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Articulating appropriate agricultural trade policy - Synthesis of the country case studies

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1. Introduction

This chapter uses observations from the five case study countries to motivate a discussion of potential improvements that could be made to processes of articulating appropriate agricultural trade policy and to pose questions to guide policy makers through this process.

Five key themes are first compared across the case study countries, including the choice of development strategy and resulting implications for the aggregate taxation of the sector, the debates relating to export led development as opposed to import substitution, and the importance of regional trade agreements in shaping national level trade policy. In addition to raising a series of issues that need to be considered in the articulation of trade policy regimes and associated policy instruments, the review highlights the importance of balancing the views of different stakeholders and of taking a more holistic value chain approach to policy formulation.

The issues are then examined in more detail in the context of ongoing debates relevant to agricultural trade policy, with the aim of generating insights useful in guiding processes of trade policy articulation.

2. Synthesis of key trade policy issues in the case study countries

This section provides a comparative assessment of the case study findings on five key policy issues which are examined in each of the country case studies:

1. Evolutions in trade policy regimes and aggregate taxation.
2. Trade and related policy in support of exportables.
3. Trade and related policy in support of import-competing food staples.
4. The implications of regional trade agreements.
5. The link between domestic support to the agriculture sector and trade policy regimes.

For each of the issues, the main similarities and differences across the case study countries are briefly examined. The assessment is then drawn upon in the succeeding section to develop insights and recommendations for the improved articulation of appropriate agricultural trade policies.

2.1 Evolutions in trade policy regimes and aggregate taxation

The five countries have all followed similar patterns of significantly reducing the level of aggregate taxation of their agricultural sectors as they moved from the restrictive policy regimes of the 1970s and 1980s towards more market oriented, export focused regimes.[1]

- The Ghana national trade policy (2004) gives primacy to an export led strategy, which, in addition to seeking to remove the anti-export bias created by the taxation of traditional exports, recognizes the fact that restricted imports can also reduce export potential.

- In Tanzania, after the period of self-reliance based on large scale public ownership which followed the 1967 Arusha declaration, policy since the mid 1980s has, with the implementation of SAPs, also become more market oriented. As a result, aggregate taxation has fallen markedly: from about -50 percent in the 1970s and 1980s to -17 percent in the early 2000s for agriculture as a whole; from about -80 percent to -49 percent for eight export crops; and from about -50 percent to a positive 6 percent by 2000/04 for foods.

[1] Unless otherwise stated, all estimates of farm taxation and support reported in this chapter are from the World Bank studies on distortions to agricultural incentives. The country case studies, all dated 2009, are authored by Ahmed et al. for Bangladesh, Bandara and Jayasuriya for Sri Lanka, Brooks et al. for Ghana, and Morrissey and Leyaro for Tanzania.

- Nepal also followed a protectionist, import substituting regime between 1956 and 1986, but in this country too, the regime has since been much more liberal. Recent debates recognize the critical importance of export development which is seen as essential in light of the country's small domestic market. Interestingly, this point is also made in the Bangladesh case study, where the argument is made that factor-neutral technical change could mean that the potential of the domestic market to absorb locally produced products becomes constraining, and a greater focus on exportables is required.

- In Bangladesh, the trade policy regime is also significantly more liberal than it was two decades ago, but there is still a relatively high level of protection in comparison with the other case study countries. Although a significant number of quantitative restrictions have been dismantled and there has been a shift towards greater use of *ad valorem* tariffs, the average tariff plus para-tariff has only fallen from 76 percent to 32 percent. Bangladesh also has an active trade policy with respect to exportables, a policy supported by their import policy which allows liberal import of key intermediate inputs.

- In Sri Lanka, the taxation of traditional exports has fallen from over 40 percent during the 1960s and 70s to about 20 percent in the 1980s and 1990s. Certain importables also receive more positive protection, and while this is modest for the main staple crop rice, it is high for other crops such as chillies, onions, and potatoes. The Sri Lankan case study also notes that trade and pricing policies have been used in pursuit of multiple goals including containing retail prices, protecting farmers, and encouraging value addition. The study argues that the use of one instrument for these multiple goals results in different stakeholders being affected in different ways, giving rise to lively debates over the articulation of trade and related policy.

An additional trend noted in a number of the countries is that support and associated protection is increasingly focused on a smaller number of products, notably certain import competing products and non traditional exports.

In summary, although the level of aggregate taxation has fallen and, in general, these countries have become more open to trade, trade policy is still a critically important instrument in pursuit of goals related to agriculture based development.

2.2 Trade and related policy in support of exportables

As indicated above, the aggregate taxation of exports has fallen over the past few decades. However, there are key distinctions across the case study countries both in the instruments of taxation (and support) and in their application to traditional as opposed to non-traditional exports.

- In Ghana, taxation of cocoa, the main export crop, has fallen significantly from 80 percent in the1980s to 22 percent in the mid 2000s. At the same time, the share of the export value received by producers has increased from 21 percent to 70 percent. The main instrument that remains is the export tax and there is active debate as to its rationale, and therefore the level at which it should be set. The case study reports a decision to justify the level of tax on the basis of services provided to the sector and exemptions that producers are provided from paying other taxes, including income tax. However, this can make the setting of the tax on an annual basis problematic.

