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HOW MIGHT AGRICULTURAL TRADE LIBERALISATION AFFECT WELFARE IN THE LEAST DEVELOPED COUNTRIES?

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The intractable controversy surrounding agricultural trade liberalisation is examined in this essay. Kate Bunworth outlines the effects, both positive and negative, that an opening up of the market will have on LDCs. She concludes that, though there will be losers, trade liberalisation is a necessary, if insufficient, condition for economic growth in LDCs.

Introduction

Protection in agriculture by developed countries is still quite high, and so remains as a continuous constraint on developing and least developed countries. Since most developing countries have a disproportionate percentage of their resources in agriculture, a more open world agricultural market would allow them greater opportunities to increase their exports and to participate more in this era of globalisation. However, despite the net economic and social benefits of reducing most of the governments' subsidies and opening economies to trade, nearly every national government intervenes in the markets for goods and services, which has distortionary effects on international commerce. They are not only particularly harmful to the world's poorest people, but they also harm the economies that have imposed the barriers in the first place. In this essay I will look at some of the possible effects that the liberalisation of agricultural markets would have on the least developed countries (LDCs) in the world. First, I will look at why developed countries oppose trade liberalisation, which significantly effect LDC markets. I will then look at the possible effect of trade liberalisation in general. Thirdly, I will look at the direct effects that trade liberalisation will have on LDCs. I will then focus on the effect that trade liberalisation would have on certain products relevant to LDCs. Finally, I will look at what is being done now in relation to trade liberalisation.

The Opposition to Trade Liberalisation

Most developing countries' agricultural export markets are in the North. On average, Northern countries import 65% of developing countries' total agricultural exports. With the exception of rice, the North, especially the U.S. and Canada, dominates world grain exports. Non-grain exports such as fruit, vegetables, and cotton are largely the domain of LDCs. When we exclude intra-EU trade, developing countries account for up to 80% of world exports of these commodities, most of which are exported to the North (Diao et al. 2002: 1). This means that the exports from developing countries do not compete directly with the exports from developed ones, which means that trade liberalisation should not directly damage developed countries' export markets. Also, by introducing trade liberalisation, exports from developing countries should increase.

Despite the fact that developed and developing countries do not directly compete with their exports, it is commodities such as vegetables, fruit, and cotton (commodities that LDCs specialise in) that developed countries tend to erect barriers to. This means that there will be increased access to developed country markets for the commodities of developing countries due to the reduction in barriers. This would hopefully compensate for the increase in the prices of imported goods.

The reluctance to reduce trade distortions and liberalise the market is almost never a result as such a reform would involve the government having to hand over even more money. On the contrary, except where we find low-income countries where there is still heavy dependence on trade taxes for government revenue, a policy reform of this kind will actually benefit government revenue because it raises income and consumption tax revenues more than the fall in trade tax revenues. Additionally, they do not have the significant burden of having to pay subsidies. In 2001 the total transfers from consumers and taxpayers to farmers averaged around 30% of gross farm incomes, cost over $300bn, which is equal to 1.3% of GDP, and was six times the amount of overseas development aid given in that year (IMF 2002: 81). We are giving more money to help animals and to keep land safe from high-rise buildings than we are helping other human beings. A disgusting statistic is the fact that each of the 21 million cows in the EU is subsidised by $2 a day, while half the world's population live on less than $2 a day. How can we justify spending more on a cow than on a human life, especially when we in the EU produce so much excess food?

The main reason why governments are opposed to trade liberalisation and cuts in subsidies is because they could redistribute jobs, income, and wealth. This is not a bad outcome and could in fact lead to a more equal society. However, the redistribution of income could alienate some of the electorate, especially powerful businesses that are supporters of the government. The government fears that, if they reduce trade distortions, their chances of remaining in power are significantly reduced (Anderson et al. 2001: 2). Also, for governments in corrupt countries, liberalisation itself could reduce the level of the government's wealth.

