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Challenges of Financial System in Economic Development

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Abstract – Agriculture and industry have traditionally been viewed as two separate sectors both in terms of their characteristics and their role in economic growth. Agriculture has been considered the hallmark of the first stage of development, while the degree of industrialization has been taken to be the most relevant indicator of a country's progress along the development path. Moreover, the proper strategy for growth has often been conceived as one of a more or less gradual shift from agriculture to industry, with the onus on agriculture to finance the shift in the first stage.

This view, however, no longer appears to be appropriate. On the one hand, the role of agriculture in the process of development has been reappraised and re-valued from the point of view of its contribution to industrialization and its importance for harmonious development and political and economic stability. On the other hand, agriculture itself has become a form of industry, as technology, vertical integration, marketing and consumer preferences have evolved along lines that closely follow the profile of comparable industrial sectors, often of notable complexity and richness of variety and scope. This has meant that the deployment of resources in agriculture has become increasingly responsive to market forces and increasingly integrated in the network of industrial interdependencies.

Keywords: Agriculture, Market, Economy, Product

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INTRODUCTION

Agricultural products are shaped by technologies of growing complexity, and they incorporate the results of major research and development efforts as well as increasingly sophisticated individual and collective preferences regarding nutrition, health and the environment. While one can still distinguish the phase of production of raw materials from the processing and transformation phase, often this distinction is blurred by the complexity of technology and the extent of vertical integration: the industrialization of agriculture and development of agro processing industries is thus a joint process which is generating an entirely new type of industrial sector.

Agro-industry, i.e. the processing, preservation and preparation of agricultural production for intermediate and final consumption, performs a number of crucial functions that support development and poverty alleviation. Agriculture in connection with industry needs to be recognised by senior-level policy makers and industry leaders as a competitive, value-adding business sector that has a positive development impact and contributes to economic growth. Rather than focusing on agricultural productivity only, policy makers must consider the competitiveness of the entire agro-value chain. A comprehensive approach could include e.g. supporting small agro-producers and SMEs, enabling market access and developing a supportive institutional environment.

An agro-industry is an enterprise that processes raw materials, including ground and tree crops as well as livestock. The degree of processing can vary tremendously, ranging from the cleaning and grading of apples to the milling of rice, to the cooking, mixing, and chemical alteration that create a texturized vegetable food. ... agroindustries can be roughly categorized according to the degree the raw material is transformed. In general, capital investment, technological complexity, and managerial requirements increase in proportion with the degree of transformation.

Today, however, it is becoming even more difficult to provide a precise demarcation of what should be considered an agro-industrial activity: the impact of innovation processes and new technologies suggests a widening of the range of agro-industry inputs that could be considered, including biotechnological and synthetic products, for example. This implies that agro-industry today continues to process simple agricultural goods while also transforming highly

sophisticated industrial inputs that are often the result of considerable investments in research, technology and innovation. Corresponding to this growing complexity of inputs is an increasing range of transformation processes, characterized by physical and chemical alteration and aimed at improving the marketability of raw materials according to the final end use.

There are a number of ways of classifying agro-based industries. Broadly these are classified as food and non-food industries. The food industries are much more homogeneous and are easier to classify than the non-food industries since their products all have the same end use. Most preservation techniques, for example, are basically similar over a whole range of perishable food products, whether they are fruit, vegetables, milk, meat or fish. In fact, the processing of the more perishable food products is to a large extent for the purpose of preservation.

Non-food industries, in contrast to the food industries, have a wide variety of enduses. Almost all non-food agricultural products require a high degree of processing. Much more markedly than with the food industries, there is usually a definite sequence of operations, leading through various intermediate products before reaching the final product. Because of the value added at each of these successive stages of processing, the proportion of the total cost represented by the original raw material diminishes steadily. A further feature of the non-food industries is that many of them now increasingly use synthetics and other artificial substitutes (especially fibres) in combination with natural raw materials.

CHALLENGES OF FINANCIAL SYSTEM IN ECONOMIC DEVELOPMENT

Agriculture is an important sector in the Indian economy. Worldwide India ranks second in farm output. Agriculture and allied sectors like forestry and logging accounts for nearly 1/5th of the GDP. The sector employs 60% of the total workforce. Although the share of agriculture in GDP has been declining, it is still an important economic sector and plays a significant role in the economic development of India.

Theoretical and empirical studies of the structural changes that accompany the development process have revealed a number of constant patterns. The most basic is a secular decline in the relative weight of the agricultural sector vis-à-vis nonagriculture as per capita income increases. This relative decline is observed as a fall in the share of agriculture in value added, employment, trade and per capita consumption. This goes together with a drop in the share of primary agricultural production in the value of the final product, and with a parallel increase in the agro processing industry value added.

These observations have emanated the popular prescription that development necessarily involves a transfer of resources out of agriculture and that this is largely coterminous with industrial development. More recently, however, the development debate has increasingly focused on the far more relevant issue of whether and how the agricultural sector can be expected to make an optimum contribution to the overall process of economic growth. This question can be asked both regarding the size and functioning of the agricultural sector itself and regarding its links with the rest of the economy. More specifically, it can be argued that the development of agro-industry, for those countries with a comparative advantage in this sector, may contribute to achieving the proper balance between agriculture and industry.

