

Developing Agricultural Markets in Post-conflict Sri Lanka for Promoting International Trade

Abstract

This paper highlights the importance of efficient and competitive markets, with the government playing a facilitating role, for agricultural renaissance in the North and the East as well as in other areas of the country in the aftermath of the 30-year conflict. When markets were organised in an orderly manner, as in the case of tea, rubber and some spices, it became profitable to export the surplus. Similarly, it may be possible to export surplus agricultural produce that could emerge from the large-scale agricultural pursuits in the former conflict zones, if steps are taken to make markets for these products more orderly, efficient and competitive.

Introduction

Sri Lanka, an island nation straddling trade routes from the East to the West, has been a trading centre for spices, gems, etc. from ancient times, but its transformation to a major exporter of tea, rubber, cinnamon and other commercial products took place during the last 300 - 400 years during colonial rule. While agricultural exports were strongly facilitated by the state through the development of harbours and roads, railways and communications networks, the private sector undertook the growing, processing, transporting, marketing and exporting of these crops. The necessary researches were conducted by state institutions, which were financed by cesses on these exports. Thus, it could be described as an instance of public-private partnership.

Although the State undertook large investments in irrigation, fishery harbours and other infrastructure to support the development of other crops, such as rice, fish, vegetables and fruits, a similar development did not take place in the non-traditional agricultural pursuits. The large number of farmers and fishermen, who were benefited from the Government investments, faced imperfect or weak marketing channels. The low or uneconomic prices fetched by them were often attributed to exploitation by

private sector "middlemen". Hence, the governments tended to intervene in these markets by way of sales and purchases. Often, the Governments' consumer welfare objectives tended to depress prices to the producers. Moreover, Government institutions engaged in trade proved to be inefficient and corrupt. As a result, domestic agriculture has languished and farmers have been made poor.

With the end of the war in the Wanni, which protracted for nearly three decades, there is now a greater scope for enhancing the agricultural pursuits, especially in the war-affected areas of the North and the East. However, as the Government has played a dominant role in liberating the North and the East, it is naturally well positioned to rehabilitate and reconstruct the economic infrastructure of the region. Beneficiaries of this improvement will be farmers, fishermen, etc. who will need efficient markets to dispose of their produce at fair prices. Past experience has shown that Government intervention in marketing has not been

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successful. Hence, partnerships between the public and private sectors, to promote efficient and competitive markets, will be essential to achieve a renaissance in this sector, by making agricultural and fisheries viable economic activities.

Recent Trends in Trade in Agricultural Products

According to national income data, the value of agricultural production increased from Rs. 156.1 billion in 1996 to Rs. 236.6 billion in 2008 at 1996 constant factor cost prices, but the sector's share of gross domestic product (GDP) declined from 17.6 per cent to 12.1 per cent because other sectors grew faster. (Central Bank of Sri Lanka Annual Reports, 1996-2008) However, the sector continues to account for a significant part of the workforce (33 per cent of employment) of Sri Lanka in

Table 1: Provincial GDP in Sri Lanka at current factor costs from 1996 to 2008
Agriculture Sector - (Rs.millions)

Year	Northern Province	Eastern Province	Total (North+East)	All Other Provinces	Total (All Provinces)	Share of North & East in total Agriculture
1996	3,397	11,536	14,933	141,175	156,108	9.6
1997	4,536	13,480	18,016	157,758	175,774	10.2
1998	4,606	17,708	22,314	170,351	192,665	11.6
1999	4,702	15,331	20,033	185,567	205,600	9.7
2000	4,510	15,451	19,961	198,447	218,408	9.1
2001	6,200	21,646	27,846	221,943	249,789	11.1
2002	9,909	25,717	35,626	252,214	287,840	12.4
2003	12,242	34,948	47,190	250,153	297,343	15.9
2004	14,586	32,020	46,606	273,917	320,523	14.5
2005	15,847	25,542	41,389	321,408	362,797	12.0
2006	16,453	26,821	43,274	365,729	409,003	11.3
2007	18,647	28,444	47,091	371,013	418,104	11.3
2008	25,456	53,388	78,844	511,154	589,998	13.4

Source: Central Bank of Sri Lanka

2008. As per provincial GDP figures, which are only available since 1996, the agriculture sector of the Northern Province, which stood at Rs. 3.4 billion and accounted for 0.4 per cent of GDP in 1996, had risen to Rs. 25.5 billion (0.6 per cent of the GDP) by 2008, reflecting an annual average growth rate of 54 per cent over this period (Table 1). On average, the agriculture sector in the Eastern Province grew by 30 per cent during this time. While the agriculture sector of the North Central Province grew by around 26 per cent per annum, growth in the other provinces ranged from 20-23 per cent per annum during this period.

