *Prochile* export promotion agency. Moreover, the liberal, non-discriminatory investment policy was instrumental in attracting FDI inflows, which helped to develop the sector¹⁷.

The Chilean experience shows the importance of commitment to trade and macroeconomic reforms for a successful adjustment. Sectoral interventions were only effective thanks to the coherent changes in the overall policy stance (Valdes, 1993; see Box 1). It also shows that adjustment (the supply-side response) may take longer than expected due to inertia and vested interests. On the one hand, initial conditions and inward-looking attitudes developed during the import-substitution era lingered on. On the other, reforms initially brought about a drastic reduction in subsidies, high interest rates and, later on, real exchange rate appreciation, which adversely affected the tradable (agriculture) sector. Imports surged, leading to a large decline in the domestic production of manufactures and import competing agricultural crops. Restoring external competitiveness through nominal exchange rate devaluation and sound macroeconomic policies helped to withstand the mounting pressure for protection. At the same time, the fiscal reform mitigated the negative impact of a decline in international trade taxes, and the extension of credit lines to smaller farmers reduced the financial distress during the adjustment period (Valdes, 1993).

16. In 2003, the export of higher value-added products, such as salmon fillets, smoked salmon, salmon burgers and salmon pâté, represented 67 per cent of total salmon shipments, up from 5 per cent in 1990 (SalmonChile, 2004b).

17. See <http://www.foreigninvestment.cl/>, which also include FDI legislation and statistics, and Agosin, 2002.

Box 1. A Glance at Policy Reforms in Chile

Macroeconomic policy. During the first phase of reform, government was concerned with quickly redressing macroeconomic imbalances through tight monetary and fiscal policy, financial liberalisation and downsizing of the state intervention in the economy. Inflation was cut down. The initially very orthodox policies were later softened, following severe imbalances and a debt crisis in 1982, through nominal currency devaluations, restrictions on short-term capital inflows and the establishment of price stabilisation mechanisms. A key concern for policy makers has constantly been to avoid an appreciation of the exchange rate, caused by large inflows of short term capital.

Price and trade liberalisation. The military regime abolished public control over imports and exports and privatised public companies responsible for infrastructure and regulation in various markets. Trade and price reform was radical and fast. All international trade restrictions other than tariffs were removed immediately in 1973, while tariffs were reduced from an average of 94 per cent to a uniform rate of 10 per cent between 1973 and 1979. Price ceilings and public purchasing mechanisms were eliminated. After a temporary reversal in the context of the 1982-84 debt and banking crisis, tariffs were gradually reduced again to 15 per cent by the end of military rule in 1989 and to 6 per cent in 2003^a. The 1990s saw a move from unilateral liberalisation to reciprocal trade agreements (Mercosur, 1996; EU, 2003; and the US, 2004). Negotiations are currently under way with India and China.

Investment policy. In 1974, the Chilean FDI regime was completely liberalised and foreign investments were allowed to play an important role in the development of the fresh fruit sector and agro-industry. In the 1990s, large flows of short-term speculative capital caused exchange rate and stock market volatility. As a consequence, the authorities put in place measures to discourage short-term flows such as a requirement for FDI to remain in Chile for at least a year and a reserve requirement of external credit^b.

Infrastructure. At the time of the structural reforms in the early 1970s, Chile already had physical infrastructure facilities that facilitated the growth of exports. This included several large ports, a new international airport and a North-South highway built with foreign aid. The privatisation and deregulation of airlines and telecommunications, which improved quality of services and reduced costs, was particularly important for the fresh fruit industry's perishable exports.

Labour market. The structural adjustment initiated by the neo-liberal reforms of the military regime had a strong impact on the labour force. The reforms incorporated a range of measures which affected workers, including reduction of the minimum wage, easier dismissal of workers, and repression of labour unions.

Land and water right reform. Reverting the land redistribution programme initiated in 1967 based on expropriations and the establishment of cooperative farms, the military regime guaranteed by law land ownership and water rights. These measures secured property rights and created the preconditions for the development of agricultural enterprises more focused on productivity than extensive farming on large areas.

Innovation and technology. Until 1973, innovation was almost exclusively in the hands of the publicly funded Instituto de Investigaciones Agropecuarias (INIA), which played an important role in dissemination of new technologies in basic crops. The liberal reforms greatly enhanced the role of the private sector in research and development with a focus on commercial agriculture. Despite the success in promoting more efficient research services, the reforms of the early 1970s would not have been possible without the investments in human capital made under the previous pre-reform agricultural research system.

Export promotion. ProChile, the trade promotion division of the Ministry for Foreign Affairs, was created in 1974 to gather market information and promote Chilean products abroad. In the 1990s, the government encouraged private companies to form sector associations in order to promote their products economy-wide.

- a. In 1982-84 government introduced export incentives such as tax rebates and deferred payment on customs duty on imports as long as some protective measures for traditional agricultural products were reintroduced on wheat, sugar, and oil seeds.
- b. Both requirements have been abolished in September 1998 and March 2000 respectively.

Source: Edwards and Cox-Edwards (1991, 2000), Ffrench-Davis (2002) and Valdés (1993).

Challenges and Opportunities

The main challenge facing the agro-food sector is to stay competitive in a market where technological advances and overall liberalisation are increasing competitive pressures and buyers are asking producers to comply with more stringent quality, health, labour and environmental standards. As Chilean fresh fruit exports achieve dominant market positions, exports may face more and more non-tariff barriers in foreign markets (Agroecómico, 2004a). In order to meet these challenges, industrial associations, the Ministry of Agriculture and other relevant stakeholders have developed *ChileGap*, a programme of certification of good agricultural practices (www.chilegap.com) promoting integrated crop and plague management systems, workers' security, and produce hygiene and safety.

Currency overvaluation can also be a threat to competitiveness and FDI flows to the sector (Agroecómico, 2004b). The government needs to resist pressures from protectionist lobbies to tamper with the country's liberal trade policy environment.

These challenges may be offset by the opportunities created by increased market access through bilateral free trade agreements and regional integration schemes. Thanks to these agreements, the majority of Chile's agro-food exports will enjoy duty-free access in major markets by 2010. The successful conclusion of negotiations with India and China may give access to potentially huge markets.

Moreover, the government has designed, in partnership with the private sector, a long-term strategy for agriculture that aims at enhancing competitiveness, supporting the rural population and contributing to a sustainable use of resources (*Gobierno de Chile*, 2001). Some of the elements of this strategy include: risk mitigation through insurance schemes, forward markets, and information; improved competitiveness through strengthened research and training; development of markets through bilateral agreements and consultations with private sector in the framework of trade negotiations.

Conclusions

The liberalisation measures of the 1970s and 1980s initiated a major transformation of the economy from import substitution to successful export orientation. Besides the copper cluster, the fresh fruit and other food sectors have emerged as drivers of growth. Fresh fruit export growth has followed a decreasing trend over the years, but other food industries have emerged, such as processed food, wine and salmon. Overall, Chile seems to be in a rather favourable position to meet increasing competitive pressures and diversify its economy further. The biggest obstacle to development might well be the country's pervasive socio-economic inequalities.

B. KENYA

Introduction

In spite of being one of the most advanced countries in Sub-Saharan Africa, Kenya has endured two decades of slow growth, deteriorating social indicators and a shrinking manufacturing sector. GDP per capita declined on average by 0.5 per cent per year over the 1990s. Nevertheless, some resource-based sectors have been able to develop. A prime example is the cut flower industry, which has been growing consistently for over thirty years to become one of the country's main sources of foreign exchange. Albeit relatively small in terms of its impact on overall employment, growth and poverty reduction, the sector is one of the rare success stories of non-traditional export development in Sub-Saharan Africa. More specifically, it illustrates the importance of the government's non-interventionist yet facilitative approach for attracting FDI and foreign expertise, which has led to the emergence of non-traditional exports.

Economic and Social Developments

Over the last twenty years, Kenya has experienced economic decline and falling living standards¹⁸. One explanation is poor governance, which has caused extensive corruption, weak rule of law, growing insecurity, and poor infrastructure (UNECA, 2003). Investment and savings rates have declined over the period, together with decreasing government revenue and a cutback in donor funding. During the 1990s, the service sector was the major driver of growth, while agriculture and industry were characterised by a dismal performance (World Bank, 2003).

Kenya's share in world trade has shrunk by 50 per cent over the same period, due to declining coffee exports and deteriorating international competitiveness of manufactures. Kenyan exports performed strongly in the early 1990s, thanks to the abolition of trade licensing and foreign exchange controls, increasing regional integration, a sharp depreciation of the Kenya shilling and a significant fall in the real average wage (Glenday and Nddi, 2000). However, these favourable export conditions were not sustained by adequate government policies. As a consequence, private investment and export performance deteriorated significantly after 1996¹⁹. Stable tea exports, in which the country has 25 per cent of the world market share and booming horticultural exports, notably cut flowers, have not been enough to reverse this trend.

More recently the AGOA has helped boost Kenyan exports, especially garments. Total AGOA exports to the US have increased almost fivefold since 2001 from \$59 million to

18. For an analysis of the most recent socio and economic developments in the country, see the Kenya country note in the OECD/AfDB African Economic Outlook (2005).

19. During the stabilisation crisis of 1997, the government raised interest rates, which attracted short-term capital inflows, which in turn led to a substantial appreciation of the exchange rate in 1997 and 1998. The average wage rate followed and reverted to its pre-1990 levels (Glenday and Nddi, 2000).

287 million at the end of 2004, with garments accounting for almost 90 per cent of the total [http://reportweb.usitc.gov/africa/trade_data.jsp (see Table 1)].