  A key observation is that Ghana, facing significant tariff escalation in export markets, has set an objective of increasing the amount of cocoa processed locally to at least 40 percent. This objective of increasing value added within the country is also reflected in the provision of incentives to industries producing and processing non traditional exports, with concessions on exporters' income tax and income tax rebates related to export performance. For these products, there is no export tax.

- As reflected above, in Tanzania there is still heavy taxation of traditional exports. The main instrument is a 20 percent tax on the sale price. However, this level of taxation has been exacerbated by the role of the exchange rate and market inefficiencies. Indeed, it has proved difficult to distinguish the effects of policy distortion from inefficiencies in marketing/market structures (Morrissey and Leyaro 2009). Although Tanzania seeks to encourage local processing by applying an export tax on raw cashew, and a cess on hides and skins, the unregulated power of crop boards and the pervasiveness of local taxes (collected on volumes and also charged at transit points) added to already high transport costs, can significantly discourage exports.

- In Sri Lanka, the case study observes that there has been a significant supply response in revitalized plantations as a result of reduced distortion on exportables, with export duties on all products eliminated by 1992. In addition, and in common with the other case study countries, non traditional exports have been promoted through Export Development Boards, using for example a subsidy on FOB value, and customs duty waivers on intermediate inputs. However, very limited assistance is provided in terms of trade and pricing policy, accounting for less than one percent of the value of exports.

  The Sri Lankan case study also raises an issue in respect of the interplay between export development and import policy. Using the example of the coconut industry, the study notes that the price of imported edible oils determines price of locally processed coconut oil, the main input for export products. A high import tariff on edible oils raises the domestic price of coconut oil hurting the export industry. Finding a balance between the interests of

the four key stakeholders, growers, coconut product exporters, the domestic market coconut industry, and consumers of edible oils is problematic given the use of one instrument, the tariff. A result of the use of the tariff to meet multiple objectives is unpredictability, with the duty revised five times in 2008 alone. A number of suggestions have been made by the industry including linking the tariff to world palm oil prices to safeguard coconut producers, preventing stockpiling when tariff adjustments are made by monitoring stocks, and reducing middlemens' margins.

- In the Bangladesh case study it is pointed out that the trend in export bias reported in the World Bank distortions study, where aggregate taxation of exports appears not to have fallen, could be misleading given that the study only refers to jute and is therefore not reflective of the trade policy applied to other, non traditional, exportables such as vegetables and shrimps, which are positively supported. In promoting the development of these export sectors, cash incentives have been extensively used, and now cover 14 products and which vary across product and time. Their use is also associated with a high tariff on frozen shrimp and jute and on some import substitution crops such as fruits and spices. Additionally, the export policy prohibits the export of raw shrimp.

In summary, taxation of traditional export crops remains in most countries, albeit at a significantly reduced level. The reduction has not, however, always resulted in a significant stimulus to additional supply. In part, this is attributable to the widespread occurrence of market failures and high transaction costs, particularly in the African case study countries. By contrast, non traditional exports have received active and positive support through a number of different policy instruments, resulting in significant increases in the production and export of these products.

2.3 Trade and related policy in support of import-competing food staples

A common theme across the studies is the pursuit of self-sufficiency in food staples, particularly in light of the 2007-08 food price crisis. However, some interesting differences in interpretation and viewpoints are developed.

- In Ghana, policy is influenced by a declining self-sufficiency rate and the impacts that this may have in terms of higher food import bills, and on poverty levels in food producing areas. Rice self-sufficiency is currently at 33 percent, and, with increasing demand and low levels of domestic production, is likely to fall without intervention. Whilst Ghana has an explicit focus on export led development, and in the 2004 trade policy states that an import regime based on tariff escalation needs to be avoided, there are some potential inconsistencies reported, with counterpoints that the policy should ensure a reasonable level of protection to all domestic producers and should use tariffs to encourage domestic production of strategic commodities.

The Ghanaian case study also notes a particular susceptibility to import surges (for example, tomato paste where the domestic market share has fallen from 92 percent in 1998 to 57 percent in 2003). Following the 2007-08 food price increases, there is also recognition that the removal of import duties to counter the price increases opened up the floodgate for dumping of foreign products.

- The Tanzanian study notes that a fundamental policy objective is raising food production and competitiveness, with increased production and self-sufficiency at the core of policy frameworks. For example, the PRSP (the NSGRP) recognizes the potential to significantly increase grain production to capture not only domestic markets, but also regional export markets if appropriate trade policy and investments are made. It sets a target of increasing food crop production from 9 million tonnes in 2003/04 to 12 million tonnes in 2010. However, trade policy with respect to food staples is currently implemented on an ad hoc and interventionalist manner. Export bans are widely used, with exports only allowed when all regions of the country are declared food secure. Given that there is almost always a food deficit in one region, the ban is effectively continuous, making prices lower and more volatile.

