



**No. 14 CONSIDERATIONS IN THE REFORM OF  
AGRICULTURAL TRADE POLICY in low income  
developing countries**

**SUMMARY**

- ▶ *Apparent contradictions between evidence supporting the case for further liberalization of agricultural trade and calls for more flexibility in the implementation of market access commitments pose difficulties for those concerned with the design of appropriate trade policy*
- ▶ *There are important questions regarding the efficacy of further trade liberalization for some products in some countries, and good reasons for re-examining the evidence upon which advice on further trade liberalization is often based*
- ▶ *The rationale for implementing protectionist trade policies in pursuit of food self-sufficiency objectives should not be confused with the rationale for using some level of border protection in pursuit of increased agricultural productivity levels in countries with underdeveloped agriculture sectors*
- ▶ *The diversity of country situations in terms of the structure of poverty, the importance of the agriculture sector in employment and income generation, and the level of agricultural market development, needs to be better recognized in debates about trade policy*
- ▶ *Trade policy is not an instrument for "correcting" domestic market imperfections, but trade policies can be an important component of a package of interventions needed to stimulate increases in agricultural productivity by providing a more stable longer term investment environment and/or by mitigating short term producer risks associated with surges in food imports.*

**Contradictions in trade policy debates**

Many developing countries are under pressure to reduce their trade barriers to the entry of agricultural products, both as a result of ongoing trade negotiations as well as due to policy advice from donors and international organizations. Much of this pressure is based on the notion that further agricultural trade liberalization is appropriate for all countries, regardless of their level of development or of their trading partners' trade policy stance.

Proponents of more liberal trade policies argue that with greater openness to trade, countries' economic sectors would be exposed to greater competitive pressures, promoting efficiency gains as resources freed-up from sectors that contract in the face of increased competition are redeployed to sectors where they would receive a higher return. This argument has been supported by an array of global trade simulation modelling approaches, many of which have generated substantial empirical evidence that countries gain from reducing their barriers to trade.<sup>1</sup>

However, debates relating to trade policy reform are also increasingly characterized by calls for flexibilities to allow developing countries

to retain some level of protection for some agricultural products.<sup>2</sup>

This seeming contradiction between, on the one hand, the "evidence" that fuller agricultural trade liberalization is the optimal strategy for developing countries, and on the other hand the calls for flexibility in the implementation of reforms to trade policies, could be dismissed as being a result of the mercantilist stance of trade negotiators, or as simply reflecting a debate regarding trade-offs between efficiency and non-efficiency objectives.

Whilst such dismissals may well be valid in considering the case of today's industrialized countries, or of developing countries with more competitive agricultural export sectors, or even of poorer developing countries where agriculture is not a significant component of national economic activity, there are important efficiency arguments for questioning whether further liberalization of trade in some agricultural products should be a key component of trade policy reform in countries with underdeveloped agriculture sectors.

<sup>1</sup> See FAO Trade Policy Technical Note No. 13 for a discussion of the results and insights from contemporary model based studies at [www.fao.org/trade/policy\\_en.asp](http://www.fao.org/trade/policy_en.asp).

<sup>2</sup> This is reflected both in the Doha mandate, which has provisions for Special Products and a Special Safeguard Mechanism that will form key components of modalities on Market Access, and in the wider literature (see FAO Trade Policy Technical Note No. 14, section 4 at [www.fao.org/trade/policy\\_en.asp](http://www.fao.org/trade/policy_en.asp)).

## **Neglect of agricultural development experience?**

A key difficulty with the current trade policy debate is that recent arguments in support of further liberalization have tended to be based on analytical studies which either fail to recognize, or which are unable to incorporate, insights from the agricultural development literature. As an example, a well established insight is that agricultural producers in many developing countries face widespread market failures which can significantly reduce their ability to generate investible surpluses from agricultural production, and to use these surpluses to facilitate diversification into higher value activities.

The process of agricultural commercialization and the associated diversification into higher value added activities in cases of successful agriculture-led growth has been observed to require significant government intervention at early stages of development to alleviate the pervasive nature of market failures as reflected in weak input and output markets, lack of seasonal financing, and limited availability of risk management instruments, combined with weak producer risk-bearing capacity.

However, whilst experience from episodes of agricultural growth suggests that government intervention is likely to be critical, there is still an unresolved question as to whether a less than liberal trade policy should be a component part of such intervention.

## **Too great a focus on export expansion?**

International debates on applied trade policy have tended to focus on promoting opportunities for increased exports to international markets, whilst playing down the potential role that trade policy could play in enhancing the competitiveness of the import competing products that are so important at earlier stages of development.

However, evidence suggests that agricultural export expansion alone has not necessarily provided a viable option for poverty reduction in many developing countries.

