

# POTENTIAL SOURCES OF IMPORT SURGES

# 3

## 3.1 Main types of contributing factors

Knowledge of the sources of an import surge allows policy-makers to take appropriate and necessary measures to control, i.e. to reverse or to accommodate the surge's effects. This chapter investigates some of the potential sources of an import surge especially in developing countries. It draws largely from Grethe and Nolte (2005).<sup>1</sup> Many factors can lead to an import surge and some of them often originate in the importing country itself. Domestic factors, and especially structural production constraints, may be far more important and widespread in determining the onset of import surges. These include domestic supply instability because of climatic or political reasons, changes in market and trade policies, or changes in the exchange rate policy of the importing country. Other factors contributing to import surges are exogenous (i.e. causes originating from the trading partners or from a third country). These exogenous or external factors include export subsidies, export credits, food aid, domestic support and exchange rate policies. The internal and external factors may work alone or, more often, interact simultaneously. These potential contributors are discussed in detail in this chapter, arguing eventually that it is the combination of these factors rather than their individual actions alone that is observed in the real world and should be the focus of the surge identification.

<sup>1</sup> See also De Nigris (2005)

## 3.2 Potential domestic causes

### 3.2.1 Domestic production shortfalls

Production shortfalls are one of the most likely causes of short-term import surges. Temporary production shortfalls due, for instance, to inclement weather and incidence of pests or diseases that disrupt domestic production may lead to surges in imports. The shortfalls can also be the consequences of other factors, such as civil strife or disruptions of the supply of inputs. Overall, production shortfalls signal some deeply rooted structural constraints that impede a sustained growth of domestic production to meet a rising domestic demand. They also expose the lack of tools to prevent and manage production risks. For many agricultural products, a positive correlation between the source of production shortfalls and level of import is an indication of whether or not the production shortfalls trigger import surges.

### 3.2.2 Domestic market liberalization and reforms

Measures taken by government to liberalize the domestic market may also lead to import surge. For instance, the elimination of the countries' producer subsidies may shrink production and encourage more and more imports to avoid a shortage. Likewise, the dismantling of the marketing board and relaxing of the import licensing rules allow swift entries of new importers and hence, increase in import. Also, reduction (or increase) in consumer taxes (or subsidies) may prompt the surge of import.

In the past, many developing countries have protected the domestic producer of staple foodstuff by limiting or preventing imports in the period after the main domestic harvest, opening their borders only after the bulk of domestic production had been sold. This, for example, was traditionally the practice in some of the small economies that border South Africa.<sup>2</sup> Others have sought to protect domestic processing by permitting imports of grain but not flour.<sup>3</sup> Elimination of such protection causes a surge in imports.

### 3.2.3 Border policy reforms (trade liberalization and trade reforms)

Reductions in tariff and non-tariff barriers to trade, particularly following the launch of the Uruguay Round Agreements, may have increased the frequency of import surges especially in developing countries. However, it is important to note that tariff reductions are usually gradual, and therefore may not logically be expected to result in abrupt and large surges of imports. Likewise, commitment to bilateral and regional trading arrangements with more competitive partners and neighbours can lead to import surge.<sup>4</sup>

### 3.2.4 Appreciation or revaluation of the currency

Appreciation or sometimes overvaluation of the currency makes imported products cheaper and affordable to domestic consumers and may, therefore, lead to import surges. Currency appreciation erodes tariff protection through specific import tariffs, thereby creating incentives to import.

Measures that apply at the national border are the most obvious means by which governments can affect the unit costs of imported goods within the domestic economy and consequently the quantities imported. The relevant variable likely to generate an

import surge is the price of the domestic currency. Rapid revaluation of the domestic currency is one of the most important sources of import surges. A recent example of such revaluation is the strengthening of the South African Rand and the tied currencies of Lesotho, Namibia and Swaziland. Between January 2002 and December 2004 the Rand more than doubled against the United States Dollar and currencies tied to the Dollar, including the Chinese Yuan.<sup>5</sup> This, *inter alia*, has led to a flood of textile and clothing imports from China as the revaluation has halved their Rand CIF price. It should be noted that a currency devaluation by a country's important trading partner acts the same way as the revaluation of country's own currency and can also be a source of an import surge.