- Sri Lanka has a stated desire to attain full self-sufficiency in rice. Import protection is the main instrument used with associated development measures such as irrigation and research. Rice trade is tightly controlled through import licensing and the STE monopoly. A major change was observed in 1996 when quantitative import restrictions were replaced by ad valorem tariffs plus licensing. However, tariffs are waived periodically when domestic prices are high, but raised when prices are depressed. The study notes that one view quite common in Sri Lanka is to have a rules-based variable tariff regime.

  Further in Sri Lanka, policy makers also have to account for the cross price effects between wheat and rice (this contrasts with the Bangladesh case where cross price effects are stated to be minimal). Indeed, the country has had a long term goal of reducing domestic wheat consumption and replacing it with domestically produced rice. The consumption of bread and wheat based products has fallen by 40 percent in five years. The case study also raises interesting questions related to the use of trade policy along the value chains, using wheat and poultry/maize as examples. These issues are returned to in more detail in the next section.

- In Bangladesh, the imports of rice are relatively unrestricted. Since 1993, coincident with the liberalization of rice trade, whereby private trade has become far more significant than public market interventions and have helped to stabilize prices, and the increased availability of rice exports from India, Bangladesh has adopted a strategy of food self-reliance. However, the 2007-08 price hike highlighted the propensity of government to re-engage in staple

foods trade, imposing a ban on exports of rice and reigniting the debate on rice self-sufficiency. Interestingly, it is noted that rice self-sufficiency may be sensible not only politically, but also economically in the Bangladeshi context, given its comparative advantage in rice production at import parity prices.

In summary, many developing countries have an over-riding policy objective of increasing levels of food self-sufficiency. However, the instruments used in support of this policy goal are often implemented in an ad hoc manner, increasing uncertainly for private sector operators and as a result acting against the achievement of the policy objective.

2.4 The implications of regional trade agreements

Traditionally, trade policy has been debated and formulated at the national level. Increasingly, however, regional trade agreements are strongly influencing the shape of trade policy at the national level.

- In the Ghana case study, the question is raised as to whether it makes sense to discuss the appropriate level of rice self-sufficiency at the national level. Self-sufficiency is increasingly important for ECOWAS members and is reflected in their trade policy documents. In Ghana's case there will be a requirement to adjust to the ECOWAS CET since, with 90 percent of imports coming from outside ECOWAS, the CET will be the effective tariff for Ghana.

  The debate as to at what level the CET should be set for different products is ongoing. A recent revision adding a new highest band of 35 percent is an indication of the priorities reflected in ECOWAP. It is also noteworthy that safeguards are given particular prominence, perhaps because the original highest band was only 20 percent. However, for agreement to be reached between member countries on the levels of CET and safeguards, further harmonization of strategic or sensitive products will be required.

- Similarly, the Tanzanian case study reflects the difficulty of setting an appropriate CET for sensitive products within the EAC. Again, different stakeholders in different countries want different levels: producing members want a high CET, non producing members want the CET to be set at a low level or zero. For raw materials such as wheat flour, manufacturers want a low level, while producers in countries with production potential want a high level.

  In EAC, there has been a particular issue with the ad hoc nature of many governments' interventions in food staples markets. Indeed, the new EAC food security strategy states that export bans on food commodities and products intended for consumption within the EAC should not be used. However, although it is recognized that current forms of intervention causes

unpredictability and dampens private sector investment, it is unlikely that governments will agree not to intervene at all. A move towards a rules based policy with clearer criteria for changing tariffs and reducing the use of NTBs has the potential to considerably stabilize maize prices in the region.

The three Asian case studies each comment upon the significance of trade relations with India. Trade with this significantly larger neighbour is seen as vitally important, but there are concerns over the use of trade barriers by India.

- In Nepal, the only significant trade treaty is with India. While the 1996 the treaty granted practically duty free access for all products produced in Nepal, a revision to the treaty in 2002 allowed for more stringent rules of origin, the use of TRQs on some products, and access to safeguard measures if a threat of injury to Indian industries was perceived. It is widely held in Nepal that the positive sides of the agreement are market access for Nepal as well as price stability in Nepal while the negative side is the intense import competition that Nepal faces in agriculture and industry. As a way of circumventing the agreement, Nepal imposes a 5-10 percent agricultural development fee which provides a degree of protection to domestic producers, but this is obviously a small relief.

- Under Sri Lanka's FTA with India, exports are said to be subject to a discriminatory sales tax which erodes any preferential margin granted under the FTA. In addition, rules of origin and the restriction of entry through a limited number of ports, the use of safeguards (quotas and canalizing imports through parastatals) also restrict levels of trade between the two countries.

2.5 The link between domestic support and trade policy regimes

A fifth theme relates to the extent to which trade policy can be considered in isolation of other measures used to support sectoral development, with the effectiveness of trade policy linked to overcoming production constraints.

- In the Tanzania study, the debate has been over the use of fertilizer subsidies as opposed to more general public investment.

- The Sri Lankan study provides an example of a case where even with a highly protective regime, field crops such as chillis, onions and potatoes have not shown much supply response. The reasons given for this are lack of appropriate technology (varieties), labour shortages/rising wages, and the focus on rice to the neglect of other field crops. The argument being that other factors need to be favourable for trade policy to work and the need to recognize the limits of trade and price policy in the face of binding supply side constraints.