A difficulty with the current debate is that any questioning of the prominence of export-led growth tends to be associated with the promotion of protectionist food self sufficiency or food sovereignty strategies and their associated, perhaps reasonably in many circumstances, negative connotations. However, to cast the choice of trade strategy in these terms is overly simplistic.

Self-sufficiency vs. self reliance arguments for ensuring national level food security objectives often dominate in the agricultural trade policy debate. However, the fact that stimulating increases in the productivity of agricultural products can play an important role in driving agriculture led growth, particularly where the agriculture sector is dominant in terms of total

employment and income tends to be less fully discussed.

It is critically important that the debate does not confuse calls for protectionist policies, consistent with self sufficiency objectives, with calls for some level of trade protection in activities where there is scope for increasing productivity levels, which are currently uncompetitive in international markets, but which could become competitive after a period and could be undermined in the interim by more competitive imports.

In more advanced developing countries, often having relatively commercialized agricultural sectors, arguments for more protectionist agricultural trade policy regimes are generally made on the basis of national food security concerns (as defined by the level of food self-sufficiency), the need to maintain agricultural producers' incomes, and/or the provision of public goods.

By contrast, in poorer developing countries, where the agricultural sectors are less developed, but potentially more important in terms of contribution to the development and economic growth that underpins household level food security, the arguments for intervention are based more solidly on the existence of widespread market failures and the associated difficulties in inducing technological improvements to allow productivity increases.

## **Enhancing the role of agriculture**

A dynamic agricultural sector can make significant contributions to broader development, but the relative importance and nature of these contributions varies in different country situations. Where the agricultural sector accounts for a large proportion of GDP and an even larger proportion of employment, increasing agricultural productivity is essential first for capital investment in agriculture itself and then for the steady release of surplus capital and labour to other sectors of the economy

Countries that have achieved periods of sustained agricultural productivity growth have tended to lift the constraints to continued growth in a sequential manner, while at the same time intervening to secure the necessary favourable environment for the transformation of their agriculture sectors, rather than adopting a liberal policy stance from the start. During phases of border protection, instances of induced innovation have been observed, with productivity growth rates exceeding those that might have been achieved in more liberal environments.

For growth to be sustained, technology, resource use, institutions and markets need to be adapted to deal with successive bottlenecks or constraints affecting particular commodity systems. Agricultural trade policy needs to be consistent with this sequenced alleviation of the

constraints to increased productivity in order for the sector to fulfil its role.

### **Pros and cons of border protection**

Arguments against the use of border protection as a component part of a package to stimulate agricultural productivity growth include the impact of potentially higher food prices on the poor. But such arguments do not fully account for the fact that (a) the majority of the poor still reside in rural areas and that their incomes are in large part contingent upon agricultural activities, whether through sales or employment, (b) the level of food staple prices in rural areas affects different rural households in different ways, and (c) the major concern of poor urban households is employment income rather than the price of food products.

The diversity of country situations in terms of such factors is often ignored. Examples of agricultural success built on strategies of liberalization and export expansion such as the case of Chile, are often held out as lessons for others to follow. However, this fails to recognize that Chile is not typical of many developing countries, since both the share of agriculture in total employment and the share of agricultural exports in total merchandise exports are less than 20 percent, and agriculture's share of GDP is less than 10 percent.

In some cases of export-led growth there is also evidence that consolidation into larger farms has displaced the livelihoods of small producing households. The number of individuals absorbed into alternative employment is likely to be less than the number displaced. The impact on the distribution of income in a country such as Chile where the agriculture sector accounts for a relatively small proportion of employment, may be negative but is likely to be viewed as "insignificant". However, a negative outcome with respect to the distribution of gains and losses could be much more visible in countries with larger agricultural sectors.

The diversity of trade situations, production status, and roles of agriculture across developing countries suggests that a "one size fits all, trade liberalization/export expansion strategy" could well be inappropriate in a variety of contexts. But is a strategy that includes a policy of import substitution in agricultural food products sensible?

Many poorer countries are not yet at a stage where there is a viable domestic market for higher value products. Added to this are the facts that distortive OECD policies and imperfect global markets will continue to make the development of agricultural export markets difficult, that there is considerable potential for growth in the absolute value of domestic staple food markets in very poor countries, and that the import-competing food staple sectors are often where the majority of the rural poor operate, particularly in countries at lower levels of development. Then for many of these poorer

producers, domestic and regional food markets are likely to provide a more promising outlook in the short to medium term than international markets.

A challenge often used against the adoption of a less than fully liberal trade policy regime is that government interventions will be distortive and result in an inefficient use of resources. For countries that are now developed and/or middle income (and which generally supported their agricultural sectors during the critical stages of development), analytical evidence suggests that the reform of agricultural and trade policies would result in significant net welfare improvements as a result of increased efficiency in the allocation of resources.

