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Market and Welfare Impacts of Foodstuffs Import Tariffs in Iraq

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Market and Welfare Impacts of Foodstuffs Import Tariffs in Iraq

This paper discusses the probable market and welfare effects of tariffs imposed on fresh fruit and vegetable imports by the Iraqi Ministry of Agriculture (MoA). These effects are visually illustrated in the supply-demand graph included on the last page.

In May, 2009, the MoA announced a tariff on imported fresh fruits and vegetables (reportedly 30% ad valorem), effective throughout the normal Iraqi harvest season (May-September, with heaviest harvest in June and July). This tariff will have a market effect (price and volume) and a social welfare effect (gainers and losers) on Iraqi producers and consumers. For this discussion, the tariff is assumed to expire at the end of the normal Iraqi harvest season.

Likely Impacts on Producers

As a result of this tariff, market prices likely will increase. Thus, producers may receive windfall income roughly equal to the amount of the tariff. When the tariff was announced, crops for the current harvest season already were planted. Thus, there was little opportunity for producers to increase output to replace imported products in response to an anticipated higher price.

Other things being equal, if producers feel that tariff-induced higher prices will prevail through next harvest season, they can be expected to plant more area and/or apply more yield-increasing cash inputs, in order to increase marketable output and thereby raise their incomes through higher volumes of sales at higher prices. In other words, one might expect a significant season-to-season supply response to expected higher prices. But other things are not equal.

First of all, producers may not have confidence that the government will renew the higher tariff for the next season. To manage this uncertainty, a strategy of risk avoidance is likely to be adopted. Producers can be expected to not significantly increase their production decisions, just in case the tariff is not renewed. Furthermore, it may be difficult for producers to rapidly increase production, even if they think the government will renew the tariff. Given the weak input supply system in Iraq, the lack of available credit to finance the purchase of additional cash inputs, and the uncertainty of increased (or the same) irrigation water allocation, they may not be able to either expand the area planted and/or to apply more yield-increasing inputs to existing production areas.

In consequence, under current production conditions in Iraq, there may be an insignificant producer supply response to increased market prices resulting from the tariff. Experience in Iraq tends to confirm this pessimistic view. Indications are that there has been little or no detectable supply response by wheat farmers to unusually high guaranteed prices (compared to border prices) offered for wheat by the Ministry of Trade (MoT) in 2008 and 2009.

Likely Impacts on Consumers

Price elasticity of demand by Iraqi consumers for fresh fruits and vegetables is rather high. Thus, consumers can be expected to spend about the same amount of money for these products regardless of price. If prices are high, they buy less volume; if prices are low, they buy more volume. Thus, other things being equal during this harvest season, if the imposition of the tariff were to increase prices in the market by as much as 30%, consumers likely would purchase as much as 30% less product. But, again, other things are not equal.

First of all, to protect their share of the Iraqi market, importers (or their suppliers) may be willing, at least in the short run, to continue to import similar amounts of product and absorb the losses occasioned from paying the tariff. With little change in the supply imported into Iraq, prices will not change significantly from what they would have been in the absence of the tariff, and positive or negative impacts on consumers and producers can be expected to be minimal.

Explanation of Illustrative Supply-Demand Graph (on last page)