- In the Bangladesh study, by contrast, the emphasis is on the need for a more transparent and predictable use of trade policy where private sector support to the development of marketing channels and infrastructure is needed. In other words the relationship between trade policy and domestic support works both ways.

- An important point is made in the Nepal study about the need to consider the level of development and/or commercialization in determining the appropriate policy mix.

The following section develops some of these issues further, in attempting to draw lessons for the articulation of more appropriate trade policy in support of, often multiple, policy objectives.

3. Articulating appropriate trade policy – issues for consideration

Although countries have used trade policy instruments to different extents, historical accounts of the net outcome of trade and related policies, in terms of levels of agricultural protection over the past four to five decades, do show some regularity. In earlier decades most developing countries taxed agriculture, directly through export restrictions and suppressed domestic prices and indirectly through industrial protection and exchange rate distortions (Kruger et al. 1988). These regularities have been further confirmed for a larger set of countries in the recent World Bank study on agricultural distortions (Anderson 2009). The latter study also demonstrates that in more recent years, the picture has changed markedly, with taxation of agriculture falling sharply on average, and in many countries, the sector being increasingly supported both directly through trade and related policies and indirectly through significantly reduced protection in non-agriculture sectors.

However, such aggregate trends and statistics can hide wide variations within and across countries. As an example, Sharma and Morrison (2009), using the estimates in the World Bank distortions studies for Asia, show that the simple average NRA for five Asian rice importers was 21 percent in 1995-99 increasing to 29 percent in 2000-04, mainly due to Malaysia (average of 64 percent in 1995-04) and the Philippines (average of 52 percent in 1995-04). However, as the NRAs were mostly negative for rice exporters, the average NRA for all 11 cases reported was 7 percent in 1995-99 and 15 percent in 2000-04 with NRAs generally within the range of plus or minus 15 percent.

Additionally, while the trends in aggregate levels of taxation or protection have been documented, such studies do not address the issue as to what policy stance is, or has been, good for the development of agriculture and of economies more

widely. The extent to which the use of trade policy instruments in pursuit of specific policy goals such as price stabilization, food self-sufficiency, maintenance of rural-urban income equality and the promotion of exports has been compatible with the promotion of trade policy regimes that allow the agriculture sector to play out its role in processes of economic development is particularly pertinent in debates on the appropriate use of trade policy.

In this section, the issues highlighted by the review of the case studies are used as a basis for providing guidance to policy makers and analysts seeking to determine the appropriate trade policy regime and set of policy instruments for their particular country context. It first looks at the balance between export promotion and import substitution and then in more detail at the formulation of export led development policy and import substitution policy respectively. Pervading each of these areas of debate are considerations as to which trade and related policies are appropriate for countries at different stages of development, that is, supportive of their process of structural transformation.

3.1 Balancing export promotion and import substitution

Although many countries have explicit objectives of export-led development, the majority also use trade policy instruments to allow domestic producers some level of support and/or protection against competition from imported products.

Import substitution has a bad name in part as a result of the perceived failure of economic development strategies in many developing countries in the 1950s – 1970s which were based on the import substitution model (albeit focused on manufacturing sector rather than agriculture), and in part due to insights generated through neo-classical economic theory, which suggest that import substitution tends to draw resources away from sectors in which they would be used more efficiently. An additional criticism of import substitution is that immunity from competition leads to inefficiency in production for domestic markets.

However, it is important to note that import substitution is not necessarily incompatible with the development of export agriculture. Indeed, the development of more competitive import competing sectors, in addition to generating significant multiplier effects through income generation and expenditure in local markets, is likely to be a necessary precursor to building the scale of activity required for the development of broad-based export agriculture in which smallholder producers can more fully participate.

These facts have generally been ignored in the advice provided to developing countries on agricultural trade which has tended to focus on promoting opportunities for increased exports (be they traditional or non-traditional) to international markets, and overlooked the potential role that governments could

play in enhancing the competitiveness of import substitutes and in supporting the development of market opportunities in domestic and regional markets. This is reflected in the focus of many trade diagnostic studies under the Integrated Framework, and even in many PRSPs, which tend to focus disproportionately on export expansion as an avenue for agriculture-led growth.

From a purely theoretical point of view, such advice may be justified. A rigorous conceptualization of export-orientation is one where not only are there no barriers to export but where all import tariffs and barriers are also eliminated. This follows from the Lerner Symmetry which states that import tariffs act as a disincentive to exports and should be eliminated. While the case for eliminating import tariffs on inputs used in the production of exportables is obvious, the Lerner Symmetry also implies the elimination of all import tariffs because such protection will undermine the exportable sector by making import-substitutes more attractive. Resources will be attracted to import-substitutes and thus will be a barrier to increased exports. On the basis of these arguments, there is no role for import protection within an export-oriented trade strategy.

