

## PRICE, IMPORTS, EXPORTS, AND TAXATION POLICIES

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### Summary

Countries employ a mix of price policies, import and export policies, and taxation policies to achieve a given set of objectives. For example, many developed countries have price policies that are intended to support their domestic producers. This is clearly seen in the European Union's Common Agricultural Policy, Japan's price stabilization band policy, and the loan deficiency payments policy in the United States. On the other hand, the import and export policies have been significantly influenced by the GATT, particularly the Uruguay Round Agreement on Agriculture (URAA). On imports, the URAA has provisions that ensure transparency and consistency through the imposition of tariffs and bindings, and market access through tariff rate quotas. This is coupled with some safeguard provisions that address drastic surges in imports and/or declines in domestic prices. Although some countries still tax their exports for revenue generation purposes, the URAA has provisions for reductions in subsidized exports. Moreover, since these policies are interdependent, there are also disciplines that put limits on trade distorting domestic support (e.g., price support), as well as requirements for the non-discriminatory application of taxes to both domestic and imported products. This

chapter provides a comprehensive review of policies on prices, imports, exports, and taxes, and the various instruments that have been used to implement them

## 1. Introduction

Countries in different stages of their economic growth intervene in many ways in their agricultural sector to accomplish varied objectives. For example, developed countries like the United States and the European Union (EU), that are self-sufficient in food but want to maintain some balance of rural and urban incomes have in the past raised farm prices administratively and provided either direct income payments or production assistance. To avoid low-priced imports from competing with their high-priced domestic production, barriers for access to the domestic market are often put into place, such as import quotas and high tariffs. As a consequence, domestic production is encouraged, even to the point of building structural surpluses to unsustainable levels. With the short shelf-life of some agricultural products, many countries often resort to providing subsidies in order to dump these surpluses in the world market, exerting a downward pressure on market prices. In contrast, other countries (primarily driven to induce industrialization with low wage rates sustained by cheap food) may maintain low food prices to benefit urban consumers at the expense of agricultural producers. Also, some countries may impose taxes on agricultural exports because their tax base is thin or because their institutional capacity to collect other types of taxes is severely limited.

This chapter provides a comprehensive review of price policies, import and export policies, and taxation policies. It includes some discussion on the different motivations driving most of these policies and the common instruments used to implement them. Actual and specific country examples will be extensively used to illustrate these policies.

## 2. Price Policies

Direct price intervention was pervasive in both developing and developed countries in the early to mid 1990s. A cross-country study by the World Bank on the “Political Economy of Agricultural Pricing Policy” that included 18 countries in four regions of the world showed a direct protection of importables ranging from 3.2 to 22.4 percent, while direct protection of exportables ranged from -6.4 to -20.5 percent. These interventions were motivated by either supporting incomes of agricultural producers, on the one hand, or supplying cheap food to urban consumers (workers) on the other. Also, there were cases where price support was used to compensate agricultural producers both from direct and indirect taxation of the agricultural sector.

Price support comes in many forms, including subsidies given to urban consumers; fixing the retail price of food; floor or ceiling prices imposed on farm prices; or dual prices that maintain high prices for producers and low prices for consumers, with the government paying for the difference. The extent and magnitude of the transfers to agricultural producers through price intervention mechanisms is very significant. From the period of 1990 to 1996, the Organization for Economic Cooperation and Development (OECD) estimated the transfers to agricultural producers for its member-states, resulting from their pricing policies. Expressed as a proportion of the total value

of transfer, it shows that transfers through price intervention represented 47 percent of total transfers in Canada, 49 percent in the United States, 47 percent in Australia, 66 percent in Mexico, 71 percent in the EU, and 84 percent in the Japan.

For price support policies to be effective, the government needs to intervene as a residual supplier or buyer, either directly in the domestic market, or through control of the level of imports allowed to enter the country and the level of exports. Since the instruments used in price interventions are so varied, several specific instruments used by particular countries will be discussed as examples. Other types of price intervention share a common feature illustrated in these examples.

## 2.1. The Common Agricultural Policy of the European Union

The European Union, through its Common Agricultural Policy (CAP), explicitly states that one of its key objectives is to ensure a fair standard of living for the agricultural community and for contributing to the stability of farm incomes. To accomplish this goal, the European Union has intervened in its market to influence prices. In many of its major agricultural commodities, the European Union has administrative prices that are set at a level which gives producers an adequate return under normal market conditions. It is called many names, but for our purposes we will call it a general name - the Target Price. For beef, veal, and wine it is called Guide Price; Target Price for cereals, sugar, milk, olive oil, and sunflower seed; and Basic Price for pig meat. In the case of the EU, the Target Price is supported effectively using both border policies and the purchase and sale activity of designated government agencies or government approved private firms. That is, to maintain domestic prices in the neighborhood of the administratively set prices, the domestic market is protected to ensure that cheap imports do not displace domestic production. This policy regime forces imports to be sold at the set Target Price. This is accomplished by setting a minimum import price called Threshold price. The Threshold Price is calculated as the Target Price less the transport cost and trading margin from the major receiving port (e.g., Rotterdam) to a main market outlet (e.g., Duisburg). Cheap imports that enter in with CIF import prices below the Threshold Price will have to pay a variable levy, calculated as the difference between the Threshold Price and the CIF import price. The variable levy regime has been banned under the World Trade Organization (WTO) agreement, and consequently replaced with specific duties, *ad valorem* duties, or a combination of both.

