



Could the proposed WTO Special Safeguard Mechanism protect farmers from low international prices? ☆



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ABSTRACT

This paper offers an empirical analysis of the proposal by some developing countries for an agricultural Special Safeguard Mechanism (SSM) in the World Trade Organization. It draws on political economy and market theory to demonstrate that the loss-averting domestic producer benefits that proponents believe the SSM would offer agricultural-importing developing countries may be illusory, insofar as agricultural-exporting countries also seek to avert producer losses. By way of illustration, the paper then uses time series data to analyze past government responses to fluctuations in the world's rice markets. The results suggest that the proposed SSM would deliver at most only a small fraction of the loss-averting benefits that have been advertised by the proponents of the SSM. Since the analysis applies to upward as well as downward spikes in international prices, it underscores the importance of strengthening multilateral disciplines on both import and export trade interventions to reduce beggar-thy-neighbor unilateral trade policy responses to food price fluctuations.

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Introduction

Upward price spikes in international food markets during 2008, 2010 and 2012 were a major concern for poor food consumers, and many governments responded by at least partially insulating their domestic food market from the international price rises. Those responses triggered heated debates and stimulated much analysis to determine the loss-averting effectiveness of those interventions at national borders. Meanwhile, the opposite market situation – slumps in prices – has been a focus in the Doha Round of multilateral trade negotiations at the World Trade Organization (WTO). An agricultural Special Safeguard Mechanism (SSM) is being proposed by some developing country members of WTO that would allow them to raise their applied tariffs on specified farm products when either their import price falls or the volume of imports surges beyond threshold levels (WTO, 2008). This proposed SSM is one of the most contentious issues in the agricultural negotiations of

the WTO, and was the issue that triggered the suspension of Doha Round negotiations in 2008. The purpose of this paper, like the recent global analyzes of responses to upward price spikes, is to examine the prospective loss-averting effectiveness of an SSM.

Criticisms of the SSM proposal include the following: it would be available to a large number of WTO members, it would require no commitments to further liberalization, it may allow import tariffs to increase above their bound rates for many products, and there would be no requirement to use an injury test nor to compensate adversely affected trading partners (Blustein, 2009; Wolfe, 2009; WTO, 2010; Grant and Meilke, 2011). Others have made the point that the developing countries that are net exporters of affected farm products would be harmed by an SSM (De Gorter et al., 2009; Finger, 2010).

Our purpose here is not to rehearse these valid criticisms. Nor is it to replicate for another product the innovative analyzes by Grant and Meilke (2006) and Hertel et al. (2010) of the possible effects of wheat import restrictions that the SSM might trigger. Rather, it is to demonstrate that the offsetting benefits that proponents believe the SSM would offer agricultural-importing developing countries may be illusory.

The illusion stems from not acknowledging that, historically, the behavioral responses to international price slumps by governments of agricultural-importing countries have been not dissimilar to those of agricultural-exporting countries. When this fact is taken

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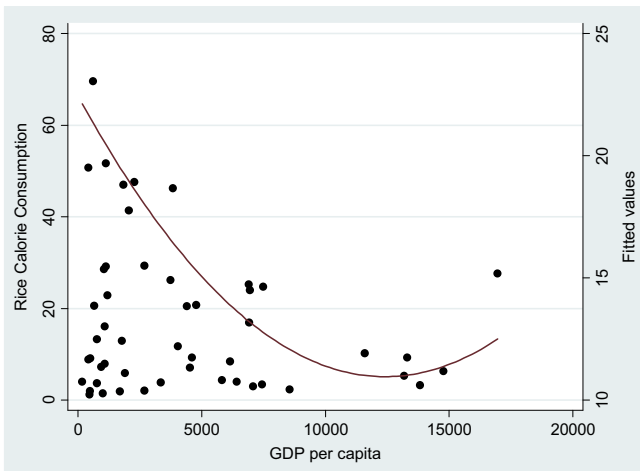


Fig. 1. Rice as a share of total calorie consumption and GDP per capita, 2009^a (percent and current US\$). ^aThe sample includes all members of the WTO's G33 plus five other important rice-trading developing countries, namely Bangladesh, Iran, Malaysia, Thailand and Vietnam. The right-side uptick in the curve is due to the inclusion of the most affluent of the G33 members, namely Korea. *Source:* Authors' compilation based on data in FAO (2012).

into account, the loss-averting domestic producer benefits of the SSM are reduced and potentially eliminated. Moreover, each international price slump is exacerbated by those responses, making it more difficult for those countries trying to cope without altering their trade restrictions, and so raising the probability that they eventually will join the insulating group of countries and thus deepen and prolong the crisis.

