Global Market Opportunities and Challenges for Central American Exporters: Strategies for Customized Competitiveness in the CAFTA Era

Thomas Reardon and Luis Flores

Michigan State University

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EXECUTIVE SUMMARY

Central American countries are entering CAFTA in the midst of the globalization period that started with trade liberalization in the early 1980s and that CAFTA now makes permanent. From the viewpoint of export market external opportunities and challenges, CAFTA does not change much Central America’s situation of trade openness with its major target market at present, the U.S. Through investment rule harmonization and promotion of a customs union, CAFTA does help position Central America more competitively to the U.S. and the world.

The terms of reference of this paper is to consider, given the above, what opportunities and challenges face Central American exporters in the world market in the CAFTA era. Moreover, the paper is called upon to provide illustrations of what measures foreign countries – successful exporting countries – are taking to maximize their competitiveness in a globalized market. These illustrations are meant to serve as input to Central America’s deliberations on their options. We conclude with reflections on new strategies for Central America and issues and trade-offs surrounding them. We focus on agrifood markets (as that sector constitutes the majority of Central American exports), and assume Central Americans want to increase their exports globally and do so with the highest rural development impact possible (including small producers and/or rural workers).

We posit that to address the sharp drop in relative growth of exports of Central America versus its many competitors, new thinking needs to develop on how to promote competitiveness, while maximizing rural development. Very necessary, but not sufficient, is major investment in “structural competitiveness” through investments in infrastructure (to redress Central America’s

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sharply high costs of doing business relative to Asia’s) and rural education. The competitors are making these investments rapidly and at grand scale. Also very necessary is to design measures – eventually suited to the specific needs and means of Central America - to promote “customized competitiveness”. This latter concept relates to exporters’ ability to meet the changing and escalating requirements of global markets in a spectrum of niches and segments that together add up to the opportunity set facing exporters.

After the introduction, then, the paper starts with a picture of that “opportunity set” and how it has evolved over the past two decades and where it is tending. Several points are made. (1) Agrifood trade doubled in the past two decades of globalization – but grain trade was mainly stagnant while trade in fruits, vegetables, meat, dairy, and fish/seafood tripled or quadrupled. Central America’s export focus on non-staple foods is clearly aligned with the opportunity set. (2) While two-thirds of food trade is still from and to the US, Western Europe, and Japan (most of the industrialized country markets), food markets in the “emerging market regions” of Asia, Latin America, and Central/Eastern Europe, are growing five times faster. The emerging markets will be by far the “growth areas” of trade in the next decades. Central America’s export focus (now nearly only on the US and Western Europe) is clearly not yet aligned with the opportunity set. (3) The nature of food markets is changing in two dimensions, and both represent key opportunities and challenges.

The first dimension is the product market cycle. The initial stage is introduction of a niche product into new markets, relatively easy entry, just competing on novelty. (Like off-season melons to U.S. market in late 1980s.) The middle stage is the shift of the product from niche to mass market, with large entry of competitors, reduction of profit margins, growth of market, and consolidation of large actors. Competition is on cost. (Like melons in the mid/late 1990s to many markets.) The advanced stage is the product differentiation stage, into different varieties and value-added (parallel with the continuation of a mass commodity market for the product), with key roles played by large companies. At each stage, the opportunities and challenges/requirements are very different, so Central American exporter strategies must differ greatly by stage and product.

The second dimension is structure. (1) The food industry segments (retail, processing, wholesale) in both industrialized “target markets” and emerging region markets have been consolidating and multinationalizing rapidly over the globalization period. Most striking is the very rapid spread of supermarkets in emerging market regions in the “second round” of globalization – knitting together (integrating) and modernizing markets that were formerly traditional, fragment, nearly inaccessible to exporters to those areas (with nearly a billion middle class consumers). (2) Supermarket chains (and other food industry actors) are recently and rapidly modernizing their procurement systems from producers (hence also exporters in Central America) toward buying in larger catchment/sourcing areas more centrally, via new-generation wholesalers and preferred supplier systems rather than spot markets and traditional brokers, and toward use of private standards of quality and increasingly, safety, more demanding than public standards. This change in the interface between food industry (the importers) and producers/exporters represents a massive opportunity (as it creates and facilitates trade) and challenge (it ups the competition and requirements for entry). Meeting those new requirements means competing on cost, quality, and
supply chain organization. These in turn imply not just structural competitiveness (for cost) but also customized competitiveness (for quality and supply chain organization).

Recall that the paper is meant to lay out the above opportunities and challenges and then provide input to the debate (and debate there will be) about the “how” to implement the needed measures for customized competitiveness. We thus give examples of innovative programs (new ideas as well as “new and improved” execution of old ideas) from other countries – mostly the “export tigers” with whom Central America is competing – and/or will be partnering in the years ahead – including here Chile, Mexico, Uruguay, and Brazil, and China, Indonesia, India, Malaysia, and Vietnam – countries vastly different among themselves, as well as different in resources, scale, and structure from Central America. Yet all offer potential lessons that may be adapted.

There are two dimensions to the “customized competitiveness” measures illustrated.

The first dimension is that all focus on building different sorts of “capital” that is needed to meet the cost, quality, and supply chain organization requirements in the target markets. The types of capital include: (1) market intelligence capital (with an emphasis on understanding the specific requirements of the food industry firms that buy, rather than just trends or prices, and an emphasis on “face contact”; (2) market-social/organizational capital (with an emphasis on facilitation of joint ventures and alliances, lean/active associations and public-private programs); (3) technology capital (with an emphasis on upgrading suppliers to meet new private standards); (4) risk-reduction and financial capital (to spur investment in upgrading, and build reputation and trustworthiness of exporters in eyes of importers).

The second dimension is that these countries appear sensitive to the need to have very differentiated programs depending on the product and the market cycle stage, and on the types of producers (large, small) with potential to be involved. Moreover, they tend to use a spectrum of approaches from purely public (to support small farmer involvement in their own actions but also in the actions of the larger local players), to public/private (such as linkage agreements among global chains, governments, and exporters), to purely private (such as trade associations).

Central America will need now to dramatically address the customized competitiveness gap – in a way that fits with its rural development needs, different scale and organization, and limited public budgets. But it needs to do it fast – the train is out of the station, and was before CAFTA is even started.
1. Introduction

The Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) are entering CAFTA. To support the deliberations concerning strategies and measures to improve Central America’s capacity to address challenges and take advantages of trade opportunities of that treaty, and maximize the participation of small producers, there is a need to have additional information.

The terms of reference of this paper is to consider what opportunities and challenges face Central American exporters in the world market in the CAFTA era. Moreover, the paper is called upon to provide illustrations of what measures foreign countries – successful exporting countries – are taking to maximize their competitiveness in a globalized market. These illustrations are meant to serve as input to Central America’s deliberations on their options. We conclude with reflections on new strategies for Central America and issues and trade-offs surrounding them. We focus on agrifood markets (as that sector constitutes the majority of Central American exports), and assume Central Americans want to increase their exports globally and do so with the highest rural development impact possible (including small producers and/or rural workers).

Consider for a moment what change CAFTA will have in the strategic positioning in world markets of Central America.

On the one hand, CAFTA builds on a history of trade liberalization between the US and Central America as old as the globalization period itself. The Caribbean Basin Initiative (CBI) in 1983 reduced tariffs for 80% of Central American exports to the US; the Generalized System of Preferences (GSP) in 1976 also liberalized trade. These initiatives were temporary, and CAFTA renders permanent the trade liberalization for most items (with some exceptions like beef and dairy, and some additions like sugar and tobacco). Thus, stated very generally and simplistically, CAFTA does not fundamentally change the conditions of trade from Central America to the US from what they have been for all of the globalization period starting in the early/mid 1980s.

On the other hand, however, CAFTA does improve structural conditions for Central America to be competitive in exports – such as through the advent of the customs union that will make it easier to aggregate cargo lots to achieve volumes needed to export to markets requiring such volume, and such as through the regional harmonization of foreign direct investment (FDI) that will attract more FDI in export operations and joint ventures.

