

Price Volatility and Border Measures

IPC/ICTSD and University of Barcelona

Agricultural Price Volatility: Prospects, Challenges and Possible Solutions

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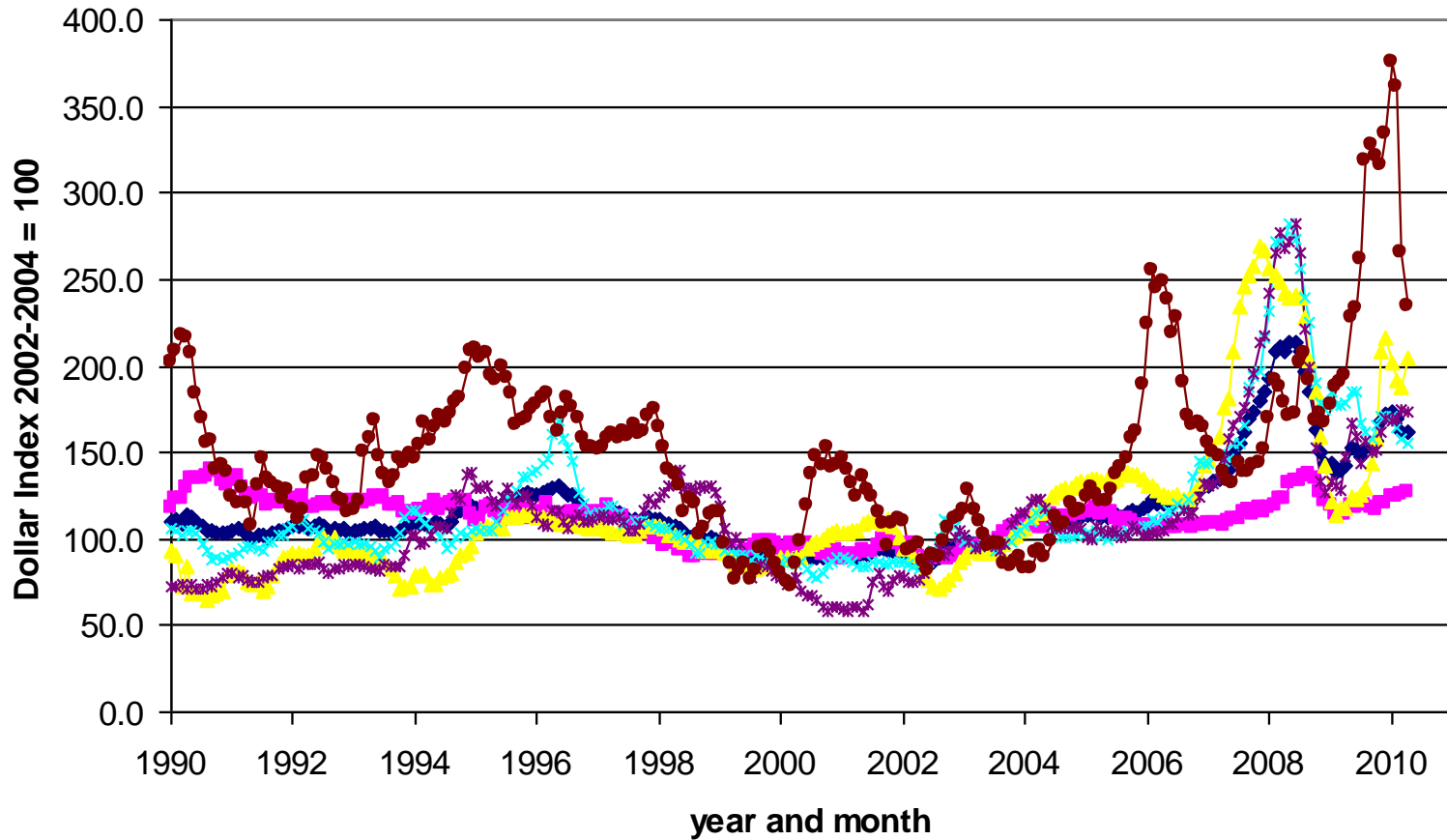
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After the price spikes:

Understanding the management of price volatility in developing countries

- To prepare for possible new shocks, and – more generally – to better handle a more volatile price environment in the future.
- Objectives of this presentation:
 - Review past policy responses in developing countries.
 - Present some questions and related commentary on how developing countries might better manage *unilaterally* agricultural price volatility in the future.
 - Address briefly the question of whether WTO rules should have a larger role to play with regard to measures that exacerbate global agricultural price spikes.
 - A look at another price phenomenon (forgotten in light of food price spikes): temporary but harmful declines below trend of agricultural prices and policy responses thereto.

FAO food price indices 1990 to April 2010



What was the policy context in 2007-08?

