Attachment

G-33[1] Response to the World Bank Publication dated 10 September 2006 Entitled "*Implications of Agricultural Special Products for Poverty in Low-Income Countries"* by Maros Ivanic and Will Martin

1. It appears that the authors of the aforementioned World Bank study have either fundamentally misunderstood, or deliberately misinterpreted, both the intended use and the impact of Special Products (SPs). They have repeatedly mistakenly asserted that the "goal of the special products proposals appears to be to *raise the prices of qualifying products* over an extended period" (p.2, emphasis added). This is contrary to the stated objectives of the proponents of the SP proposal, and also the historical experience of administering the current broad policy flexibility with regard to agricultural tariffs due to the gap between bound and applied rates.

2. The SP proposals *do not envisage either removal of bindings or increase in the bound rates*. In fact, they propose either a freeze in the current bound rates or an actual reduction, albeit the bound tariff reductions are less than what would be dictated by the tiered-formula. Thus, there is no increase in absolute protection; only the relative protection of SP lines would tend to rise. This fact is recognized by the authors themselves in p.6, but they ignore it in the subsequent analysis particularly in scenarios 1-3.

3. The misrepresentation is compounded by a rather selective enumeration of the indicators based on the three agreed criteria of food security, livelihood security, and rural development needs, proposed by the G-33 for designation of SPs (p.2). The impression given in the paper is that SPs are primarily about consumption intensity of the products (staple or proportion of total household income spent) and, to a lesser extent, about the nature of the producers (low-income, subsistence farmers). In fact, SP proposals are concerned mainly with livelihoods and vulnerability, and a more complete listing of the G-33 indicators would have revealed this. The fact that any production activity is necessarily associated with consumption of its product, and therefore protection of the consumption base is essential to the survival of the activity, does not provide a basis for inferring a reversal of intent.

4. On the basis of these two fundamental misinterpretations, the authors have modeled the purported operation and impact of SPs in a manner which simply does not capture the reality of agrarian structures in developing countries, and thereby gives rise to completely predictable, and totally misleading, results. There are two features of their analysis that deserve elucidation: (a) the

[1] Antigua and Barbuda, Barbados, Belize, Benin, Bolivia, Botswana, China, Cote d'Ivoire, Congo, Cuba, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, India, Indonesia, Jamaica, Kenya, Korea, Madagascar, Mauritius, Mongolia, Mozambique, Nicaragua, Nigeria, Pakistan, Panama, Peru, The Philippines, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Senegal, Sri Lanka, Suriname, Tanzania, Trinidad and Tobago, Turkey, Uganda, Venezuela, Zambia, and Zimbabwe.

assumption that SP proposals will lead to a rise in the domestic prices of the identified products; and (b) the model's specification of the measure of welfare of households.

5. Consider first the assumption on prices, where it is assumed that classification of a product as an SP automatically raises its domestic price by 50% (especially in Scenarios One and Two). The extent of this domestic price increase is simply sought to be justified on the grounds that "… this [domestic price increase of 50 per cent] is well below the average tariff binding of 78 per cent in least-developed countries …, and below the applied tariff on many politically sensitive products such as sugar in poor countries" (p.9). However, surely the authors realize that the maximum extent to which tariffs can be raised is the *difference* between the bound rates and the actual applied rates, and not their absolute values? Such differences are in reality much lower than assumed.

6. The error is compounded by the implicit assumption that a 50% rise in tariffs will lead to a 50% increase in domestic prices. This is true only if the country is a substantial importer of the concerned product and continues to be an importer after the tariff increase. If not, then a tariff increase will either have no impact on domestic prices or, at most, a less than proportionate impact. The authors actually recognize this in their characterization of Scenario Three: "We first identify the putative special products with net imports, and then apply the 50 per cent price increases only to them" (p. 10), but do not appear to fully carry it through in their actual analysis: "we removed from our simulation price increases to those commodities that are exported" (p. 17). These are obviously not the same. In the presence of positive tariffs, there is no reason to believe that any product which is not exported must necessarily be imported. It is curious why the authors make this obvious error between their stated intent and their application, and casts doubts on their intentions.

7. Furthermore, as has already been mentioned, the SP proposals simply cannot lead to tariff-induced price increases over and above what is feasible at the moment since they do not envisage any increase in the bindings, but rather to tariff decreases in 90 per cent of the agricultural tariff lines (or 88.5 per cent in the case of the more vulnerable agricultural economies). The authors could likely argue that since the Doha Round aims at substantial reductions in tariffs for all products, including non-SP agricultural products, the proposed 50% increase in tariffs of SPs is equivalent to a 33% reduction in all other bindings with the SP bindings remaining unchanged. If this indeed is the argument, as seems likely from the description of Scenario Four: "If this reduction does bring about a reduction in the applied rate, then exclusion of this commodity results in an increase in the applied rate relative to the post-reduction counterfactual" (p.18), then the authors are guilty of more than disingenuity: they are guilty of bad economics. For this presumption to be true, it has to be assumed that the "post-reduction counterfactual" would have exactly the same expenditure and profit functions as the pre-reduction actuals. This would be a heroic assumption indeed since the relative price changes (between traded and

non-traded goods and between importables and exportables) induced by a generalized reduction in tariffs should be expected to change the parameters of these functions quite dramatically. Thus, any conclusions drawn on the basis of an inappropriate counterfactual are necessarily erroneous.

8. It would have perhaps been more appropriate for the authors to have examined the impact of a *reduction* in tariffs of SPs on the basis of the argument that with appropriate continuity assumptions relatively small parametric changes will have symmetric (but with opposite sign) effects on either side of the initial equilibrium. Thus, if it could be shown that a reduction in tariffs of SPs led to an unambiguous reduction in poverty, their case against the SP proposals would have carried more conviction. Unfortunately, such an exercise would probably have not served their purpose of discrediting the SP proposals. For a developing country, the impact of an increase in tariffs and/or prices is not symmetric with that of a decrease, especially for agricultural products.