Our paper thus starts with the premise that in terms of trade opportunities and challenges, CAFTA does not fundamentally alter the opportunities – or the existing challenges - that have been facing Central American exporters in world markets starting in the mid 1990s, what we refer to as the “second round” (like in boxing) of globalization – which we distinguish from the
“first round” of globalization that “started” (actually, just intensified in a discrete major leap) in the mid 1980s through the early/mid 1990s with the GATT Uruguay rounds.

A striking fact is that while Central America started strong in the “first round” era of globalization, an early success story in non-traditional exports in the mid 1980s to mid 1990s, thereafter (in the “second round”) it has fallen sharply behind a host of competitors from around the world. CAFTA provisions regarding regional “enabling conditions” are useful to address the pending challenges – and are necessary - but not sufficient to fundamentally change Central America’s competitiveness. New strategies are needed regionally and in the member countries. Our paper is based on two concepts of those competitiveness strategies. The first is that “structural competitiveness” (based for example on basic infrastructure and education) is very necessary but not sufficient in the current “second round” of globalization. In addition, countries have to pursue “customized competitiveness”\(^3\). The latter is an ability to compete in specific to market niches and segments in a constantly changing market. CAFTA’s likelihood to improve Central America’s trade performance will depend on the ability to adopt customized competitiveness to address costs, quality, organization, and volume challenges to take advantage of a number of trade opportunities.

We proceed as follows. Section 2 discusses global market opportunities, and Section 3 discusses challenges, for Central American exporters. Section 4 presents illustrations of measures taken by a number of “food export tigers” countries to build customized competitiveness (on a base of solid investment in structural competitiveness). Section 5 concludes with reflections on issues and strategies for Central America in the CAFTA era.

2. Export Market Opportunities

2.1. There has been a vast increase in food trade in the “globalization period” starting in the mid 1980s.

The volume of food trade increase 2.1 times from 1980 to 2003 (3.4% annually, faster than the annual rate of growth of GDP/capita in the world, of 2.65%. The rate was 3% per year trade growth in the 1980s, 2.3% in the 1990s, then 8% per year in 2000-2003.

The trade increase was driven by trade liberalization policies (such as GATT, NAFTA, MERCOSUR, and soon CAFTA). These policies bore fruit partly because they coincided with demand side factors (growth of consumer incomes) and supply side factors (improvements in packaging, storage, transport technology, and communications).

2.2. The increases in trade were extremely uneven over product categories, with “non-staples” (fruits, vegetables, meat, fish, dairy) the clear winners, and grains the clear losers.

First, there was stagnation or even decline in trade of most basic staples like grains (rice, maize, and wheat trade stayed nearly unchanged over two decades!). Only soybean trade increased greatly, but that was from derived demand for meat.

Second, by contrast, there were vast increases (300-500%) in trade in non-traditional products (non-staples) -- fruits and vegetable trade grew 330%, and meat and fish/seafood trade grew 300-400%. Frozen produce trade grew very rapidly. The growth in non-staple trade is not surprising: in food economics, Bennett’s Law predicts that as incomes rise, consumers switch into non-staples and out of staples.

Central America’s export focus is already aligned, in general, with this continuing trade opportunity in non-staples. And Central America has examples of great success in these. For example, world plantain trade jumped 10-fold to 145 million in 2003; Central America’s exports grew at the same pace. World pineapple trade jumped 10-fold, with Central America’s exports grew 20-fold, mainly due to the massive entry of Costa Rica.

Third, over the two decades, the diversity greatly increased. For example, basic fruit commodities like apples and oranges each dropped from 5% to 3% of trade). By contrast, there was a huge increase in diverse (initially) “niche” tropical products and vegetables and specialty items like berries. These diverse product markets are the key opportunities for Central American exports in the next decade.

However, it is difficult to class products as permanently “narrow niche” or “broad commodity.” This is because a given product tends to transition from initial status as a narrow niche market when it is introduced, to a basic commodity as the market grows, and then proliferates into a series of niche markets again, and the cycle starts again. This is important for Central American exporters, because usually one thinks of “niche” markets as more defensible against incursion of large, low-cost competitors. But the usual cycle starts with early entrants enjoying large profits and defending their turf rather easily. Then the high initial profits induce others to massively invest and jump into the same market, the original “innovator” has to shift into a stage of stiff cost and quality competition, and perhaps, if it can, into a new cycle of innovation and product innovation. As we discuss more below, typically the structure of market for a given product changes over time, with initial spot market relations shifting to contracts, and with consolidation and multinationalization in the buying and supplying sectors (even as there is a geographic de-concentration of consumption and production of the product).

Following are several examples of such cycles experienced by the world market in general and Central American exporters within it.

- Key fruit items illustrate the cycle. Using melons and mangoes as an example (see the ANNEX for a detailed illustration), the beginning of a cycle, perhaps lasting from several years to a decade, was from a niche product like a basic melon or mango, with few

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exporting competitors, and high profits in the late 1980s and early 1990s – shifting to a massive commodity market with many competitors, low profit per ton of the commodity product in the mid to late 1990s.

Starting in the mid 1990s, starting in fact with the “second round” of globalization, the melon and mango markets shifted to a mix of a commodity market dominated by large, low-cost players, plus a differentiated set of niche markets in different and even new melon and mango varieties plus value added products like juices, fresh-cuts, branding, and so on in the 2000s.

- **Beef**, important in exports of several countries in Central America, also illustrates the cycle. Its trade doubled over the globalization period, from 1980 to 2003, to $18 billion in 2003. This growth was far slower than cheaper meats displacing it in diets and trade: pork trade grew from a mere $66 million in 1980 to $4.8 billion in 2003; chicken trade quintupled to $8 billion in 2003. These trends are likely to continue. While beef trade did not grow fast, the number of competitors did, as did the diversity of types of beef on the market, including a swath of high-quality products (branded high quality beef, natural and organic beef, and so on). Central America’s share declined three fold (to a mere 0.7%) and exports declined twofold over the period. A number of large competitors took the field, made huge investments, and increased very rapidly their presence; for example, Brazil went from equal footing with Central America in 1980, to 8.3% of the world market in 2003. A number of small specialized competitors also took the field. Roughly comparable in size to Nicaragua, Uruguay for example tripled its beef exports and has made an important foray into “natural beef”.

- **Shrimp** illustrate the cycle. The world shrimp market is important to several countries in Central America (Nicaragua, Honduras, Guatemala), despite the shrimp virus problems that have beset production in those countries. The shrimp market is a classic case of a niche market that became a globalized, massive commodity market. Prices have fallen 15% over the 1990s past decade with increased supply, leading on the one hand to cost-based competition, and excess supply in the traditional markets, and the growth of new niche markets demanding quality, organization, and value-added. Exports reached $10 billion 2003, about half of which were from Asia (mainly Thailand, China, India, and Indonesia, with Vietnam coming up quickly), with smaller actors in Latin America and Europe. About half of shrimp imports are by the US and Japan, with other smaller importers mainly in Europe. 1.8 billion pounds of shrimp were produced in 1980, with very little of that in aquaculture, the rest via capture. By 2002, production had tripled to 4.2 billion pounds, of which 40% came from aquaculture (and 75% of that in Asia). Supply is starting to exceed demand in traditional markets (US, Europe, Japan). The emerging markets for shrimp are in Southeast Asia, China, and Latin America. The niche markets that are growing fastest include various forms of value added (into which the Asians are entering quickly, with substantial FDI from Japan in particular), including butterfly cuts, ring presentations, and coated shrimp. Moreover, niche markets are growing for organic aquaculture shrimp, specific species, and denomination of origin.
2.3. There is great variation over regions in the speed of growth of imports and exports.

A key point is that the “emerging market regions” will be the center of food trade opportunities (as importers) over the next several decades, and also as the home of Central America’s key competitors and possibly partners.

The two main trends are as follows.

First, there indeed was substantial growth in markets in the “traditional export target markets” for Central America of the US and Western Europe and Japan. Industrialized countries are still the main food importers in the world, accounting for 75% of food imports worldwide. This has been basically unchanged for the past two decades. In 2003, 63% of the 75% was from imports just from US, Western Europe, and Japan, with the rest of the developed countries making up the other 12%. Moreover, developed countries also dominate 72% of world food exports in 2003 (up from 69% in 1980).