- Recent price spikes occurred in an environment of increasingly-open ag markets in many developing countries – but barriers to trade remain.
- Ag markets have been liberalized, particularly so in Latin America.
- Ag tariffs have declined – openness of agriculture has grown.
- Liberalization led to more integrated local and international markets; and in some countries (e.g., Brazil and Chile) consumers pay domestic food prices close to border prices.
- But these benefits of integrated markets have also exposed domestic prices to the volatility of international prices.

Two considerations to remember in our analysis

- First, policy concern: price spikes harm primarily net food importers, the majority of developing countries
 - By contrast, few are net food exporters to benefit from spikes - foreign exchange earnings, fiscal revenues from export taxes.
 - But export restrictions are a concern for int'l food markets.
- Second, spikes hit big commodities more than food generally:
 - Higher incomes → diversified diet (even in low income countries. E.g., in India cereals increasingly overtaken by vegetables, fruits, milk, and meats, although grains still important for farmers' income (A Gulati).
 - “New” products mainly not commodities, and few exchanges exist for these more-processed foods and horticulture.
 - And magnitude of price spikes for new products during 2007-08 was much lower, smoothing the impact on real household income. Perhaps a reason for lower panic in some countries.
 - But governments have few policy options to smooth price transmission in these new products. (Meats more complex.) 5

To what extent did higher international prices filter into domestic markets?

- They filter faster into urban markets where logistics and communications are better developed.
- Thus, quickest effects felt by urban consumers. (FAO confirms.)
- Politically sensitive - urban consumers have greater political weight than remote farmers.
- Large range of price transmission velocity.
- FAO: for 2003-08, Kenya and Uganda maize price took 7 months to adjust fully to world prices changes; but much faster after mid-2007 spike. (Maybe low home stocks compounded effect).
- In Asia, spike transmission to domestic rice prices depended on local supplies, policy responses, and US\$ exchange rate changes.
- In India, Thailand and the Philippines, currencies appreciated, cushioning increase in border prices in US\$.
- India, (major rice exporter), talked about banning exports in late 2007, restraining prices.

To what degree do small producers – poorer farm families – enjoy higher world prices?

- Depends on farmers participation in local markets and linkage between local and int'l markets.
- Small African farmers face lower price transmission than commercial farmers in Brazil or Argentina.
- Eastern and Southern Africa: small % of small farmers participate in the commercial chain, most engage in informal markets unrelated to well-specified grades and standards.
- They sell little of their production, and are often net buyers rather than net sellers.
- Eventually, they benefit from sustained higher prices.

The range of government policy responses?

- Immediate response: protect consumers: keep lid on food prices.
- Variety of border measures: tariff and NTB reductions on imports, restricted exports.
- Border measures and export restrictions easy and quick, and low fiscal costs. But many countries did nothing at all at the border.
- Insulating price spikes with export restrictions exacerbate price increases in global markets.
- Also non-trade interventions to control prices (bread, grain, milk).
- Some governments built buffer stocks, expanded food distribution programs, subsidized food prices, cash transfers to the poor.
- Some food subsidies already in place (e.g., Egypt and Tunisia).
- Other countries had removed subsidies during 1990s reforms.
- Initiating internal measures for food distribution and subsidies are fiscally costly, logistically difficult to implement.

Countries: Latin America, Sub-Sahara Africa and China	Border measure change in response to price spike				
	Reduction or elimination of import tariff and quota	Raising export taxes	Export quota or control	Export ban	Govt to govt trade*
China		yes	yes	yes	
Argentina		yes		yes	
Bolivia	Yes	yes*		yes	
Brazil	Yes	yes*			yes*
Chile		Did nothing			
Cuba					yes*
Dominican Rep.		Did nothing			
Ecuador	yes				yes*
El Salvador	yes				yes*
Guatemala	yes				
Haiti		Did nothing			
Honduras	yes			yes	
Mexico	yes				
Nicaragua	yes*				yes*
Peru		Did nothing			

Sources: Yes, without star from FAO, The State of Agricultural Commodity Markets 2009. Annex Table 1, Policy responses to rising commodity prices in selected countries. With a star, from the World Bank draft policy note, “Don’t play with food: Managing volatility in agriculture markets in LAC.”

Countries: Latin America, Sub-Sahara Africa and China	Border measure change in response to price spike				
	Reduction or elimination of import tariff and quota	Raising export taxes	Export quota or control	Export ban	Govt to govt trade*
Benin	yes				
Burkina Faso	yes		yes		
Ethiopia				yes	
Guinea				yes	
Madagascar	yes			yes	
Malawi				yes	
Niger	yes				
Nigeria	yes				
Senegal	yes				
United Rep. of Tanzania	yes			yes	
Zambia			yes	yes	
Did nothing: Angola, Burundi, Cameroon, Central African Rep., Chad, Côte d'Ivoire, Dem. Rep. of the Congo, Eritrea, Ghana, Guinea-Bissau, Kenya, Lesotho, Liberia, Mozambique, Namibia, Sierra Leone, Somalia, South Africa, Sudan, Swaziland, Uganda, Zimbabwe.					

Looking ahead, what are national policy options for addressing future price volatility?