### 3.2.5 Opening to foreign direct investment

Investments leading to increases in the number of supermarkets, tourist hotels or means of transport into the country change the patterns of food procurement and increase imports in several countries. Other types of investments on infrastructures linked to food trade such as construction of more storage facilities in port areas may also encourage higher levels of imports.

### 3.2.6 Other demand shocks

Sudden changes in consumer preference and animal and plant diseases may shift import demand. Changes in consumer preference, induced, for instance, by population increase or economic boom are not usually abrupt as they do not occur overnight, and are therefore unlikely to lead to a sudden increase in import. But preference changes due to spread of animal or plant diseases may happen fast and trigger a surge in import demand. An example is the case of avian influenza (AI) which in 2004-2006 severely curtailed poultry consumption in many affected countries, thus, lowering international poultry meat prices, changing trade patterns and causing import surges of chicken in other countries. Outbreak of diseases in one type of animal may also prompt the demand in import for

<sup>2</sup> The main aim was protection from South Africa, but the import restrictions applied to all countries and, for example, in the case of Namibia also protected farmers from imports of maize from Zambia.

<sup>3</sup> This has been the practice in Swaziland.

<sup>4</sup> Oxfam (2004) discusses some of the implications of free trade agreement on rice farmers.

<sup>5</sup> In January 2002, one Yuan purchased 1.405 South African Rand. By December 2002, the rate was 1.081 and by December 2004 it had fallen to 0.692.

other product substitutes. For instance, the decline in poultry meat demand because of the AI pandemic may have increased the import demand for bovine meat.

Large national or international gatherings (sporting, political and social events) that draw many foreigners into a country may also prompt import surges as the domestic supply cannot keep up with the temporary but sharp increase in consumption. However, such an increase in import may have been long anticipated prior to the event and the increase in demand may not appear as a shock in the market.

### 3.2.7 Other domestic causes

Changing and rising costs of inputs or energy affecting the cost structures of domestic industries may lead to import surges. Breach of security in the frontiers especially during wartimes may also lead to an import surge. For developing countries with a porous border, undocumented and illicit imports, and underinvoicing or undeclared imports often occur and may encourage the surges in agricultural imports. A sudden increase in export demand of a product may also prompt the imports of one of the inputs used to make the export products.

## 3.3 Potential external causes

### 3.3.1 Export subsidies

Export subsidies lower international prices, make import attractive and may lead to import surges. But export subsidies often criticized for their alleged role in the onset of import surges account for only a fraction of the value of global trade and may be phased out completely in the near future if the talks on the WTO Doha Development Round reach an agreement. The incidence of export subsidies in agriculture is continuously declining since their peak in the 1980s before the conclusion and implementation of the Uruguay Round which limited the use of export subsidies effectively for the first time as the figures on developed countries' subsidies in Annex 3.1 show. This suggests that the importance of export subsidies in explaining the occurrence of import surges may

be overestimated.<sup>6</sup> However, where export subsidies are relatively high (butter, skim milk powder [SMP], cheese and other milk products), they depress world prices and may channel trade flows to countries with low market protection.

### 3.3.2 Export credits

Export credits have been mostly granted for exports to Organisation for Economic Co-operation and Development (OECD) destinations, and were therefore unlikely to cause import surges in developing countries in the past. Still, changes in policies may these effects. In the period 1995 to 1998 almost 60 percent of export credits were received by OECD countries, whereas only 9 percent were received by Net Food Importing Developing Countries and 0.2 percent was received by Least Developed Countries (LDC) (OECD, 2002).

Data on export credits remain scarce as they are not subject to any notification requirements in WTO. Therefore, the latest figures available stem from OECD (2000) calculations for members of the Export Credit Arrangement. In addition to the total export credits granted, the OECD study assesses the subsidy elements within these export credits from the various relevant credit parameters, e.g. interest rates, terms, fees and payment modalities. Some of these results are summarized in Table 3.1.