On the other hand, there have been concerns about the distribution of the benefits of export expansion. In many cases these tend to remain with a small group of more sophisticated, better-off farmers and are not widely distributed among smallholders less able to participate in these higher value markets. For this reason, export development has often been enclave development, in the sense that its benefits are not widely shared among the rural populations and the profits generated have not been sufficient to lift significant numbers of rural households out of poverty.

In some countries, Chile for example, export success has been associated with a significant reduction in rural poverty, albeit the proportion of rural inhabitants was already relatively low and the development of export agriculture was from a higher level of agriculture sector development. The case of Chile is reflective of a number of better developed, more commercialized agricultural exporting countries (e.g. Brazil, Argentina, Thailand) where policy reforms have intentionally, or otherwise, favoured further increases in export levels at competitive prices. Although Chile is often held as a model of export led development, it is not clear to what extent this path can be replicated in countries still at earlier stages of agricultural development.

In practice, it is rare to find extreme forms of export-orientation. Rather, many countries use import trade policies and then implement measures to offset the extra cost on exports due to import duties on inputs, such as rebates on import taxes or duty drawbacks. Going one step further, export promotion zones have been created to avoid altogether the hassles of returning import duties to exporters. Such measures are commonly recommended in the DTIS/PRSP documents.

The choice of policy regime is therefore not clear cut. Indeed, Buffie (2010) argues that the choice between export promotion and import substitution is a false one and that policy packages are likely to include elements of both. Appropriate trade policy regimes must therefore take account of the extent to which the sector produces exportable product, import substitutes and non tradables.

The sizable literature on the East Asian experience of the 1970s and 1980s supports the argument, demonstrating that several of these countries built competitive advantages using dynamic trade policies based on complex combinations of selective openness and restriction within the context of overarching development strategies. These kinds of trade policy regimes were proactive and strategic, evolving over time and differing across sectors according to development needs. There was a well-sequenced combination of openness and control within the context of overall development strategies. Thus, the formulation of effective trade policy was not a simple, static choice between openness (and trade liberalization) and protectionism, but more about the correct sequencing of these instruments over time.

In terms of sequencing, historical evidence also provides a fundamental argument for a greater focus on food staples in relation to the process of agricultural transformation and its role in growth and poverty reduction at early stages of development. Many of the countries falling short of poverty and food security targets are still at an early stage of agricultural commercialization and most episodes of rapid poverty reduction and food security improvement (e.g. in India's green revolution) can be linked back to growth in food staples in these early stages of agricultural transformation.

While there is evidence that liberalization may have worked in favour of some export cash crops, which were often taxed under previous regimes, and in which the risks facing investors can be reduced by interlinking imperfect input and output markets, the scope for development of risk reducing non market institutions to overcome such imperfections in staple food crop systems are more limited.

Indeed, a key reason for the lack of transformation in many countries is that poor farmers will only diversify into, and then specialize in the production of, export crops when they can be certain of remunerative market access for any increases in their surplus staples production, and can afford to purchase rather than produce their staple consumption requirements.

Low-income producers simply may not be in a situation to respond to changing incentives. For example, they may be unable to alter their cropping mix, and their incomes may be reduced if the relative price of their product falls. Investments required to allow shifts of resources out of subsistence, basic food or traditional export crop into higher value alternative activities are not likely to occur where market failures are pervasive without some form of state intervention.

However, Dorward et al. (2004) contend that with the focus on export agriculture, many of the contemporary poorer countries have by-passed a critical stage of support and protection to their food sectors. Many of these countries are now left with relatively liberal trade policies, but weakly developed agriculture sectors, the development of which policy makers are now less able to support in the longer term and which, by virtue of low levels of applied border protection, are now more susceptible to short term external shocks.

When discussing the relative merits of import substitution versus export promotion, it is, therefore, important to distinguish between countries at different levels of development. In LDCs there is a strong rationale for focusing on the phase of transformation from a traditional to modernized agriculture, and which implies investment in basic food production. In middle to high income countries, the transformation from a modernized to globalized agriculture, where a more outward oriented policy stance may well be appropriate, will be a more relevant focus of trade policy debates.

The key policy problem faced by developing countries is not therefore whether to pursue export promotion at the expense of import substitution, or *vice versa*, but the ordering and sequencing of openness and control across different sectors over time rather than the extent of aggregate openness at a point in time.

The longer term objective of a more liberal agricultural trading system, where trade barriers would play a minimal role in offsetting or reducing the risks associated with appropriate levels of private sector investment in agriculture is not questioned. However, evidence suggests that support, and, sometimes, a moderate level of protection in favour of import substitution, may be required in moving towards that objective. 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. But in the short term, given the prevalence of market failures, they clearly do not.

3.2 Facilitating export promotion

Perhaps the most commonly stated goal of trade policy, found in almost all PRSPs, with statements such as "maximizing exports", "making agriculture export-oriented", and "maximizing the contribution of export to economic growth", is that of export promotion. While these are fairly clear objectives, and are not particularly divisive, some issues continue to be debated. These include: i) whether to restrict the export of raw materials to promote domestic industries or to allow free export; and ii) which products should receive export assistance and incentives.