Thus for Central America, the main market is still the developed countries, and in the short term the main potential growth market.

But that is changing now, and set to change a lot over the next decade. The growth in the industrialized country food markets has recently slowed as the markets become saturated. Food retail sales are only growing at 2% per year in upper income countries, growing as slow or slower than GDP. Moreover, every inch of these saturated markets is becoming extremely contested either on the basis of cost or quality or both. Each inch of gain in the mature markets will be fought for by top suppliers from around the world.

Second, by contrast, food markets are growing extremely fast in the emerging market regions of Asia, Latin America, and Central and Eastern Europe (CEE) – home to circa 1 billion middle class consumers (in an overall population of more than 4 billion). These emerging-market region food markets are growing on average FIVE times faster than those in the US and Western Europe. Food sales are growing at 7% in upper-middle income countries (like Republic of Korea, Czech Republic, Hungary, Poland, Argentina, Brazil, Chile, Mexico, South Africa); food sales are skyrocketing up at 28% a year in lower-middle income countries (such as China, Philippines, Thailand, Bulgaria, Russia, Colombia, most of North Africa and West Asia).

Moreover, their growth rates as importers – and exporters – are 50 to 100% greater than the developed countries, showing a basic shift emerging. For example, the CEE doubled, and Western Asia nearly doubled, their food imports over the past two decades, but most of that growth was in the past five years. Southeast Asia imported $5 billion in food in 1980, and tripled to 14 billion in 2003. Mexico imported 2.4 billion in 1980, and quadrupled to 8.4 billion in 2003.

The upshot is that the fastest growth, and thus the major new opportunities, in world food trade will be in the emerging markets over the next two decades. Central America’s export focus is not yet aligned with this opportunity.
2.4. During the two decades of globalization, but far more intensively in the past 5-10 years, the structure of world food markets is changing fast – with consolidation and multinationalization. A key trend is the rapid spread of supermarkets. This change works in favor of an expansion of trade.

The consolidation and multinationalization of the segments of the food industry (retail, processing, wholesale, food service) have been occurring for decades in industrialized countries, and in the past decade, have emerged rapidly in the emerging-market regions. This change in food industry structure is modernizing, integrating, deepening, and extending markets, creating recently and into the next decade massive new opportunities in particular in the emerging markets.

This change in the market structure is dual: consolidation and multinationalization of the agrifood industry. There is a very rapid spread of global and regional chains of supermarkets and food service firms (such as fast food chains) and large processing firms and attendant spread of specialized wholesalers and logistics firms. This is a crucial change – US food suppliers tell us that the single largest change-factor in the markets they face at home and abroad is the consolidation of these food industry actors. We discuss – why – these market changes affect suppliers, below, after an illustration from retail of the market changes.

As an illustration, and a leading change agent, we focus for a moment on how the retail sector is consolidating and multinationalizing rapidly in all Central America’s target markets.

On the one hand, supermarkets/hypermarkets have spread and then are consolidating rapidly in the “traditional target markets” of Central American exporters. In Western Europe and the U.S., the share of supermarkets went from 0% in 1920 to about 80% today - 70% in Japan. The top four chains in the UK now have 50% of the market, in Germany 55%, France and Spain, 60%. The share is only 35% in the US, although consolidation is expected to continue rapidly (in January 2006 there was a huge merger between two lead chains).

On the other hand, supermarkets are very quickly displacing traditional retail (the same traditional retail system that had reigned in the US and Western Europe in the past, small shops and open air wet-markets). The share of supermarkets (and hypermarkets, discount stores, convenience stores and other modern retail) in overall food retail went from 10-20% in South America in 1990 to 50-60% in 2004, from 10% to 40% in Mexico, from 0 to 30% in urban China, from 10% to 40-50% in Central and Eastern Europe and Southeast Asia. The “supermarket revolution” came quickly to emerging market regions especially from the mid 1990s to now, what we term in this document the “second round” (like in boxing!) of globalization.

Foreign direct investment is a crucial part of this story. (In fact we believe that policy liberalization of foreign direct investment has had a much greater effect on world food markets than has trade liberalization, its little brother. For example, supermarkets (mostly foreign owned or in joint ventures) inside Latin America currently buy twice as much fruits and vegetables from local farmers as local farmers export to the rest of the world!)
Foreign direct investment in the food industry has grown through push and pull forces. As the food market became “saturated” in Western Europe and the US in the 1990s, and growth was very slow, capital poured outward, mainly between Europe and the US and between Western Europe and US toward Mexico, the Mercosur countries, and Asia. The sales of US foreign-affiliates (sole or joint venture) in the food sector quadrupled from 1982 to 2000 (to 176 billion in 2000), twice as fast as food exports from the US rose. 40% of this is from US retailers abroad, 30% from US processors. US processing companies located in foreign countries sell five times more abroad than US companies export. FDI is even more important for European countries and companies. The retailer global giant Ahold (Netherlands) has $75 billion of sales, 84% foreign; Carrefour $93 billion, 48% foreign, Metro (Germany) with 70 billion, 47% foreign; Wal-mart, $293 billion, 21% foreign. In food processing/manufactures, Nestle has $70 billion, with nearly all foreign and most outside Europe; Kraft (US) has $32 billion in sales, of which 20% foreign.

Moreover, beside the above change in the structure of the food industry globally, there has been a rapid and recent transformation in how food industry firms source farm and processed products from producers. These changes are extremely important to local producers as well as exporters. Four key trends characterize this transformation.

The first sourcing trend is that food industry firms (such as supermarket chains) are extending the coverage of their procurement catchment areas. A given chain tends, as it grows, to start by sourcing locally store-by-store; as more stores are added, it sources in a given zone and builds a distribution center (DC); then it creates a national network and a few linked DCs; the next move is to source over several countries in a region (as Central American Retail Holding Company, CARHCO is starting to do, involving chains La Fragua and CSU), choosing suppliers over the region, and finally as the chain spreads over several regions or globally, the chain creates global sourcing networks. Hence, for example, Wal-mart sources avocados from Mexico for its stores in Mexico and its stores in China.

The opportunity from this trend is that if Central America exporters enter regional or global sourcing systems of supermarket chains (or large processing or food service chains). An recent example is the deal struck between the global chain Carrefour, the Brazilian government, and a set of fruit exporters. Carrefour is sourcing for their large operation in Brazil, but then also sending the products to its stores globally. Getting into the sourcing system means market growth locally and vastly facilitated trade relationships. This is the wave of the future.

The second sourcing trend is that food industry firms (such as supermarket chains) are shifting sourcing from traditional wholesale markets and brokers to “new-generation wholesalers” (Reardon et al. 2006) that are specialized in a product line and dedicated to one or two modern food industry segments. They then usually serve as the “channel captain” for a supermarket chain in a given domain. For example, Melissa’s World Produce in Los Angeles buys fruits and vegetables, sourcing about half from imports half from domestic sources, and then supplies supermarket chains and restaurants with a very wide range of fresh products, many of them specialized niche products and “exotics.” Half of their business is from Wal-mart, for whom they are the “channel captain” for specialty produce. They play that role for a number of other major chains. That means that an exporter from Central America wishing to sell to these chains may often find, depending on the product (larger basic commodities are often sourced direct from
suppliers) that they need to contact and work through Melissa’s or another new generation wholesaler like it. These wholesalers in turn are on the constant look-out for new produce items, high quality and fresh, to diversify the produce section of its clients. There are a number of similar firms in Western Europe (such as Fyffes, Mack Multiples, and others), and many emerging now in Latin America and Asia. An important implication is that these new-generation wholesalers become active “marketers” and “partners”, playing a service role supplier and buyer that is more like a combination of Research & Development Department, section manager, transaction manager, enforcer of private standards, filter/monitor, and eyes and ears of their client chains – beyond the “buy it and move it” or “move it on commission” role played by traditional brokers or freight forwarders.