Trade Liberalisation in General

It is estimated that if there was a further liberalisation of 50% on what we have now, then there would be a $53bn annual increase in global GDP by 2010, using the counter-factual as the alternative (ABARE 2000: 1). When we look at the possible effects of liberalisation it seems as though it is a major worldwide problem but, in fact, a small number of countries in the North cause most distortion in world agricultural markets, especially the EU and US. The elimination of import tariffs should increase the demand for imports and, at the same time, domestic agricultural supply should contract in these developed countries. Also, most developed countries use some form of domestic support policies, which encourage excess production. By reducing or eliminating these domestic subsidies, farm incomes in those countries would fall (Diao et al. 2002: 5). These factors lead to the beliefs that trade liberalisation would lead to price rises. According to some models, by eliminating agricultural tariffs, domestic support and export subsidies worldwide, agricultural prices would increase by about 12% (Diao et al. 2002: 4). However, this is only a static analysis so it doesn't take account of investment responses to the change in prices of how the development of new technologies might take place because of this increase in prices. Those effects are taken account of in a dynamic analysis, which looks at the long-term effects. The static gains in welfare to the world economy are valued at $31bn. Unfortunately it is the countries that had the highest levels of distortion initially that make the most gains, with developed countries receiving $28.5bn from a full policy reform. In contrast, most of the dynamic gains should go to emerging and developing countries, with developing countries' welfare increasing by around $21bn annually (Keeney 2004).

Although we can see that developing countries benefit from the liberalisation of developed countries, gains also accrue to the developed nations from lifting their own restrictions. Some of the major producing countries such as the LDCs in Sub-Saharan Africa benefit to a lesser extent because local producers generally receive relatively lower levels of protection. For Sub-Saharan Africa (SSA), it is thought that the benefits from the removal of agricultural support in developed nations are greater than the benefits if developing countries were to remove their support. This is due to the fact that developed countries generally have a higher level of protection against SSA exports. However, if all developing countries liberalise their agriculture, the terms of trade for SSA would deteriorate, which lowers the efficiency gains from liberalisation. This is because both developing countries and SSAs export much of the same products so liberalisation by these countries causes the prices of their exports to fall in comparison with SSA's export prices (IMF 2002: 86).

If the international agricultural market was more open, then there would almost definitely be an increase in export opportunities among LDCs. But, because they are importers of food grains and meats, some of these countries would more likely experience a rise in food prices. For most LDCs grains and/or meat account for over 20% of their total agricultural imports. Many of the net food importing countries are poor and among the less developed, so that food expenditures account for a significant portion of household budgets (Diao et al. 2002:12). Therefore high-priced food imports caused by agricultural liberalisation may hinder food security, which is something I will look at in greater detail later.

The ways in which global trade liberalisation might affect LDCs

Benefits from domestic policy reform

As I have said, it is important for countries to reduce their own barriers to entry. However, gains from liberalisation can be unequally distributed within a country with larger export-oriented farms benefiting at the expense of subsistence farms or import-competing crops. There is also the assumption here that countries are actually able to increase their supply to take advantage of these new opportunities, which may not be the case, especially for LDCs.

Terms of Trade effect

Trade liberalisation would lower the world prices faced by exporters due to increased competition, which would be to the detriment of LDC exporters and of benefit to LDC importers.

Dynamic effect through induced innovation

While this is ignored by the static gains approach, using the dynamic approach we can see that technical change could be induced as expected levels of profitability rise.

Full multi-sectoral liberalisation

Agricultural liberalisation may have negative impacts through overvalued exchange rates and there could be possible higher protection in non-agricultural sectors. Here, LDCs may face lower domestic prices because countries may currently keep domestic food prices higher than international levels through higher protection. It is true that removing these distortions will reduce farm incomes and urban households will benefits from lower food prices. However, food self-sufficiency will fall, and it is this fall in both farm earnings and food self-sufficiency that provides the focus of attention for those who argue that agricultural trade liberalisation is bad for poor households (Anderson et al. 2001: 33).

