IPC Alert

International Food & Agricultural Trade Policy Council

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What is the role of trade in reducing price volatility?[1]

Here is an argument often heard: The events of 2007-08, as well as 2010-11, have demonstrated that countries are foolish to rely on international markets. Twice burned, so the argument goes, efforts must be geared towards greater self sufficiency and to building up national reserves. Some countries heavily reliant on imports, are even undertaking questionable large-scale investments in land abroad in an attempt to lock in a reliable flow of agricultural commodities for their domestic population in the future.

The food price crisis has triggered renewed attention on the agricultural sector, which in many countries and over many decades, had been neglected. This is to be welcomed since the agricultural potential in many parts of the world has not been sufficiently exploited and scaling up production will play an important role in meeting increasing global food demands.

Yet, turning away from international markets is not advisable: we must keep in mind that the world output of a particular agricultural commodity is far less variable than the output of that commodity in an individual country. This does not mean that international markets are working sufficiently well – events over the last few years have certainly demonstrated this. Rather than turning away from international markets, however, IPC and its members strongly believe that *improving* international markets must be a priority.

Much needs to be done both in order to improve international markets and mitigate price volatility. Improving the ability of agricultural sectors around the world to become more productive and resilient, increasing market transparency, and establishing sound social welfare nets are all of vital importance. In these brief remarks, I will limit myself to the role that trade policy reform can play.

First, it is useful to review how trade distorting policies over the last decades have created what are referred to as "thin" or "shallow" markets, which are more vulnerable to supply and demand shocks. Secondly, I want to speak about the ad-hoc measures countries undertook in an attempt to insulate themselves from steep price increases, which in many cases served to increase price volatility. Lastly, I will also briefly refer to biofuels.

There are reforms that can be undertaken on all of these fronts, which, along with other policy responses and investments, can help both to mitigate price volatility itself as well as its impacts. The G-20 has an excellent opportunity to not only call for such reforms, but to take action and clearly commit themselves to such reforms.

I. "Thin" International Markets

"Thin" international markets are the result of imperfect price transmission between international and domestic prices. Imperfect price transmission leads to a relatively lower share of world production of a particular commodity being traded, and is therefore more vulnerable to supply or demand shocks than a deeper market would be.

1 These remarks were made by Charlotte Hebebrand, IPC Chief Executive, at an IFPRI seminar on "Informing the G20 Agenda: Actions to Address Food Price Volatility," June 14, 2011. They reflect the views of IPC members and draw on the 2 June 2011 policy report prepared by international organizations "Price Volatility in Food and Agricultural Markets: Policy Responses" at the request of the G-20. The paper can be found at http://www.unctad.org/en/docs/2011_G20_FoodPriceVolatility_en.pdf

Again, a number of factors can impede price transmission, such as physical barriers, remoteness, inadequate transportation infrastructure or high energy prices. Trade distorting policies have also played a role. Although the agricultural sector has been subject to international trade disciplines since 1995, it remains heavily distorted: average food and agricultural tariffs for middle and high income countries are 25% and 22% respectively and as such are four times higher than tariffs on non-agricultural goods. Export subsidies can still be undertaken, when they have long been illegal for non-agricultural goods. Government support in OECD countries (as of 2009) still makes up 22% of agricultural producers' total receipts, and more than half of that fits into the trade distorting category of domestic support. These policies have been pursued in order to insulate domestic prices from world markets, so as to provide domestic producers in wealthy countries with higher incomes. They have also served to drive down world market prices (a trend often forgotten given present concerns over increasing prices), which, along with trade distorting policies pursued by developing countries (which often made accessing export markets prohibitively costly), created a serious disincentive for producers in poor countries and led to the declining levels of investment in the agricultural sectors of many developing countries. These policies thus serve to distort, obscure and impede the transmission of price signals to competitive producers, thereby creating thin markets.