Economic stagnation has led to a significant deterioration in social indicators. Wage employment has declined in the formal economy and employment is now larger in the informal sector. The number of poor people increased during the 1990s to reach 55 per cent of the population in 2001. Life expectancy has decreased to reach 47 years in 2000, with HIV/AIDS taking a heavy toll. Primary school enrolment has declined and infant mortality has gone up to reach 78 per 1 000 live births. Gender differences prevail; women persistently have lower education, less access to health services, and heavier workload than men (World Bank, 2003).

Cut flower Industry Developments

Industry Performance, Structure and Impact on the Economy

With a 2 per cent share of the world market, Kenya was in 2002 the world's seventh largest exporter of cut flowers and the largest exporter to the EU²⁰. Exports amounted to \$100 million, accounting for 7 per cent of total exports, with roses as the single most important item²¹. The volume was up 25 per cent from the previous year and very strong growth continued in 2003 (Gray, 2003). This is a remarkable result, considering that twenty years before export volumes were ten times lower.

The origins of the industry date back to the late 1940s, but exports only started around independence, as the country emerged as an exporter of off season vegetables and fruits to the UK. Further developments were fuelled by increased tourist-related air traffic, foreign investments on preferential terms, reinvestment of tea export earnings, expatriate professionals, and training of small-scale growers. The industry continued to expand in the 1980s, driven by foreign investments and technical expertise from abroad, combined with domestic investment from local fruit and vegetable companies and public officials. The major boost came after trade liberalisation and deregulation of air freight tariffs in the early 1990s. The industry also benefited from improved transport infrastructure (Thoen *et al.*, 2000).

The industry is made up of around 5 000 farmers or enterprises, employing between 40 and 50 thousand people — predominately young women — which corresponds to less than 1 per cent of total employment (Opondo, 2002, and KCBS, 2004). Jobs are precarious, but households that are involved in horticulture seems to be better off than non-horticultural households thanks to higher wages and better access to credit (McCulloch and Ota, 2002, and Minot and Ngigi, 2004).

Flower production has prompted the development of local expertise and stimulated the establishment of a network of support services and business. As a result, Kenya now provides

20. Two-thirds of the produce is marketed through the Netherlands, either through auctions or directly (Opondo, 2002). Direct sales to supermarkets in the UK are other important outlets (Gray, 2003).

21. UN COMTRADE database, SITC rev. 2 code 2927 Cut flowers and foliage.

consultancy services to neighbouring countries (Dijkstra, 2001). Inputs such as greenhouses, shade structures, agrochemicals, irrigation and other equipment can be procured locally.

Government Policies

Economy-wide reforms have conditioned the development of the cut flower industry, but their impact has probably been less important than in other industries. In fact, the government's intervention in the sector has traditionally been limited, unlike the tea and coffee sectors. The authorities have actively promoted commercial horticultural production but mostly acting as a facilitator and through the provision of extension services and research and development. The sector has benefited from a relatively liberal trade policy regime, characterised by low export taxes and no marketing or distribution control (Opondo, 2002).

The liberalisation of foreign exchange controls, the lowering of import barriers for input and the decrease in state interference with air freight tariffs in the early 1990s greatly benefited the cut flower industry by reducing the previously high transaction costs. At the same time, the reforms introduced were not sufficient to tackle the underlying distortions in the economy and the mismanagement of the public sector, as witnessed by the stagnation of other industries (Reinikka, 1996). In fact, the cut flower industry expanded, while the overall economic growth rate continued to decline throughout the 1990s (Thoen *et al.*, 2000).

The reform process ran out of steam between 1997 and 2000, following the onset of the Asian financial crisis, a budgetary crisis related to election spending and, eventually, the collapse of the IMF stabilisation programme (Glenday and Nddi, 2000). Aid was frozen in July 1997 when the government refused to comply with IMF conditionalities on governance reforms and was resumed only in July 2000 (Bonaglia and Fukasaku, 2002). The crisis was accompanied by a strong exchange rate appreciation that, in conjunction with strong devaluation in Asian currencies, negatively affected the competitiveness of Kenyan exports. Cut flower exports contracted by 16 per cent in 1998, but then fully recovered with the real decline of the Kenya shilling in 1999.

Preferential access to the European market under the Lomé Conventions has played an important role in the development of the industry. In this respect, the outcome of the EPA will be critical for the industry, since Kenya cannot benefit from the duty-free access granted to LDCs under the Everything But Arms initiative. In contrast, the AGOA initiative has so far been largely irrelevant as far as cut flower exports are concerned²².

Foreign capital and expertise have been vital for the development of the cut flower industry, bringing technical know-how, management skills, planting material, as well as facilitating marketing contracts and joint-ventures, sometimes with the support of donors. The industry and its institutions have indeed received non-negligible international donor support, much of which seems to have been directed at smallholding farmers (Thoen *et al.*, 2000). Alongside foreign investment and donor support, domestic sources of investment in the industry

22. Kenya began to ship cut flowers to the US under AGOA for the first time in 2001, reaching not more than \$1.8 million in sales in 2003 (USITC, 2004a, and Gray, 2003).

have included tea estates, large fruit and vegetable companies seeking to diversify, spin-offs from already established cut flower companies and prominent public officials. Investments were attracted thanks to Kenya's basic competitive advantages for flower production (based on favourable geographical, climatic and labour conditions) and the expected profitability of the cut flower market. Foreign investment in the industry was granted legal guarantees on taxes and profit repatriation, as well as work permits for expatriate personnel (Minot and Ngigi, 2004; FKAB Feldt Consulting, 2001).

Hence, investments in the cut flower industry have taken place against a background of overall dismal Kenyan FDI performance in the 1990s. This performance is mainly explained by the poor governance and weak institutions that have raised the cost of doing business and deterred investor (World Bank, 2003).

Ease of access to infrastructure is also vital for the industry's perishable products. Infrastructure has traditionally been more developed in Kenya than in most other African countries, even though its quality has deteriorated over the past decade because of lack of investment. Kenyan air transport, which is a key element for the sector, is competitive and operating well (World Bank, 2003; Minot and Ngigi, 2004). In addition, there are government-run cooling facilities in the airports, though they are reported to be deficient. This has affected the quality of goods from smaller producers, while most large producers have invested in their own cooling facilities (Thoen *et al.*, 2000).

A number of public institutions support the cut flower industry, including the *Horticultural Crops Development Authority* (HCDA), established in 1967 and funded by an export levy and various donors. HCDA has not been directly involved in buying and selling produce. Instead, it has played more of a facilitator's role, regulating and developing the sector through disseminating market information and advisory services (Ebony Consulting International, 2001). In addition, the *Kenya Agricultural Research Institute* is responsible for flower research and development and the *Kenya Plant Health Inspection Service* issues phytosanitary certificates for exports. Two business associations — the *Kenya Flower Council* (larger enterprises) and the *Fresh Produce Exporters Association of Kenya* — represent the industry and are involved in policy making through various consultative processes (Opondo, 2002). Both have approved codes of practice covering social and environmental criteria and are active lobbyists to the government.

Future Challenges and Opportunities

Kenya's cut flower industry faces several major challenges. First, there is stiffening competition from other producer countries, not least in the region, while buyers are becoming increasingly demanding in terms of both prices and quality (Thoen *et al.*, 2000). Second, the EU is putting more and more stringent phytosanitary restrictions on flower imports (Riungu and Mbaria, 2004). Third, civil society, importers and consumers are constantly pressuring for higher labour and environmental standards and there is a multitude of codes and labels (Gray, 2003). Fourth, a major setback would be anticipated if Kenya loses its preferential access to the EU market in 2008. The outcome will depend on the result of the EPA negotiations, but there is a risk that growers will begin to outsource production to neighbouring LDCs (FKAB Feldt Consulting, 2001, and Gray, 2003). Fifth, growers are worried that the government may get increasingly

involved in the horticulture industry through direct intervention or taxes (FKAB Feldt Consulting, 2001). Sixth, poor governance and deteriorating security increase the cost of doing business in the country and harm Kenya's image (World Bank, 2003).

All these challenges are likely to be felt disproportionately by small and medium-sized producers, with a potential negative impact on employment and poverty. Despite the government's attempt to promote smallholder involvement in flower production, small farmers face an uncertain future. They cannot meet demands for higher quality and face increasing costs, such as having to pay royalties under the International Convention for the Protection of New Plant Varieties that Kenya signed in 1999 (Thoen *et al.*, 2000).

On the positive side, the Kenyan cut flower industry has been able to develop and thrive in quite adverse domestic policy conditions and fierce international competition. The sector has an early-mover advantage compared to new competitors and there is a backbone of well-established enterprises with a high degree of control over the supply chain. This will provide some "protection" in the short term, but in the long run the industry relies on its ability to constantly innovate to stay competitive. A further positive development may be the increased market access to the US through AGOA, but so far it has mainly benefited the Kenyan garment industry. Business associations have been developing their own standards, covering labour and environmental criteria, but so far these have been less stringent than international codes. Work is under way to develop a national code on social accountability (Thoen *et al.*, 2000; Opondo, 2002).

Conclusions

Despite poor governance, general economic stagnation and growing poverty, the Kenyan cut flower industry has been able to thrive. Overall, the government has played a facilitating role, providing and securing sufficiently attractive investment opportunities in the industry for both domestic and foreign capital. A key decision by the government in the past has been to avoid direct intervention in production and sales, partly because of the diversity and perishability of the products. At the same time, both public agencies and business associations have been actively involved in the country's policy making through various consultative processes. This approach has proven to be most appropriate for an industry that has to adjust to rapidly changing market conditions. Yet, the industry is now facing a multitude of emerging challenges, as international trade and regulations evolve. Its future depends in no small measure on expanding trade opportunities in new markets and enhancing the competitiveness of small- and medium-sized producers.