The **opportunity** from this trend is that rather than only having the sector of traditional brokers in Rotterdam, Hong Kong, or Miami handling as just intermediaries in a spot market the flows of product coming in from Central America, there are now “marketing agents” working actively on behalf of food industry firms to set up supplier relationships, seek product differentiation and all-year sources, and screen potential suppliers in order to apply private standards. This “marketing” service can potentially help exporters seeking to grow market share and diversify. The other side of the coin is that these new actors become “gatekeepers” to the major new opportunities.

The third sourcing trend is that food industry firms (and their agents the new-generation wholesalers) are shifting (at different rates over different products and regions) from sourcing from spot markets, toward preferred supplier lists, sometimes even contracts. Suppliers are screened for their ability to meet the private standards (see below) of the retail or processor clients, and whether they can meet the volume and consistency requirements. It is obvious that this trend is both risk reducing and market developing and thus an **opportunity**, but also challenging to suppliers. More and more, spot market “doors” are being closed and these “managed relationships” are taking their place. If an exporter is prepared to meet the requirements, they are in; otherwise, the world of trade grows cold for them.

The fourth trend is the rapid emergence of private standards of quality and safety. These are either in place of missing public standards (usual in the case of quality) or what chains perceive to be inadequate public standards (in the case of food safety). The most visible case of private standards at present is the institution of EurepGAP for fresh produce to a set of major European retailers. The **opportunity** this represents is that the retailers are using these standards to differentiate product, reassure nervous consumers, communicate quality and safety, and thus “grow the market” for many products, and product origins. The challenge is that the standards are tougher than the public standards. No longer just meeting the public standards (say of the European Union or USDA or FDA) assures that an exporter will have a chance to sell to a major chain. They must in addition meet sets of additional standards (such as for production processes) or higher standards for existing regulations (such as pesticide residues).

In sum, the above changes are integrating and modernizing the target markets (shifting from spot markets to contract relations), allowing market growth, and product differentiation undreamed of two decades ago. These changes imply vast opportunity if one “gets in” to the regional and global procurement systems through being the chosen exporter or domestic supplier – but as with all in globalization, it is a knife edge, as we explore in the surprising challenges next.
2.5. Melons and Specialty Produce Examples

Given that half of Central America’s exports are fruits and vegetables, we focused on that category to provide in-depth illustrations of the above points. We chose melons and specialty produce. Melons represents the general category of export products that moved from mere niches (themselves specialties) in the first-generation of globalization, in the 1980s and early 1990s, to a broad cost-competed commodity by 2000, and into product differentiation and segmentation again under the second generation of globalization. The rural interface is mainly through labor demand and medium farms. Specialty produce represents a category of export that allows great differentiation and growth but requires important investments and flexibility. It also is a category that allows both labor demand and small farm and agroindustrial growth.

3. Export Market Challenges and Requirements

Fundamental challenges face Central America in taking advantage of the vast new opportunities. These challenges started a decade before CAFTA, and will continue to be the central challenges for the next decade. CAFTA magnifies somewhat the opportunities and makes more noticeable the challenges that globalization presented the region in the past 5-10 years.

3.1. Central America did well in what we call “round 1” (like boxing) of globalization, circa 1985-1995.

In “round 1”, markets had been recently opened, geographic closeness to growth markets (that used to be the US and Western Europe) meant first-entrant advantages; the new thirst for year-round produce supplies in those markets, coupled with shipping technologies, and several savvy moves in products like snowpeas, pineapples, and melons, put Central America in the “early success” ranks.

3.2. Central America did not stay there. Its position slipped sharply in “round two” of globalization and it has fallen sharply behind its (many) competitors in the race that started mid 1990s.

Central America increased its food exports over the globalization period (1980-2003), but only by a factor of 1.3 – and its share in global food exports suffered a spectacular decline – it HALVED - from 2 to 1%. Even in non-traditional exports like fruits and vegetables, where it had been an “early success” when the first round started, over the whole period (1980s to present), surprisingly, Central America actually increased its exports much more slowly then other emerging market region suppliers. Horticulture exports are Central America’s most successful trade rubric - increasing exports by a factor of 2.5 in the 1980-2003 period – but that was less than the increase of overall horticultural world trade. So Central America’s share in world produce trade dropped from 3 to 2.2%. The trade story for horticulture is to Central America what the story for soybeans is for the United States – one of watching competitors come from behind and race ahead.
While we observe a tendency in the region to focus on the huge competition that Mexico has recently offered on many products, the competition has actually come from many quarters, around the globe – a free for all bar-fight in the second boxing round of globalization. Central America’s export growth fell well behind a series of emerging heavyweights, some they perhaps expected (Chile, Mexico), some they perhaps expected less (China, India, Philippines, Poland, Vietnam, Thailand), and some somewhat surprising (the vast investments by producers in the target markets of the US and Western Europe). There have been, and will be more, cases of the new entrants taking over markets that Central Americans thought they had cornered (berries, frozen vegetables). More generally, the vast entry of top-flight competitors from around the world, coupled with improvements in shipping and packaging, meant that Central America simply lost most of its climatic and geographic advantage. It became part of the pack running in a market where formerly niche products became broad commodity markets competed hard first on costs and also on quality.

Examples of “many-categories” competitors with Central America in the horticulture domain, who raced ahead, include:

- **Mexico**, which increased 6.7 fold its horticulture exports, from EQUAL to Central America in 1980 – and even still in 1990 – to pull far ahead in the 1990s and 2000s to have twice Central America’s level of exports today; overall food exports were 1.3 billion in 1980, and quintupled to 6.3 billion in 2003.
- **Southeast Asia**, in particular Thailand, Indonesia, Malaysia, and Vietnam, which more than doubled their horticulture exports, keeping pace with Central America to be a major exporter today at the level of Mexico, and producing similar products to Central America and increasingly competing in the same markets; in overall food products, Southeast Asia exported 6 billion in food products in 1980, and nearly tripled to 15 billion in 2003.
- **China** started at the level of Southeast Asia’s exports, somewhat more than Mexico in 1990 (2.3 versus 1.5 billion) and then shot past both Southeast Asia and Mexico by 2003, quadrupling from 1980 to reach 5.5 billion today, with trends and plans to increase much more. Just as one example, China puts garlic – competitively – into wholesale markets in Central America and Mexico. That is merely the start of what will be a series of such products from China in Latin American markets, let alone in other Asian and in North American markets.
- **India** and various middle eastern/north African countries like Egypt and Morocco (who just entered a bilateral free trade agreement with the US) are similarly entering the ranks of “mega competitors” with Central America for both its traditional export markets as well as in the new emerging markets.

The rapid rise in exports makes sense in the light of the decrease of trade barriers by their main trade partners, their large investments in infrastructure and productive capacity such as the enormous port and road and railway investments in China, Thailand, Mexico, Chile, and South Africa in the past decade, and basic improvements in shipping and packaging technology that have since the mid 1980s greatly reduced transport costs for meats, seafood, and produce.

Below we will show that this general story extends into specific markets – that while Central America was if not alone, at least in a limited field of competitors, in its early success stories in
the late 1980s and early 1990s, the trade arena has changed vastly since then, and many strong competitors vie for every market in fluid and quickly changing food markets.

3.3. The Boxing Ring in the Second Round of Globalization – Fought Niche by Niche

Very different from the much slower and safer 1980s, by the 1990s and into the 2000s the second generation of globalization, nearly no product niche is “owned” by a country or region, everything has become fast paced, competed, changeable, geographic and climatic advantages disappear, and the global food market has become a fast-paced pitched battle. Just as food import growth in currently developed regions was matched by increases in food export prowess, so it is in the emerging markets.

A number of new products were introduced as novel “niche” products in the 1980s, but as trade barriers declined and transport and post harvest technologies improved, and massive FDI and domestic investments were made, there was very rapid entry of “food tigers” such as Chile, Mexico, China, Southeast Asia, South Africa, and now India. That avalanche of new suppliers moved many products (such as mangoes, melons, frozen vegetables) from niche to commodity products, with heavy price competition.

Examples of “specific ‘Central-American-high hopes’ categories” of competitive horticulture exporters include the following.

- While Guatemala is known for its export “boom” in snowpeas, Central America entered strongly in the 1990s but stayed with a minor presence as the market for fresh green peas increased 10-fold over the 1980-2003 period. Other competitors entered the field. China went from a third of Central America’s fresh pea (including snowpeas) exports in 1990 to about equal to Central America in 2003.