Policy effects

The adverse terms of trade effects arise because LDCs have become net importers of temperate zone foods. The fact that there are lower world prices may cause LDC governments to focus on cheap food policies, which would discriminate against domestic agriculture. However, if world prices were higher, LDCs would reverse the discrimination that they imposed on their own agricultural sector through overvalued exchange rates, compulsory purchase requirements at low official prices, and the neglect of agricultural research. This would then cause food self-sufficiency to rise. However, critics have claimed that this places too much weight on the role of the external environment and ignores domestic policy reasons as to why cheap food policies were used in the past. These critics say that there is greater instability in world markets, which LDC governments recognised and therefore sought to rely more heavily on domestic production for food security reasons (Keeney 2004).

Stability effect

How trade liberalisation will effect the stability of world prices is ambiguous. It is not as simple that removing protection and allowing world prices to be transmitted to domestic markets will stabilise world prices (i.e. the elasticity effect). It is not as simple as removing protection and allowing world prices to be transmitted to domestic markets and so stabilise world prices, which is known as the elasticity effect. This effect could be outweighed by other factors: 1) Governments would no longer have an incentive to hold surplus stocks, which have helped to stabilise prices before. However, the private sector may hold larger stocks than in the past and privately held stocks can be more sensitive in responding to world price fluctuations. This is known as the stock-holding effect, of which the net result is unclear; 2) When agriculture is liberalised, there could be a reallocation of agricultural production from high-protection to low-protection countries. This may also mean a shift in production from low-risk to high-risk areas of the world, which is known as the production effect.

If the elasticity effect dominated, then trade liberalisation will stabilise world prices, which should benefit both LDC exporters and importers. Then, if there was greater stability, countries could take advantage of the trade opportunities due to their comparative costs (Keeney 2004).

Preference effect

Some LDCs have access to higher prices from developed countries for some particular exports under a preferential agreement and so they currently benefit from the quota rents that they obtain by selling some of their exports at higher prices. As a result, the liberalisation of trade would mean that these LDCs would lose out because they are now receiving lower prices for their exports. The loss of preferential agreements could also cause significant adjustment costs that poor countries would have to try to deal with. These preferential agreements have entrenched dependence on the supported activities and have not addressed major areas of need in the supplying countries. This means that some of the small countries that are very dependent on preferential access to the EU and US in some markets, such as sugar, may lose out from liberalisation. However, the aid provided by the EU and the US could be redirected to make it more beneficial to the recipient countries that currently avail of commodity specific aid-through-trade (ABARE 2000: 3). However, these preference agreements may be harming many other equally poor LDCs, which can be seen from the EU's banana import policy. Also, these preference schemes reduce the capacity for developing countries as a group to press for more access to developed country markets. If the preference schemes had not been offered in the first place, developing countries may have negotiated much better deals in previous GATT rounds (Anderson et al. 2001:20).

Food security and Food Aid effect

Some LDCs receive food aid on very favourable terms or for free, which could be seen as dumping by the rich on the poor. However, if agricultural liberalisation reduced food stocks, as I said before, then the volume of food aid to LDCs could also fall. Trade liberalisation would lower barriers to trade on the part of LDCs and there would be an extension of trade policy reforms to sectors in which these LDCs are likely to enjoy some comparative advantage, thereby raising income levels and purchasing power. Producers in LDCs, who must compete now against developed country export subsidies or who cannot access developed markets due to high trade barriers, would benefit if distorting measures were removed. However, food-insecure importing countries that benefit in the short-term from lower import prices resulting from developed export competition measures may face higher import prices if such measures are further disciplined. Trade liberalisation encourages deeper market penetration so that more regions within LDCs can choose food self-reliance instead of being forced to attempt food self-sufficiency. In the absence of trade opportunities, then the food security of individuals in these regions may also be improved.