In addition, the subsidy component of export credits is limited. If conditions of public or publicly financed export credits are more favourable than those which would prevail under market conditions, they have an effect which is similar to that of export subsidies. Such favourable conditions consist of reduced long-term interest rates and this implies that a high amount of export credits could play a role in the emergence of agricultural import surges. But actual figures (Table 3.1) show the low amount of total subsidy elements in export credits and suggest that their relevance in the emergence of import surges to be even smaller than that of export subsidies. Table 3.1 shows that Australia, Canada, the European Union and the United States are the major providers of export credits and accounted for more than 99 percent of total export credits in 1998. In terms of subsidy elements within export credits, the United States accounted for a share of 86 percent in 1998. Although subsidy

<sup>6</sup> See Ashraf, et al. (2005) for deeper analysis.

TABLE 3.1

**Agricultural exports, export credits and subsidy elements within these export credits compared with export subsidies, 1998**

	Ag. exports	Export credits	Subsidy shares of export credits (SSEC)			Export subsidies (ES)		SSEC/ES
			..... million USD.....	% of ex. cr.	% of ex.	million USD	% of ex.	%
Australia	10 501	1 553	5.1	0.3	0.0	1	0.0	510.0
Canada	17 555	1 108	13.6	1.2	0.1	0	0.0	
European Union	57 028	1 254	23.8	1.9	0.0	5 968	10.5	0.4
United States	57 395	3 929	258.0	6.6	0.4	147	0.3	175.5
Others	9 749	65	0.1	0.2	0.0	89	0.9	0.1
<b>Total</b>	<b>152 228</b>	<b>7 909</b>	<b>300.6</b>	<b>3.6</b>	<b>0.2</b>	<b>6 205</b>	<b>4.1</b>	<b>4.8</b>

Sources: OECD (2000), Grethe and Nolte (2005).

elements in export credits play a more important role than direct export subsidies for some countries such as Australia, Canada and the United States, their worldwide total in 1998 was far below total export subsidies granted in that year as well as export subsidies granted since then. That export credit was an unlikely source of import surge for many developing countries in the past does not guarantee that it will remain that way as agricultural export policies change. As the effect of subsidized export credits is similar to export subsidies, they are under discussion in WTO. In this regard, the August 2004 agreement on a framework for modalities provides a rough approach to distinguish between “green” and “prohibited” export credits.

### 3.3.3 Domestic supports

Aside from the direct effects of export subsidies and credits, other policy measures, particularly the domestic income and price supports, can affect net exports and world market prices. Domestic supports may contribute, depending upon the extent to which they are coupled to production, to higher output levels and surpluses that have impacts on

world markets, thus lowering world market prices and affecting long-run conditions of competition for industries in other countries. In any case the surpluses in the world market may trigger import surge in the importing countries.<sup>7</sup>

### 3.3.4 Food aid

Food aid has played important role in emergency food supply response for many developing countries but the amount of food aid varies over the years (see Box 3.1). One way to examine how food aid could have an impact on import surges is whether or not food aid is included in the definition of imports for the analysis of import surges. If food aid is included in the definition, the mechanism is straightforward: a situation with suddenly increasing food aid, for example, emergency aid, would easily establish an import surge. If only commercial imports are taken into account, food aid may still have an impact because it can be seen as substitute to commercial

<sup>7</sup> Example on dairy is discussed in Oxfam (2002).

<sup>8</sup> For a discussion of the “additionality” of food aid see FAO (2002, 2005).

imports; the elimination or reduction of food aid can therefore result in an increase in commercial imports, which could establish an import surge.<sup>8</sup>

The timing, targeting and the distribution of food aid are important to avoid longer-term adverse impacts on competing domestic industries. International food aid includes various forms of providing food commodities among countries free-of-charge or under highly generous terms. The motivation for food aid in the donor country is often twofold: development objectives for the receivers and an outlet for surplus production for the donors. Due to the ambiguity of distinguishing clearly between food aid and commercial export interests, international rules on food aid have been part of various international agreements like the

Uruguay Round AoA, the Food Aid Convention, and the FAO Principles of Surplus Disposal.