C. LESOTHO

Introduction

Lesotho is a land-locked, least-developed country surrounded by, and to a large extent dependent on, its South African neighbour. Despite that, the country has managed to develop a flourishing garment industry and become one of the largest exporters of garments in Sub-Saharan Africa. This case study reviews the Lesotho garment sector and focuses on government policies that have influenced the expansion and competitiveness of the industry. A combination of factors has helped attract (mainly Asian) investors to the garment sector: *i*) relative political stability; *ii*) a relatively well-educated and productive labour force; *iii*) an active export and investment promotion policy; *iv*) access to South Africa's infrastructure; and *v*) preferential access to the EU and US markets. The US AGOA has helped trigger an industry boom, but it is important to emphasise that the first investments occurred long before the introduction of this Act.

Economic and Social Developments

At independence, in 1966, the country was totally dependent on agriculture and lacked a manufacturing base. Rapid growth in the 1970s (average real GDP growth of 7 per cent a year) and between 1987-97 (6.4 per cent), first driven by remittances from migrant labour and aid money and later by foreign investments, transformed the economy. Manufactures now make up 18 per cent of GDP, around half of which comes from the garment sector (IMF, 2004).

Traditionally, the economy has been heavily dependent on workers' remittances, which accounted for nearly half of the GNP during the 1980s. At that time, almost half the adult male population was employed in South Africa. Yet declining demand for low-skilled workers in South Africa – in conjunction with domestic civil unrest – contributed to a severe crisis and dramatic reduction in remittances, down to one fourth of GNP by 1998 (Lundahl *et al.*, 2003).

Exports have grown markedly during the 1990s and increased even more dramatically at the end of the decade thanks to the US AGOA. Exports now make up over 50 per cent of GDP, with garments accounting for three quarters of this figure. Approximately 95 per cent of garment exports are sold on the US market under AGOA²³. Even though all inputs to the garment industry are imported from Asia and South Africa, the sector's export growth has contributed to lowering Lesotho's large trade deficits. Nevertheless, in 2002, overall imports stood at more than double that of exports and came mainly from the countries of the Southern African Customs Union (SACU).

23. In 2004, the value of total exports to the US amounted to \$467 million, and 96 per cent of these exports were in textiles and garment under AGOA [Source: http://reportweb.usitc.gov/africa/trade_data.jsp (see Table 1)].

Although remarkable, Lesotho's growth performance has been combined with a low level of formal employment creation and rising poverty, because of factors such as low productivity in agriculture and declining possibilities in South African mines (Lundahl *et al.*, 2003). The official unemployment rate is over 30 per cent. Employment in the garment industry surpassed that in the public sector in 2001, but has not been sufficient to absorb the loss in other sectors.

Moreover, income inequality is among the highest in the world and gender inequality is pronounced. Women have fewer opportunities than men, partly because women are still prohibited from owning and transferring property. HIV/AIDS is taking a heavy toll and life expectancy has declined from 53 years in 1989 to 45 years in 1999. Education has been a priority of the government since the structural adjustment programmes of the late 1980s and Lesotho's educational attainments are higher than the Sub-Saharan average²⁴.

Garment Industry Developments

Industry Performance, Structure and Impact on the Economy

The garment sector has become the main source of economic growth and employment in Lesotho. The origins of the industry date back to the early 1980s, when garment operations were moved from South Africa to Lesotho, to avoid international sanctions, take advantage of cheap and relatively productive labour and benefit from the country's derogation to the Lomé Convention rules of origin²⁵. Preferential market access to the EU and the US and the provision of incentives contributed to lure investors. The first East Asian investment was made in 1986. Since then, the industry has grown at a sustained pace, which only slowed down at the end of the 1990s. A major boost to the industry came from the approval in 2000 of the US AGOA (Gibbon, 2002, 2003; IMF, 2004).

The garment industry has created a large number of jobs for a predominately female labour force. In February 2003, 43 firms with 43 000 employees (90 per cent being women) were reported to operate in the industry, with several investment projects under way. In addition, numerous small manufacturers produce for the domestic market. Chinese Taipei-owned companies dominate the industry. Production is almost entirely focused on jeans (60 per cent) and t-shirts (40 per cent) aimed for the US market²⁶. All inputs are sourced from abroad, but rules of origin that will apply from 2007 have prompted investment in fabric, spinning and knitting facilities (ITC, 2001; USITC, 2004b; and Gibbon, 2002). As a result of the low local value-added, the linkages between the garment sector and the domestic industry are limited (Integrated Framework, 2003).

24. Adult literacy rate is 81.4 per cent, which is much higher than the Sub-Saharan average (63 per cent).

25. This derogation allows Lesotho to export duty free garments produced in Lesotho from cotton of non-ACP origin. Productivity levels are at about 70-80 per cent of that in Asian factories for basic garments, but lower for more elaborate items (USITC, 2004b).

26. The major customers in the US include The Gap, Wal-Mart and K-Mart.

The private sector is very polarised and there is no internal coordination to voice common concerns to the government. Larger firms tend to rely on their own networks for trade information, while smaller ones are reported to be quite unaware of production standards and market opportunities. Overall, there are very limited links between the foreign-owned export sector and the domestic firms, e.g. in terms of providing inputs and services.

Government Policies

A specific feature of Lesotho is its high dependency on South Africa in terms of macroeconomic policies, trade, investment, transportation and employment. Nevertheless, government policies have played an important role in the development of the garment sector.

The late 1970s saw an important shift in the country's development strategy, with the government adopting an industrial promotion policy that comprised a combination of import-substitution and export-oriented production, and acknowledged a larger role for the private sector (Matloa, 1999). This was not enough, however, to overcome the structural weaknesses of the economy (Lundahl *et al.*, 2003). Economic stagnation in South Africa, combined with rising budget and current account deficits, led to a build up of public debt in the 1980s. At the end of the decade, the country embarked on a set of structural adjustment programmes sponsored by the international financial institutions (IFIs). This co-operation has continued since, with a focus on macroeconomic stability and structural reform.

In terms of macroeconomic and trade policy, Lesotho's room for manoeuvre is constrained by the country's membership in the Common Monetary Area (CMA) which comprises Namibia, South Africa and Swaziland, and the Southern African Customs Union (SACU), which also includes Botswana²⁷. The currency is pegged to the South African Rand, which, as a consequence, affects Lesotho's external competitiveness and inflation rate. Lesotho applies the common SACU external tariff policies and trade laws and enjoys duty-free access to other member countries' markets. Half of government revenue comes from customs duties collected and redistributed by the South Africa's National Revenue Fund²⁸.

The common external trade regime is relatively open, with an average simple tariff rate of 11.4 per cent in 2002, down from 15 per cent in 1997. However, this conceals significant tariff peaks on garments and inputs, which creates an anti-export bias for Lesotho. In addition, there is a range of less transparent, specific, mixed, compound, and formula duties (Integrated Framework, 2003, and WTO, 2003*a*). A combination of weak institutional capacity and a poor public-private dialogue undermine the ability of the trade policy making process to handle complex policy issues.

27. See Grandes (2003) for an detailed analysis of the functioning of the CMA and its implications for the various members. Lesotho is also a member of the South African Development Community (SADC), which is engaged in establishing a free-trade area amongst its 14 Member States, but withdrew from the Common Market of Eastern and Southern Africa (COMESA) in 1998.

28. Until 2002, South Africa primarily determined tariff rates, but under a new agreement, rates will be set by a separate Tariff Setting Board. See www.tralac.org for details.

In terms of international market access, Lesotho's garment exports enjoyed in the 1980s preferential market access to the European Economic Community (EEC) under the Lomé Conventions (I and II) and to the United States under the Generalised System of Preferences (GSP). At the end of the decade, the EU requested that two stages of production be carried out in the country of origin or in an eligible ACP country. After an eight year dispensation period, several foreign producers reduced their activities in Lesotho, while others shifted their exports to the US market to take advantage of unused quota under the MFA.

Lesotho, one of the AGOA-eligible countries since the inception of this initiative, is a beneficiary, at least until 2007, of the Special Rule regarding third-country fabric provision granted to lesser-developed countries²⁹. The diagnostic trade integration study undertaken as part of the Integrated Framework process in Lesotho nevertheless notes that "export expansion to the US took place even before the local content was allowed under the AGOA. This suggests that Lesotho's performance could hardly be attributable to special preferences, setting it aside from a large number of developing countries. Furthermore, this suggests that attractiveness of Lesotho to foreign investors goes beyond special preferences, albeit — as far as textiles are concerned — preferences have mattered" (Integrated Framework, 2003).

Foreign direct investment has played a fundamental role in the development of Lesotho's garment industry and its export performance (World Bank, 1998, Lundahl *et al.*, 2003). The country has no foreign investment law but the investment regime is considered to be liberal and non-discriminatory. There are no restrictions on ownership and no history of expropriation. The Investment Promotion Centre, a branch of the parastatal Lesotho National Development Corporation (LNDC) acts as a one-stop facility for investors, providing a range of incentives for them. These include an export finance facility, long term loans and/or equity participation, unimpeded access to foreign exchange and general sales tax exemption on capital machinery and equipment for manufacturing industries³⁰. Besides the LNDC, the Basotho Enterprises Development Corporation (BEDCO) provides finance, training and assistance to local enterprises. Although important, incentives were not the main drivers of FDI. The attractiveness of Lesotho as a destination of FDI resides in a number of factors: favourable international trade agreements (including the exceptions from the EU rules of origin), the productive labour force, access to South African ports and the efficient mechanisms in place for exporters.