This notable growth in the agricultural sector in the Northern and the Eastern Provinces, which were centres of military conflict until very recently, gives an indication of the possibilities that await during peaceful times. With unrestricted access to 480 km of coastal seas of the Northern Province (in addition to the 436 km of coastal seas of the Eastern Province), the fisheries sector also has a tremendous potential to contribute to the growth in the agricultural sector.

However, strong growth may involve glut in agricultural produce in the market, which would dampen their prices. Sometimes, there may be difficulties in moving the produce to the market centre, owing to inadequate transport and infrastructure facilities.

As per Sri Lanka Customs Department data, earnings from agricultural exports amounted to only US dollars 1.8 billion by 2008, 85 per cent of which comprised of tea, rubber and coconut exports. Thus if the market for the non-traditional agricultural products can be made more competitive and efficient, the surplus may be exported, after meeting domestic consumer demand. If the new domestic surplus could be diverted to the export market, not only would the domestic prices stabilise, providing a fair price for the producers (farmers), but the country would also be better off as it would fetch better prices for its products.

Unlike the already developed export markets, the domestic rural economy comprises a large number of small land holders, producing seasonal crops of rice, vegetables and fruits. Fishery

output is also linked to the monsoon seasons. Wholesale traders either buy direct from producers or from village and town trade fairs known as "polas". Traders in cities buy the produce and distribute to near-by markets. But, the major surplus from rural markets ends up in Colombo, from where, it is distributed island wide. This involves an additional transport cost, but this is often offset by the transporters who return to their origins with full loads of imported goods available in Colombo.

The universal complaint of the farmer producers is the inadequate price or income they obtain from so called "middlemen". Hence, Governments have set up co-operative systems of farmer associations and traders, which too have been found ineffective in obtaining better prices. Therefore, the Government has been brought into agricultural markets by setting up produce-buying organisations, such as the Paddy Marketing Board and the Fisheries Corporation, whose performances have been erratic.

As islandwide agrarian services organisation has been set up to distribute subsidised fertiliser and other inputs, but here too, there have been complaints of inefficiencies. Some form of crop insurance has been introduced, which too has suffered from bureaucratic lethargy. In short, a vast bureaucratic apparatus has been set up ostensibly to help the large number of small farmers and fishermen, who have thus become dependent on government intervention. The many complaints by farmers regarding inadequate prices and inputs seem to indicate that this apparatus has been found wanting.

Economic Centres

The town of Dambulla grew naturally as a wholesale centre for agricultural produce, where transporters from 15 districts converged on the city to exchange their produce. In order to relieve city congestion, the Government set up a separate trading centre, within close proximity, called a "Dedicated Economic Centre", which became a conspicuous success initially. The Government provided infrastructure of buildings and trading spaces, banking services, etc. Agricultural produce from the

surrounding regions converged on Dambulla, and the transporters in turn, picked up produce demanded in the surrounding regions on their return journey. For instance, upcountry vegetables and imported goods from Colombo were available in Dambulla. This enabled two way loads for transporters, which in turn made transport remunerative.

The Centre was run efficiently by an organisation of private traders, who leased the premises at nominal rents. They introduced a system of forward contracts with producers with the objective of developing a "forward market" for agricultural and fishery products. Forward contracts involve an agreement to deliver a specific quantity of produce of a specific quality on an agreed upon date in the future for an agreed upon price, regardless of the price prevailing on the date of delivery. This enables farmers to sell their produce in advance to buyers willing to purchase commodities in advance. The number of forward contracts entered into by farmers had increased over the years to reach 69,000 contracts by 2008, in rice, corn, ginger, etc.

However, the Dambulla Centre, with its round the clock trading, attracted considerable attention. Hence, the Government promoted a similar form of trading centres erroneously called "economic centres", which have not been successful. A cardinal mistake was to treat them as one way, wholesale and retail trading spots. Most of them were located with poor access. Basically, there was no congruence of trading interests.