### 3.3.5 Changes in policies of state trading enterprises (STE)

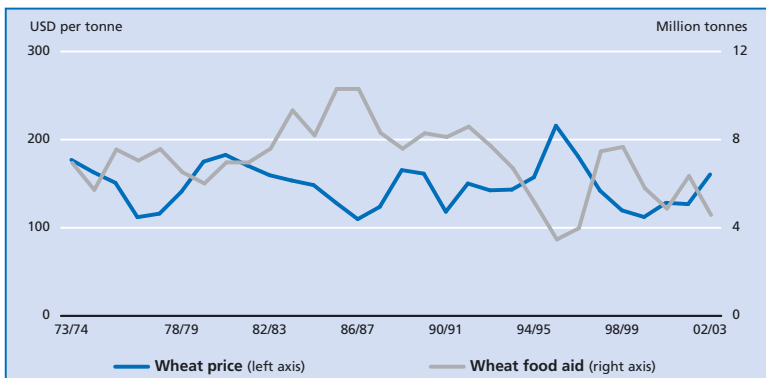
In some countries, external trade is controlled by state trading enterprises (STE) which either have the monopoly to export and import certain products themselves or are able to control external trade by issuing import and export licenses. Rationale behind the installation of such agencies by governments are manifold. They can for instance be intended to use their monopoly power to attract the producer surplus of exporting farmers or to secure the supply of basic

#### Box 3.1 Food aid (1970-2003)

Total food aid varied considerably between 1970 and 2003 with a peak of almost 17 million tonnes in 1992 and a minimum of about 6 million tonnes in 1973 and 1996. Cereals account for more than 90 percent of total food aid, with the United States granting a 40 to 60 percent share of the total.

The ambiguity in the motivation of food aid results in non-optimal targeting with respect to development issues. An example for this is the high prevalence of food aid in periods of low world market prices as shown in the case of wheat. This is because of the higher domestic market pressure in the donor countries and the lower opportunity cost of food aid in such a situation in contrast with the needs of the food aid receiving countries, which are relatively more in need when world market prices are high. The countercyclical pattern of the international price level and food aid is presented in the following figure for wheat.

Wheat food aid and international wheat price (1973/74-2002/03)



Sources: FAO (2005), OECD (2004), Grethe and Nolte (2005).

**Box 3.2****Liberalization of rice export in India**

In 2002, India announced a new export/import policy for the next five-year period. This new policy included the lifting of the quantitative export restrictions and lowering of the minimum export price for certain types of rice in order to reduce public stocks (FAO, 2003). The new policy led to an increase of Indian rice exports from around 2 million tonnes to around 5 million tonnes in 2002 and 3.5 million tonnes in 2003 (FAO, 2005a). The repartition of rice imports from India is shown in the following table. In absolute terms most of these additional imports as a result of the policy changes went to Asian countries as can be seen in the following table. In particular this policy change contributed to an import surge in Bangladesh, where imports from India rose from 0.3 million tonnes in 2000 to 0.9 million tonnes in 2002. Large relative increases in imports also took place in some African countries. In most cases listed, the increase in imports came with either significant declines in import unit values or persistently low levels in previous years, generally below USD 200 per tonne, in some cases even below USD 150<sup>9</sup> (ITC, 2005).

It is important to note that some countries had already faced large amounts of imports of Indian rice in 1998, especially Bangladesh. This corresponds to a peak in Indian exports of rice in 1998 which had already risen to almost 5 million tonnes from a level of 2.0-2.5 million tonnes in the previous years and decreased again in the following years. Unit values of Indian exports in 1998 do, however, not show a serious decline.

**Rice imports from India 1998-2002**

	1998	1999	2000	2001	2002
Bangladesh	2 333 278	380 738	318 416	102 984	937 239
Indonesia	18 722	1 184	10	142 066	561 945
Malaysia	25 345	301	10 601	52 985	359 601
Philippines	55 394	52	0	153	527 196
Singapore	16 172	16 812	18 692	41 716	102 517
Comoros	1 201	0	22	0	31 151
Djibouti	9 435	10 486	3 457	5 624	21 038
Gabon	0	0	0	0	51 050
Kenya	37 115	13 118	22	12 178	31 750
Madagascar	3 000	0	0	0	22 681
Sudan	9 746	84	2 377	1 704	24 412

Source: USITC (2005).

<sup>9</sup> The exemptions are Gabon and the Philippines with import unit values of USD 239 and USD 295 per tonne, respectively.

food commodities by policies such as stockholding, as has been the case with the Food Corporation of India (see Box 3.2). Sudden changes in the policies of such agencies can have strong effects on world markets and markets of major trading partners, especially if the respective country is a large exporter or importer.