29. In July 2004 the AGOA Acceleration Act of 2004 (AGOA III) was passed into law. AGOA III extends preferential access for imports from beneficiary Sub-Saharan African countries until 30 September 2015; extends third-country fabric provision for three years, from September 2004 until September 2007; and provides additional Congressional guidance to the Administration on how to administer the textile provisions of the bill. Namely, textile and apparel provisions should be interpreted in a broad and trade-expanding manner to maximize opportunities for imports from Africa (www.agoa.gov).

30. See LNDC's website: <http://www.lndc.org.ls>.

Future Challenges and Opportunities

The most acute challenge for the garment industry in the future might be the changing market access conditions. The threat posed by the phasing out of the AGOA? Special Rule in 2007 has induced some companies to invest in backward integration, but the overall impact on the industry is still unclear. At the same time, the elimination of the MFA quotas will probably mean stronger competition from countries like China and other Asian producers. Opportunities for the industry include the free trade agreement that is being negotiated between SACU and the US, and the EU's Everything But Arms initiative, even though the rules of origin of the latter need to be clarified (IMF, 2004).

On the domestic side, the government faces major challenges to further develop and diversify the economy. As regards garments, there is a need to enhance the linkages between the foreign-owned firms and the local economy, by improving the business climate, supporting local entrepreneurs and enhancing on-the-job training. This task is complicated by the weak entrepreneurial culture in Lesotho, the cultural differences between foreign investors and the local population and the declining quality of the vocational skill component in the educational system (Lundahl *et al.*, 2003). Training facilities are lacking, partly because of the reluctance of foreign employers to train and promote local employees (Integrated Framework, 2003). In parallel, HIV/AIDS looms as a major health and development threat.

The lack of dialogue between government and the private sector may seriously undermine the country's ability to handle trade-related challenges, such as those enumerated above (Integrated Framework, 2003, Capra-TFOC, 2003). In this respect, donors have been very active in supporting the country's trade policy making process, in particular through the Integrated Framework for Trade-Related Technical Assistance (see Box 2).

There are concerns that the booming garment sector may contribute to the spread of HIV/AIDS, since the employment opportunities created has fuelled rural-urban migration of young people. In response, a Private Sector Coalition against HIV/AIDS was launched in 2002 (IRIN, 2003). In addition, the sector might have a negative environmental impact, due to its extensive use and pollution of scarce water. The 2000 Environmental Bill deals with the environmental threat, but stakeholders have been slow to implement concrete solutions (Gibbs and Gibbs, 2002).

Conclusions

The expansion of Lesotho's garment industry has been called a "*success story*" (IMF, 2004) and the sector undoubtedly has made an important contribution to economic growth, exports and employment. However, the spillover effects to the local economy are limited and it remains to be seen how the foreign-owned export enterprises respond to the changing market access conditions. In any case, the economy has now become dependent on one major industry, which makes it vulnerable. Further diversification and promoting local entrepreneurship should be high on the government's agenda.

Box 2. Integrated Framework for Trade-Related Technical Assistance

The Integrated Framework for Trade-Related Technical Assistance (IF) is a multi-donor programme that aims to integrate LDC's trade priorities into national development plans, such as the Poverty Reduction Strategy Papers (PRSPs), and to assist in the co-ordinated delivery of trade-related technical assistance, in response to needs identified by the LDCs. The programme was initiated in 1997 by six multilateral institutions (IMF, ITC, UNCTAD, UNDP, World Bank and the WTO). Fourteen countries are currently participating in the IF, including Lesotho.

An important element of the IF is the Diagnostic Trade Integration Study (DTIS) – a country report that assesses the participating country's present trade and investment regime, identifies trade bottlenecks and opportunities and suggests recommendations for policy reform and technical assistance. The Lesotho DTIS was finalised in November 2003 and is available on the IF website. The following recommendations are included in the report:

- Engage actively in regional arrangements (SACU and SADC), including pursuing liberalization of SACU's common external tariff, limitations on the use of non-tariff barriers, and regional cooperation in the introduction of trade facilitating measures.
- Undertake efforts to improve the country's investment climate for foreign and domestic investors alike, which includes streamlining the licensing system for new business entrants and foreign trade operations, land management, and the system governing entry of foreigners into Lesotho.
- Invest in infrastructure and human resources, both in long-term education and short-term training, especially in the garment sector.
- Attempt to improve statistical reporting and administrative procedures.

The DTIS recognises that there is great need for external assistance to develop the institutional capacity required to address these issues. As a consequence, a national IF steering committee, with participants from the government, the private sector and donors, has been established to manage follow-up activities (i.e. the implementation of technical assistance and capacity building projects).

Source : Integrated Framework (2003), www.integratedframework.org.

D. MAURITIUS

Introduction

Despite preconditions that may be considered unfavourable, such as high population growth and monocrop dependency, Mauritius is now widely cited as a success story in terms of development and economic diversification (Subramanian and Roy, 2001). In less than three decades, it successfully transformed itself into an “upper middle-income” country, experiencing sustained growth of real per capita GDP and developing an internationally competitive garment industry and a flourishing tourism industry.

A combination of (OECD) trade preferences and incentives in the form of EPZ allowed the garment industry to grow rapidly. However, it is strong public institutions and democratic traditions, which facilitated the introduction of well-crafted and widely accepted economic reforms, that made this expansion possible. Preference erosion and a relative decline in international competitiveness now put pressure on the government to help the garment sector adapt through upgrading and regional integration. This case study reviews the emergence of the Mauritian garment sector since 1970, placing specific emphasis on the role of government policies in this process.

Economic and Social Developments

Both economic and social developments have been impressive since Mauritius gained independence. The country has enjoyed political and macroeconomic stability, which favoured the inflow of foreign investment and the development of export-oriented manufacturing. The economy has diversified into manufactures (mainly garments), services (e.g. tourism and financial services), agricultural products and fisheries. These changes are also reflected in trade patterns, with manufactures accounting for around 65 per cent of total exports in 2003. Moreover, from a net recipient of FDI, Mauritius has now become an outward investor to neighbouring countries, such as Madagascar (garments) and Mozambique (sugar)³¹.

The economic achievements have been coupled with social improvements³². Mauritius today ranks second in Africa in the UNDP Human Development Index. At independence, most people lived in poverty. According to the most recent survey, less than 14 per cent of the households fall below the official poverty line (CSO, 2002). Life expectancy at birth increased considerably and infant mortality declined to 64 per 1 000 live births in 2002 — a fourth of the

31. At \$44 million in 2003, Mauritius was the fourth largest source of outward FDI in Sub-Saharan Africa, accounting for nearly 4 per cent of the total (http://www.unctad.org/sections/dite_dir/docs/wir_outflows_en.xls).

32. For an analysis of the most recent socio and economic developments in the country see World Bank (2002), UNDP (2003), Anker *et al.* (2001), as well as see the Mauritius country note in the OECD/AfDB African Economic Outlook (2005).

1970 level. Income equality is much higher than in other non-LDC sub-Saharan countries (Anker *et al.*, 2001). The status of women has also progressed, through improved education, labour market participation and political representation.

Garment Industry Developments

The expansion of the garment industry, which was facilitated by a wide range of government policies, has been the main driver behind the structural change that has taken place in Mauritius since the 1970s (Chernoff and Warner, 2002). The main growth period took place in the 1980s, yet slowed down during the 1990s, when the industry was confronted with increasingly difficult market conditions.

Industry Performance, Structure and Impact on the Economy

Mauritius exported almost \$1 billion garments³³ in 2002, accounting for nearly 55 per cent of its merchandise exports and 1 per cent of world garments exports. The industry involves more than 200 companies, employing 62 500 workers (13 per cent of total employment), mostly women (CSO, 2004)³⁴. About two thirds of the firms are owned by Mauritian nationals, which mainly export to the European market. Chinese-owned companies mainly export to the US (Gibbon, 2000).

The main products are t-shirts, men's shirts, trousers, and pullovers. The all-year demand for these product types makes Mauritius' remoteness and long delivery times to the main markets less of a problem. Production is heavily dependent on imports of intermediary products such as yarn and fabrics. Imports — mainly from China and India, Europe and South Africa — make up about half of the exports (CSO, 2004, and Anker *et al.*, 2001).

The industry developed during the 1970s, thanks to capital from sugar exports and foreign investors (mainly from Hong Kong, China), who were attracted by cheap labour, preferential access to export markets and the incentives set up by the government. After a dramatic growth during 1970-77 (employment in the sector grew by almost 40 per cent a year), rising labour costs and the appreciation of the exchange rate contributed to reduce the competitiveness of the garment industry. A second expansion took place during the 1980s, when structural adjustment programmes contributed to economic stabilisation and the government granted improved incentives to investors (Chernoff and Warner, 2002). The downside of the boom was a significant increase in labour costs. Labour shortages drove up wages, without a corresponding increase in productivity. In the 1990s, Mauritius' garment industry witnessed an intensification of international competition. Increased pressure forced inefficient companies out of business. Others were compelled to adjust by improving productivity, upgrading their production, importing foreign labour and outsourcing to lower cost location, such as Madagascar (Gibbon, 2000).

