

## **SOUTH-SOUTH TRADE – IS IT A SOLUTION?**

**A paper contributed by the  
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*Trade can work at three basic levels to boost country's growth and reduce poverty. First, the right policies to encourage trade in general, which helps generate income and provides resource base for development. Secondly, the governments can promote exports specifically in sectors that maximize jobs and incomes. Third, they can help the poorest people – those who hardly participate in formal economy – to become active participants in exports.*

Since independence in 1991 followed by severe economic decline the recovery and subsequent dynamic growth of the economy of Kazakhstan was boosted by exports. Real GDP grows at 10% per year during last years bringing Kazakhstan in category of middle-income countries per the UN definition. Dynamic growth is recorded in all sectors of economy. Unemployment gradually declines (8% in 2005) and income increases in real terms (12% rise in 2005).

**Box 1:** Poverty in Kazakhstan like in all CIS countries has a number of specific features. Poverty as defined by the UN in its all dimensions was a new term in these countries since it did not exist as such before transition. Soviet system guaranteed (and even required!) that everybody has job, health care and education with particular care of those unable to earn for their living like families with many children, disabled and other similar sensitive groups. Deep economic decline combined with unfair privatization following independence induced very rapid impoverishment and acute polarization of country's population, posing particularly adverse effect on rural population making rural poverty deeper than in cities.

The World Bank review<sup>1</sup> reports the following findings: economic growth led to decline in poverty (from 35% in 1996 to 15% in 2002); poverty is increasingly becoming a rural phenomenon (22% in 2002); living location is one of main determinants of poverty depth; the southern and eastern parts of Kazakhstan are the poorest in (17-23%), and the impact of growth on poverty reduction was found positive though modest especially in rural locations. The UNDP millennium development goal<sup>2</sup> to eliminate extreme poverty and hunger was re-formulated to halve the number of people lacking balanced nutrition since there is no direct evidence of hunger in Kazakhstan.

High rate of Kazakh exports growth exceeds almost twice that of the world exports and is driven by favourable situation in the external markets on major exported commodities – oil, metals, and grain. Strong export performance allowed the country accumulating resources for the further development and integrating the world markets through wide diversification of markets. For a newly independent country with small economy like Kazakhstan, which was part of Russian empire for several centuries and then Soviet Union and never traded as a sovereign independent entity, it is a serious achievement gained within relatively short time.

**Main economic indicators, 2005**

|  |       |
|--|-------|
| GDP, USD bln.                            | 56.1  |
| GDP per capita, USD                      | 3,687 |
| Exports, USD bln.                        | 27.8  |
| Imports, USD bln.                        | 23.8  |
| Foreign direct investment, net, USD bln. | 3.1   |
| Government balance, %GDP                 | 6.0   |
| non-oil gov't balance, %GDP              | -4.8  |
| Gross reserves*, USD bln                 | 15.1  |
| Real income, USD                         | 1570  |
| Average monthly wage, USD                | 391   |

\* Incl. the National Oil Fund

Source: Statistical Agency of Kazakhstan; IMF Country report, June 2006

<sup>1</sup> Dimensions of poverty in Kazakhstan, World Bank report, volume 1, 2004

<sup>2</sup> Millennium Development Goals in Kazakhstan "UN\_MGD\_Extreme\_poverty\_reduction\_eng.pdf" [www.undp.kz](http://www.undp.kz)

At the same time the overall rise brings up another challenge for the country – exports become highly concentrated on a limited number of low value added products making the economy increasingly vulnerable to the external shocks and endangering sustainability of further development. The government addressed this challenge by adopting in 2003 the Strategy of Industrial and Innovative Development for 2003-2015. A network of development institutions such as Development Bank of Kazakhstan, Investment Fund, Innovation Fund, SME support Fund, Centre for Marketing and Analytical Research, Kazakh Agromarketing Research and others funded by the government was established to improve access of small and medium business to financial resources, innovations, information and other services. Cluster initiative with focus on priority processing industries was launched to improve value-chain structures of domestic higher-value added producers through developing private-public partnership involving all value-chain stakeholders.

**Box 3:** In addition to social programmes, specifically addressing rural needs, development of agribusiness sector in Kazakhstan had been and is on the top agenda of the government because over 40 percent of population lives in rural location. Since independence the government had a series of both national and regional scope programmes of state support of agricultural sector and rural locations development implemented with varying success. The latest operational one was for the period of 2003-2005 “Aul<sup>3</sup> Development” and addressed the issues of existing social, infrastructure and economic problems of rural people. Reportedly<sup>4</sup> the programme contributed substantially increase of agriculture output by 38% reaching KZT800 bln (about USD6.4 bln) in 2005 with almost doubled since 2000 number of profit-making farms.