### 3.3.6 Depreciation, devaluation of the currency

Depreciation or the devaluation of large exporting countries' currencies may have significant effects on the imports of other countries. The depreciation in an exporting country will make that country's exports cheaper and attract importers from its trading partners and lead to import surges.

### 3.3.7 Concentration of trade and markets

Concentration of exports (or imports) of some food and agricultural products among few countries affects imports (or exports) in other countries. As the level of concentration is far greater among agricultural exporters than among importers, any shock (e.g. policy or weather) from these few exporters can have a strong impact on the world market prices and promote variations in trade levels among many smaller importing countries. But the size of a country's domestic market, regardless of the size of its trade, also plays an important role. Indeed, production or consumption shocks from countries (e.g. China or India) which for some commodities are only marginal traders but are with large domestic markets, may affect the world's import volume and price significantly.

### 3.3.8 Other market shocks that can result in sharp declines in commodity prices

Agricultural production is inherently variable due to climatic and other factors affecting annual outputs. Variations in output in major importing or exporting countries were a primary cause of fluctuations in world market prices. Bumper crops due to exceptionally favourable production conditions in the exporting countries may lead to large surpluses that affect world market prices and result in import surges in importing

countries as mentioned earlier. Similarly, dumping of nearly expired food products also prompts an import surge in some developing countries.<sup>10</sup>

When prices fall, importing countries may expand their purchases to take advantage of the low price, thereby encouraging an import surge. Rapid innovation in production and marketing technologies as well as changes in factor endowments, induced by, for instance, government intervention, can result in rapidly rising export supplies.

## 3.4 Concluding remarks: interaction of the various causes

The interaction among the contributing factors to import surges often brings about outcomes that are different from the effect of each individual factor. What is important when such interaction occurs is to examine what source is most influential in creating an import surge. Such a combination and interaction always occurs as the timing of the involvement of each policy is often difficult to assess and that some factors may not be separated from others.

An example is a small economy reducing its import tariff and producing a more skilled workforce for more skilled-intensive exports. Because of the country's orientation towards the export of skilled-intensive products, the ratio of the wage of the skilled to that of less skilled workers may decrease because an educated workforce will stay away from sectors that use unskilled labour (sector like agriculture). The increase in labour costs in sectors that use unskilled labour combined with the measures to reduce tariff and accumulate technology may weaken the competitiveness of the import competing sector and prompt an increase in import. In this case the interaction and combination of education, tariff reduction and technology have generated an increase in import. Whether the increase in import in such a circumstance is qualified as a surge is another question, but what is important in this example is that the determination of the main source of an import surge is difficult and requires careful analysis of the sequence and combination of events happening prior to the surge. This disentangling of the causes of import surges is important in evaluating the main sources of the injuries and consequence of the surge and will also be discussed in the next chapter.

<sup>10</sup> See Oxfam, 2003.

## APPENDIX 3.1

# AGRICULTURAL SUBSIDIES, THE URUGUAY ROUND AND IMPORT SURGES

The following table presents export subsidy bindings agreed upon in the Uruguay Round as well as since for the implementation period.

In 2002 worldwide expenditures for export subsidies were at USD 3.1 billion, which is only about 24 percent of the current WTO limit and 13 percent of the Uruguay Round base period. Export subsidies have mainly been a phenomenon in European Union agricultural policy, during the base period for reduction commitments and even more so since that period. The European Union accounts for 71 percent of current export subsidy bindings and about 90 percent of export subsidies paid in 2002 worldwide.

**TABLE A.3.1**  
**Percentage shares of selected countries in total value of agricultural export subsidies**  
**(WTO limit and annual expenditures)**

	WTO limit		Expenditures		
	Uruguay Round base	2004	1995	1998	2002*
Total (million USD)	23 003	13 065	7 712	6 641	3 092
European Union		70.9	88.5	87.9	89.8
United States		4.5	0.4	2.2	1.0
Switzerland		2.7	6.3	4.4	6.2
Others		21.8	4.9	5.5	3.0

\* Notifications for all countries were not yet available. Among those countries where no notification had been submitted, only Switzerland and South Africa had applied export subsidies in the previous year. Expenditures of these countries are therefore based on 2001 data.

Sources: Grethe and Nolte (2005).



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