Some companies have recently invested in backward integration into textile production to comply with the AGOA's rules of origin requirements, since the country was not granted, until

33. Comtrade database, SITC code 84.

34. The employment figures refer to firms located in the EPZ. It should be noted that 9 500 jobs were lost in the garment sector in 2003, compared to the end of 2002, when employment stood at 72 000.

2004, the special third-country fabric provision. Others have attempted to move up the value-chain, by producing for niche markets (e.g. high fashion, low volume products) or trying to develop their own brands. The latter attempt did not prove successful because of the high costs involved and the remoteness of the markets (Gibbon, 2000). More promising results were obtained from the active support from the government to the industry, especially in terms of lobbying for improved market access (Manchester Trade Team, 2005)³⁵.

The impact of the garment industry on the rest of the economy has been substantial in terms of contribution to growth, export, employment and poverty reduction, but less so in terms of production linkages (Anker *et al.*, 2001, Chernoff and Warner, 2002). The EPZ sector has created a demand for services in packaging, consultancy, water and other areas, and local enterprises have learnt extensively from foreign companies (UNCTAD, 2001). The room for linkages creation is however constrained by the small size of the economy and the inability of local suppliers to meet world standards requirements in terms of quality and timeliness (Wignaraja, 2003).

Government Policies

The garment sector has benefited from a stable macro-economic environment and the adoption of outward oriented policies. On the one hand, fiscal deficits and inflation have been under relative control and the exchange rate has remained competitive. On the other, the government has actively promoted the development of export oriented industries, mainly by establishing an EPZ and joining the Yaoundé Convention and subsequent Lomé Convention, which gave Mauritian exports privileged access to the EEC market.

The failure of the import substitution policies of the 1960s in reducing high unemployment made it clear that a change in development strategy was needed. However, the government was facing a trade-off, as it sought to develop a labour-intensive export oriented sector without disrupting the import-substitution industries established in the second half of the 1960s. To solve this trade-off, the government adopted a two-track approach, by insulating the export sector from the import-competing one. The main feature of the dual system was the establishment of the EPZ, which benefited from tax incentives, duty-free imports and loose labour legislations.

Public investments in infrastructure, cheap and abundant labour supply and preferential market access helped attract international and domestic investments in the nascent garment industry of the EPZ (Durberry, 2001; Alter, 1990). Domestic investment mainly originated from

35. Most importantly, the Mauritian government was successful in lobbying the US Congress, which led to two tangible results. First, it was able to exploit the so called "short supply provision" by proving that certain high quality fabrics used in men and boys' shirts were in short supply in both the US and in African countries, in other words, these fabrics could not be supplied in commercial quantities in a timely manner. Therefore, Mauritian exporters were exempted from the origin rule and allowed to use Asian fabrics. In 2004, about 22 per cent of total Mauritian imports into the United States are estimated to have entered the market under this provision. Second, the Mauritian government was able to obtain the benefit of the third-country fabric provision.

exports earnings from the sugar industry. Mauritius has benefited from an export quota to the EU at the internal EU sugar price (which exceeds the world market price under the ACP/EU Sugar Protocol). Between 1977 and 2000, the resulting rents have amounted to an average 5.4 per cent of GDP per year and made it possible to sustain high investment levels in the Mauritian economy (Subramanian and Roy, 2001).

The mix of import substitution and export promotion prevailed until the structural adjustment programmes of the early 1980s, when trade liberalisation was gradually completed. Structural adjustment grew out of a combination of exogenous shocks, such as falling sugar prices, international recession and domestic fiscal imbalance. Key reforms boosting the garment sector included the introduction of a flexible exchange rate and wage restraint to restore competitiveness. Quantitative restrictions on imports and a number of price controls were abolished (Gulhati and Nallari, 1990).

By the mid-1990s, Mauritius was one of the most liberal regimes in Africa although protection was still higher than in the newly industrialising countries in South East Asia (Milner, 2001; WTO, 2001)³⁶. In addition, measures were introduced to streamline bureaucratic procedures and further attract investment, such as the adoption of double-taxation agreements, the establishment of a one-stop-shop for investors, the Mauritius Export Development and Investment Authority (MEDIA), export guarantees set up by the Development Bank of Mauritius and tax reforms. The reforms paid off, stability was restored and sustained growth resumed³⁷. The situation started to worsen in 2000, with a widening fiscal deficit, declining garment exports and sluggish income growth³⁸.

The Government has invested heavily in improving the country endowment, both in terms of human and physical capital and by supporting the private sector through various support structures (see Box 3). The Development Bank of Mauritius and MEDIA have been important vehicles for financing infrastructure and industrial facilities (Lamusse, 2001). A range of public institutions support the private sector in general and the garment industry in particular (Bonaglia and Fukasaku, 2001; Wignaraja, 2002).

36. In 2001 the average import tariff was around 20 per cent and there were eleven tariff bands, with the highest reaching 80 per cent (WTO, 2001).

37. Annual real GDP per capita growth averaged 7.4 per cent over 1985-89, 5.4 per cent over 1990-94 and, despite slow productivity growth, 5 per cent during 1995-99 (Bonaglia and Fukasaku, 2002).

38. Between 2001 and 2002 the volume of exports declined by 9 per cent, with EPZ exports declining by more than 10 per cent. See National Accounts of Mauritius 2003, <http://statsmauritius.gov.mu>.

Box 3. Public Support Institutions in Mauritius

Throughout the years, the government has actively promoted trade and investment activities in the garment sector. Four parastatal institutions under the Ministry of Industry, Commerce and International Trade make up the backbone of the system:

A range of other public organisations also support the Mauritian industry, such as the recently established *National Productivity and Competitiveness Council* and the *Industrial and Vocational Training Board*.

In spite of an impressive institutional framework, government efforts to upgrade technology in the garment industry are reported to have had limited impact. Wignaraja (2002) concludes that overall, the support institutions have been too constrained in size, financial resources and technical skills to be able to respond to emerging industry needs, even though the situation has improved in recent years. What seems clear, however, is that the *Development Bank of Mauritius* has played a key role in providing long-term financing and investments in infrastructure to the garment industry.

Overall it is difficult to gauge the importance of the support institutions in the development of the garment industry relative to other factors. However, even though the direct impact may be limited, they are part and parcel of a strong public framework for promoting business.

Source: Bonaglia and Fukasaku (2002), Gibbon (2000) and Wignaraja (2002).

Well-managed investment incentives and promotion have played an important role in attracting foreign enterprises, allowing them to exploit the country's comparative advantage to the fullest extent. However, these measures would not have been so successful without the overall conducive macro- and microeconomic environment. Foreign enterprises brought advanced technologies, know-how, managerial skills and an industrial culture to Mauritius. However, domestic investors got involved in the garment industry very early on and later surpassed FDI, to the extent that a majority of the garment firms are now owned by Mauritian nationals. (Kinunda-Rutashobya, 2003).

A key element for success has been the country's stable and inclusive democratic traditions, based on political consensus, a free media and the respect for the rule of law and property rights. The need for social cohesion – vital in a country characterised by significant ethnic diversity – also fostered relatively strong public institutions and important social protection, including centralised wage bargaining, price controls on sensitive items and generous social security (Subramanian and Roy, 2001)³⁹.

A number of examples show that this participatory policy environment has been of significant importance to the economy in general and the garment sector in particular. Firstly, the government was responsive to demands from the business circles to establish the EPZ in 1970.

39. Mauritius is a multi-ethnic society, with a Hindu majority and Franco-Mauritian, Creole and Muslim minorities. This diversity has played an important role in shaping national policies. In the years leading up to independence, it fostered political compromises aimed at protecting minority rights within the Parliamentary system inherited from the British.

Secondly, ethnical networks were largely instrumental in attracting FDI to the EPZ. Thirdly, a deal was struck between sugar exporters and the government; the property rights of the sugar owners were guaranteed while a share of the sugar rents was transferred to the public sector. In that way, earnings from the sugar exports were available for private investment in the garment industry, while the government could pay for civil servants and social protection (Subramanian and Roy, 2001). Fourthly, Gulhati and Nallari (1990) argue that Mauritius democratic culture helped the country get through the economic imbalances at the end of the 1970s by providing politicians with early signals about what was wrong in the economy. Finally, the private sector participates in trade policy discussions and negotiations, e.g. through the *Joint Economic Council*, its apex organisation (see Box 4). This enhances the possibility to reach an outcome supported by all actors (Bonaglia and Fukasaku, 2002).

Box 4. Public Sector-Private Sector Dialogue: the Joint Economic Council

The participatory nature of policy-making, through private sector representation in parastatal institutions and regular consultations with industry groups, has had an important impact on the adjustment process. A key mechanism for inclusive politics has been the *Joint Economic Council* (JEC), established in 1970.

It operates as the coordinating body of the nine major multi-sectoral institutions and industry associations in Mauritius (Chamber of Commerce; Chamber of Agriculture; Employers' Federation; Sugar Producers' Association; Export Processing Zone Association; Bankers' Association; Insurers' Association; Hotels and Restaurants Association).

The structure and functioning of JEC enable an enhanced coordination amongst the different institutions while permitting to build an institutional expertise for each represented industry. Hence, sectoral issues are dealt with the relevant industry association, while cross-cutting issues such as national budget, wage negotiations, international trade negotiations are dealt with all the JEC members. The dialogue takes place in a structured manner as well as on an *ad hoc* basis. The JEC is fully funded by its members.