In relation to raw materials, debates relating to trade policy interventions too often focus on particular products (e.g. wheat) without considering the influence

of trade policy on inputs to its production or on higher levels of processing. Equally, the focus may be on sectors such as dairy, without differentiating between products within them. In determining appropriate trade policy, it is important to consider the impact of trade policy along the value chain. This is particularly the case where a policy objective is to encourage diversification into higher value products up or across value chains within a sector.

An appropriate trade policy might, for example, impose low levels of tariffs on wheat, in a country where local production is limited, or minimally affected by import levels. By contrast, it may impose a higher level tariff on wheat flour where there is a nascent milling industry and/or where wheat flour competes with other processed products that are produced locally.

With regard to export assistance, Jha (2008) lists a series of constraints to increasing exports to advanced markets. These include: low income elasticity of demand, low population growth rate in developed countries, agricultural protection in OECD, high standards and supply chain governance. It is interesting to note that there is little discussion in the DTISs about the potential of poorer countries to penetrate international agricultural target markets. For example, how realistic this is, the relative competitiveness of competitors, the size and maturity of the market, the difficulties of achieving higher standards and other value chain requirements etc. Indeed, South-South trade maybe more important/viable but is little discussed.

More attention is given in DTIS to niche export markets. But while the potential market for these interesting/different/organic products may be large individual transactions tend to be small. Jha argues that an export strategy cannot be based on niche marketing alone as by definition these are short term and fickle in nature.

3.3 Promoting import substitution – when, why and how?

While broad-based export agriculture has contributed to the reduction of poverty and food insecurity in some, perhaps more developed, countries with stronger institutions and safety nets for facilitating structural transformation, greater orientation to export agriculture has not significantly impacted on rural poverty and food security in many poorer countries where agriculture is the potential growth sector.

In such countries, significant inroads to reducing food insecurity will more likely be made through the modernization of basic food production systems for supplying domestic and regional markets. In addition to the obvious effect of reducing the reliance on food imports (particularly in periods of high food prices), historical evidence strongly supports the contention that the development of these systems has been critical in the transformation of agricultural sectors to a level at

which transition to higher value products can be made. The development of food production also allows producers to move from own consumption of food crops towards greater participation in cash crop production. In turn, this allows the building of scale in these products necessary for eventual penetration of export markets.

However, agricultural trade policy for import substitutes is complex, notably given the issue of food self-sufficiency which is argued for from a number of perspectives which are more or less relevant in different country contexts.

Food self-sufficiency – the arguments

Several quite different reasons have been given for pursing the goal of food self-sufficiency. These can be categorized into those related to concerns about the ability to source sufficient food and those related to the role of increased food staples productivity in wider agricultural and economic development.

The first category includes: i) world markets not being reliable as a source of food staples – this is especially the case for rice; ii) large countries such as India and China should not rely too much on world markets; iii) the negative experiences of export bans of 2008; and iv) underdeveloped domestic infrastructures meaning that stabilizing prices with imports is problematic and so there has to be sufficient production locally.

Policy responses to the difficulties associated with high food prices in 2007-08 were generally contrary to the longer term trends towards greater openness to food imports and to export promotion. Short term responses by competitive food exporters to restrict their exports in order to maintain affordable prices for domestic consumers, and by food importers in releasing stocks and in subsidising both food prices and the provision of key inputs for basic food crop production were out of sync with orthodox policy advice. Importantly, there has also been significant discussion of longer term responses, although no significant action has been taken to date focusing on countries' ability to enhance their own food supply capacity and hence to reduce their reliance on imports from what are perceived as being increasingly more volatile global markets (see for example, FAO 2008a and 2008b).

Another reason often given for pursuing the goal of food self-sufficiency irrespective of the economic costs is that for countries with underdeveloped infrastructure (e.g. Nepal, but also large tracts of backward regions in countries like India, Indonesia and China), imports will fail to stabilize prices within a reasonable band because the gap between import and export parity prices is very large, and food production in those regions has to be sufficiently stimulated to keep downward pressure on real consumer prices.

The second category relates to increased self-sufficiency as a means by which widespread backward and forward linkages can be taken advantage of to promote dynamic rural economic growth and poverty reduction.

Most PRSPs, and similar national development plans, acknowledge this role with statements such as "to maximize the contribution of agriculture to economic growth and poverty reduction". While it is rightly claimed that higher levels of self-sufficiency and associated increases in intensive agricultural activities can create widespread backward and forward linkages and so a dynamic rural economy, the point of debate is again on the role of trade policy in increasing or maintaining self-sufficiency, because these policies also come at some economic cost.

In contrast to export commodities, where improved market conditions generally imply increased producer prices and incomes, with basic food commodities, there is a greater degree of conflict between price increases faced by consumers and those received by producers because of the importance of the commodities in the consumption baskets of poor households in these countries.

However, for this reason, cereal based intensification can have significant multiplier effects. Dorward et al. (2006) explain how linkages in rural economies are strongly influenced by levels of resource use in the production of food crops, and by the investment and use of surpluses from staple crop production which tend to be more concentrated on local markets. Increased farm incomes and demand for rural labour as a result of increases in productivity are key drivers of wider growth in rural incomes.

