

The International Trade System and Agricultural Price Volatility

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Thank you very much for inviting me to this event. I am very happy to be here and look forward to benefiting from interaction with this distinguished audience. I want to talk about some important aspects in the context of the International Trade System and Agriculture Price Volatility. One fact that is clear to me is that this is a very complex issue. In fact, I realized this very early in my life.

I come from a farming family in the Gangetic plain of India. The concept of agriculture price volatility was introduced to me initially through the worry lines on the foreheads of my elders. I also learnt early that there was a link between the volume of production and price of the agricultural output in the market. Since the family largely provided its food from its own produce, we felt safer when the production output was large, even if the price was lower. Nonetheless, we felt elated when the prices were higher. In sharp contrast, the landless agriculture workers and consumers in the city were devastated. For me, early lessons included that it was not volatility *per se* but the effect of volatility which should be a major focus, and that that any price change could be a source of joy to some and sorrow to some others. This showed the importance of balancing different effects and stabilising volatility. I also saw the varying degrees of vulnerability amongst small and larger farmers. The dangers of a "Double V", i.e. Volatility and Vulnerability, were high for most of the rural population.

Thus, the importance of having a higher output and stability of income was abundantly clear to even the children in my village. So, as some of us would say, "***The issue is so clear that even a child knows the importance of both higher agricultural output and stability of income and prices***". This meant **increasing productivity** and addressing the variability of both **yield and prices** of agriculture.

I grew up to be an economist with a focus on development and international trade, and the issue of agriculture price volatility has been with me ever since, in some form or the other. Among the various additional insights that I have gained include that international trade is crucial for agriculture growth and improving opportunities for all nations. Especially for developing countries and Net Food Importers, **international markets are their economic lifeblood, their passport to greater development and better living standards.**

With the additional important insights overtime, I realized that:

- World prices and price variability are influenced both by domestic agriculture policy, and by other factors such as input costs, including fertiliser (i.e. oil prices), or changes in supply and demand (e.g. due to droughts, biofuel production, rapid growth, or speculation).

- Many of these factors are outside the scope of agriculture policy and some are even beyond the control of policy makers, as such.
- Since volatility of agriculture prices occurs for a variety of reasons, completely stabilising agricultural prices is not possible. In fact, some price volatility may even be desirable so as to indicate market signals.
- In general, price spikes are a consequence of unusually low levels of aggregate stocks or due to major policy shifts.
- It is therefore necessary to develop improved buffer stock practices, and to understand the implications of major policy shifts.
- Appropriate market signals are an important part of any regulatory regime to create efficiency.
- Some existing major policy interventions in agriculture not only produce extensive adverse incentives, they are also seen by many as inherently unfair. For example, while subsidised exporters may be insulated from the vagaries of international agriculture markets, unsubsidised exporters are exposed to the highs and lows of prices swings.
- These distortions make it difficult to adequately address the two types of policies needed with respect to agriculture price volatility. One, is to mitigate price volatility. The other, to address the effects of the price volatility.
- To improve the situation, we require a combination of policies, both domestic policies and those dealing with the international trade market.
- Policy regimes which improve stability and predictability include a stable and predictable International Trade System.

The WTO system is the multilateral trade system providing stability and predictability in international trade. In addition to its disciplines, this system provides a forum for:

- greater transparency and information on trade related policies;
- sharing concerns and perspectives on appropriate responses;
- working on reducing major distortions in global markets so that appropriate incentive mechanisms are in place;
- keeping markets open and thus enhancing opportunities, together with the possibility of flexible response in specified, justified situations; and,
- Aid for Trade, i.e. assistance to promote supply side capabilities for poorer countries to better integrate in the International Trading System and benefit from additional opportunities.

Subsequent to the food price crisis of 2008, some experts are of the view that we have now entered a new era of more unstable food prices on international markets. The food crisis has also underlined a need to contain the volatility of food prices. The crisis also focused the attention of many nations on increasing their domestic agricultural production.

At the time of high prices in 2008, a number of countries resorted *inter alia* to trade policies, though with an interesting dichotomy with respect to their imports and exports of food items. For imported food items, nations reduced tariffs and applied trade facilitation measures to reduce domestic prices. These nations therefore relied on international markets to help them deal with the effects of the price rise. A majority of the countries resorting to trade policy measures were in this category of implementing market opening policies. In contrast, a number of nations exporting certain food items restricted their exports to keep their domestic

prices low for consumers. These trade restrictions caused global prices to rise even more, leading to widespread alarm and concern, and even increased tensions.

Many have noted that trade policy restraints are very blunt instruments for dealing with volatility, especially in the modern era of myriad financial instruments for risk management by food buyers and sellers. Furthermore, beggar-thy-neighbour policies diminishes the international public good contribution of trade openness. In contrast, some analysts examining agriculture price volatility have argued that to keep domestic prices stable, nations should be able to raise import tariffs and impose other restraints when required. However, the suggestion for exporting nations is different, namely that they should be more disciplined and not impose export restraints. Before we move further and take a closer look at these suggestions, one point seems to be clear. Exporters of agriculture products are NOT being advised to impose trade barriers. To the contrary. They are being advised to have greater disciplines with respect to their trade restraints.