Source : <http://www.jec-mauritius.org> and Bonaglia and Fukasaku (2002)

Future Challenges and Opportunities

Mounting global competitive pressures -in terms of demands for lower price, higher quality and shorter lead times- are putting Mauritius' garment industry in peril. In view of the failed attempts to move up the value-chain, Gibbon (2000) foresaw a rapid contraction of the Mauritian garment industry. He reckoned that in absence of reforms to increase the industry's productivity, Mauritian enterprises would become delocalised mid-market suppliers of basic garments to the EU and the US.

Improved market access through the AGOA has temporarily provided relief to the industry, by promoting backward linkages and increased regional investments and sourcing (IMF, 2003a). By 2003, half of Mauritius' garment exports to the US benefited from the AGOA. Yet, total garment exports to the US increased only by 10 per cent between 2000 (the year before AGOA) and 2003.

Moreover, the sugar quotas are now being challenged, with possibly adverse consequences for Mauritian sugar production and the availability of domestic capital (IMF, 2003a). An EU sugar regime reform proposal by the European Commission suggests that the price ACP producers receive may be reduced by more than one third⁴⁰. In addition, the government's budget deficit is growing because of falling revenue, poorly managed state-owned utilities and increased public investments, reducing the room for manoeuvre.

Acknowledging these challenges, the government has undertaken a thorough examination of the industry's competitiveness within the framework of its *Economic Agenda for the New Millennium* (2000), in view of upgrading the sector's productivity, promoting diversification and attracting new FDI. The insufficient skill composition of the labour force and the poor quality of the educational system have been identified as a major constraint to the development of a competitive and diversified economy. Despite high literacy rates and educational progress, many students still do not finish primary school. Secondary and tertiary enrolments remain low and few take scientific subjects. This compares very unfavourably with the Asian countries Mauritius is competing with.

The government aims to transform Mauritius into a high-tech, high-income services and knowledge economy, by increasing competitiveness and productivity of the sugar and EPZ sectors, expanding the ICT and financial services sectors and bringing about deeper social development and social cohesion (World Bank, 2002). As regards the garment-dominated EPZ sector, specific measures are being evaluated to promote skills and technological upgrading, re-engineering of business processes, development of clusters and linkages, product and market diversification, as well as encouraging SMEs to become exporters. For instance, an equity fund managed by the Mauritian Bank of Development has been set up to invest in EPZ enterprises that upgrade their technology or undergo restructuring. Such a fund can help promote backward integration into spinning and encourage technological upgrading (UNECA, 2003).

Deepening regional integration is also an important priority. Neighbouring countries are of increasing importance to the garment sector, as a destination for investments, a source of inputs and a market for its products. Overall, Mauritius is trying to position itself as a regional services industry hub. The country participates actively in regional co-operation arrangements such as the Common Market for Eastern and Southern Africa (COMESA), Southern African Development Community (SADC) and the Indian Ocean Commission.

Conclusions

The emergence of the garment sector has played a key role in the transformation of the Mauritian economy, helping it to move away from mono-crop dependency. The core locus of this process is the period between 1983 and 1988, when a 20 per cent unemployment rate was absorbed by the booming garment industry, an example of a pure structural change according to Chernoff and Warner (2002). A number of favourable circumstances made this possible, the most important ones being preferential access to export markets and a pool of cheap labour. However,

40. A final EC proposal for the reform of the EU sugar regime will be submitted on 22 May 2005. See http://europa.eu.int/comm/agriculture/capreform/index_en.htm.

it was the government's choice of a dual-track approach to openness, based on an EPZ sector and a gradually liberalised import competing sector, that made it possible to exploit these opportunities.

The macroeconomic stability, export and investment incentives and support structures were managed in a way that attracted investments into the garment industry. This was a result of Mauritius' strong civil service, its tradition of participatory policy-making, and its focus on social cohesion. It may be difficult for other developing countries to follow a similar path as Mauritius, among other things because of declining global trade preferences and the lack of high-quality public institutions (Subramanian and Roy, 2001). Mauritius now needs to move on to the next step of development and diversify into higher value-added activities. This will require reforms to enhance the competitiveness and diversity of the manufacturing sector and substantial investments in human resource and education, the areas in which the country has lagged behind. The Mauritian government seems well aware of these challenges, as documented in Sacerdoti *et al.* (2005).

F. THAILAND

Introduction

Thailand has been called a new Asian tiger, because of its high economic growth – despite the 1997-98 economic crisis – and rapid industrialisation, on the basis of both vertical and horizontal export diversification. The development of traditional and high-value agriculture and fishery have stimulated the growth of export-oriented food processing industries and contributed significantly to the country's industrialisation process. In particular, the seafood industry has enjoyed rapid growth, making Thailand a world leader in international markets for canned tuna and frozen shrimps. The industry managed to expand continuously over the last two decades, despite chronic problems of shortage of raw materials and labour, increasingly stiff international competition, as well as non-tariff measures imposed by importing countries (Nikomborirak and Tangkitvanich, 2003). Thus, the industry presents an interesting case study for other developing economies. This review will examine the various factors that have contributed to the development of the seafood industry, with special reference to government policies.

Economic and Social Developments

The Thai economy has grown at very high rates since the mid-1980s, at levels not far from the Newly Industrialising Economies (NIEs) of East Asia. Between 1986 and 1991, the growth rate was among the highest in the world, averaging 9.6 per cent a year in real terms (Dixon, 1999). Despite the favourable macroeconomic situation, maintained by relatively low inflation and stable exchange rates, the economy was characterised by some structural problems, such as heavy reliance on imported inputs and weak inter-industry linkages.

The rapid growth of the early 1990s, attracted by the country's financial opening and exchange rate peg, led to a large inflow of private capital. Fuelled by such capital flows, notably short-term capital, private credit booms made the economy vulnerable to external shocks. Indeed, heavy capital inflows became disruptive for the Thai economy, as they led to a real appreciation of the baht, heightened inflationary pressures and widened the current account deficits to an unsustainable level. The country was badly hit by the currency and financial crisis, following the government announcement to abandon the peg in July 1997. Real GDP fell by over 10 per cent in 1998 and did not recover to the pre-crisis level until 2002 (IMF, 2003b). In 2003, the economy grew by 6.8 per cent, its fastest pace since the 1997-98 crisis.

In 1970, 85 per cent of Thailand's exports were primary products, such as rice, rubber, tin and maize. In 2002, manufacturing products made up 86 per cent of total exports, while agriculture represented only 10 per cent of the total. However, employment patterns have not shifted as drastically as export composition: around 40 per cent of the population is still employed in agriculture.

Economic growth has brought about improvements in living conditions and social indicators. The incidence of poverty has been cut by three since the mid-1970s, to reach around

10 per cent of the population in 2002. However, regional differences in income levels are wide and income distribution is characterised by high inequality (World Bank, 2004). Life expectancy and infant mortality have improved markedly, as well as literacy rates thanks to the expansion of primary education.

Seafood Industry Developments

Industry Performance, Structure and Impact on the Economy

Thailand is the largest exporter of seafood products in the world, surpassing even China. Export values totalled \$4.2 billion in 2002, corresponding to a world market share of over 18 per cent and to 6 per cent of the country's total exports⁴¹. The expansion of the seafood industry has been based on ease of access to fishing grounds, high levels of domestic investment and foreign capital and expertise (Dixon, 1999). During the 1970s, signs of depletion of fish stocks, rising fuel prices and the loss of traditional fishing grounds (due to the establishment of Exclusive Economic Zones), pushed the industry to introduce aquaculture and develop new marine fishing technology. Agreements with other countries in the region gave access to more distant fishing grounds. Since the mid-1970s production has expanded at a sustained pace and exports have multiplied by 30.

The seafood industry is an important source of employment and export revenue. Fish is also the major source of protein for most people in Thailand. The industry involves marine fishery establishments and fishing crafts, aquaculture farms, and processing factories⁴². It is estimated that 700 000 people, representing approximately 2 per cent of total active labour force, are engaged in fishing and related industries (Nikomborirak and Tangkitvanich, 2003). Aquaculture in particular has also fostered a range of related activities, in fields such as animal feeds, chemicals and construction (FAO, 2000). Yet, the industry generates negative environmental spillovers in the form of a damage to mangrove ecosystems and water pollution (Huitric *et al.*, 2002).

The two major export products are canned tuna and frozen shrimps, mainly destined to the US, Japan and the EU markets. The canned tuna industry grew rapidly in the 1980s and Thailand is now the main producer of canned tuna in the world. However, the industry has been facing shortages of domestic raw material. Since 1995, over 80 per cent of the tuna is imported from countries such as Indonesia and Chinese Taipei, making Thailand the largest importer of unprocessed tuna, together with Japan (Josupeit and Catarci, 2004). Shrimp farming was initiated in 1973 and intensified in the 1980s. Farmed shrimp became a global commodity mainly thanks to a Thai multinational enterprise, Charoen Pokphand (also known as CP Group), and not by

41. UN COMTRADE mirror data: world imports of "Fish, crustaceans, molluscs, aquatic invertebrates" (HS code 03) and "Meat, fish and seafood food preparations" (HS code 16). See also Vannuccini (2003).

42. Around 480 factories operated in 2001, the majority of which are small in size and less than a tenth of the factories involve multinational companies, which are mostly from Japan and the US (Nikomborirak and Somkiat, 2003).

linking up to an established “northern” agro-food conglomerate (Goss *et al.*, 2000)⁴³. Thailand became the world’s leading producer of shrimp in 1991 and accounted at its peak for over a third of world production (Huitric *et al.*, 2002).