Also, the CAP sets an Intervention Price, which is the price at which government agencies are obliged to buy products offered to them by producers. This in effect is the floor price guaranteed by the European Union. The Target Price is fixed annually to apply for the 12-month period. The Intervention Price is estimated as the Target Price less the transport cost from producing centers to main market outlets. Agricultural producers can export, with the difference between the World Price and whichever is higher, the Intervention Price or Reference Price, refunded to them. The European Union's Reference Price is the official market price that is used to assess the state of the market.

The beef regime in the EU has two types of intervention buying. The Normal Intervention buying is triggered if for a period of two consecutive weeks, the EU market

reference price falls below 84 percent of intervention price, and at the same time the price of the same quality in a particular member state falls below 80 percent of intervention price. The second type of buying is called Safety-net Intervention purchases, which is triggered when the reference price falls below 78 percent and the price of the same quality in a particular member state falls below 60 percent. For the pig meat regime, intervention purchases when the price is low is still an option; but the Commission has preferred to provide subsidies to encourage private storage, instead of direct public intervention purchases. This is triggered when the market reference price falls below 103 percent of the pork Basic Price, and when it is likely to remain at this low level. The most recent CAP reforms included under the Agenda-2000, changes the beef regime to follow the pork regime in 2002, where Private Storage Aid is the more dominant instrument, and is triggered in the same way as pork aid.

## 2.2. Japan's Price Band

Japan uses a price stabilization band for beef and pork to meet its policy objectives of ensuring food security, stabilizing prices, and maintaining a rural living standard that is comparable to that of urban areas. A farm-to-wholesale-price transmission function that estimates a transmission elasticity and distribution of the error structure (i.e.,  $k \rightarrow N(\mu_k, \sigma_k)$ ) is key in determining the price band. The midpoint of the price band is determined using an average of the farm price adjusted by an index of the annual cost of finishing slaughter-ready swine, and translated into wholesale price using the price transmission elasticity. The floor price is derived from the midpoint price by subtracting one standard deviation of the regression error estimate, and adding one standard deviation of the regression error estimate to the midpoint price derives the ceiling price. The Livestock Industry Promotion Corporation (LIPC) intervenes in the market through its purchase (or storage subsidy granted to producers) and selling activities to ensure that market price always moves within the limits of the band. Moreover, the price band is supported at the border by requiring that all imports enter at a minimum import price called the Gate Price, which is linked directly to the midpoint of the price stabilization band. Prior to the General Agreement on Tariffs and Trade (GATT), a variable levy was used to implement the gate price policy for low priced imports (i.e., imports with CIF import price below the gate price). Imports with CIF values above the Gate Price are charged an *ad valorem* tax of 5 percent.

The GATT rules have radically altered Japan's import policies. Although the Gate Price was maintained, it is effectively decoupled from the stabilization price band and is subject to reduction commitments until 2000. The variable levy has been converted into a specific tax, and together with the *ad valorem* duty, is also subject to reduction commitments. However, the implementation of specific taxes that exempts any excess of the import price from the standard import price (SP, i.e., gate price with *ad valorem* duties applied) makes it still behave like a variable levy.

## 2.3. United States Loan Deficiency Payments

The United States Federal Agricultural Improvement Reform Act of 1996 (FAIR Act) shifted the regime by which the U.S. government conducts agricultural policy. In the past, a target price is used together with deficiency payments when market price falls

below the target price. The current policy has stronger emphasis on decoupled predetermined income payments. However, the United States still maintains a loan deficiency payment that effectively puts a floor price on major agricultural commodities. Loan deficiency payments can be availed of by producers whenever the posted county price for an eligible commodity is less than the local loan rate established for Commodity Credit Corporation (CCC) non-recourse loans. Wheat, corn, grain sorghum, barley, oats, soybeans, minor oilseeds, rice, and upland cotton are commodities eligible for payments. The loan rates and prices established at the local level are determining variables for the loan deficiency payments. Loan rates are established annually at the national level based on formulas and statutory limits. The loan rate formula for wheat, corn, and soybeans is 85 percent of the average price in the five previous marketing years, excluding the highest and lowest prices for those years, but not exceeding statutory limits. Once the national loan rates for commodities, except rice, are established, the local level (county or warehouse) are adjusted to reflect spatial differences in markets, transportation costs, and other factors. The applicable local price reflects the CCC's estimates of a local posted county for each of these commodities. When the posted local county price falls below the loan rates, the farmer may apply for a loan deficiency payment based on the difference between the price multiplied by the quantity of the commodity that otherwise could have been placed under a non-recourse CCC loan.

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### **Biographical Sketch**

**Dr. Jacinto Fabiosa** is the international livestock and poultry analyst with the Food and Agricultural Policy Research Institute (FAPRI) at Iowa State University. His FAPRI work centers on developing and maintaining the international livestock and poultry model; including updating estimates, and keeping track of the macroeconomic, domestic and trade policy environments, and phytosanitary status and regulations that impact on the world livestock and poultry markets. Dr. Fabiosa's research involvement has been in the areas of modeling methodology, food aid, food safety, and international trade. Dr. Fabiosa received a B.S. in Agribusiness from the University of the Philippines at Los Banos and an M.S. in Agricultural Economics from Michigan State University. He first came to ISU as a Fulbright Academic Enrichment Scholar from the Philippines and finished his PhD in Economics at ISU with CARD in 1993. Prior to joining FAPRI-CARD, Dr. Fabiosa worked with the International Rice Research Institute (IRRI)

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