- The world mango trade increased nearly 20-fold from 1980 to 2003, from only $30 million in 1980 when it was a tiny niche product, a rare specialty in the US and Western European markets, to its development as a broad commodity product in the 1990s, moving from 108 to 385 million dollars, to a half billion in 2003. Despite this growth, Central America exports held steady; mangoes from Central America only became admissible into the US around 1994. By contrast, Mexico quintupled its exports over the period, as did India, Israel, Pakistan, Thailand, Yemen, and others, jumping very quickly and massively into the new market. Brazil went from 340 thousand to 75 million, jumping up to rival India. In most cases there were massive foreign direct investments (FDI), such as Dole in Brazil and Philippines and Thailand, Del Monte in Philippines, and so on. Although the natural seasonality of mango production limited Central America’s volume expansion, other locations facing the same limitation managed to multiply area planted and dominate their market window against the entry of other potential competitors.

- World frozen vegetable exports jumped 7-fold from 1980-2003, from $400 million to 2.6 billion. Central America (specifically Guatemala) entered very strong with circa 20 million per year of exports in the early to mid 1990s, as with competitors such as Mexico.
(an early recipient of US FDI in this) and Poland and Hungary. However, by the late 1990s and early 2000s these competitors, along with China, had pulled far ahead, with Guatemala down to about 1 million in 2003, and China up to 350 million, Mexico to 180 million, Poland at 148 million. While most developed countries did not work in this rubric, France increased sixfold to 180 million, and invested heavily in Poland and Hungary. The US invested heavily in Mexico, and Japan and Singapore in China.

- World raspberry exports quintupled over the period, and tripled just over the 1990s. Central America entered but then edged down and nearly out of the market, while Chile entered, doubled its production over the 1990s, and attained a fifth of the world market today.

3.4. Specific Challenges and Requirements

While there are many more opportunities now than in the earlier heyday in the late 1980s and early 1990s of strategizing for export success, a key point is that the challenges have emerged apace, and demand a new strategy for Central America to grasp the trade opportunities in the “second round” of globalization.

3.4.1. A first key challenge that this competition presents is sharp competition on cost, from competitors now around the globe, for the traditional target markets and certainly for the emerging markets.

The broadening of the sourcing catchment area of procurement systems of food industry firms (into regional and global procurement systems) discussed above, combined with sharp decreases in transport costs and sharp increases in product packaging and storage/preservation technologies, means that Central American exporters have increasingly to compete on cost (before anything else) with suppliers around the globe who are now linked in a “free-for-all brawl.”

The combination of low labor costs and efficient market and transport systems and infrastructure is making Asian producers formidable competitors in all markets, especially in the Pacific Rim. Central America’s production costs are often higher, and due to extreme (relative) under-investment in the infrastructure of trade, its transaction costs to move product are much higher. Its cost competitiveness is slipping quickly, even for nearby markets, let alone in the markets where the action will be increasingly, in the emerging markets. Competing on costs means large investments.

3.4.2. A second key challenge is that competing on cost is now merely necessary but not sufficient. There is sharp, and rapidly increasing, competition on quality.

The increase in public regulations and standards in the world market is by now a very well known story, with great attention now paid to the WTO SPS provisions and FDA and USDA standards, among others. However, public standards for quality and particularly safety are merely the “lower bound” of market requirement that will increasingly face Central American exporters. Above we discussed the rapid emergence of demanding private standards that are
“raising the bar” for quality and safety. The best known example of this in fresh produce is the EurepGAP standards enforced by a number of principal retailers in Europe. Such standards are spreading in the US market as well, and emerging in the Asian and parts of the South American markets. The challenge for exporters is that meeting public standards is becoming merely “necessary but not sufficient” and the more demanding private standards will mean significantly higher requirements. Practices that are now considered “special investments” such as integrated pest management in orchards will become merely standard practice for all fruit exporters – who are still in the market. Competing on quality means large investments.

3.4.3. A third key challenge is that competing on cost and quality now requires competing on market organization.

Competitive suppliers globally are forming networks across countries, joint ventures, alliances, grabbing key positions as channel captains and preferred suppliers for regional and global multinationals that increasingly dominate food trade. Competing on organization, to be in those partnerships, means large investments.

Suppliers to supermarket chains (and large processors and food service companies, as well as specialized wholesalers) internationally are innovating organizationally to capture these markets. Adding to the giant wave of FDI by retailers and processors and eventually wholesalers internationally, in the past few years, and building momentum fast, is a huge stampede of exporters/suppliers building international networks, strategic alliances, and joint ventures in order to compete in the global and regional procurement networks of the retailers and processors and food service firms. It is essential that Central American firms and associations place a high priority on becoming involved in these new arrangements, as the latter are starting to dominate trade in many rubrics. Here are some examples of the “cutting edge” in this domain.

A number of key produce exporters are recently entering strategic alliances with the main specialized wholesalers to gain access to the latter’s distribution networks and often also their brands recognized and trusted by consumers; for example, Zespri (New Zealand) in alliance with the Oppenheimer Group (Canada) for the North American retail market, Uniban SA (Colombia) with Fyffes (Ireland) for the US market, and so on.

Producers are forming horizontal alliances to have year-round supply of perishables. Examples include “Global Berry Farms” (www.naturipe.com) with the office in Florida, the marketing company for a joint venture among Hortifruit of Chile, Michigan Blueberry Growers Marketing, and Naturipe of California. They now have a marketing alliance in Spain for accessing the European market, through a new Spanish partner. A competitor has also organized such a multi-actor network/alliance: Driscoll’s (www.driscoll.com), the largest strawberry producer in the US, is in alliance with the Kentish Group in the UK, in turn in alliance with VitalBerry of Chile, and they are together investing in Argentina and South Africa, and together accessing retail distribution networks in Europe and the U.S. Moreover, Sunkist, the largest citrus cooperative in the world, based in California, has entered an alliance with a company in South Africa to supply the Asian market. The list goes on and on, and most of the dates for these alliances start in the past three years…
Large retail chains are also entering alliances with producers, a cross between simply listing the supplier as a “preferred supplier” and being in a proper alliance where planning and investment is done jointly. An example is Carrefour in alliance with Qingdao Binhua Industry Co. Ltd a major fruit processor in China (www.binhua.cn).

A crucial development is that major produce exporters are entering into alliance with seed companies in order to diversify varieties to create niches on the world and domestic markets. An example is the new (March 2005) joint venture between Syngenta Seeds and Tanimura & Antle Inc. (a major produce company in California); they bred a new variety of seedless, personal-sized watermelon and will supply 5000 supermarkets with it at the time of our writing. Entering such alliances would provide Central Americans with “niche creation” power in the international market.

3.4.4. **A fourth key challenge for Central America beside competing with cost, quality and market organization is competing on volume.**

Those countries winning the raise in joining global supply networks have the capacity to respond with enough volume of homogenous quality for hundreds of stores. This has been a major disadvantage for Central America’s often failed trials to attract direct business with large supermarket chains and processors. The capacity to produce volume by dozens of container loads is aggravated by the difficulty of consolidating product over Central American countries. Distances in the region are relatively short, but borders across the region still shut down in the evening and reopen the next day, creating major disadvantages for companies to move cargo fast and efficiently. Such factors discourage the establishment of regional production and packing centers as part of larger, complex and functional puzzles of global networks. Mexico or Brazil do not have that problem across their provinces. CAFTA provisions promise to solve the logistics gridlock across Central America’s borders through universal customs procedures, more efficient institutions and 24/7 operation schedules. These measures will make shipping port-isolated areas such as vast production lands in Nicaragua become more attractive for investment.

3.4.5. **The final challenge is that the landscape is constantly changing, with change many times faster today than in the heyday of non-traditional exports of Central America in the “first round.”**

The premium is on speed and flexibility, new products, new packaging, new processing technologies, spotting value added opportunities and leaping on them, spotting vacancies in networks and joining, and keeping up with the food industry firms’ demands that constantly change and increase as they pursue their own white-hot competition. These changes require new strategies.
4) Strategic Approaches to Building “Customized Competitiveness”: Illustrations from Foreign Experiences

This section mainly focuses (per the terms of reference for the paper) on illustrations from foreign countries. We focus on examples mainly from emerging markets regions (with some exceptions) that have addressed the issue, de facto, of customized competitiveness, building the latter on a foundation of solid investment in structural competitiveness.