Thus, the advice is for importers of the food products to increase tariffs in order to stabilise agriculture price volatility. To me, this is a very partial assessment of the situation. Let me explain by taking a closer look at specific situations faced by nations.

We have seen that for food imports, countries reduce tariffs on imports when agriculture prices rise in the international market. This action keeps domestic prices more stable and makes food more affordable. It would not make sense to increase tariffs in such a situation.

Let us now consider the situation when food prices are falling. Basically any advice to raise import tariffs in this situation to achieve greater price stability in a food importing country is an advice to increase the price of its import requirements.

There is something which makes me uneasy about this policy suggestion. And this is not because I have seen how the hungry behave politically when they see deliberate policy steps to limit their access to food. It is much more because of the extensive acute poverty in many countries. As Amartya Sen has explained in his work on Poverty and Famines, an increase in food price means for the poor a **substantive loss of entitlements to food**. It makes a difference between life and death, between malnutrition and being healthy. We saw this phenomena at a global scale in recent times when the food crisis of 2008 led to the number of persons being affected by malnutrition crossing 1 billion.

The argument for raising tariffs is to encourage domestic farmers. I feel that two alternative major initiatives would be much more meaningful. One is to focus on removing or substantially reducing the policy induced distortions that prevail in agricultural markets, and thus correct the incentive structure and create a more level playing field. This will also enhance the incentives to unsubsidized domestic producers.

The other important initiative is to increase production through a major increase in the agriculture investment. The potential for increasing productivity is immense, especially for smaller farmers. This needs co-ordinated effort at both the national and international level.

The huge scope of this work is evident, for example, in the document produced by the Alliance for a Green Revolution in Africa, on the "Strategy for an African Green Revolution". If you examine this document for the perspectives on trade *per se*, the relevant

views do not agree with the suggestion to increase import restraints. The views seem to emphasise the opposite, and I quote, "*Targeted government investment in infrastructure, and policy reform that eases cross-border trade, would likewise expand markets. ... As an organization active in countries across sub-Saharan Africa, AGRA [Alliance for a Green Revolution in Africa] is particularly well placed to encourage regional initiatives such as ... Advocating for improved regional trade agreements to remove trade barriers and build transport link*".

Let us now consider another possible reason for suggesting higher import tariffs. It may be to help certain nations, normally developed nations, to operate their supply management policies. This suggestion, however, overlooks political economy issues arising in the context of interactions among nations. It is noteworthy that many of these countries are more capable of assessing and dealing with the implications of price volatility. Certain developed countries in this groups are presently the subject of strong requests to reduce existing major distortions in their agricultural regime. Suggestions to introduce another form of distortion in the international market in this situation is potentially short-sighted.

An important point often overlooked in practice is that the presence of these distortions in some nations encourage other nations to also introduce their own distortions. Developing countries which find it difficult to provide subsidies are under pressure to resort to the distortions that are easily available to them, namely tariffs. Such actions do not result in any levelling of the field. In fact they are not advisable. For food importers, imposing tariffs on food items would be like *shooting themselves in their stomach to feed their ego*. Similarly, import tariffs on raw materials would introduce non-competitiveness in value added activities. Moreover, as Professor Lerner showed us long ago, import tariffs are also equivalent to taxes on exports.

Further, policy analysts deal with second-round effects differently for agriculture price volatility in comparison to the analysis used for suggesting trade measures. For agriculture price volatility and its effects, even elementary analysis in Economics 101 such as the cobweb theorem, usually takes account of developments over more than one period of time. However, for suggesting imposition of trade barriers, the analysis quickly becomes oriented towards a single period analysis, without much consideration of the subsequent effects of such policies. Apart from other effects, such actions would give rise to negative reactions and increase tensions in today's world with its changed political economy and power balances, rapid communications, heightened sensitivity to international policies taken to limit economic opportunities, and a major focus on whether or not policies of larger nations are fair. This would be counterproductive in several crucial areas where co-operative efforts from the international community are required, including food crisis, energy crisis, financial crisis, climate change, and of course the functioning and improvements in the international trade system.

Even if you do agree with me in the criticism of agriculture trade restrictions and distortions, you may be thinking that someone like me is expected to make such a point. Allow me to quote Mr. Jaques Diouf, Director General of the FAO. Regarding international trade he has stated that we must "*devise agricultural development policies, rules and mechanisms that can forge an international trade system that is not only free but also equitable*". He elaborated further that, "*We must correct the present system that generates world food insecurity on account of international market distortions resulting from agricultural subsidies, customs*

tariffs and technical barriers to trade, but also from a skewed distribution of resources from official development assistance." His reference to customs tariffs here is as a barrier to trade which needs to be reduced, not as a policy which should raise further barriers.