Although a successfully concluded Doha Round would not lead to deeper markets overnight, it would certainly pave the way for deeper markets, in particular if it were combined with a strong Aid for Trade initiative. The agricultural modalities – if implemented – would achieve significant reductions in tariffs, make sharp cuts in domestic programs that distort trade and finally eliminate export subsidies. Decreasing, or in some cases eliminating trade distortions will provide greater incentives for investment in the agricultural sectors of developing countries, leading to badly needed productivity increases to meet the rapidly growing demand for food as a result of anticipated growth in population and incomes.

While it has become fashionable in some quarters to declare the Doha Round dead, IPC continues to emphasize the importance of these negotiations in particular for the agricultural sector, which to date has only been subject to multilateral negotiations once.[2] It is important to keep in mind that the multilateral approach holds the most promise for substantial agricultural trade reform given the sensitivity of the sector and the need for trade-offs with other sectors. Bilateral and regional trade agreements can lead to increased market access, but only for participating countries, and certainly cannot adequately tackle domestic support reductions.

Some helpful steps could be taken as part of a "Plan B," i.e. a commitment to provide duty free, quota free access to LDCs, a commitment to phase out export subsidies and equivalent measures, and addressing trade distortions in the cotton sector, but it will be important not to lose sight of the need to conclude an overarching agreement, which tackles tariff and subsidy reductions more broadly.[3]

II. Ad hoc measures in the face of price volatility

It is interesting to note that the more recent wave of ad hoc measures has served to *block or decrease* exports and *increase* imports and are thus in stark contrast with the measures outlined above that were primarily intended to *limit* imports and *expand* exports.

It is also interesting to note that existing WTO trade disciplines do not truly cover these kinds of measures. This can be explained by the fact that the major preoccupations in the run up to but also in the aftermath of the Uruguay Round Agreement were around access to markets and the impacts of surpluses in OECD countries and the dumping of such surpluses on world markets.

Export restrictions

According to the FAO, during the 2007-08 crisis, out of some 81 developing countries surveyed, 25 banned exports or increased taxes. Export restrictions by major food exporters had a significantly destabilizing effect: it is estimated that they led to a tripling of prices in the rice market in 2007 despite stable demand and harvest. The impact of export restrictions imposed on wheat in 2010 also led to very sharp price increases.

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2 Doha and Beyond: Continuing the Reform of the International Trade System for Food & Agricultural Products, June 2011, http://agritrade.org/Publications/DohaandBeyond.html

3 IPC Policy Alert on Plan B, June 4, 2011 http://www.agritrade.org/pressroom/documents/PlanB.pdf

Such measures have contributed to a collapse of confidence in international markets and have been most problematic for the poorest import dependent countries (who recently tabled a proposal on export restrictions in the WTO) and have also created difficulties for humanitarian organizations seeking to procure food aid.

Art.XI of the GATT prohibits quantitative restrictions but allows exceptions on exports that are temporarily applied to prevent or relieve critical shortages of food stuffs other products essential to the exporting contracting party. The Agreement on Agriculture expands on this by requiring countries to give due consideration to the effects of export restricting / prohibiting measures on importing members' food security, to give notice in writing, as far in advance as practicable, and to consult, upon request, with other members. This requirement, however, does not apply to developing country members unless they are net food exporters of a specific foodstuff. Altogether, these disciplines are not very tight, contain a number of loopholes and undefined references and weak as they are, have not been properly implemented: not a single country provided advance notice of its intention to impose restrictions during the 2007-08 crisis.

Countries have also agreed to exempt humanitarian food aid purchases from export restrictions, but it remains to be seen whether these pledges will be honored. The Doha Round agricultural modalities include some modest improvements to the WTO disciplines on export restrictions and IPC has made some suggestions for a more ambitious approach, that also encompasses export taxes.[4] We have also called for the including improved disciplines on export restrictions in a Doha Plan B.

Although such export measures are often undertaken in order to shield a country's population from steep price increases, they are not always successful in doing so, and moreover hamper badly needed supply responses and only contribute to higher prices (as we demonstrate in an IPC paper on export restrictions in Argentina[5]).

