



*The World's Largest Open Access Agricultural & Applied Economics Digital Library*

**This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.**

**Help ensure our sustainability.**

Give to AgEcon Search

AgEcon Search

<http://ageconsearch.umn.edu>

[aesearch@umn.edu](mailto:aesearch@umn.edu)

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

*No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.*

## **Comment 1 on ‘National and global price- and trade-distorting policies’ by Anderson**

Donald MacLaren<sup>†</sup>

The behaviour of prices in agricultural commodity markets reflects the extensive variety of policy instruments used both at-the-border and behind-the-border. To understand their trade and welfare effects, a theoretical framework is needed in order to provide a precise definition of ‘distortion’. The economic framework underpinning both the theory and the consequent empirical measures of distortions is largely that of competitive markets and ‘small’ countries in which a distortion is defined as a policy-induced realised price which is measured relative to the price that would prevail if the law of one price held and there were no market failures. In this context, the presence of a distortion implies a loss of social welfare compared with that in competitive markets.

In his comprehensive review, Kym Anderson has shown clearly the substantial contribution of Australian economists to policy-relevant international trade theory, as well as to CGE analysis, and empirical research on the economic consequences of the distortions created by agricultural policies in open economies. The empirical research has enabled the trade and welfare effects of a broad range of policy instruments to be measured, and time series constructed that permit a story to be told about how distortions have changed over time at commodity, national and global levels and, by implication, the direction of changes in welfare.

It would have been useful if Kym had also provided a typology of policy instruments with which to identify the instruments included in, and excluded from, the empirical measures displayed in the time series. The time series of themselves do not reveal whether the settings of existing instruments have changed, or whether governments have re-instrumented their market intervention, or both. Observed changes in measured distortions also reflect the consequences of changes in commodity prices and exchange rates, holding policies and their settings constant. Certainly, there has been greater emphasis in recent years on the decoupling of income support from production, influenced perhaps by the insights gained from the concept of by-product distortions discussed by Corden (1974). But, in addition, there is the role that the WTO plays in imposing constraints on the types and settings of trade-distorting instruments and thus on the time series of distortions.

Choosing competitive markets as the benchmark for defining and measuring distortions imposes several costs. Only three of them will be

---

<sup>†</sup> Donald MacLaren (email: [d.maclaren@unimelb.edu.au](mailto:d.maclaren@unimelb.edu.au)) is at the University of Melbourne.

mentioned here which may provide elements of an extended research agenda. The first is associated with the use of a deterministic model of agricultural production and associated deterministic trade functions; the second is the use of a market structure that ignores market intermediaries with market power; and the third is the omission of some nontariff measures.

First, one consequence of introducing uncertainty into the theory of the firm is that the welfare effects of specific policy instruments may be reversed from their effects under certainty. It can no longer be safely presumed therefore that a price distortion leads necessarily to a loss of welfare. Introducing uncertainty also allows consideration to be given to safety-first approaches to food security and provides a wider set of rationales for the choice of instruments of intervention.

Second, imperfectly competitive intermediaries, either private firms or parastatals, moderate the size of price transmissions, one effect of which is that a given tariff reduction is not transmitted in full to the domestic market, thus leading to an upward bias in the size of the welfare measure calculated assuming perfect competition and ‘small’ country (see MacLaren 2016). A further consequence of market power is that the welfare effects of a given instrument may be of opposite sign to those under perfect competition.

Third, many countries apply nontariff measures, only some of which permit the calculation of ad valorem equivalents. Therefore, it may be a mistake to interpret the measurable wedge between international and domestic prices as a welfare-reducing distortion, while recognising that they are of necessity an incomplete set of wedges.

It would be gratifying to economists if the transparency provided by theory, by CGE modelling and by empirical measures were to have been a substantial causal factor in the reduction over the past thirty years in the size of the distortions in agricultural commodity markets.

## References

- Corden, W.M. (1974). *Trade Policy and Economic Welfare*. Oxford University Press, Oxford.
- MacLaren, D. (2016). The contingent tariff of the special safeguard mechanism: what happens when markets are imperfectly competitive?, *Journal of Agricultural Economics* 67, 62–83.