For example, such an economic centre set up in Meegoda is 3 kilometres away from the town, with no access to public transport and no advantage of a return load. Hence, it currently operates twice a week, while a majority of the people patronise the regular "pola" at the heart of Meegoda town. The retailers who set up their businesses there are unable to cover their costs and have refused to pay rentals.

The current tendency to set up economic centres based on non-economic factors should be discouraged. As in the case of Dambulla and Maradaghamula, when

a trading centre grows spontaneously, due to the preference by private traders, the government can facilitate to upgrade such centres with modern facilities. That will ensure that natural two-way transactions will take place.

The objective should be to facilitate smooth trade, instead of uplifting the welfare of anybody. Several such key centres are likely to evolve naturally in the post-conflict era, and the government could support them by providing improved transportations services, access to pipe-borne water and grid-based electricity, and other resources.

Perhaps, the facilities could be gradually enhanced over time to include cleaning and processing in order to produce value-added products for the export market.

Supermarkets and Co-op Centres

Another recent innovation of the private sector has been "supermarkets" which comprise sophisticated marketing centres capable of offering competitive prices to consumers, out of the advantages of bulk buying directly from the producers, most often, through their own fleet of transport vehicles.

They face some competition from "Co-op Shops" of the government. Incidentally, the Co-operative Wholesale Establishment (CWE) was set up during the times of the World War to be a wholesale bulk buyer for the large number of co-operative society shops. Later on, however, the CWE set up an island-wide chain of its own retail outlets for foodstuffs and groceries.

They were successful in distributing government-subsidised food stuffs in times of shortages. At almost all other times, these co-op shops burdened with bureaucratic regulations, and operated by persons with little flair for commerce and trade, proved unable to compete with the large number of private traders.

They have failed intermittently, and have been revived from time to time by governments keen on providing affordable food stuff and groceries. However, their role has been marginal.

Government Intervention in Trading

The above account shows the long history of government intervention in trading, which has proved to be ineffective. Certainly, the farmer producers have not benefited from them, as these policies were more oriented for consumer welfare. It is important to appreciate that successful trading is a two-way process, with traders buying from growers at remunerative prices, and thereafter selling the produce to consumers at competitive, reasonable prices.

With the overriding concern for the welfare of consumers, governments have heavily intervened to regulate prices and supplies, which have disadvantaged both the growers and the traders. This has taken place out of a gross misunderstanding that the traders are "middlemen" who exploit people.

This belief has ignored the important role played by intermediaries who as middlemen, facilitate markets to function smoothly and efficiently. Farmers seek these markets for price discovery.² These middlemen have access to a vast volume of information, on the quantities of goods supplied and demanded, their qualities and respective prices, garnered through their constant interaction with many producers, wholesalers and retailers, which put them at a competitive advantage over the farmers and the government.

Thus, it is difficult to see how bureaucratic government organisations can engage in efficient wholesale or retail trading. Government intervention has not only been costly to the tax payer, but has often failed in its objective of ultimately helping the farmers and the consumers.

Facilitation of Trade

In this context, the end of the conflict in the North and the East has given an opportunity to revisit the government's agricultural trading policy. Ad hoc interventions in government purchasing of agricultural produce and the rationing of their distribution are bound to be counter-productive. The role of the government

should not be to engage in trade directly, but to facilitate its growth by co-ordination of growing and trading. This will help increase output and create a surplus, which can then be diverted to export markets, channelled through efficient central markets and private channels. In this effort, the government must work in close cooperation with the private sector, which consists of thousands of traders spread across the country, and those firms which have expertise in wholesale distribution and exporting. This provides an ideal field for public private partnerships. Some areas in which the government could help facilitate trade are discussed below.

Transport and Handling

The major facilitation which the government can engage in is in developing efficient transport and handling of agricultural produce. It is well known that about 40 per cent of farm produce is lost as wastage in transport (Cyril, 2006). This can be obviated by using suitable containers and packages for transporting agricultural produce.

The lorries that are currently being used, which have been designed to transport tea and rubber, can carry only smaller loads with plastic containers. The lorries could be redesigned to maximise space to transport bigger loads of agricultural produce safely and efficiently. Alternatively, the 20-foot containers could be used to help transport a similar volume of agricultural produce in crates, with minimum wastage.

