Economics and Political Economy of Trade Interventions in Response to Commodity Price Spikes

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Abstract

This thesis analyses the economic effects and the political economy causes of actual and proposed trade policy interventions in response to agricultural commodity price spikes. It does so by employing a theoretical model of world trade that incorporates both import and export policies in a common framework.

The thesis begins with an analysis of the economic effects of trade interventions by investigating terms of trade effects, welfare implications, and distributional impacts within countries. The international price effect of trade policy interventions of large (or sufficiently large group of small) food-importing countries in response to a price spike is to reinforce the initial exogenous price spike. Insofar as the policy reactions of importing countries trigger exporting countries to respond with trade policies, the price spike is further accentuated. The own-welfare effects also are accentuated. This thesis shows that if countries began with some trade restrictions, the national welfare effects are more complex. The welfare of countries that do not intervene in trade also is affected by interventions of other countries. The within-country distributional effects show that the effects on households‟ real income depend on initial proportions of their income from different productive factors and the initial proportions of their consumption expenditure on agricultural and non-agricultural tradables and on non-traded goods.

The thesis then explains why countries alter their intervention in trade in response to a price spike despite their global economic cost, and analyses the implications for policy outcomes between food-importing and exporting countries. A political economy model is developed which predicts that government preferences for averting losses for domestic interest groups from a price spike lead to a change in trade distortions. In particular, trade interventions in response to a downward price spike are predicted as proposed by some developing country members of the World Trade Organization (WTO) for an agricultural Special Safeguard Mechanism. The model predicts that higher import tariffs are likely in a non-cooperative setting, and that higher export subsidies/lower export taxes will emerge in exporting countries in response to the raising of those tariffs. Another contribution of the thesis is to show that cooperative trade policies could lead to a more efficient outcome, and while self-enforcement of cooperation is unlikely in a one period game, in a repeated game setting and with possible involvement of the WTO an efficient outcome is possible.

Drawing from the same political economy model to provide a political economy explanation for trade interventions in response to an upward price spike, the results show that the higher the concern for consumers, the higher will be the assistance received by them in the form of insulation from the international price spike. Similar to the results of the case of a downward price spike, the model predicts that cooperative trade policies are welfare improving for both importers and exporters even though the cooperation may not be self-enforcing in one period. An

efficient trade policy outcome between food-importing and food-exporting countries can be achieved in a repeated game setting and with possible involvement of the WTO.

Declaration

This work contains no material which has been accepted for the award of any other degree or diploma in any university or other tertiary institution to T.M. Jayanthi Upamalika Thennakoon and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text.

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