Aligning Aid with Adjustment

Stephen Tokarick

For the small group of countries that will be hard hit by liberalizing agricultural trade, special financing schemes will be needed

AGRICULTURAL TRADE liberalization has long been high on the multilateral trade reform agenda, given anticipated global welfare gains that the IMF and others estimate could be as large as $125 billion. The biggest net beneficiaries would be the rich countries, which have the largest barriers in place. But developing countries also stand to gain billions of dollars from the removal of subsidies and tariffs that developed countries impose on agricultural products. This agricultural support—which includes import tariffs, tariff-rate quotas, direct payments to farmers, and production, input, and export subsidies—depresses the international prices of goods of export interest to many developing countries and reduces their export earnings. However, some developing countries worry that they also stand to lose if they continue to import products such as wheat that developed countries currently subsidize.

Would agricultural trade liberalization increase import costs and thus create a need for external financing for the potentially vulnerable group of developing countries that imports these products? We undertook a study to answer this question and found that while a number of poor countries would probably face higher import bills as a result of liberalization, the size of these increases generally would be small. For a small group of countries, however, the increases could be significant.

Who are the winners and losers?

If developed countries discontinue their support for agricultural products, it would affect other countries principally through higher international prices of the previously protected products. Net exporting countries of these products would experience a terms-of-trade gain: they would benefit from an increase in international prices and would export more. Net importing countries, on the other hand, generally would lose by having to pay higher prices for their agricultural imports. Within these countries, liberalization would have opposite effects on different groups, benefiting producers and hurting consumers. On balance for the net importing countries, the consumer losses would outweigh the producer gains, so overall, they would be worse off. But, for the net exporting countries, the producer gains would outweigh the consumer losses.

Photo shows wheat being harvested in the western United States.

However, net agricultural importing countries are not the only ones that might lose. Net exporters of agricultural products that benefit from preferential access for their exports could be hurt because trade liberalization would likely erode the value of these preferences. For example, the African, Caribbean, and Pacific countries enjoy preferential access for selected products that they export to the European Union (EU). When trade barriers are reduced, the "advantage" these countries enjoy over third countries in the EU market is reduced.

But this sort of prediction about who would gain and who would lose is too simple and must be further developed, for at least two reasons. First, it is possible that if the international price of the previously protected product rises sufficiently following trade liberalization, a country that had been a net importer could become a net exporter. A country would likely import less in response to a higher international price by reducing consumption and increasing domestic production of the good. The critical question is whether the increase in the international price would be large enough to reverse the net trade position. Historically, it is not unusual for a country to switch its trade position. Since the early 1990s alone, a number of countries have done so.

Second, countries may put in place policy measures (that is, distortions) that interact with their agricultural sectors in complicated ways. Using a real-world example, a few net agricultural importing countries subsidize the consumption of food staples such as bread to assist the poor. This subsidy causes the consumer price paid for bread to fall below the international price, requiring the government to pay the difference between the international price and the now lower domestic price. If the United States, the EU, and others remove the support that they provide to wheat, the international price would rise.

How would this affect a country that subsidizes bread? Assuming that the subsidy is a fixed proportion of the international price, the consumer price for bread would rise, although it would still be below the international price. But as a result of the price increase, consumption, namely imports, of bread would fall, reducing government spending and thus benefiting the country. So the net welfare effect of an increase in the international price of wheat in this case would depend on the magnitude of the reduction in subsidy expenditure compared with the loss to consumers from an increase in the price of bread. Conversely, if the price of bread were controlled at a fixed level below the international price, an increase in the international price would reduce welfare in the importing country because government expenditure on the subsidy would increase, since the gap between the international price and the controlled price would widen and the quantity consumed would remain unchanged. This extra spending would need to be financed, perhaps through higher taxation elsewhere in the economy.

Net importers or exporters?