As the plastic crates have to be circulated from one transaction to another, they would have to be arranged as a public good³, which will circulate freely. Although the government may have to bear the initial costs of designing, producing and distributing suitable light-weight crates, as well as popularising their use, the saving of nearly 40 per cent of produce from wastage may be worth the effort. A recent proposal to make transport by plastic crates mandatory (Daily Mirror, 2009) may prove counterproductive.

The existing railroad system could also be developed to provide an alternative

mode of transport, if found to be economical. As rail transport involves extra handling, it may be viable for longer hauls only. Ferry routes along the rivers, could be developed to transport goods within the country which involve extra handling costs, if found to be cheaper.

Given the perishable nature of agricultural produce, the development of the domestic air freight services would also help in transporting goods from the periphery to the major international airports in a timely manner in order to cater to the export markets. It has been noted that more than 90 per cent of Kenya's agricultural exports are shipped by air (Brown and Sander, 2007). In fact, bulk transport of agricultural produce could be undertaken on negotiated special airfares.

Out-grower Schemes

The government may encourage widespread out-grower systems with groups of exporters, at the new economic centres. Out-grower schemes, wherein, the traders in the markets at the centres provide seeds, fertiliser, technical know-how and finance, in return for the harvests, are already in operation. Such out-grower schemes between traders and growers could be extended to include the exporters and banks should be encouraged to finance these schemes. For example, a commercial agricultural partnership with a large business conglomerate has linked groups of farmers in the Eastern Province to global agricultural supply chains, including companies such as McDonalds, Burger King, Unilever and Heinz, as a result of which farmer incomes have increased (USAID, 2009). This has prompted farmers to switch from subsistence farming to produce crops in demand, such as gherkins, jalapeno peppers and pineapples.

Currently, the key players in the local supermarket business operate their own out-grower systems by designating collection centres for fruits and vegetables in villages across the country, which are brought to their supply centres and distributed to their outlets. However, the problem of identification of farmers is one of the key issues that they face in expanding

the out-grower systems into new territory in the Northern and Eastern provinces. They would perhaps require the assistance of the local government officials or village headmen to set-up farmer groups or associations to undertake outgrowing.

Global Supply Chain

Given the right incentives and support, small-scale farmers could be benefited by participating in the emerging global supply chains. However, it has been reported that small- and medium-sized producers and exporters of agricultural products are often marginalised by the supermarkets in the developed world in favour of dedicated suppliers in view of their assurances of due diligence and quality control (Brown and Sander, 2007).

Problems faced by small holders in trying to sell to supermarkets include the high transportation costs, due to poor roads and the unreliable rural transportation services, the lack of negotiating skills and their inability to maintain the consistent quality required for the export markets. Growers also have to be prepared to respond quickly to changes in supply and demand, which requires a degree of market information and capital investment, which is out of reach of many smallholders.

Also, supermarkets are often reluctant to source from small holders in view of the increased transaction costs in dealing with many small farmers, and the failure to meet food safety or environmental standards, which could result in bad publicity (Brown and Sander, 2007). The Government could facilitate closer links between the smallholders, supermarkets and potential exporters by promoting agricultural companies and commodity exchanges with forward contracts.

Commodity Exchange

Because of the slow progress made with respect to forward markets, sharp seasonal fluctuations in prices of agricultural produce continue to be a strong deterrent to farmers and traders. Hence, the government could encourage widespread use of forward markets to even out price fluctuations and to provide firm future markets to growers, under the guarantee of a

commodities exchange. Similar to the Stock Exchange, the Commodity Exchange should be a company or body of traders, who collectively guarantee the contracts.

Sales and purchases of the contracts by the public would provide them the necessary liquidity to the exchange. However, forward contracts require certain specifications of standards of agricultural produce. Standards are bound to help the export markets as well.

Standards

According to the United Nations Environment Programme/United Nations Conference on Trade and Development (UNEP/UNCTAD) Capacity Building Task Force of Trade, Environment and Development, confusing standards, lack of transparent requirements and fragmented knowledge are barriers for producers trying to meet international health and safety standards (2008). It recommends setting up of regional organic standards, which could reduce the certification costs of farmers, who are forced to comply with standards set by most importing countries, which tend to be not only cumbersome to comply with, but also, very expensive.

However, the South-Asian Association for Regional Cooperation (SAARC) is in the process of setting up regional standards for organic products. Perhaps, the Sri Lanka Standards Institute (SLSI) could set simple standards for export-quality agricultural produce. Interestingly, it is generally the small scale farmers who cannot afford the relatively expensive chemical fertilisers and pesticides that could gain the most from market information and technical support on maintaining standards for organic products.