After outlining the SSM proposal, the next section of the paper summarizes the political economy theory of loss aversion as it applies to agricultural trade policy. The following section provides the basic economic theory of the partial equilibrium effects of loss-averting trade policy responses by the governments of both agricultural-importing and agricultural-exporting countries. To see the extent to which governments in the past have altered trade restrictions in response to import price slumps, time series data are analyzed for rice, which is one of the world's most important foods, especially for low-income countries (see Fig. 1).¹ The results reveal that both of the unacknowledged facts mentioned in the previous paragraph are indeed important in the case of rice, which suggests the proposed SSM would deliver at most only a small fraction of the purported loss-averting benefits. In the light of these findings, the penultimate section points to far more efficient and equitable ways than an SSM for dealing with potential losses from market volatility for vulnerable groups. The final section concludes.

The proposed Special Safeguard Mechanism (SSM)

The proposal of the SSM was included in Doha Development Agenda in 2004 as a response to the concern in some developing countries that sudden increases of cheap imports can adversely affect their farmers. The WTO provides member countries with a number of legal measures to manage import surges and rapid price declines. For example, a Special Safeguard to deal with price depressions and import surges is currently available to those WTO members that undertook tariffication following the signing of the Uruguay Round Agreement of Agriculture (AoA), as a reward for their commitment to liberalize through tariff reductions.

¹ Rice in 2009 provided 19% of the calories consumed by the world (the same as wheat), and 28% (compared with wheat's 15%) of the calories consumed in low-income food-deficit countries. Developing countries account for all but one-sixth of the world's rice consumption and production (FAO, 2012).

However, many developing countries bound their tariffs outside the AoA tariffication process, and so they are not eligible to use the WTO's existing Special Safeguard to deal with agricultural import surges and price slumps. Hence their proposal for an SSM.

There are two types of safeguards for developing countries in the current proposal of the SSM, namely the price-based SSM and volume-based SSM (WTO, 2005). With regard to the price-based SSM, if the c.i.f. import price of a shipment falls below 85% of the average monthly price of imports from all sources in the preceding three-year period (the trigger price), an additional duty can be applied to remove up to 85% of the shortfall. With regard to the volume-based SSM, if the import volume in a year exceeds the preceding three-year average by more than one-tenth, the current rate can be raised depending on the size of the import surge: a one-quarter addition if there is a 110–115% import surge; a two-fifths addition for an import surge of 115–135%, and a 50% rise if the import surge exceeds 135%.

Why countries seek to insulate against international market volatility

Why do countries act unilaterally to insulate their domestic market from price fluctuations in international markets for farm products? To address that question, it is possible to draw on and adapt recent political economy theory of loss aversion developed by Freund and Özden (2008), who in turn built on the pioneering work of Grossman and Helpman (1994). Assuming only trade measures are available to policy makers, they show how the preference for policies that insulate domestic prices from year-to-year changes around a desired level that differs from world prices can be specified in a welfare function. Corden (1997, pp. 72–76) suggests that such a pattern of intermittent border interventions implies a conservative social welfare function.

An objective function that represents this type of preference, and is closely related to one developed by Freund and Özden (2008), has been suggested by Jean et al. (2010). The latter model predicts that the lower the international price for a farm product in any year relative to its long-run trend value, the higher will be the rate of distortion of the domestic price that year, ceteris paribus. More than that, the key coefficient in their model is one minus the coefficient of price insulation in the international-to-domestic price transmission equation estimated by Tyers and Anderson (1992). It suggests that such policy makers will adjust their rates of distortion to domestic food prices to partially offset deviations of international prices from their trend value.

Even in the absence of generic national social safety nets, governments may be able to directly assist farmers when international prices slump (or assist consumers when prices spike upwards) at lower economic cost and more effectively with domestic measures rather than via altering their restrictions on trade. But if trade measures are considered by policy makers to be the only (fiscally or politically) feasible instrument available to them, this would mean that when international prices fall below trend, (a) agricultural import restrictions will rise (or import subsidies reduced) in importing countries, and (b) export restrictions will be eased (or export subsidies introduced or raised) in countries that are net exporters of food – and conversely when international food prices rise above trend.

It follows from this loss aversion theory that one should expect rates of producer assistance (and consumer taxation) from such trade measures to be correlated negatively with a product's international price, and more so during periods of extreme international price spikes. In so far as a country has a larger array of feasible domestic policy instruments at its disposal the more advanced its economy, the correlations should be less significant for

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