9. There are at least three major sources of asymmetry which need to be recognized:

   a. First, an increase in the tariff rate does not materially alter the market characteristics unless it is prohibitive and completely excludes all existing imports. The authors have clearly assumed this possibility away. A decrease in the tariff rate, however, can induce imports when none existed earlier, which would create a discontinuity in the domestic supply function.

   b. Second, the output of a specific agricultural product does not increase significantly with an increase in its price in the short run since there are technological rigidities in the production function and land-use patterns are determined more by traditions than relative prices. The only substantive effect would be in the share of the "marketed surplus". A decline in the price, on the other hand, can lead to significant reduction in production through a decline in the application of purchased inputs. Most farmers in developing countries, including subsistence farmers, sell a fair proportion of their produce after harvest in order to repay production loans. Any reduction in the terms of trade of the household will necessarily get reflected in the purchase of inputs.

   c. Third, agricultural wage rates tend to be upwardly flexible but downwardly rigid. Thus, although an increase in the price of the product may lead to some increase in the wage rate, a decrease in the price will be reflected almost entirely in a reduction in employment of landless agricultural labour, who are a major constituent of the rural poor.

10. The consequence of these three asymmetries would be that the dominance of the negative price effect over the positive income effect in determining the welfare of the poor which characterizes the findings of this study would be reversed in the case of a tariff reduction and product price decline. In such a case, the negative income effect could be vastly larger than the positive price

effect, and poverty could increase even more than the results obtained in this paper. The authors would then be forced to conclude that SPs are desirable.

11. On the model itself, although the specification of the welfare of households given in equation (1) in p. 7 is quite standard, it should be noted that it cannot capture the asymmetries and discontinuities discussed in the preceding paragraphs, and is therefore limited in its applicability. Moreover, it is puzzling as to how the parameters of the expenditure and more particularly the profit function were estimated. Standard cross-sectional household survey data can yield linear expenditure systems, but these cannot and should not be used for large discrete price changes. More importantly, such data sets are completely useless for estimating production relations. Longitudinal data sets are somewhat more useful in this regard, but the authors have nowhere indicated that such data were used. In the absence of any meaningful description of the data and the estimation procedures used by the authors, the conclusion is inescapable that the production relations captured by the profit function assume Leontieff production functions with zero cross-price effects. The discussion in p.7 of the paper further evidently suggests that the output vector of the "family firm" has been taken to be fixed. If this is indeed the case, the model has ruled out the possibility of positive supply responses to a price rise by its very assumption. It is hardly surprising then that the results are biased towards showing an increase in poverty.

12. There is another feature of the analysis which is curious: in equation (1) the authors introduce a term (_) which captures the transfer to households from the government, but it is assumed that this is completely independent of prices and therefore does not change in nominal terms when the prices of SPs rise. It does not require any modeling or even any economics to realize that for all households which receive a substantial portion of their expenditure through government transfers, this assumption alone will reduce their welfare in the case of price increase of any product they consume, whether SP or not. Since typically such transfers are generally targeted towards the poor, and form a relatively higher proportion of their total expenditure, virtually nothing else is required to show a poverty increasing impact of price rise. Almost all countries, especially developing countries, have some form of income or consumption support for its poor. In most instances, these are fully or partly indexed. If the authors were serious about modeling reality, they should have specifically characterized this term on the basis of the transfer systems prevailing in the selected countries.

13. The authors are disingenuous when they present these findings in a misleading fashion. Even though the authors have recognized that their analysis based especially on scenarios 1, 2 and 3 could not be achieved by the implementation of the SP proposals, the paper very dramatically claims that raising the prices substantially of staple foods produced by subsistence farmers through the SP proposals would have "disastrous consequences for poverty" – sufficient in some cases to undo decades of development progress – and push the already poor deeper into poverty. In the paper's abstract and conclusions, nowhere is it

mentioned that "we find that the special products proposal would, in fact, have no impact on agricultural prices or on poverty", a finding expressly noted in the body of the paper in the context of the more realistic tariff policy under the Doha Round negotiations (scenarios 4 and 5).

14. These technicalities apart, the most curious aspect of the paper is its repeated insistence that the SP proposals are only about a single-minded, if not mindless, desire of G-33 governments to raise the prices of selected agricultural products without taking into account its likely consequence on their people, especially their poor. Besides the various other statements to this effect, the most tendentious one, which reveals the bias of the authors, reads: "*Fortunately*, it turns out that the *inability* to bring about higher prices for those products that happen to be exportables reduces the damage done by the original policy of raising the prices of these goods" (p.17, emphasis added). In short, G-33 countries need to be protected from their own governments' folly.

15. At this stage, therefore, the G-33 reiterate the logic and rationale for the SP proposals so that such analyses do not "crowd out" the much-needed legitimate research in this important area. It can be nobody's case that there is sufficient rigorous research on the relationship between various components of trade policy reforms and poverty, and nobody is more concerned about this *lacuna* than policy-makers in developing countries. However, such research should be based on an honest appreciation of the concerns of the developing country policy-makers and an accurate representation of the problematic. The principal objectives of SP proposals are defensive and strategic. They seek to provide sufficient flexibility to developing country governments to nurture products which are essential to the livelihoods of their poorest and most vulnerable, and which have the potential for significant productivity gains in the long-run, and to guide a process of transition towards trade in a less unequal world. Any such analysis would necessarily have to be in a dynamic context since mere comparative statics will be able to address the larger issue only in a limited manner.

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