Growing rural-urban income gaps are seen as yet another challenge facing policy makers. This becomes more of an issue as the rate of structural transformation in a country takes off, and the gap between rural and urban incomes widens rapidly. It is one of those empirical regularities of economic transformation that as non-agricultural sectors grow faster, agriculture's GDP share shrinks while agriculture's employment share falls more slowly, thus reducing relative farm income *per capita*. This has been a policy challenge for developed countries for decades, and is now also being felt strongly in the fast growing developing countries. The typical government responses have been maintaining higher profitability of agriculture, provision of subsidized inputs and services, and direct payments where affordable. As structural transformation continues, this pressure will only increase, and governments will continue to respond in one way or other, including through the use of trade and related policies.

The wide array of justifications for food self-sufficiency highlights the importance of understanding the relationship between the rationale provided for interventions in support of food self-sufficiency and the level of agricultural development in a given country.

It is clear that among the goals that seem to have been pursued, the goal of price (or supply) stability stands out for the main basic foods. This was also noted very clearly in the World Bank distortions project case studies, where the data showed that in many cases there was little year-to-year correlation between the domestic and border prices of the major food products. This implies that, as noted by Timmer and Dawe (2007), the estimated NRAs - positive or negative - are mostly the by-products of the pursuit of this goal, and will continue to fluctuate as long as this goal is pursued. The societal preference was very clear – supply/price stability for basic foods is valued for a variety of socio-economic reasons, and this preference is unlikely to change any time soon.

In both categories, the sub-objective of price stabilization is therefore critical. Whilst for the more advanced economies, consumer interests and income inequalities may explain this primacy, in poorer countries, price stability is critical to ensuring adequate levels of investment in improved productivity levels (see also Dawe 2010).

Is import substitution feasible? - Domestic markets and import substitution

In countries where stimulating broad-based agricultural export growth has proved difficult, there are often more promising opportunities to produce food for domestic markets. Many poorer countries are not yet at the stage where domestic markets for high value products provide substantive outlets. Hazell (2006) notes that because of the "small initial value of these domestic markets (and similarly of markets for non traditional exports), even rapid growth would not translate into significant economic leverage within the next 10 to 15 years". By contrast, the current value of Africa's domestic demand for food staples is about USD 50 billion per year, and this figure is projected to almost double by 2015, a USD 50bn increase in market opportunity by 2015 (Hazell 2006). Only part of this output is currently sold (the rest is consumed on farm), but it still represents a large and growing market. Diao and Hazell (2004) further argue that since Africa currently imports 25 percent of grain products such as maize, rice and wheat, domestic production could potentially displace some of these imports. There is in principle, therefore, very large scope for expansion of cereals production by small farmers in substitution of imports.

However, while large domestic internal markets have often been found to be a pre-requisite to agricultural growth in Asian economies which was based on basic food production, since they facilitated the shifting of the commodity from surplus to deficit areas, helping to ensure effective demand was maintained even in times of surplus and therefore assisting in stabilising prices, in many of today's poorer developing countries, domestic markets are relatively small and cannot adequately fulfil this critical role. Here there may be a potential role for regional grains markets with common external tariffs but no restrictions to internal trade, as a substitute for the lack of a large domestic market (Morrison and Sarris 2007; Sarris and Morrison 2010).

What policy instruments in support of import substitution?

There is also the policy challenge of determining the extent to which to use trade and related policies to respond to the widespread desire for increased self-sufficiency.

Taken from the consumer perspective, given that positive or negative NRAs may be associated with some resource misallocation costs, a natural policy question is to what extent should the supply/price stability objective be pushed? A common, and reasonable, answer is that this should not be excessive, and some transmission of fluctuating prices is desirable whether world prices are in an upswing or downswing. Would trying to stabilize domestic prices within some band such that the resulting NRAs are moderate, e.g. within plus 15-20 percent, be an "appropriate" trade policy? A nuanced trade policy suggestion, reflected in current practice, suggests that this band would vary by the importance of both the product[2] and the level of agriculture sector development (i.e. the sector's ability to react to/absorb the impacts of price instability).

WTO rules have not been helpful on this, not just on export bans but also in making transparent the operations of large food multinationals and STEs. Further trade reform is, to a large extent, also conditioned by reforms in these areas at the WTO so that food importers have more confidence in global food markets.

Taken from the perspective of the role of increased staples productivity in structural transformation, the approach will be different. The fact that economies are expected to transform highlights the importance of taking a longer term view of trade policy. The trade policy set that is appropriate at one stage of development/ commercialization may not be appropriate at another.

Take, for example, import competing commodity sectors which would contract in the face of greater import competition (perhaps as a result of tariff reduction), but which are critical to rural growth and/or livelihoods, and which could become competitive in the medium to longer run. Providing a better investment environment could promote levels of investment in productivity enhancing technologies, generating surpluses and in turn allowing the diversification of resources to more "competitive" sectors (Morrison and Sarris 2007). Providing a more stable and remunerative investment environment, through a moderate level of border protection during which the sector (and wider economy) develops as improvements in productivity are made may therefore be critical at this stage.