Structural competitiveness investments (on which we dwell little here, as they are treated by another paper in the conference) involve elements normally considered in competitiveness strategic thinking as “basic” – including hard infrastructure (roads, ports) and soft infrastructure (contract enforcement institutions, fair commercial practices codes, and so on) and building of human capital through rural education and research/extension. These basic investments are essential for reducing costs and increasing the participation of small producers and maximizing rural development. This basic investment is needed to broaden the base of rural producers in exports and also to cut costs and help flexibility in response to changing trade opportunities. Note however that this investment is needed to even “stay in the ring”… the competitors are already making more of this investment, faster, so running to catch up is in order.

It is also very important to put in place new strategies for what we call “customized competitiveness.”

This involves government and private sector association investments in building various kinds of capital needed to meet the challenges noted above. We discuss these investments in various categories of “capital” formed by innovative programs in other regions where countries are pursuing this competitiveness.

4.1. It is critical to build “Market intelligence capital” to understand the rapidly changing opportunities and requirements of the market. This extends from information into facilitating face-to-face communication between buyers and suppliers.

This is the most strategic and difficult to access asset for the producer, but is the linchpin of "customizing" competitiveness. Information on prices and on current imports of countries of various products is information that is (based on the arguments in this paper) necessary but very far from sufficient to know where the market opportunities are developing and what the market requirements are likely to be. Examples of ways to build the “sufficient” information are the following.

Government and private-sector “market intelligence” about the needs and requirements of supermarket chains and processors both locally and internationally is crucial. Examples of the “institutionalization” of this pursuit include: (1) La Fundacion Chile, which provides a wide variety of strategic market information as well as undertakes supplier development projects, both for export markets and for local dynamic markets such as supermarket chains (www.fundacionchile.cl and www.agroeconomic.cl); and (2) ASERCA (the Mexican market promotion service of the Secretariat of Agriculture), which undertakes market intelligence and promotion activities for export markets, including for example requirements and needs of
supermarket chains in Asia, the US and Europe, and of the domestic market retailers and processors, with specific information as to private standards and types of products demanded. The Australians have had, for the past several years, a government program called “Supermarkets to Asia” (www.supermarkettoasia.com.au) designed to gather and disseminate detailed information about modern food industry segment opportunities for Australian investments and exports to Asia’s supermarket chains and processors.

Reverse trade missions are crucial to know the details of the buyer’s perspective and to reduce the perception of supplier risk by the buyer. An example is the Mexican government’s continuously inviting missions of supermarkets from the US to Mexico to visit suppliers and explain their specific needs, over the past three years (Direct Buying Programs; see www.mexbest.com.mx), or trade missions to supermarket shows in Europe or US or Mexico by Mexican suppliers.

General and periodic regional and country-level trade conventions among foreign and regional buyers such as supermarket chains, exporters and local suppliers are another useful instrument.

Ad hoc meetings among local supermarket chains, local suppliers and local governments to understand local supermarket needs are useful. An example is the program “Fabricas do Agricultor” by the Brazilian government, the World Bank, and the Government of the State of Paraná facilitating three way meetings for promotion of small scale processed food manufacturers, as described by Mauricio del Grossi and Jose Graziano da Silva4.

Regular "supplier summits" between a supermarket chain and its suppliers are useful to allow suppliers to meet supermarket needs and gain customized competitiveness in the supermarket chain’s regionalized or globalized procurement system. An example is the “supplier summit” meetings of the global chain Ahold with its suppliers, as for example Ahold undertook with its vegetable suppliers in Thailand, as described by David Boselie5.

4.2. It is crucial to build market-social/organizational capital, which involves linkages among supermarket chains and exporters or local producers, for example facilitated by government.

As noted above, it is crucial that Central America vigorously explore means of entering into networks, strategic alliances, and joint ventures. It is through these arrangements that issues of seasonality and critical mass as well as product diversity (one stop shopping) are being resolved by the leading exporters internationally. The competitors (who may also then be the partners) of Central America – the Southeast Asians, the Chinese, the Mexicans, the Brazilians, various Europeans, various US and Canadian and New Zealand and Australian companies, often the


leaders, are rushing – stampeding – into these arrangements starting very recently and accelerating greatly at present. While one can paint “potential markets” in terms of identifying particular products, that is really not “the future.” Products come and go as market opportunities, moving quickly through their cycle as profitable early niche, transition to broad commodity, then differentiation into niches again along with value added and new varieties.

The key is to position producers in Central America to be in partnerships where they are positioned in the product corridors and networks that grasp these new opportunities and move flexibly to meet them. This will also then serve as a conduit and an incentive for FDI from foreign suppliers.

For example, a produce cooperative in Michigan, North Bay Produce Inc., entered joint ventures with Peruvians and Argentines and immediately began investing heavily in upgrading facilities among their partner farms in those countries. Or, just appearing in the news today, February 7, 2006, one of the three largest produce wholesaler in Europe (Fyffes) just purchased a controlling interest in the largest melon producer/exporter in Brazil (Nolem) to work as a joint venture in marketing into Europe.

Governments can facilitate alliances with retailers to spur exports. In 2004 a linkage agreement was established between Carrefour, the Brazilian Export Promotion Agency (APEX) Development, and the Brazilian Industry and Trade Ministry for Carrefour to promote Brazilian fruit first in its European stores and then in its stores in Asia and the Americas. In 2005, Metro (German global chain) entered into similar arrangements in India and Vietnam, and Wal-mart is discussing a similar arrangement in India. The Malaysian government has a program called the Federal Agricultural Marketing Authority (FAMA) which arranges linkages between local suppliers and foreign hypermarket chains (as well as domestic supermarket chains) in Malaysia, to supply them locally as well as to enter regional and global procurement systems of these chains.

Governments can promote local linkages with processors and farmers that help farms upgrade both for the modern domestic market but also then for export. In 2004, the Chilean INDAP (the government agricultural and rural development agency), set up a four-way linkage agreement between INDAP, the Chilean Processors Federation, the Supermarket Association, and the Berry Producers Association, to work out market agreements and facilitate upgrading specific to the private standards and other product requirements of the buyers. Similar accords are beginning to emerge in other countries. In 2004 for example, the Government of Mexico State in Mexico facilitated a linkage between a small farmer organization and a major Mexican supermarket chain, and provided technical assistance.

Governments need to think hard about the role of “new generation cooperatives” and other farmers association and how to design new programs to assist them in new markets. In particular for small and medium producers, groups or associations are crucial for reducing the transaction costs for retailers and processors of dealing with multiple suppliers in a coordinated fashion.
Julio Berdegué⁶ for Chile found, however, that forming small-farmer organizations (for export and for modern markets locally) is “necessary but not sufficient”; groups and clusters are often needed to attain critical mass of volume and economies of agglomeration to enter a market – but a series of key management and organizational investments are needed by groups, and a continuous and flexible upgrading and adaptation to the needs of specific clientele, to stay in the market and prosper. Many do not make the grade or stay in a dynamic market niche – but for those who do take the needed steps, the payoffs can be indeed quite high, as a recent study shows for the case of a meat producers’ cooperative in Costa Rica.

Governments and private sector associations are working to build “country brand images” and at the same time induce generalized upgrading by instituting broad private standards and codes. Examples of these are ChileGap, MexGap, and MalayGap, all similar to and meshed with EurepGap discussed above. These measures are complemented by quality seals that promote the export products, such as MexBest and Mexico Calidad Suprema. Some countries, such as Argentina in the dairy sector, are experimenting with working to have their public standards converge, at least partially, with the more demanding private standards, gradually, in stages. The goal is to have more and more farmers upgrade so that the ranks of exporters (and successful small farms and firms) can expand. At issue of course is that raising standards means exclusion of those without the means to invest – the crucial dilemma facing governments.