Value Addition and Branding

Development of the agricultural sector depends, to a large extent, on the level of the value chain of the product and on the efficiency of the marketing system. With plenty of sunshine around the year, Sri Lanka has a huge potential in developing a variety of "sun-dried" products such as raisins, tomatoes, etc. for the local and export

market. While little value addition takes place in the form of sorting, grading, quality control and packaging, etc. for fresh produce, the semi-processed and processed products have reached the branding stage and are considered growth products (Anwar et al., 2005). For example, Ceylon Tea continues to fetch premium prices in the international markets. More recently, special tea brands have been developed by selected superior tea gardens. The government is currently in the process of branding "Ceylon Cinnamon".

Agricultural Research and Technology Transfer

As mentioned before, catering to the international market would require farmers to be able to standardise their products, for which they would need to obtain high-quality seeds and fertilizer. Agriculture research facilities at Gannoruwa and other research stations could be developed further to identify the best varieties of seeds suitable for the country's varying climatic conditions.

The knowledge and technology should be made freely available to the farmers, perhaps through selected model private farms. Some private firms have had a successful record for transferring knowledge. The good varieties of seeds and information on best agricultural practices should be made widely available in shops and seed farmers in the private sector.

Alternative methods of disseminating technical information through media such as television, radio, and internet, which are becoming increasingly popular, may be effective in reaching wider audiences. Agricultural exhibitions and tours of model farms could also be an effective method of technology transfer.

Agricultural Companies

A major challenge facing small holders is their small farm size, which makes it difficult to compete with the larger agricultural pursuits which benefit from economies of scale. Banding together, as cooperative enterprises, would enable them to make their presence felt. Collectively, they could increase their bargaining power with

the buyers, in terms of price and quality of products as well as with the government, on the level of investment in infrastructure.

However, since "cooperatives" come under a special law with a huge bureaucracy, groups of farmers could, instead, be encouraged to form companies under the Company Law. This would also help in raising new capital for the development of the enterprises.

Finance

The government has concentrated in providing liberal subsidised inputs to various agricultural activities. However, better results may be achieved if finance is directed at enterprises, and not crops, in general. Getting orders from the large international trading chains may require investments in irrigation facilities, greenhouses, storage facilities and trucks with cooling mechanisms, and packing technologies that minimise damage to fresh produce. This would require a fair amount of funds for initial investment, and may require the assistance of a financial intermediary.

Small farmers could be encouraged to set up cooperative societies or agricultural companies, which will be more capable of raising the required finances and achieving economies of scale. The banking institutions in the Northern and Eastern provinces could be used to promote company formation.

Conclusion

Development of agricultural markets for international trade involves the integration of rural and urban markets within geographical areas and among the various regions of a country, in order to facilitate trade within the country as well as between nations.

Irrational beliefs that traders or middlemen extract higher margins from economic activity by offering low prices to the farmers, and are therefore exploitative by nature, have lured welfare-oriented governments away from competitive markets towards state trading and intervention. Given that governments all over the world have failed at trading directly, it would

be better for the government to remain only as a facilitator of infrastructure, and as a promoter of competitive markets, and thereby help establish the crucial links between the producers and exporters.

It is best if the government could focus on the provision of public goods and collective services, such as the development of transportation networks, dissemination of technology and information, and promotion of out-grower schemes and forward markets, leaving the growing and trading activities to the private sector farmers and traders.

The government could also engage in other activities that would enhance the efficiency of agricultural markets, such as setting standards, encouraging value addition and branding, and linking producers, processors and exporters, in order to meet larger orders that are required for export markets.

A clear demarcation of the role of the government and the private sector, in partnership, would help the innumerable organs of government to be consistent in their policy statements and initiatives.

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Footnotes:

¹ The views expressed in this paper are those of the author and do not necessarily reflect those of the Central Bank of Sri Lanka.

² Price discovery involves the process of buyers and sellers arriving at a transaction price for a given quantity of goods of a specific quality. Generally, large quantities of goods result in lower prices and vice versa. However, other factors, such as the number, size, location and competitiveness of buyers and sellers, the pricing methods, and the amount, timeliness and reliability of information, also affects the price discovery process.

³ Public goods are products that the Government is best positioned to provide compared to the private marketplace.