[2] For example, for Asia, it has been found that the extent of the transmission is much less for rice, moderate for wheat and significantly greater for maize (Sharma 2002).

At later stages of development, preventing short term disruption to such domestic sectors which may otherwise now be competitive under "normal" trading conditions, 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 may be paramount. In these cases, variable levels of border protection maybe more appropriate than a moderate level of tariff protection.

As the economy (and markets/institutions) develops further, such safeguards may become inappropriate given improved access to markets and institutions to offset risks to investment. In such cases policy support could encourage the removal of now inappropriate retention of resources in such sectors.

In the more advanced developing countries, often having relatively commercialized agricultural sectors with significant export potential, arguments for agricultural policy in favour of import substitution 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 food producers' incomes, to ensure adequate and accessible food for poor consumers and the provision of public goods. Such concerns have been cited during the current food price crisis and policy responses of a short term nature used to alleviate these concerns. In these middle income countries, a focus on export promotion is however more likely to be an optimal policy stance than one that favours import substitution.

In order to contribute effectively to development efforts, trade policies must therefore be dynamic and must avoid giving constant and linear support to the economy as a whole or to certain sectors. On the contrary, they must be adaptable, and differentiated between sectors and between the various segments of a given sector. Consideration of this issue, therefore, must not be restricted to the sterile debate between openness and protection - it must focus on seeking the optimal combinations of the different instruments of trade policy and on building the necessary institutions in order to support the economic development process and improve the competitiveness of national economies.

Equally important is that protection is not seen as being permanent. It is a common criticism of proponents of liberalized trade regime that once established, a certain level of protection can be difficult to reduce or remove. Evidence from more advanced countries supports this criticism. In the EU for example, significant transfers to producers remain although a core initial reason for their introduction was to improve levels of food security. Often, the transfer remains, but the "rationale" changes. For example, a policy objective can change from food security to supporting incomes, to environmental management.

In articulating appropriate trade policy, mechanisms should be put in place for ensuring that trade policy itself can change in line with changing objectives and

needs. As such, policy should ideally be simple, transparent (to reduce political economy considerations), credible and not too variable (see, for example, Buffie 2010).

A link to domestic support

The agricultural sector strategy that is followed obviously matters in formulating trade policy. For example, according to Timmer (2009), placing rural diversification at the centre of agricultural and rural development means that two quite different tasks need to be managed simultaneously – raising productivity of staples for farmers continuing to grow them and using the low costs of these staples as fuel for agricultural diversification (wage good for labourers and feed for livestock).

In determining the appropriate trade policy, it is also important to consider to what extent trade policy alone can generate a supply response. It is often assumed that trade and price policy uniformly affects producer prices. But this is only if there is strong spatial price transmission and significant smallholder market participation – i.e. markets need to be well linked and producers need to be active in them (Barrett 2010). If this is not the case, then the impact of trade policy will not be noticeable (this may also be an issue for trade support measures).

Different sets of producers will be more or less responsive to identical changes in output prices depending on the policy and institutional environment that they face. However, border protection/trade policy is only one component of support to import competing sectors. Indeed it is often unclear how effective border policy will be. For instance, staple food producers in many rural areas may be argued to be well "insulated" from competition from world markets, with or without tariff protection, due to the wide gaps between import and export parity prices in producing areas (akin to natural protection). Here, the reduction of factors contributing to such margins, through, for example, improvements in rural infrastructure is critical to stimulating greater volumes and therefore reducing risks and transaction costs in rural markets. Establishing the determinants of such differential supply response is critical in explaining the impact of policy and institutional support interventions.

4. Conclusions

A key rationale for this chapter is to stimulate policy makers and analysts into reconsidering the articulation of appropriate trade policy. The discussion in the preceding sections has illustrated the need to rebalance the debates regarding export promotion and import substitution. The two should not be seem as incompatible. Indeed both are required, and the emphasis will in large part be determined by the stage of structural transformation and associated role for agriculture and agricultural trade in a particular country.

Structural transformation is a dynamic process and the role of trade policy – especially the instruments used – will change. The challenge for policy makers is to lead this process, and not follow. There has been insufficient research into both the policies that may be appropriate at different stages of transformation and the extent to which current, or potential, agreements might constrain their use. Having reached, or crossed, a threshold in terms of negative to positive NRAs, policy makers need to be better informed in designing and implementing trade and related policies. They will also continue to need trade rules and related institutions that are conducive to the implementation of different policies in different contexts.

Most countries are already becoming more nuanced in the articulation of trade policy, which now tends to be more focussed on a smaller number of key strategic products. In general, for bulk of the over 600 agricultural tariff lines at the HS-6 level (about 200 products at the HS-4 level), applied tariffs have been both low and stable from year to year, and very few other interventions on these tariff lines. In other words, most trade interventions are limited to a small sub-set of agricultural products. In the Doha Round negotiations too, Members seem to be more concerned with provisions designed for a sub-set of agricultural products, such as for sensitive and special products, and in the design of an effective SSM, than in the extent of formula tariff cuts.

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