The 2006 budget allocations for the continuing national support of agricultural farming and primary processing totals KZT64 bln (USD533 mln) having increased 10 times as compared to 2000.

Government support usually includes the measures like exemption of most taxes, privileges on land use, micro-crediting facilities, subsidizing interest of commercial borrowing, funding of fuel and seeds, co-funding leasing of machinery and equipment, and many others. This type of support facilitates poverty reduction, but proves low efficiency in terms of developing competitiveness of the agricultural producers.

The priorities in government policies have been further refined by a need of developing and promoting higher-value added exports through increasing international competitiveness. An ambitious objective was put forward to become within 10 years one of 50 top world competitive countries implying bringing the standards of Kazakh people’s life to those in competitive countries<sup>5</sup>.

Fruits and vegetable processing sector is essential to sustain non-oil growth and reduce the poverty since it provides rural employment and income generation. In Kazakhstan the majority of processing capacity is located in southern region, where rate of poor is higher than average in the country (see Box 1). The sector has proven export potential due to the unique favourable climate and land conditions, historical and cultural traditions in cultivating and processing fruits and vegetables and concentration of population (southern region accounts for 32% of total population). Proximity to the border with neighbour countries with strong cultures in farming create a potential for ensuring volumed supplies needed for developing economy of scale for both domestic and external markets.

Economic transformations in 1990s negatively affected the financial and economic position of the agricultural processing enterprises of Kazakhstan. The outputs dropped dramatically from 50,000 tons in 1992 to almost zero level by 1996 implying disappearance of sales opportunities for the farmers. Subsequent recovery was uneasy because by the time the domestic producers began to recover, the market in Kazakhstan was already highly competitive. An expanding domestic demand, driven by an overall rise of country’s economy (see Box 2) fueled sector’s output growth, which gained accelerating impulse during last three years (up to 30% annually). Expenditures on food account for a major share

<sup>3</sup>[1] “Aul” (Kazak) - “village”

<sup>4</sup> Data of the Ministry of Agriculture of Kazakhstan

<sup>5</sup> Address of the President of Kazakhstan to Kazakh nation, March 2006.

of the consumption basket in Kazakhstan. Average real income per capita has been increasing at about 8% per year in the recent years, supporting larger consumption and increased demand for food processed products, particularly fruits and vegetables.

However, the limited capacity of domestic market does not allow the industry to maintain current dynamics of growth causing a need to develop exports to ensure sustainability of operations. However exports of both fresh and processed fruits and vegetables to traditional markets (within CIS) has been tending to decline due to a whole number of factors, most of which have domestic origin. Supplies of raw materials insufficient in both volumes and quality have become a major constraint for expanding processing. This in its turn does not allow the processors to meet volume requirements even at the acceptable markets and market segments and thus constraining efficient business development. Although this does not exclude a need to develop other competitiveness attributes like quality, price, reliability, etc, nevertheless the raw supplies base remains a major concern to make the processing growth sustainable and efficient.

In 2005 with the assistance of ITC the sector elaborated export development and promotion strategy based on the value chain analysis of a number of products identified as having the highest export potential with the involvement of all stakeholders. The process of developing strategy was uneasy and even painful, nevertheless it has furnished a rich and solid experience in joining efforts to uncover problems and find solutions as well as to ensure commitment of various stakeholders.

The Strategy was specifically designed for horticultural sector in view of its peculiar and unique history, circumstances and opportunities and is aimed to boost trade in the area of horticultural processing that will entail formation of a cluster of an international competitiveness playing a meaningful role in the region. The scope of the strategy covers enterprises and farms that produce and process horticultural products and located in southern region as well as other actors of value added chain.

Top strategic goal, specified by the strategy is a formation of a high-capacity raw materials base, maintaining close ties with raw materials producers in Kazakhstan and Central Asian republics to use productive capacity for horticultural processing to the maximum effect.

The strategy defined the set of measures needed for strategy implementation and detailed action plan for the nearest several years. The measures were elaborated to address the problems of processors through supporting farmers. The set of such measures is quite broad, but it covers the needs of not only horticultural processors, but also overall food sector issues (see Box 4), particularly those related to the supplies provided by rural producers.

**Box 4:** Examples of measures directly addressing the needs of farmers. The programmes include both those adopted and currently reviewed by the government to implement the export strategy of fruits and vegetable processing sector.