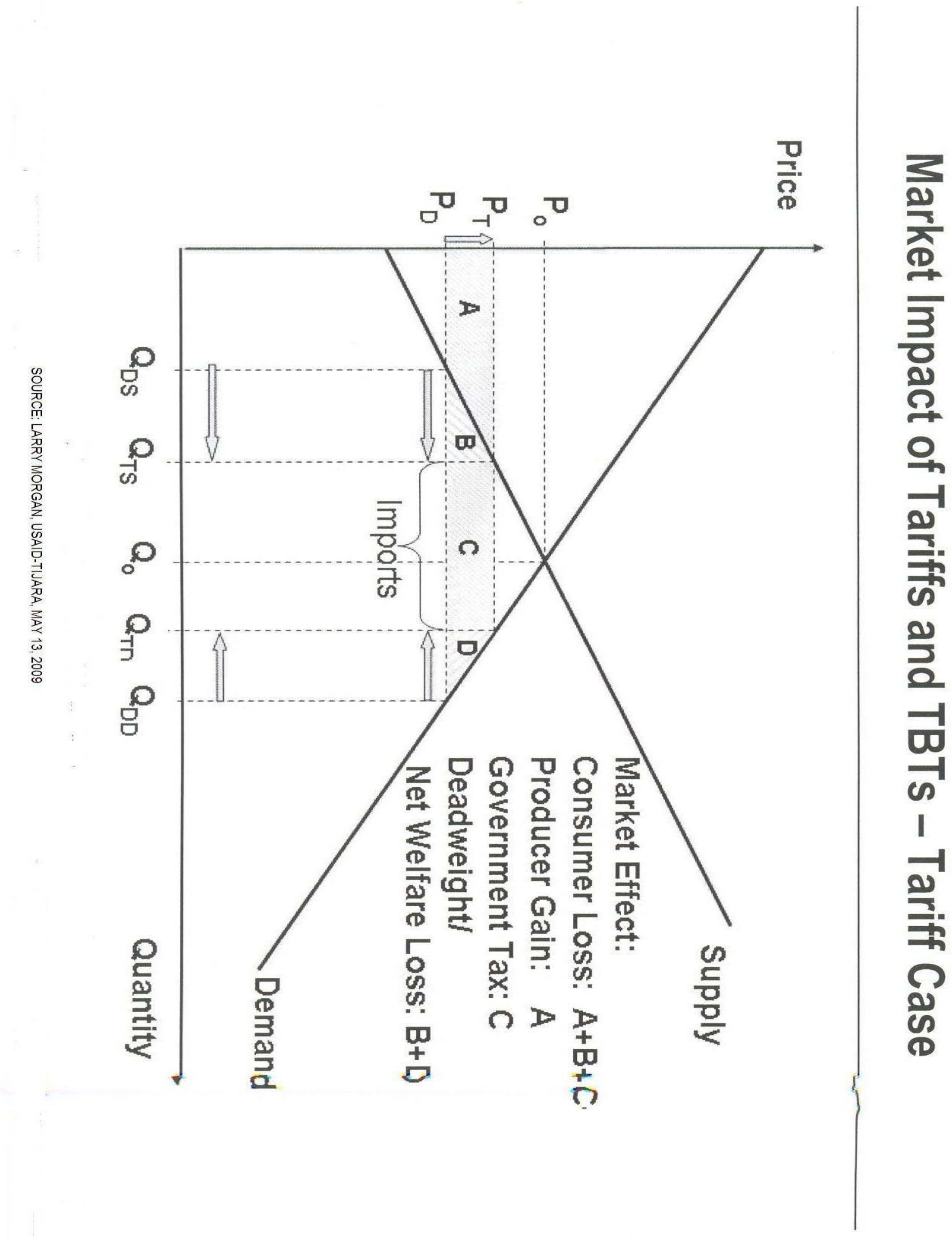
The graph on the last page is a stylized visual presentation of the dynamics of supply and demand adjustments expected to occur when a tariff is imposed on imported foodstuffs. It illustrates the manner in which a market seeks equilibrium between supply and demand when an economic distortion (e.g., an import tariff) disturbs the existing equilibrium. The tariff raises the price from P_D to P_T, which results in a theoretical expansion of national production from Q_{DS} to Q_{TS}, along with a reduction of imports from Q_{DD} to Q_{TN}. Equilibrium is again achieved at Price P_T and quantity Q_{TN}. As explained in the graph text, the economic impacts are: producers gain (amount A), consumers lose (amounts A+B+C), the government gains revenues (amount C, less the cost of administering the tariff), and the citizens of Iraq suffer a net welfare loss (amounts B+D).

Other Likely Economic Impacts

This seasonal tariff may have other negative economic impacts on Iraqi agriculture, on the national economy, and on Iraqi consumers. To illustrate:

1. Because the tariff is seasonal, it is subject to timing uncertainty (and manipulation). Government decisions to impose or lift the tariff could be influenced more by rent-seeking motives than by market conditions (or by miscalculation of expected market conditions), and producers and importers are faced with uncertainties as to when the tariff may be imposed or lifted. Uncertainties increase transaction costs and reduce competitiveness.
2. Producers may have less incentive to optimize their returns through targeting production to off-season markets
3. Tariffs that increase prices of foodstuffs are regressive to consumers: the poorest consumers are the first to be "priced out of the market" by higher prices.
4. Subsidies and tariffs favor capital-intensive inputs, which is not consistent with Iraq's current unemployment crisis.
5. Import tariffs raise internal prices above a competitive equilibrium, resulting in reduced incentives to producers to make more efficient use of factors of production. For example, they are less likely to incorporate productivity increasing technologies, invest to improve enterprise management, etc. This dampens increases in agricultural competitiveness, and becomes an additional impediment to achieving dynamic economic growth and improved national welfare.

Policy-makers should ask themselves the following question: Are Iraqis better off or worse off with this tariff?


Market Impact of Tariffs and TBTs – Tariff Case
Price
Quantity
Supply
Demand
P_o
P_T
P_D
A
B
C
D
Imports
Q_{DS}
Q_{TS}
Q_o
Q_{TD}
Q_{DD}
Market Effect:
Consumer Loss: A+B+C
Producer Gain: A
Government Tax: C
Deadweight/
Net Welfare Loss: B+D
SOURCE: LARRY MORGAN, USAID-TIJARA, MAY 13, 2009