What about the trade positions of developing countries with respect to liberalization—on which side of the market do they fall? A key 1999 study by McCalla and Valdes classified the positions of 148 developing countries according to their incomes and trade positions on food products and the wider category of agricultural products, using 1997 data. Their key findings can be summarized as follows (see Table 1):

- An overwhelming majority (105) of the 148 developing countries were net food importers, while only 43 were net food exporters. A still larger majority (48) of the 63 low-income countries were net food importers and 15 were net food exporters.
- For the broader category of agricultural products, the picture was much different, particularly for low-income countries. Of the 148 developing countries, 85 were net agricultural importers and 63 were net exporters—a much smaller margin than for food trade. Of the 63 low-income countries, a small majority (33) were agricultural exporters.
- The results reveal that 22 countries were net food importers and net agricultural exporters at the same time. Only two countries were both net food exporters and net agricultural importers.

Thus, in assessing the impact of agricultural trade liberalization on developing—particularly low-income—countries, we have to distinguish between liberalization of trade in strictly food products and trade in all agricultural products (including cotton, a nonfood agricultural product that is of export interest to a number of poor countries).

Offsetting liberalization

How would liberalization of trade in agricultural products—both food and nonfood—affect the import bills of net food

Table 1

Food versus agriculture[1]

The vast majority of developing countries are net food importers . . .

	Low income	Middle income	Upper middle income	Total developing countries
Net food importers	48	35	22	105
Net food exporters	15	17	11	43
Total	63	52	33	148

but a small majority of low-income countries are net agricultural exporters.

	Low income	Middle income	Upper middle income	Total developing countries
Net agricultural importers	30	32	23	85
Net agricultural exporters	33	20	10	63
Total	63	52	33	148

Many developing countries are both net food importers and net agricultural exporters.

	Net food importers	Net food exporters	Total developing countries
Net agricultural importers	83	2	85
Net agricultural exporters	22	41	63
Total	105	43	148

Source: McCalla and Valdes (1999).

[1]Based on a study categorizing 148 developing countries according to their incomes and trade positions in food and other agricultural products, using data for 1997

importing countries? This is a crucial question because before the previous multilateral trade round (the Uruguay Round) could be completed, the net food importing countries insisted that a financing mechanism be set up to address possible balance of trade shortfalls that might result from liberalization, due to higher international prices.

We began our study by estimating the effects of liberalization of trade in 10 commodities (beef and veal, cotton, maize, milk products, rice, lamb and mutton, soybeans, sugar, wheat, and wool) on the import bills of 79 countries designated as net food importers by the World Trade Organization (WTO). We obtained these calculations by applying estimated changes in international prices that would result from agricultural trade liberalization by developed countries and calculated how trade volumes in net importing countries would respond.

We found that ***agricultural trade liberalization should not raise import costs in the case of all net food importing countries.*** While nearly all 79 countries were net importers of grains (wheat and maize), some of these countries were also exporters of other supported commodities, such as cotton, refined sugar, and rice. For example, for Côte d'Ivoire, Pakistan, and Uzbekistan, the gain in export revenues from removing support for these 10 commodities would actually offset the increase in import costs across all 10 commodities. Limiting liberalization to grains would mean that more countries would face higher import costs.

Next, we found that, ***although all 79 countries were net food importers, they differed in terms of their net trade positions in various commodities.*** The results show that a number of countries from several regions, mainly in the Middle East and North Africa, would be hurt by liberalization of grains (wheat and maize). The largest increases in import bills following liberalization of these two commodities would be borne by Egypt ($11.4 million), Mexico ($6.7 million), Morocco ($5.7 million), the Philippines ($4.3 million), Syria ($3.6 million), and Russia ($3.2 million). Many small island economies, including the Maldives, Samoa, Sri Lanka, the Eastern Caribbean islands, Cape Verde, the Seychelles, and Tonga, as well as Venezuela, the Philippines, the Dominican Republic, and Singapore, would experience relatively large increases in import costs in percentage terms, reflecting their dependence on grain imports.

We also found that, ***for most of the countries whose import bills for the 10 commodities would rise, the increases would be less than 4 percent of total affected imports, although nine countries would experience increases exceeding $10 million.*** Six countries—Samoa, Laos, Trinidad and Tobago, Dominica, Lebanon, and the Maldives—would experience increased import costs exceeding 3 percent of affected imports (see Table 2), reflecting their dependence on imported agricultural products. While some countries would experience an increase in import costs of $10–30 million, these tend *not* to be the countries for which agricultural imports represent a significant share of total imports. Therefore, liberalization would not likely entail special external financing needs for these countries. The largest increases in import bills as a percentage of the value of imports of the 10 affected products would likely occur in the small island economies that are dependent on imported food. These findings are broadly similar to those of Eiteljörge and Shiells (1995), who calculated that import bills for net importing countries would rise on average by less than 4 percent following the Uruguay Round over a six-year period.