- Subsidize the cost of the commodity-material values (fuel, mineral fertilizers and seeds), necessary to carry out harvesting
- Prepare a state support programme on developing the insurance system of the risks of the agricultural production
- Subsidizing of seeding of the longstanding fruits and berries and grapes
- Support of seeds selection and adaptation for processing fruits and vegetables
- Increase financing of the research surveys in the area of seeds selection, raise harvesting from the gardens and vineyards, using modern technologies
- Subsidizing expenses for transportation of the agricultural raw from the rural areas, located in 100 km and farther from the processing enterprises
- Developing proposals on land improvement
- Formation of the production infrastructure of the food-processing sector:
  - \* rehabilitation of vegetables storages;
  - \* developing seeds selection households
  - \* organization of the wholesale markets of agricultural products
  - \* support of organizing machinery and equipment points with specialized transportation vehicles for shared servicing of farms;
  - \* chemical servicing of rural commodities' producers

The sector strategy development exercise produced good results and undoubtedly valuable experience, but it also brought up the issues, which are not directly related to exports but substantially affect competitiveness of the final products both fresh and processed.

Thus, numerous and generous support provided by the government to the farmers hardly managed to increase the competitiveness of their produce, because as a rule it does not address solving the issues related to the demand for the farmer's produce. State programmes provide support to the farmers in growing the product, but do not address issues how and where to sell their crops. Support of access to credit resources and other market instruments like leasing does not directly correlate with a need for farmers to develop demand-driven operations. Small farms, which are in majority, suffer most of all of such approach, failing to sell the crops, since have no knowledge of market demand and distribution channels added by inability to arrange transportation, storage and pricing, allowing them making profits, and thus eventually get out of poverty.

An important strategic emphasis – make development of horticultural processing exports a drive of farming development - has been made in the course of strategy development. The government made small revision of its agricultural support programmes enabled to channel the state funds allocated for farm support through processors, which formerly were not eligible for such support, and at the same time have no sufficient capital to fund farmers' operations to ensure needed supplies.

What benefit does such revision have? Getting money from the government designed for farmer support, the processor incurs liability to use these funds only for purpose of employing the farmers to provide supplies for processing. Such contract-based cooperation usually comprises, but not limits to identifying what crops are needed, training on techniques to be applied for growing to ensure the required product characteristics, furnishing seeds and providing necessary machinery, transportation, as well as timely payments. Commitment on such cooperation is secured by the assets of the processors and by guaranteed sales for farmers. It also encourages the small farmers to join their efforts to use the facilities storage, machinery facilities built or organized by the processors through involving other businesses or local governments.

Development of processors capability to export through meeting export market requirements and strategic orientation on internationalization forces them to improve their production. For example, the mandatory requirement to ensure back and forth traceability through the whole product chain makes companies to lead the farmers to assure implementation of the requirements. Although this proper fulfillment of such requirement is a matter of more distant future rather than today agenda the processing companies started arrangements to develop the needed understanding and skills among farmers' communities.

Aiming in overall to meet the international requirements the strategy specifies the step-by-step implementation. Therefore the identified first priority markets for the exports of horticultural processing focus mainly on CIS countries, with Russia being of major interest. A number of advantages makes these markets attractive: geographic proximity, lack of customs taxation, common pattern of consumption, availability of various segments in the market – both modern and highly demanding, and old Soviet style, pricing, similar procedures, common language and traditions of trading. Given the current status of exporter's capacity in Kazakhstan, the trade with CIS is seen as the most likely way to bring the poor in export activities.

Sourcing of inputs for production from neighbour countries is another attractive facet of trade directly related to the poverty reduction in the region. Whereas sourcing of labour is de-factor existing in Kazakhstan, flow of supplies is a matter of close future rather than well spread practice of nowadays. The major constraint here is a lack of correlation between trade-related and poverty addressing policies at both national and intra-regional level.

**Conclusion:** Among a number of lessons drawn from sector-level activities, the one is definitely important for achieving the strategic goal of reducing poverty: policies addressing poverty reduction should be closely correlating and embedded in the trade-related policies.

The few examples, when processors export by diversifying their deliveries through combination of the processed and fresh produces, collected either from own suppliers or arranging fresh part of lot from

neighbour countries' sources, prove that existing opportunities are underused and worth more thorough addressing from both business and public part.

Currently Kazakhstan launches a process of developing national export strategy using Executive Forum methodology. And the Kazakh team expects that Executive Forum global debates would allow knowing the practical lessons on what works and how, and what does not work and why in implementing challenging correlation between various policies to maximize the effect of "development gear" in the national export strategy.