A precise theoretical rationale for emphasizing the role of agro-industry during the process of development is provided by Hirschman's linkage hypothesis, which postulates that the best development path lies in selecting those activities where progress will induce further progress elsewhere. Thus, an activity that shows a high degree of interdependence, as measured by the proportion of output sold to or purchased from other industries, can provide a strong stimulus to economic growth. While the issue of linkages will be discussed in some detail later, the general observation can be made here that, because of its high degree of interdependence with forward and backward activities, agro-industry can play a very important role in accelerating economic activity.

Agro-industry plays a fundamental role in employment creation and income generation. Particularly the food and beverages processing sector remains important at all levels of economic development. This sector is a leading employer in many developed and developing countries. Taking only into account countries where data is available the ILO calculates global employment in the formal food and beverages sector at 22 million. However, one should bear in mind that in developing countries an estimated average of 60% of workers in food and beverages are employed in the informal economy. In addition to the direct employment effect, vibrant agro-industry is found to generate employment in downstream and upstream sectors such as agriculture, commerce and services.

Agro-industry can play a strategic role in pro-poor growth strategies, particularly in developing countries where 75% of the poor live in rural areas. As possibilities for income generation are restricted in rural areas, rural non-farm earnings from trading, agro-processing, manufacturing, commercial, and service activities constitute a significant part of household income. For developing countries as a whole, non-farm earnings account for 30 to 45% of rural household income. They complement agricultural wages and serve household risk diversification and the evening out of consumption patterns. With low capital requirements and undemanding local marketing channels the rural non-farm economy offers opportunities for poor

households particularly women, small-scale farmers and other smallholders, representing an important instrument for rural poverty alleviation. The development of agro-industry can also have an important impact on the local agricultural sector as well as the livelihoods of small holder farmers, provided they can produce on a stable basis, supplying regular quantity and quality.

An extended definition of the agro-processing sector which includes not only agroindustries but also distribution and trading activities, would roughly account for more than a third of the GDP in Indonesia, Chile, Brazil and Thailand, and between 20 and 25% in Sub-Saharan countries. The entire food system, including the production of primary goods and commodities, marketing and retailing, would account for more than 50% of developing countries GDP (based on World Bank, FAO and UNIDO databases).

DISCUSSION

Trends illustrate that there are large value-adding opportunities in agro-industry relative to agriculture. In low and middle income countries (see World Bank classification of developing countries according to income) the food processing sector is typically one of the largest industrial activities in terms of value-adding. Using the UNIDO Industrial Statistics Database 2005, agro-processing value added as a share of GDP amounts to 4.3% for low income countries and 5% for lower middle and upper middle income countries. This, however, neglects artisan production and the informal sector, which are particularly important in low income countries. We can therefore safely assume that the figures heavily underestimate the true extent of agro-industry's contribution to GDP in those countries.

Within manufacturing, the agro-processing sector occupies a significant position in overall turnover and value added in developing countries – though huge heterogeneity may exist among them. On average, productivity levels in food processing are above the manufacturing average, making it one of the more efficient economic sectors in least developed countries (classified according to the Human Development Index).

Strong synergies can exist between agro-industry, agriculture and poverty alleviation. Agro-industry provides capital and services to farmers (e.g. seeds and equipment, training, production and market information), promotes entrepreneurship, raises demand for agricultural products and connects farmers with markets through the handling, processing, marketing and distribution of agricultural products. As a result, productivity and quality of agricultural production, farm returns, and economic stability for rural households; food security and innovation throughout the value chain can be enhanced. Efficient agro-industry can therefore spur agricultural growth, and – accompanied by a strong link with smallholders – reduce rural poverty.

The development of rural agro-industries can play a major strategic role in stabilising and regenerating countries and in consolidating rural and regional development. It can do this by providing employment and supporting wealth creation and economic growth in a decentralized manner in areas that have been affected by internal conflicts, natural catastrophes or out-migration resulting from uneven regional development.

Developing agro-industry in such areas promotes a more balanced, decentralised growth within the country by generating productive employment alternatives. It thus not only reduces migration, especially of young unskilled labour into crowded cities, but it can even reverse migration trends by offering new employment opportunities in those affected areas, thereby alleviating social pressures and demands on public services within the city.

Developing countries have a natural comparative advantage in global markets in many agro-industry sectors. They have shown that they can be competitive in traditional tropical crops, but also in non-traditional exports and in components of the animal protein complex. Non-traditional food exports such as fruits, horticulture and fish products, as well as livestock products, have already become an important part of exports. However, due to protective trade regimes and distorted tariffs in developed countries, developing countries have been unable to increase their overall market share in world agricultural trade (including agricultural raw materials, fisheries, processed food, beverages and high-value products) since the 1980s.

CONCLUSION

Despite continuing barriers to trade, it is believed that developing countries can identify and explore export market opportunities by developing their agro-industry. The markets for organic, fair trade and origin products, for instance, are high-value outlets for agricultural products and demand from developed and some middle-income developing countries has been growing strongly over recent years. With the help of a competitive agro-industry that increases value-added and improves product safety and quality, the efficiency of technical processes and business practices, access to such potentially lucrative specialty markets would be facilitated. Crucial for successful integration into global agro-markets, however, are also issues such as adherence to standards, quality consistency, volume requirements and timely delivery.

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