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On the Non-Equivalence between Specific and Ad-Valorem Tariffs under Loss Aversion: Implications for Agri-Food Trade

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One of the accomplishments of the Uruguay Round of multilateral trade negotiations has been the tariffication of non-tariff barriers. The objective pursued was to make trade policies more efficient and more transparent. Yet, "tariff simplification" is listed as one of the 10 key outstanding agricultural issues to be resolved in the current Doha Round. Tariffs can be quite complicated. Specific import tariffs are defined in monetary terms (e.g., Can$/kg) while ad valorem tariff are expressed as a percentage of the border/world price. A compound tariff combines specific and ad valorem tariffs by adding them together or by subtracting one from the other while a mixed tariff uses the specific tariff under some conditions and the ad valorem tariff otherwise. Specific, compound and mixed tariffs are relatively more popular in agriculture than in other sectors of the economy. We believe that one contributing factor is the volatility of prices along agri-food supply chains and the manner with which agricultural producers' behavior is impacted by volatility. Our theoretical model posits that agricultural producers are pricetakers and compete against foreign suppliers when selling their goods to imperfectly competitive retailers. In the absence of volatility, the best policy calls for an import subsidy to offset the retailers' tendency to limit their purchases to secure higher margins. Ad valorem and specific subsidies are then equivalent. When price volatility is present, the best policy entails taxing imports and the specific tariff dominates the ad valorem tariff.

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