One of the toughest issues and challenges is to figure out how to promote the development of local “tiger” companies that attract joint ventures and alliances, because they are large and strong enough to be attractive, and at the same time find ways to “include” medium and small firms and farms. Every country is now struggling with this issue. Government budgets are limited and it is expensive to help some farms or firms upgrade to enter the export market struggle, and there are tradeoffs with using the same funds to help many smaller firms in the local market. Finding complementary approaches are now at a premium, and innovation is needed. CEPAL for example had a conference in October 2003 to discuss how Latin America might field large “conglomerates” (like Bimbo or Sadia) to compete with large foreign firms in the international markets. China is focused on this issue now also, seeking to acquire foreign firms to build such giants. At a smaller scale, governments are wrestling with how to equip “lead firms” that can spearhead reputation and technological upgrading and thus help the country’s “brand image” and also attract further investment. The Chinese have a program called “Dragon Head Companies” that are given preferential credit arrangements and are expected to become lead competitors, including exporters, in their fields, and draw along local smaller firms in cluster arrangements.

4.3. It is crucial to build technology capital toward supplier upgrading (for example to meet the tough new private standards like EurepGAP).

There are several recent innovative public and private and public-private programs being put in place to help producers, in particular small/medium producers, as well as other actors in the

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agrifood system such as wholesalers, have specific technical knowledge for the supermarket chain's needs:

In Indonesia, the private sector, a farmers’ association, and government have created an innovative five-way linkage, with global retailer Carrefour (France), the specialized wholesaler Bimandiri, a small melon-producer association Makar Buah, the seed/credit purveyor Syngenta, and the Indonesian Ministry of Agriculture’s new extension unit to assist technically such arrangements. The specific variety of melons earns farmers much more than the traditional variety, and producing these to Carrefour’s specifications opens up a significant urban Indonesian market niche and a substantial market niche in Southeast Asia and elsewhere via Carrefour.

In Mexico, in March 2004, SAGARPA (the secretariat of agriculture) signed an accord with the supermarket association ANTAD and the Economics Ministry (in particular the small business administration) to promote local supermarkets’ sourcing from local suppliers, and to identify specific upgrading of the latter needed to meet the chains’ requirements. There has so far been an innovative activity of linkage with the Monterrey Tec (technical university) and small/medium producer groups. In January 2005 CNC (The National Peasant Federation) and ANTAD (the Retail Association representing most of the Mexican chains) signed accords expressing the intention of increasing sales of Mexican small/medium producers to supermarkets in Mexico. In December 2004 CNC and Wal-mart did the same (www.agricultura.com.mx, 2004) It appears that the specific modalities of the implementation of all three of these accords will be worked out in the coming year. The goals of technology upgrading of suppliers coupled with specific market identification and increased finance for the upgrading were expressed on all sides. Even these general accords are a significant innovation in the way that developing region governments are approaching the new issue of facilitating “customized competitiveness” of local producers through public-private partnerships.

Retailers themselves are taking significant innovative steps to build technical expertise among producers and wholesalers. For example, the produce buying arm of the CSU Supermarkets in Costa Rica (and in Nicaragua and Honduras) extends technical assistance to farmers in its preferred supplier list. In both Vietnam and India, global retailer Metro (Germany) has signed memoranda with the governments to provide technical assistance for the upgrading of the distribution network, with technology transfer to both the pertinent ministries, and farmers and wholesalers.

Governments can also promote linkages between input companies and farmers to help develop exports. Malaysia’s FAMA set up an “International Tropical Fruits Network”; they are using that as a basis to build alliances that are like the strategic alliances we discuss above. For example, in October 2004, FAMA signed a Memorandum of Understanding between the global Syngenta Crop Protection Company and the Network to assist Malaysian fruit growers increase access to European markets to help the farmers move quickly to EurepGAP certification (www.agrolink.moa.my).
4.4. It is crucial to build risk-reduction measures and financial capital as working capital and investment capital for upgrading.

Reduction of the market-risk faced by retailers coupled with increase in access to financial capital (as working capital and for investments in equipment and other physical capital upgrading) are crucial final elements of “customized competitiveness” for suppliers. There are several recent innovations with respect to these in terms of local supermarkets-local suppliers.

Retailers and their specialized/dedicated wholesalers are themselves intermediating between commercial banks and suppliers to solve problems of credit access by providing the equivalent of a “collateral substitute” for small and medium farmers – by proffering a de facto contract as evidence that that suppliers will be able to repay the loans. An example (for certain products and circumstances) is Metro in Croatia, and Gigante in Mexico.

Governments are moving to provide similar guarantees so that small/medium farmers can get access to commercial bank loans to upgrade to sell to supermarkets. Again, the case of the innovative actions of the Mexican government to facilitate “direct commerce” between suppliers and supermarkets in Mexico is interesting. Firstly, SAGARPA is extending the existing “factoring service” - where a supplier gets immediate cash instead of having to weather the “waiting period” for payment, in return for a share of the invoice paid to the factoring service (public in this case) or company - from the domain only of exports to the domestic market in particular for sales to supermarkets (see www.mexbest.com.mx). Secondly, as part of the SAGARPA initiatives discussed above, the Mexican government is working to bring in the Financiera Rural (which replaced the BANRURAL (Banco Nacional de Crédito Rural) in June 2003) to pay small farmers immediately and then invoice the local supermarket chains. Thirdly, the CNA (the Consejo Nacional Agropecuario) and SAGARPA are developing a project to institute a type of credit-worthiness evaluation service similar to the Blue Book www.bluebookproco.com or the Red Book (www.rbcs.com) services found in the U.S. The objective is to demonstrate the credit worthiness of domestic suppliers to domestic and foreign supermarkets in order to show reduce the perception of risk on the part of the supermarket chains in sourcing from local producers and producer groups.

5. Conclusions

As we end this paper, thinking back over the points of the paper, we are frankly very worried about the situation in which Central America finds itself. It is a region with one of the highest poverty rates and lowest education rates. Much of its rural population has been neglected or worse for centuries. Its investments in basic infrastructure are so far behind its competitors in Asia that its basic transaction costs are much higher.

Not much of that mattered very much strictly from the point of view of export competitiveness (our assigned theme) – say, 15-20 years ago, at the start of the non-traditional export boom. In that “first round” of globalization, one often heard talk in Central America about its having a “natural comparative advantage” with its “proximity to the US market” and its “excellent climate”. Just being able to get melons or snowpeas off season into the US or Western Europe meant quick success, as there were few competitors, cost and quality and safety were not yet
competed on in the extreme fierce battles of today, and frankly, there were few real competitors in the tropical or sub-tropical climes: Mexico was neck-and-neck with Central America, China and Southeast Asia were still years from entering the markets substantially, India was marginal, Chile was just awakening.

But that was then, and this is now… Now Central America is in a vastly different global trade setting, in the “second round” of globalization. The non-traditional export product markets in the “natural market” (as it has become common to say…) of the US are now relatively saturated and each new “window of opportunity”, in niche quality markets, is highly contested by a host of world-class competitors in the US and Europe, and in Chile, Brazil, Mexico, Peru, China, Southeast Asia, the near east, North Africa, India, the list is stunning. Central America’s position in trade dropped by half in the past decade relative to these others, its exports growing much more slowly. The relentless “product cycle” marched along turning what were safe, dependable, and easily defensible product niches in produce markets for example, into first mass commodity markets and then sophisticated differentiated product markets. The nature of the market changed too, with massive consolidation in the food industry in the “traditional markets” of US and Europe and now even in the emerging markets. CAFTA comes in the midst of this “second round”, not really changing much the export terms, and changing them only for the US market, which is growing very slowly and every inch is fought over from around the world.

It is fair to say that with this second round of globalization also comes massive opportunities, with access nearly suddenly to the massive middle class market of the emerging market regions, with new-generation wholesalers and supermarkets around the globe to market aggressively and intelligently the rich diversity of products of Central America. The only catch is that Central America must not only catch up with competitors on basic “structural competitiveness” while attending to massive poverty problems, but it must keep pace with the “tigers” competing with it for the non-traditional export markets. That is a very tall order indeed. CAFTA helps immediately in its provisions regarding harmonization of investment and customs union. Those are steps forward, at the very least because Central America will need to cut logistics costs, cut investment uncertainty, and improve chances of bulking product to reach volume, just to stay in the global game. We have offered here some illustrations of what other countries – actually, let us be frank, major competitors – are doing to “customize” their competitiveness to refine their export readiness and market penetration. It is like sharpening a sword.