The seafood industry faces a range of non-tariff barriers in export markets. The frozen shrimp industry has been particularly affected (Nikomborirak and Tangkitvanich, 2003, see Box 5). These barriers and the uncertainty created have prompted some Thai companies to move abroad to bypass these barriers. For example, the tuna producer Unicord, established itself in the US and Germany in the early 1990s. The CP group is also considering setting up a shrimp farm in Madagascar to take advantage of zero import tariffs as opposed to the 20 per cent import duty for fresh shrimp and 15 per cent for processed shrimp products that Thai exports to the EU currently face (Dixon, 1999; The Nation, 2004a).

Box 5. Non-tariff Barriers affecting Thailand' Seafood Industry

Environmental standards. In the “shrimp-turtle case”, the US placed an embargo on imported shrimps that were caught with nets lacking a turtle escape devise. Thailand, India, Malaysia and Pakistan brought the case to the WTO dispute settlement body and won the case in 1997. Nevertheless, in 2004, the US is still threatening to impose an import ban on sea shrimps. In another case, in the early 1990s, the US tried to curb Thailand's canned tuna exports on the grounds that steps had not been taken to protect dolphins while trawling for tuna (“dolphin-tuna case”).

Sanitary and phytosanitary measures (SPS). The US, Japan and the EU have put a ban on the use of certain antibiotics in shrimp production, which have forced the industry to undergo costly inspections of shrimp shipments.

Anti-dumping. In February 2004, the US initiated anti-dumping investigations on imported shrimp from Thailand and five other exporting countries. In July 2004, a preliminary tariff of 6.4 per cent on Thai shrimps was announced by the US Commerce Department. The final decision will be taken by the US International Trade Commission in early 2005.

Source: Nikomborirak and Tangkitvanich, (2003) and The Nation (2004b, 2004c, 2004d).

As a consequence of the constant threat of trade barriers facing seafood exports, the industry has become highly organised. The main business organisation, the *Thai Frozen Food Association*, has played an important role in dealing with the SPS and anti-dumping cases through lobbying, financial assistance and training, while other associations provide specific services to members⁴⁴.

⁴³. The CP group is the largest company in the Thai shrimp industry, with highly vertically integrated operations spanning research and development, feed inputs and farm technology, processing and marketing of products in export markets. Its involvement in shrimp farming started in 1986, with the acquisition of technologies in a joint-venture with the Japanese company Mitsubishi, employing Taiwanese technicians. The group has also promoted shrimp farming in neighbouring countries (see <http://www.cpthailand.com>).

44. For instance, the North America Shrimp Exporters Group negotiates freight prices with liners on behalf of members. Public agencies and private sector association have set up an Export Problems Solving Committee to deal with problems in importing countries (see www.thai-frozen.or.th).

Government Policies

The Thai government is said to have been the “least interventionist of any in South East Asia”, basically restricting its role to promoting private enterprise development (Dixon, 1999). Consequently, there is very little direct government involvement in the Thai seafood industry, making it open to competition (Nikomborirak and Tangkitvanich, 2003). Nevertheless, a range of government policies have had direct or indirect impact on the expansion and international competitiveness of the industry.

Since the 1960s, the development strategy of the government has sought to combine conservative macroeconomic policies with a mix of import substitution, export promotion and strong investment incentives. This policy mix has stimulated the emergence of a strong group of Thai industrialists in import-competing, light industries – mainly through joint-ventures with foreign investors – as well as in the agribusiness and food processing sectors – mainly thanks to the support of local commercial banks (Lauridsen, 2004). The period of highest growth and structural change in the Thai economy occurred between 1980 (when the economy entered a period of recession following the second oil shock) and 1998 (second recession, following the Asian financial crisis). These crises contributed to trigger important economic policy changes.

The first recession in 1980 led to the adoption of a World Bank-supported structural adjustment programme. In the following years, the economy experienced an unprecedented growth, driven by booming manufactures exports. Undoubtedly, the adoption of a more export-oriented policy stance and better targeted export-promotion measures contributed to attract FDI to the country. However, the slow implementation of trade reforms suggests that they only played a limited role in fuelling the recovery⁴⁵. Initial conditions and concomitant international developments probably had a greater impact. The most important factors fuelling recovery seem to have been the devaluation of the Bath vis-à-vis major partner countries’ currencies (as a consequence of the 1985 Plaza-agreement) and the declining competitiveness of (other) Newly Industrialized Countries in labour-intensive production, combined with low labour and land cost and existing spare capacity in the Thai industry (Jomo and Rock, 1998, and Dixon, 1999).

Overall, Thailand’s agro-industrial industry survived the 1997 Asian financial crisis, while other manufacturing industries floundered under heavy debt. In fact, the industry benefited significantly from the weaker baht, which enhanced its price competitiveness (Nikomborirak and Tangkitvanich, 2003). However, the aggregate performance masks significant differences, even within the seafood sector. While frozen shrimps exports received a significant boost from the devaluation, import-intensive industries such as canned tuna contracted sharply due to production costs rising by about 35 per cent (UNESCAP, 1999)⁴⁶.

45. Import barriers are still relatively high and complex today (Nikomborirak and Somkiat, 2003, World Bank, 2004).

46. For example, in the year 2000, export of canned tuna was only half its value in the previous year while export of frozen shrimps jumped. The trend was reversed in the following year when canned seafood experienced a rebound, while frozen seafood has weathered various non-tariff measures imposed by the EU and the United States (Nikomborirak and Somkiat, 2003).

Recently, Thai trade policy has focused on negotiating bilateral free trade agreements with a range of countries⁴⁷. As a result of the agreements, seafood exports are expected to meet lower tariff barriers in various markets (Nikomborirak and Tangkitvanich, 2003). In addition, the country is a member of two important regional groupings: the Association of South East Asian Nations (ASEAN), which is in the process of developing an free trade agreement amongst member countries, and the Asia Pacific Economic Co-operation (APEC)⁴⁸. It is worth noting that in 1999 Thailand “graduated” from its developing country status in the EU General System of Preferences, which led to increased tariff barriers for exports to the EU market⁴⁹.

The relatively open investment regime and the incentives schemes developed as part of the import substitution strategy of the 1960s, attracted FDI into the industry. Yet, the positive spill over of FDI, i.e. transfer of knowledge, has probably been more important than the modest share of FDI in total investment would suggest. In particular, foreign partners have provided expertise, technology and privileged access to export markets. Thai exporters have, for example, been able to concentrate mainly on production (following specifications set by their foreign partner), invest less in marketing activities and penetrate more easily the Japanese food market thanks to joint-ventures with Japanese companies (Nikomborirak and Tangkitvanich, 2003). The Thai *Board of Investment* (BOI) recently started redefining its role from being a regulator (that focuses on tax incentives) to becoming a facilitator that actually addresses the needs of investors. Instead of trying to attract high quantities of investments, BOI now works to promote quality investments with potential for research and development and technology transfers. One of the five focus industries that have been identified is agro-industry.

A range of sector-specific policies and services targeted at the seafood industry have been implemented under the auspices of the *National Fisheries Policy Committee* – chaired by the Prime Minister – and the Department of Fisheries within the Ministry of Agriculture. The latter is engaged in fishery conservation and research and development and has played an important role in developing the seafood industry, by providing technical and financial assistance (FAO, 2000, and Dixon, 1999). The *National Food Institute* (Ministry of Industry) undertakes research and offers training to raise competitiveness and support compliance with food safety standards (Nikomborirak and Tangkitvanich, 2003).

Future Challenges and Opportunities

There are a number of challenges facing the Thai seafood industry. First, a number of non-tariff barriers (mostly SPS measures) prevail in developed country import markets (Box 5). Second, future growth is threatened by constraints in the quality and quantity of raw material, due to environmental problems and diseases. Third, there is increasing competition from low cost producers, originating from China and Vietnam (for shrimps) and the Philippines and Indonesia (for tuna). At the same time, the Thai seafood industry enjoys a strong market position and the industry has reacted to increased competitive pressures by moving into higher-value

47. The first agreement was signed with Bahrain in 2002. Negotiations are underway with China, India, the US, Australia, Japan, and Peru, and are being considered for Mexico and the South Africa Customs Union.

48. Members joining the ASEAN free trade agreement will be abiding to a Common External Tariff of 0.5 per cent.

49. http://www.foodmarketexchange.com/datacenter/product/seafood/shrimp/detail/dc_pi_sf_shrimp0802.htm.

production and possibly de-localising into low-cost areas (Nikomborirak and Tangkitvanich, 2003). Overall, international demand for shrimp continues to be strong, yet the canned tuna industry suffers from over-capacity⁵⁰. The bilateral trade agreements that are being negotiated also have the potential to further boost trading opportunities.

A major challenge for the government is to address the emerging industry constraints by: *i*) developing quality control, tracing and certification systems; *ii*) improving natural resource management; *iii*) enhancing vocational skills and *iv*) promoting R&D. Such efforts may be hampered by the inequality (in education) that prevails in the country. In comparison to other Newly Industrialized Countries, a relatively high share of the Thai population still lives in rural areas, with on average much lower incomes than those living in urban areas and relatively low educational attainment past primary education (Dixon, 1999).

The government has already taken action to respond to a number of those challenges. It is actively pursuing various measures to promote Thailand's international competitiveness across various sectors. In early 2003, the government set up the *National Competitiveness Committee*, whose main task is to set up, implement and supervise a strategy for upgrading national competitiveness, both at macro and sectoral levels. A range of niche sectors are being targeted, one of which is the processed food sector⁵¹.