However, this contention is less strongly grounded where governments are intervening to correct the pervasive market failures that are preventing required investments in activities in which the country would otherwise hold a comparative advantage.

### **A need for greater flexibility**

If there are arguments for a less than liberal trade policy stance, particularly as concerns production of import-competing food staples, how much flexibility do developing countries need to retain in trade negotiations to allow them to pursue such policies?

The distinction between different types of country is important. It is argued by some trade negotiators that it is imperative that policy flexibility is maintained for some categories of countries to allow them to support their agricultural sectors until they are at a level where (i) they are in a better position to compete with more competitive, or subsidized, imports, and (ii) the central, though transitory, role of agriculture in the economic development of these countries has been played out to a sufficient extent during the process of successful economic development.

Key arguments made *against* the provision of policy space are supported by some model based studies which suggest that even where countries are provided with the flexibility to continue to protect only a very small proportion of tariff lines, the gains from multilateral trade liberalization are all but wiped out. However, more recent model based analyses suggest that the global "losses" incurred by recourse to special product provisions by developing countries are likely to be minimal. Whether or not recourse to special product provisions would reduce potential *global* gains, their use has been agreed to on the basis that they will assist *individual* countries in achieving their development objectives by continuing to provide some level of protection for certain agricultural products.

Another argument made against the provision of such flexibility is that, particularly in the case of staple food production in rural areas,

producers may already be well “insulated” from competition from imports, with or without tariff protection, due to the wide gaps between import and export parity prices in producing areas as a result of high transportation costs.

Critical to stimulating greater volumes in rural markets is the alleviation of constraints contributing to such margins through, for example, improvements in rural infrastructure. However, infrastructural improvements could also allow greater penetration of competitive imports against which local producers may be unable to compete. As transport costs fall, some level of border protection may therefore be required to prevent surges in imports while domestic producers make investments in local production to take advantage of the reductions in transaction costs and risks.

In the context of current WTO debates, it has been argued that for most countries requiring policy space, the proposed agreements will not restrict their ability to implement required policies. Indeed, on the basis of (a) the fact that many (but importantly not all) countries have space between bound and applied tariffs, (b) that most developing countries do not come close to using their *de minimis* levels of domestic support, and (c) that least developed countries (LDCs) are anyway exempt from reduction commitments, many argue that a possible reduction in policy space as a result of a WTO agreement is a non issue.

However, being able to demonstrate that there will be no loss in policy space following an agreement is not the same as being able to state that the existing policy space is sufficient to allow appropriate, though currently unused, levels of support to the agriculture sector.

### Concluding remarks

There is a critical distinction to be made between state intervention *per se* and trade policy intervention. It is recognized that trade policy should not be used as the main instrument to “correct” market failures that are preventing productivity increases in agricultural production and/or investment into higher value activities.

However, for a defined period during which state interventions to promote productivity enhancing investments are being made, some level of border protection may be required for producers to be able to react positively to the incentives created by such interventions.

The question therefore becomes one of when (rather than if) countries should open their agriculture sectors to greater competition. Many arguments for, or against, further trade

liberalization essentially come down to the issue of sequencing.

The long term objective of a more liberal agricultural trade policy regime is *not* questioned. But this is because in the long run, markets (input, credit, output including adequate risk management instruments) are expected to function adequately, thus not necessitating government interventions over and above regulatory controls.

In the absence of such well functioning markets, and in conjunction with other targeted state interventions, a less than liberal trade policy regime may have a role to play in countries with underdeveloped agriculture sectors, much as it did in the now more advanced economies when they too were at earlier stages of development. When markets function adequately, it may then be appropriate to liberalize agricultural trade policy to release further agricultural growth potential.

In circumstances where the agriculture sector is still to play out its potential growth enhancing role, border protection can therefore have potentially important roles to play in complementing policies to assist the expansion of agricultural trade. This can be done in two broad ways:

First, by providing a more stable and remunerative investment environment for import competing commodity sectors in which the country does not necessarily presently hold a comparative advantage, and which could contract in the face of greater import competition, but which are critical to the development of agricultural and wider rural growth, and could become competitive in the medium run. Providing a better investment environment could promote levels of investment in productivity-enhancing technologies, generating surpluses and in turn enhancing international competitiveness, or allowing the diversification of resources into more “competitive” sectors. This is a *prima facie* case for a moderate level of protection (for example, through special product provisions) while such improvements in productivity are being achieved.

Second, by preventing short term disruption to domestic sectors which may otherwise be competitive, but which by virtue of susceptibility to risk in conjunction with limited access to risk management instruments and safety nets, could suffer from exposure to low-cost, often subsidized, imports and associated price instability. This provides a case for a variable level of border protection (e.g. through access to a Special Safeguard Mechanism).