We are conscious, however, that there will be diverse reactions by the reader to reading about these measures taken by the competing export tigers.

The “old timers” will correctly be saying – “wait, we have had some of these kinds of programs over the years in Central America, what is new in what these authors are saying?”. We admit that that is partly correct. There were successful programs, like PROEXAG, and elements of these, incorporated into public policy and private action, will be needed.

The “business linkage donor program managers” will correctly be saying – “wait, we have some of these kinds of programs in place right now.” We admit that this is partly correct. The problem is that most donor programs are probably spending 5-8 times more per farmer than the local
governments are spending, so there will be major challenges in up-scaling these programs so that they fundamentally change regional competitiveness.

The “national governments” will correctly be saying – “hey, wait, we do not have the resources, even near, of China, Mexico, Brazil, Chile, and we simply cannot afford to put customized, let alone basic, competitiveness programs into place.” We admit that this worries us a lot. It is clearly going to be necessary to pursue many of the generic lines of the customized competitiveness programs undertaken by competing countries, but figure out cheap and locally adapted ways of doing it. And if the region wants to not slip further in trade, dig deeper for more resources for agriculture, markets, and infrastructure.

The “donors, in particular the Inter-American Development Bank or the World Bank” will correctly be saying “Hmmm, many of these customized competitiveness measures are plainly important and needed, but many look like “private goods”, helping one group of suppliers and/or one or two major buyers, but not acting as public goods accessible by any and all farmers, and thus do not fit the profile of our investments.” Fair enough. The dilemma, however, is that it appears that in order to render truly profitable and successful over the long term the public investments, some set of customized competitiveness measures will be needed. Build a road to berry producers who then do not have a food safety program in place, and the berries go unsold on the world market, and the return to the road is low. The art will be in constructing public-private mixes and alliances that allow public goods to be designed in a way that increases market access by small producers but does so in a way that helps farmers gear up for demanding markets. This may involve not just physical investments (like cold chains) but regulatory and institutional investments.

And the “agribusiness leaders” will be recognizing the reality of the challenges we describe, agreeing that there need to be more small producers involved to allow volumes to be scaled up, but be justifiably impatient at the probably lengthy sequence of steps needed to “move the situation along” and be wondering what the shortcuts may be. We admit that a minority of actors - the most capable farmers and firms - are already well-positioned to enter alliances and joint ventures even in the difficult second-round situation.

In fact, the success of these private sector leaders is crucial to build reputation and pave the way for others; that is the essence of the Chinese policy of supporting “dragon head firms” (and it is these firms who sell Central Americans garlic, clothes, and soon, cars…). The issue is not whether Central American governments should help position potential “dragons” – who open the breach in the walls of emerging market regions’ commodity markets and developed market regions’ niche markets.

Rather, a key issue is plainly the balance of policies and investments to support the differentiated actors and markets we have discussed. That is, to make the investments in upgrading the segment of commercialized small producers who can share in the export markets, at least the early niche stages and the aggregating of product needed for some commodity markets, while facilitating the action of the stronger players in forming alliances with global players who “own” certain markets and penetrating new niche markets. That game of balance will be a challenge – but a necessary one. The approach may well have to be staged – so that in the short run a rapid set of
steps will be needed to focus on likely early successes, while incubating the following generation of players. The intermediate level players would do well to focus on emerging markets and the local regional market to build up quality and volume, as and end in itself, and as a stepping stone.

The medium- and long-term grasping of opportunities in global markets in the CAFTA era will depend in the end on a savvy, fast, and affordable set of measures put in place in the region to build the four kinds of capital for “customized competitiveness. The CAFTA regional measures, such as harmonization of investment rules and better logistics, are necessary but not sufficient. It is crucial to invest in market intelligence capital, social/organizational capital, technology-upgrading capital, and financial risk management and credit access measures. The world market now offers the incentives and challenges: now there must be a major acceleration of capacity to meet those challenges.
ANNEX

Product Cycles and Customized Competitiveness: Illustrations of Melons and Specialty Produce

We believe Central America has the potential to become a “tiger” in a number of products and product categories in the CAFTA era if constant innovation and market development investments by public and private sectors focus on customized competitiveness. The following review of product cycles of melons, avocados and specialty products help illustrate the examples.

One approach to success in taking advantage of what “specialty products” niches can be, is as a function of the early, middle and late stages of product development cycles. Evidence shows that a product cannot be permanently classified as a “niche” or as a “commodity” given a product tendency to transition from low volume in an early stage, to high volume in a mid stage, and then into a later stage of niche variations to complete the cycle. At each stage, opportunities and challenges are very different for exporters and public sector/donor support programs.

As an example, melons started in the US and Europe as an off-season niche market during the late 1970’s and early 1980’s, but throughout the 1990’s, trade grew from $420 to $870 million in 2003. Although marketing investments where high at the beginning to position the product in stores, suppliers succeeded in positioning melons as a popular off-season fruit, turning a niche product into a commodity where price competition is fierce. Later, this has motivated research and development of other varieties with different quality traits such as low-sugar, single-serve types, fresh-cut and lately 100%-juice based beverages, creating small niches away from the mainstream trade. With this example we also show that investment and actions vary according to the stage of the product. At first, yielding and adaptability studies in the field preceded further investments in trade missions promoting the product with wholesalers and advertisement at stores. At the mid stage, volumes transacted became massified, attracting other competitors and progressively competing on costs. In the last stage, differentiation from the commodity follows parallel to commodity business, and different kinds of investments are needed to market other varieties or value-added products in high-end stores and food service through specialized wholesalers.

Another approach is to consider what a popular product in one location is, can be exotic elsewhere. To illustrate this point, we take the example of Mexican, Californian and Chilean wholesalers promoting avocados as a specialty in the U.S. market for the past three decades (early stage), turning in it into a commodity (middle stage), and now promoting it in Asia where avocados are considered a specialty now (late stage). Even though avocados have been planted in the Indonesian archipelago for years, it is the initial investment in market promotion by Mexicans, Californians and Chileans what is creating the market momentum for avocados in that region, and it will take a few seasons before massive competition drives prices down, pushing suppliers to the next stage in product development.

Central America has followed a similar process in a number of specialty produce over the last two decades thanks to the support of agriculture diversification programs promoted by
government-donor programs. Medium to large private companies and multinationals have also participated in the first stage of niche market development (melons, mangoes, berries, pineapples) to the US and Western European markets. But with the exception of a number of successful hits (e.g. roots and tubers, podded peas, Chinese eggplants, baby vegetables), the last decade has shown a slower rate of success in new products to the US and Europe and very few or none to emerging markets in Southeast Asia or Eastern Europe.

In this second round of globalization, market innovation and product diversification cannot longer be managed separately. As in the case of avocados, product innovation has to be tightly linked to market information on what can be grown in the region that can be sold elsewhere.

Strategic implications

To ensure faster success, the job of developing a new niche product and carry it through the different stages of product development, as illustrated above, cannot be done by Central American companies on their own in the second round of globalization. Public and private sector support should concentrate on improving the enabling environment for exporters to attract the establishment of alliances between exporters and their best match partners. Retailer/wholesaler alliances bring with them the market shelves, which are the trial grounds to boost the first or third stage of product development, and the capacity to transact larger volumes for products in the second stage of product development.

Government-donor-private sector efforts must focus on customized competitiveness keeping in mind a categorization of supplier when pursuing alliances. For instance, the Brazilian Government helped melon exporters establish an alliance with Carrefour, the second largest retailer in the world, because they were large and organized enough to match this large retailer’s needs. On the other hand, small niche fruit and vegetable exporters could enter alliances with major retailers and new-generation wholesalers where diversification, volume needs are of a lower scale. And for those industries that may see their inclusion into global supply chains more difficult, like in the case of avocado sales to Asia, where Mexico, California, New Zealand and Chile, the opportunities to develop sub-alliances is worth exploring.