Articulating and Mainstreaming Agricultural Trade Policy and Support Measures

An FAO study based on analyses for Bangladesh, Ghana, Nepal, Sri Lanka and Tanzania

Policy Brief 7 – Highlights of the country case study – Sri Lanka. May 2011

Introduction

This brief presents key highlights of the Sri Lanka case study under the FAO Project *Articulating and Mainstreaming Agricultural Trade Policy and Support Measures*. The objectives of the Project were to contribute to improving the process of: i) articulating trade policies consistent with overall development objectives; ii) articulating appropriate trade support measures; and iii) mainstreaming these policies and support measures into development frameworks such as the Poverty Reduction Strategy Paper (PRSP).

Mainstreaming of trade policies is defined as a process whereby trade policies are drawn from, and are consistent with, development strategies articulated in the apex policy framework such as the PRSP. In a mainstreamed process, policies, programmes and support measures are mutually consistent across key policy frameworks, create synergies and avoid inconsistencies. This is the sense in which mainstreaming has been analysed in the country case studies. The main policy frameworks reviewed for Sri Lanka were: three PRSPs (2002 Regaining Sri Lanka, 2004 National Poverty Reduction and Growth Strategy and 2006 Ten-year Horizon Development Framework); National Export Strategy 2004-08 as the key document for trade support measures; and other policy papers in agriculture and industry.

Key highlights

Economic reforms have been beneficial for non-agriculture and export crops but much less so for the import-competing food sub-sector - Sri Lanka switched to a liberal, export-oriented regime in 1977 after two decades of an import-substituting industrialization regime. As a result, economic and trade policies have become highly liberal for the export agriculture and non-agricultural sub-sector, but much less so for the food sub-sector. The fairly high taxation of the agricultural export sub-sector due to pricing and trade policies has been eliminated while importables (food sub-sector) continue to enjoy modest protection. Overall, economic growth performance since the reforms of late 1970s is considered to be satisfactory for the two liberalized sub-sectors but not for the food sub-sector (dominated by rice, but also dairy, meat, edible oils and sugar). Two structural weaknesses are seen as being key challenges to overcome: high food import bills; and the poor state of food producers, mostly small farmers.

Articulating an appropriate and rules-based trade regime for basic foods has been a challenge – The review of the trade policies on basic foods (rice, wheat, poultry, milk powder, edible oils) shows two prominent challenges facing the policy makers (and which are also the main complaints of the private sector): i) *ad hoc* changes in trade policy, notably import tariffs; and ii) the level of the tariff itself. They are related. For several products, the difficulties are due to the practice of fixing more than one intervention price (farm and maximum retail price) and trying to balance the interests of multiple economic agents (farmers, processors and consumers) with a single trade measure (tariff). Striking this right balance is challenging, even impossible in some cases. Even if a balance is reached or negotiated at a given point in time, this is easily destabilized by exogenous shocks and domestic developments. For some products, there are also strong cross-commodity linkages (poultry and maize, palm and coconut oil), further complicating the policy. Faced with these difficulties, the response has been frequent and *ad hoc* tariff changes, creating an environment of uncertainty for the private sector. There are no clear cut solutions to these problems. It might be the case that it is simply not feasible to set two prices along a chain and defend the interests at both points with a single measure like a tariff. If so, more policy instruments need to be used, e.g. safety nets for consumers and compensation to farmers through inputs or other non-price supports. There is a serious dearth of sound analyses on these complicated policy issues. In the mean time, the preference of traders and manufacturers is for rules-based, predictable trade and other policy responses.

The policy orientation of the PRSP has changed markedly since about 2005 - The review of the PRSPs, or PRSP-like frameworks, that began in the late 1990s, shows how the political process has influenced their design and orientation, and goals and policies. These are reflected in the extent to which economic policies are liberal, export orientated and focussed or not on the food sub-sector and poverty aspects. By 2005, the balance of the political position had shifted, and accordingly the current PRSP (Ten-year Horizon, 2006-2016) calls for refocusing efforts towards *inter alia* the farm sector and agro-industry, import substitution where necessary, a larger role for the state and active perusal of trade policies, but also recognizing the value of liberal policies for overall growth. While this is seen as a positive move towards a more inclusive and pro-poor development model, there is also some apprehension that it could lead to an era of greater instability in trade and pricing policies.

Value chains are considered to be appropriate frameworks for identifying and prioritizing trade-related support measures – The Sri Lanka case study illustrates this argument through two value chains for vegetables and coconut kernel products. It finds that the framework provided added value to the analyses of constraints and required interventions. Although these analyses have to be product-specific, they are also useful in identifying constraints that are common across similar products, e.g. land, labour and macro policies. An additional advantage of a value chain framework is its bottom-up approach to the identification of constraints, based as it is on micro-level studies and stakeholder consultations at the local level.

Trade and poverty – an official mechanism is desirable for monitoring the transmission of the impact of trade and other policies on producers – One hotly debated issue which has influenced policy from time to time is the extent to which farmers and the rural economy in general have benefitted from increased exports. The overall view seems to be that while trade has benefited the economy and non-farm sectors, the rural poor have not gained much. A similar view prevails for importables where the issue is that the intended benefits of the trade policy, notably import tariffs, are not being transmitted to the small farmers and rural areas but captured by various market intermediaries. The lack of sound, credible analyses has hindered informed debates on the issues. Therefore, two recommendations are made: i) to put in place a monitoring system that generates data and indicators for assessing the transmission of benefits (for example, the scheme in Ghana where the share of the export price captured by cocoa farmers is carefully monitored and publicised); and ii) more analyses using value chain frameworks with a view to quantifying the margins at different points in the supply chain from the farm to consumer, or farm to export markets.

For details, see the three chapters on Sri Lanka in the book *Articulating and Mainstreaming Agricultural Trade Policy and Support Measures*, edited by Ramesh Sharma and Jamie Morrison, 2011, FAO, Rome, available at http://www.fao.org/economic/est/projects/en/. Trade and Markets Division, FAO, Rome. The studies were supported by the Department for International Development (DFID) of the United Kingdom.