Success with development initiatives contributes to improve the capacity to deal with the effects of agriculture price variability. We need an International Trade System and international efforts to adequately address these concerns. An indication of the type of International Trade System required is given by Target 2 of Goal 8 of the Millennium Development Goals or MDGs, which states as follows: "*Develop further an open, rule-based, predictable, non-discriminatory trading and financial system*". These are the same conditions as used to describe the WTO system. We can thus see the relevance of the WTO system. The focus is not to devise a new System but to improve the existing one for better achieving the relevant objectives. Negotiations in the Doha Round are precisely an effort to do this.

Similar to a System to address development concerns, we need an International Trade System which helps mitigate agriculture price volatility. This would be a system which maintains stability and predictability in the international market.

Would it not be ideal if for agriculture price volatility we require an International Trade System which is similar to that required for addressing development concerns?

If we consider the various analyses of the 2008 agriculture price rise, an important conclusion is that no new international regulatory mechanisms are required in the area of international trade. The basic structure of the existing mechanism is thus adequate, i.e. that contained in the WTO. This does not mean that improvements in certain areas are not required. They certainly are needed, and as I mentioned just now, WTO Members are making such efforts in through the Doha Round negotiations.

Therefore, to address price volatility too, we need an open, rule-based, predictable and non-discriminatory trading system. This is the system which is encompassed in the WTO regime.

The WTO System provides greater transparency, enhances stability and predictability of the regime in both domestic and international markets; allows flexibility for addressing national concerns relating to farmers and consumers; embodies flexibility to establish relevant market mechanisms, to make disciplined public policy response to mitigate risks, and provide insurance to farmers or poor consumers. Moreover, it has a permanent fora to make co-operative efforts, settle disputes amicably, and better manage the international market interactions.

The WTO system provides the flexibility to implement the necessary policies, including those arising from the various analyses of recent agriculture price volatility. These studies emphasise a number of initiatives, including: developing better buffer stocks mechanisms, and improving the availability of information and response time in the market to enhance the efficiency of markets. These would address to some extent the speculative activities in agriculture markets. Likewise, the importance of putting in place new international regulatory mechanisms for the financial sector is seen as very high priority. Another noteworthy point is an explicit recognition that trade finance is a different type of financial instrument and needs to be both encouraged and be less strictly regulated than finance in

general. Better availability of trade finance would make it easier to conduct agriculture trade to fill the gaps in supply and demand. Trade finance needs less rigid regulation because repayment of trade finance is quicker and more certain in comparison to other types of finance. For this reason the WTO too has been highlighting the importance of facilitating the provision of trade finance, and has worked with other international institutions to make this possible.

All these policy initiatives are possible within the WTO regime. Moreover, we need some additional reforms which are possible only under a multilateral trading system, i.e. the WTO.

Since agriculture markets tend to be thin, major distortions in agriculture can lead to production and trade effects which lead to greater price volatility. Reduction or elimination of these distortions can help reduce the unevenness in world production and partly mitigate geographical risk in food supplies. The Doha Round agriculture negotiations focus *inter alia* on reduction in major domestic support, elimination of export subsidies, and improved market access opportunities through larger market access and reduction in tariff escalation. In addition to encouraging more efficient production of agriculture and facilitating access to international agriculture markets, this should help to reduce price volatility. The WTO framework thus provides the possibility of reducing the major distortions in agriculture and improve the disciplines required for greater predictability and stability. With such improved disciplines and more level playing field, together with investment to increase productivity in regions where production is presently adversely affected by these distortions, we would over time have stronger markets and domestic abilities. These efforts would contribute to more predictable trade flows and a reduction in agriculture price volatility.

Since special concern has been expressed about export restraints, I want to give a quick comment on this issue. Some WTO Members have put forward a proposal in the Doha negotiations for strengthened disciplines on export prohibitions and restrictions. Taking account of the discussion in the Comprehensive Framework of Action developed by the UN Secretary General's High Level Task Force on Food Security, we could emphasise four distinct points with respect to these export restraints. One, food aid should be exempt from any export restraint. Two, countries should be encouraged to consider alternatives which make export restraints their last rather than first option. Three, the importance of following WTO procedures of transparency and prior consultations. Four, the possibility of improving the disciplines through Doha Round negotiations.

A successful Doha Round will result in a number of additional opportunities not only in agriculture, but also for industrial products and services. We have seen that factors beyond agriculture *per se* are also relevant for agriculture price volatility. These additional opportunities will help improve overall efficiency and income earning opportunities and allow policy makers to better address the effects of price volatility.

An important requisite for addressing price volatility is for nations to address it together in a co-operative way, with better awareness of each other's sensitivities and of the multiple links between various areas and initiatives. The existing WTO Committees and Councils provide a very useful fora for such efforts. This fora was used to great effect in the recent financial crisis to diminish fears on account of the potential for widespread use of protectionist measures. This fora is similarly available for other trade-related concerns. It also provides the possibilities of discussing and better informing the Members on emerging concerns which

may be relevant for dealing with agriculture price volatility through the International Trade System.

Thus in the context of price volatility and other relevant objectives, we have a well established and robust International Trade System in the WTO. This can be improved further through a successful result in the Doha Round. We should both keep this system strong, and make concerted efforts to bring the Doha Round negotiations to a successful conclusion.

Thank you very much.