As you can see, food security is, and has to be, a great concern of the world's poorest countries, especially those who are dependent on food imports where there are fears that by reducing subsidies and protection the price of imports will rise. This can seriously damage a country's food security when a country has a very limited budget with which to buy food. However, if a rise in prices is transmitted domestically throughout the poorest countries, the majority of the people in these countries will benefit because the very poor are predominantly found in farm households and are net sellers of food. We can even take this a step further and say that even those who are landless and so are net buyers of food in these poor countries will benefit because an increase in agricultural prices will cause an increase in the demand for unskilled farm labourers due to the rise in supply which would hopefully offset the rise in food prices in rural areas.

The Effect of Trade Liberalisation on specific products relevant to LDCs

The removal of support on rice, refined sugar and wheat would result in an increase of 2 to 8% in world prices. A few countries, including some poor countries that are exporters, as well as some rich countries, can make substantial net gains. The major losers are mainly small islands in the Middle East and North Africa, who are net importers and also some who currently enjoy preferential access to developed country markets (IMF 2002: 89).

The liberalisation of beef would increase world beef prices by around 7%, which would benefit some rich and some poor countries. The main beneficiaries are the middle- to upper-income countries in Latin America, while the loser from the liberalisation of beef would include a number of low-income countries that have to import their beef (IMF 2002: 89).

Milk and milk powder are subject to very high levels of support in developed countries, as can be seen in the example of Jamaica. Here, there has been a long history of milk production in rural communities and resources of land, labour, water, and livestock but now the dairy farming sector is in rapid decline due to unfair competition from subsidized milk powder. Dairy farmers do not have an alternative activity to keep their land in agricultural production. The declining dairy industry is seriously contributing to the economic pressures being experienced in rural communities resulting in urban drift and inner city crime. Increased food imports and the negative impact this has on the balance of payments also makes Jamaica more vulnerable to external shocks and has a detrimental effect on Jamaican food security. As a result of the high supports, liberalisation would lead to an increase in world prices of 23%, which would be of benefit to any Jamaican milk producers that have survived. As in the case of beef, the main countries that would gain are middle- to high-income while developing countries, including many poor ones, lose out.

What is being done now?

The EU has recently introduced the "Everything but Arms" (EBA) initiative, which provides duty- and quota-free access to the EU for LDCs. This initiative was received at the WTO Ministerial in Doha in November 2001. It may sound liberal but it doesn't include trade in services, of which the movement of people would be most important to LDCs. Also a number of provisions are included in addition to the EU's anti-dumping measures. Access to bananas, rice, and sugar is only to be phased in gradually over this decade (Anderson et al. 2001: 19).

The World Bank study for Sub-Saharan Africa, and the effects that the recent initiatives of the US and Japan would have, reveals that SSA would benefit very little because the US economy is already very open and the SSA countries do not have any comparative advantage in products that were previously protected, for example textiles. Contrasting this to the EU proposal, we see that with EU access alone, SSA exports would be raised by over $0.5bn. However, these results are overstated because the World Bank assumes all SSA, and not just the LDCs, would get duty- and quota-free access (Anderson et al. 2001:\20).

As you can see there are both benefits and costs associated with trade liberalisation for LDCs. For some LDCs, the total increase in agricultural exports after liberalisation would be quite small. World trade for a specific commodity may not rise and may even decline if the current trade barriers imposed by importing countries on the commodity are low. This is why some LDCs have no choice but to focus on one or a few export products, such as the tobacco leaf or coffee bean, and so many may not benefit from liberalising world agricultural markets. We can see that trade liberalisation is a necessary condition, but it is not sufficient, for nurturing economic growth in LDCs. For trade liberalisation to work it needs to be complemented by socio-economic policies, and a network of institutions that support the transition to a more market responsive economy.

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