Many countries view disciplines on such restrictions as a threat to their sovereignty, and given the often limited means poor countries have to support vulnerable parts of their population, this is certainly understandable. Yet, for many decades, countries were also adamantly opposed to disciplines on their import regimes, but with sufficient safeguards and exceptions, their resistance greatly lessened.

Temporary reductions of import tariffs, precipitate purchases and hoarding

The FAO also found that 43 countries reduced import taxes and several countries sought to procure large quantities of supplies from international markets, not because they had an immediate need for doing so, but because they feared that high prices would persist and lead to scarcity.

IPC is certainly in favor of reduced import tariffs, but the reality was that such sudden decreases led to greatly expanded demand which served to further drive up prices. Precipitate purchases and hoarding – also by private sector actors - had the same effect.

There is considerable debate around the pros and cons of food reserves. IPC's position is that stockholding is most effectively undertaken by private actors, that government reserves are costly and difficult to manage, not effective at stabilizing prices, but possibly helpful for emergency use in vulnerable countries. What is clear is that attempts to rapidly build up reserves during times of high prices in the last few years contributed to a sense of panic and drove up prices even further.

III. **Biofuels**

There is of course a lot of deliberation around the impact of biofuels on price volatility and again, I limit myself to just a few trade related remarks. High tariffs on and subsidies for biofuels have distorted markets: more open international markets would allow renewable fuels and feedstocks to be produced where it is economically, environmentally and socially feasible to do so.

IPC has raised questions about domestic support that contributes to food price increases, such as biofuels subsidies, but arguably also set-aside requirements. Historically, of course, the concern of producers around the world has been the

4 Agricultural Export Restrictions, January 2009 http://agritrade.org/documents/PolicyFocus.pdf

5 The Domestic Impact of Export Restrictions: The Case of Argentina, http://agritrade.org/ExportRestrictions.html

price depressing impact of subsidies, as reflected in the WTO rules on domestic support, and measures that might contribute to higher prices were rather welcome. If prices are likely to remain high, as many experts predict, might domestic support rules also need to address the impact of subsidies that serve to drive prices up even further, to the detriment of consumers?

Lastly, the elimination of mandates or the creation of more flexible mandates would be welcome, but it is important to keep in mind that if the price of oil remains high enough, there will be incentive to produce biofuels even in the absence of mandates. A recent IPC paper floated the suggestion that governments could purchase call options on agricultural feedstocks from biofuel producers, to be exercised in times of need, was taken up in the preparatory materials prepared by a number of international organizations for the G-20 discussion on policy responses to price volatility.[6]

Conclusion

To sum up, while there are many factors that contribute to both thin markets and price volatility, trade policies play a significant role.

G-20 members have of course continuously called for a conclusion of the Doha Round, and will likely do so again. Especially in light of their efforts on price volatility, it would be particularly appropriate if they back up these calls with more concrete actions geared to actually concluding the Round! A Plan B can be helpful, but should not detract from the larger goal.

The G-20 is also expected to weigh in on the topic of export restrictions. A clear commitment to exempting humanitarian purchases from export restrictions certainly seems widely acceptable. More reforms will however be necessary – the steep food price increases of the last years, combined with the expectation that high prices and increased vulnerability to shocks may define the years ahead, means that trade reform efforts must also focus on the rights of importers, and not solely on the rights of exporters as they have traditionally done.

The question of how trade rules apply to the biofuels sector has long been rather murky, and here, too, IPC sees the need for clarification.[7]

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6 Biofuels and Food Security: Time to Consider Safety Valves? February 2011 http://agritrade.org/Publications/Biofuelsand-FoodSecurity.html

7 Biofuel and Biomass Subsidies in the U.S., EU and Brazil: Towards a Transparent System of Notification, September 2010 http://agritrade.org/BiofuelSubsidiesUSEUBrazil.html; WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, October 2006 http://agritrade.org/Publications/wto_biofuels.html

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