Table 2

How costly is agricultural trade liberalization?

The largest import bill increases would likely occur in small island economies dependent on imported food.

Countries bearing largest import cost increases[1]			
(millions of 2000 U.S. dollars)		(as a percentage of affected imports)	
Saudi Arabia	35.4	Samoa	3.8
Philippines	29.6	Laos	3.7
Mexico	20.2	Trinidad and Tobago	3.1
Russia	15.6	Dominica	3.0
United Arab Emirates	13.2	Lebanon	3.0
Venezuela	12.1	Maldives	3.0
Singapore	11.7	St. Kitts and Nevis	2.9
Bangladesh	11.7	St. Lucia	2.8
Nigeria	11.3	Sri Lanka	2.8
Sri Lanka	9.3	Tonga	2.7

Source: Tokarick (2003).

[1]Based on estimates of trade liberalization effects in 10 agricultural commodities on the import bills of 79 countries designated as net food importers by the WTO.

In the present study, the sharp rise in the world price of milk products and other dairy products following liberalization has a large influence on import cost increases in net food importing countries, many of which are among the world's poorest. For many net food importing countries, the increase in the cost of imported milk makes up more than three-quarters of the increase in total import costs.

Pushing liberalization forward

Trade in agricultural products is significantly distorted by the myriad types of support measures in place in developed countries. Clearly, elimination of these measures would make the world trading system more efficient, benefiting many countries. However, some countries might be hurt as a result of trade liberalization—particularly those that are heavily dependent on imports of agricultural products.

These findings should not deter progress in liberalizing agricultural commodities—nor should they argue for taking a selective approach exempting certain sensitive products, such as milk, from liberalization commitments. The size of the increases in import costs following trade liberalization are likely to be manageable for most countries. The small number of countries facing significant increases in their import costs would tend to be the small island economies that must import significant quantities of agricultural goods. And while many poor countries might have to pay more for imported food as a result of liberalization, some of these costs could be offset by also liberalizing nonfood agricultural products.

If industrial countries were to remove support to their cotton sectors, for example, this would raise the world cotton price and increase the export earnings of many poor coun-

tries in West Africa and Central Asia that are net exporters of cotton. This would offset some of the increase in food import costs borne by these poor countries following liberalization of food products. Benin, Burkina Faso, Côte d'Ivoire, Mali, Pakistan, Syria, and Uzbekistan would benefit from particularly large gains in export revenues from liberalization of cotton. Thus, the structure of trade would keep more countries from being harmed because in many cases, countries that are importers of the heavily supported agricultural products also are exporters of some other protected product.

The results do show, however, that, as trade is liberalized, greater attention needs to be paid to compensation schemes that will make comprehensive liberalization more attractive to all parties. The IMF's Trade Integration Mechanism (TIM) is available to help countries make trade-related adjustments. It comes at an opportune time in the Doha Round and fills a vacuum that that has existed since the Uruguay Round. The TIM is not a new IMF facility, but rather a policy designed to make financial resources more predictably available. The TIM aims to address the concerns that many developing countries have concerning possible balance of payments shortfalls that might arise as a result of agricultural trade liberalization and that might otherwise deter them from undertaking liberalization. This should go a long way toward encouraging the much-needed liberalization of agricultural trade. ■

Stephen Tokarick is a Senior Economist in the IMF's Research Department. This article is based largely on his IMF Working Paper 03/191, "Measuring the Impact of Distortions in Agricultural Trade in Partial and General Equilibrium." A more technical version of the F&D *article will appear in a forthcoming issue of* World Economy.

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Use Your Imagination

"[L]et us not forget that what we are observing is exactly what the founding fathers of the IMF and the World Bank would have loved to imagine one day."

—Jean-Claude Trichet

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