In addition, it has taken various measures to promote more sustainable fishing practices in light of emerging environmental concerns, for example by establishing conservation zones, reducing the number of fishing vessels, promoting community-based fisheries and introducing regulations on fish farming in mangrove areas (FAO, 2000). The *Frozen Foods Association* and the Department of Fisheries have promoted a code of conduct on "Sustainable Marine Shrimp Culture" to address social and environmental impacts and problems related to diseases. Education and training, which are essential to raise awareness of rules and regulations among fish farmers, are also being offered.

Conclusions

The development of Thailand's seafood industry should be seen in the context of the country's long-term economic transformation. Industrial groups and capital from the import-substitution period have played an important role, often relying on joint-ventures with foreign companies for acquiring expertise and penetrating foreign markets. Direct government intervention in production and sales has been limited, but the industry has benefited from public support for production and technology transfer, as in the case of shrimp farming, and increasingly active export promotion at a later stage. In addition, the industry initially faced relatively lax environmental regulations. While Thailand's seafood industry has a favourable position in the world market, issues such as natural resource management, access to sustainable raw material and non-tariff barriers in export markets pose a considerable challenge for the industry. The active involvement of industry associations in national policy-making process can help design effective policy responses to these issues.

50. http://www.foodmarketexchange.com/datacenter/product/seafood/dc_pi_seafood.htm

51. See www.competitiveness.in.th

ANNEX: STATISTICAL TABLES

Table 2. Chile: Structure of the Economy
Average percentages

	1976-1984	1985-1994	1995-2002
Agriculture, value added (% of GDP)	7.4	9.1	8.7
Industry, value added (% of GDP)	37.9	38.8	34.7
Services, etc., value added (% of GDP)	54.8	52.1	56.6
Trade (% of GDP)	45.7	59.8	60.3
Exports of goods and services (% of GDP)	21.8	31.3	30.2
GDP growth (annual, %)	3.9	7.4	4.7
Employment in agriculture (% of total employment)	16.0	19.1	14.5
Employment in industry (% of total employment)	20.8	24.7	25.0
Employment in services (% of total employment)	63.1	56.2	60.5

Source: World Development Indicators CD-ROM (2004).

Table 3. Chile: Export Structure
Average percentages

Product name	HS Code 2	1976-84	1985-94	1995-03
Non-ferrous metals	68	40.9	32.6	27.6
Metalliferous ores and metal scrap	28	22.2	13.4	14.1
Vegetables and fruit	05	8.9	15.1	12.8
Fish, crustaceans, molluscs, preparations thereof	03	3.0	6.2	8.7
Pulp and waste paper	25	3.9	4.5	5.1
Cork and wood	24	2.9	5.4	4.9
Beverages	11	0.3	0.9	3.0
Feeding stuff for animals	08	5.6	5.1	2.6
Inorganic chemicals	52	1.0	1.5	1.8
Paper, paperboard, articles of paper, paper-pulp/board	64	1.0	1.3	1.8

Source: UN COMTRADE Database, SITC Rev. 3.

Table 4. Kenya: Structure of the economy
Average percentages

	1976-1984	1985-1994	1995-2002
Agriculture, value added (% of GDP)	35.3	30.7	24.1
Industry, value added (% of GDP)	19.7	18.6	17.3
Services, etc., value added (% of GDP)	45.0	50.7	58.7
Trade (%of GDP)	60.2	57.4	62.5
Exports of goods and services (% of GDP)	28.1	28.0	27.9
GDP growth (annual, %)	4.5	3.6	1.9
Employment in agriculture (% of total employment)	23.0	15.5	18.6
Employment in industry (%of total employment)	21.6	18.7	19.5
Employment in services (% of total employment)	55.4	65.5	61.9

Source : World Development Indicators CD-ROM (2004).

Table 5. Kenya: Export Structure
Average percentages

Product name	HS Code 2	1976-84	1985-94	1995-2003
Coffee, tea, cocoa, spices, manufactures thereof	07	56.7	52.9	34.6
Vegetables and fruit	05	9.2	12.1	12.2
Crude animal and vegetable materials, n.e.s.	29	5.0	6.9	9.5
Petroleum ,petroleum products and related materials	33	7.0	0.9	5.1
Fish, crustaceans, molluscs, preparations thereof	03	0.2	3.0	5.0
Articles of apparel and clothing accessories	84	0.1	1.4	4.2
Non-metallic mineral manufactures, n.e.s.	66	4.6	2.9	2.7
Iron and steel	67	0.0	0.6	2.1
Miscellaneous manufactured articles, n.e.s.	89	0.5	0.9	1.7
Inorganic chemicals	52	1.6	1.9	1.6

Source: UN COMTRADE Database, SITC Rev. 3.

Table 6. Lesotho: Structure of the Economy
Average percentages

	1976-1984	1985-1994	1995-2002
Agriculture, value added (% of GDP)	30.9	21.2	17.4
Industry, value added (% of GDP)	24.7	33.0	40.9
Services, etc., value added (% of GDP)	44.4	45.8	41.7
Trade (%of GDP)	134.8	135.5	133.3
Exports of goods and services (% of GDP)	16.5	16.9	31.1
GDP growth (annual, %)	8.0	5.0	3.3
Employment in agriculture (% of total employment)	40.2	40.0	n.a.
Employment in industry (%of total employment)	34.1	27.9	n.a.
Employment in services (% of total employment)	25.6	32.1	n.a.

Source: World Development Indicators CD-ROM (2004).

Table 7. Lesotho: Export structure
Average percentages

Product name	HS Code 2	1976-84	1985-94	1994-2003
Articles of apparel and clothing accessories	84	5.9	78.0	86.7
Non-metallic mineral manufactures, n.e.s.	66	18.0	7.7	11.6
Gold, non-monetary (excluding gold ores and concentrates)	97	0.0	6.5	0.6
Fish, crustaceans, molluscs, preparations thereof	03	0.0	0.0	0.4
Vegetables and fruit	05	3.7	3.8	0.3
Other transport equipment	79	0.3	0.0	0.1
Miscellaneous manufactured articles n.e.s.	89	30.3	0.2	0.0

Source: UN COMTRADE Database, SITC Rev. 3.

Table 8. Mauritius: Structure of the Economy
Average percentages

	1976-1984	1985-1994	1995-2002
Agriculture, value added (% of GDP)	17.4	13.4	8.2
Industry, value added (% of GDP)	25.7	32.4	31.6
Services, etc., value added (% of GDP)	56.9	54.2	60.2
Trade (% of GDP)	100.5	123.6	126.6
Exports of goods and services (% of GDP)	46.3	60.2	62.7
GDP growth (annual, %)	4.0	6.4	5.2
Employment in agriculture (% of total employment)	29.4	15.1	14.5
Employment in industry (% of total employment)	24.5	43.0	39.8
Employment in services (% of total employment)	42.9	40.5	45.7

Source: World Development Indicators CD-ROM (2004).

Table 9. Mauritius: Export Structure
Average percentages

Product name	HS Code 2	1976-84	1985-94	1995-2003
Articles of apparel and clothing accessories	84	21.8	52.3	57.2
Sugar, sugar preparations and honey	06	63.5	30.1	19.3
Fish, crustaceans, molluscs, preparations thereof	03	2.8	2.1	5.2
Miscellaneous manufactured articles, n.e.s.	89	1.4	2.8	4.4
Non-metallic mineral manufactures, n.e.s.	66	1.1	1.8	3.0
Textile yarn, fabrics, made-up art., related products	65	2.0	2.0	1.7
Photographic apparatus, optical goods, watches	88	1.8	3.0	1.5
Professional, scientific and controlling instruments	87	0.1	0.3	0.7
Fertilizers, manufactured	56	0.2	0.3	0.5

Source: COMTRADE Database, SITC Rev. 3.

Table 10. Thailand: Structure of the Economy
Average percentages

	1976-1984	1985-1994	1995-2002
Agriculture, value added (% of GDP)	22.3	13.4	9.5
Industry, value added (% of GDP)	29.7	36.4	41.1
Services, etc., value added (% of GDP)	47.9	50.2	49.4
Trade (% of GDP)	48.4	69.0	106.0
Exports of goods and services (% of GDP)	21.7	33.0	55.5
GDP growth (annual, %)	7.0	9.0	2.5
Employment in agriculture (% of total employment)	64.8	63.0	49.2
Employment in industry (% of total employment)	12.6	13.8	19.5
Employment in services (% of total employment)	20.5	23.3	31.3

Source : World Development Indicators CD-ROM (2004).

Table 11. Thailand: Export Structure
Average percentages

Product name	HS Code 2	1976-84	1985-94	1995-2003
Office machines and automatic data processing equipments	75	0.2	7.3	15.6
Electrical machinery, apparatus and appliances n.e.s.	77	4.6	7.8	12.8
Fish, crustaceans, molluscs, preparations thereof	03	7.6	10.5	6.7
Telecommunications and sound recording apparatus	76	0.1	4.0	6.5
Articles of apparel and clothing accessories	84	4.9	8.8	6.0
Miscellaneous manufactured articles, n.e.s.	89	1.8	6.8	4.9
Crude rubber (including synthetic and reclaimed)	23	8.8	4.6	3.3
General industrial machinery and equipment, and parts	74	0.3	2.0	3.2
Non-metallic mineral manufactures, n.e.s.	66	4.5	4.3	3.1
Cereals and cereal preparations	04	14.5	5.1	2.9
Textile yarn, fabrics, made-up art., related products	65	5.1	4.2	2.7
Vegetables and fruit	05	16.8	7.5	2.6
Sugar, sugar preparations and honey	06	5.7	2.8	1.3

Source: COMTRADE Database, SITC Rev. 3.

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