- Price projections highlight potential social costs of neglecting ag sectors, and importance of ag productivity.
- Domestic farm productivity might promote food security and reduce import dependence, but self sufficiency not viable or efficient for most countries.
- Most countries will remain exposed to international shocks
- What are sound policy responses to address price volatility?
- How can governments apply less distortionary policy measures while at the same time mitigate the impact of price volatility?
- How can they avoid raising expenditures aimed at lessening the effects of price spikes, while still letting price signals reach farmers, and funding their longer-term programs to expand food production?

Looking ahead, national policy options, cont.

- Negative externalities of export restrictions: exacerbated global prices spikes, and undermined the reliability and credibility of world food markets.
- Vicious circle: Unreliable markets propel countries to shift toward self-sufficiency, incurring high social costs – domestically and internationally. Reinforce political incentives to insulate domestic markets.
- Import side: lowering tariffs to counteract price spikes effective option, but arguably, contributed to sustaining import demand, helping to keep global prices high.
- Some non-trade barriers (NTBs) could also be relaxed in times of high prices, although most NTBs (e.g., SPS) are not supposed to be discretionary in any event.

Looking ahead, national policy options, cont. – non-border measures

- Subsidies and safety-nets reasonable 1st responses, if possible.
- But food subsidies tend to last, distort price signals, fiscally costly, unsustainable. Food subsidies often untargeted, and difficult to remove.
- Whether or not preferable to border policies, recent economic downturn highlights fiscal attractiveness of other policies and market-based mechanisms: strategic food reserves, commodity exchanges and price derivatives.
- Most interventionist: grain or food reserves, and most countries cannot manage them directly as a matter of strategic policy.
- Brazil, Ecuador, Honduras, Mexico, Bolivia, announced reserves, but only Brazil actually has one of significant size.
- Starting and managing large enough reserves to impact prices, expensive and likely distorting
- They limit transmission of signals along supply chain, including private storage, and users of commodity exchanges.

Looking ahead, national policy options, cont. – commodity exchanges

- Benefits straightforward, when they work: lower transaction costs, price discovery, hedging, support financing for traders.
- World price discovery role usually played by developed country exchanges. Improving local exchanges would help.
- For example, rice: international exchanges play limited role due to low correlation with CIF prices for specific varieties and qualities.
- Nevertheless, even in the case of rice, world exchanges can offer a useful hedging tool in the event of a severe price spike.
- In some developing countries, local exchanges well established; in others, they are absent.
- Although developing country buyers, importers, processors and other enterprises have increased their use of local and international exchanges, do not expect small farmers to participate. But consumers and farmers benefit from price discovery regardless.
- Policies that would facilitate local exchanges would reduce financial exposure of investments all along the supply chain.

What might be some international responses to price volatility?

- The international community can provide food aid and financial assistance in times of price spikes, but the challenge here is how to do so most effectively and with greater transparency.
- International support – both private and public – to enhance agricultural productivity, particularly in vulnerable, least-developed countries, is also a desirable goal.

WTO's role in addressing price volatility?

- World price shocks can be shared, cushioned by transmitting the effects across many countries.
- Controversial question: the role of WTO rules and price volatility.
- WTO has weak rules on export restrictions that create negative externalities for other countries.
- The Doha Round includes new provisions on export restrictions, but maybe we should consider negotiating more meaningful disciplines on export restrictions.
- Stronger rules on export restrictions would make more difficult shifting domestic shocks onto world markets. Difficult to negotiate.
- Import side: difficult to argue against reducing tariffs to aid poorer consumers – in the event of a price spike.
- But reducing tariffs and NTBs make import demand more inelastic and so extends the persistence of higher prices abroad.
- It is hard to visualize how the WTO might address this issue, given that governments always want more flexibility to protect consumers.

What about the historical long-term declines in real food prices?

- Food price spikes focused attention, but important to point out the longer-term trend of declining commodity prices,
- There have been periods where prices fall below this trend and persist longer than price spikes.
- Such runs of very low prices sometimes threaten sensitive import-competing activities in poorer countries.
- Such activities might be competitive in the long run, but do not have access to sufficient credit and derivatives markets to enable them to survive extended low-price periods.
- Governments want to maintain the flexibility of intervening during the downside of the price volatility cycle by keeping high bound tariffs and having access to remedial measures (anti-dumping, safeguards and countervailing duties).

New special safeguard?

- SSG under Uruguay Round not accessible to most developing countries, because most opted for bound tariffs instead of tariffication.
- Attention on proposal to create new Special Safeguard Mechanism under discussion in Doha, maybe a helpful element in addressing price volatility for the downward side.
- Unfortunately, discussions surrounding SSM in stalemate in the ag negotiations.
- Some developing country demands unacceptable to exporters.
- How to unravel this disagreement is a topic in itself.
- Difficult issues: the “trigger”– volume or prices – and the number of products to be covered.
- General rule: limiting number of products eligible to avoid misuse.
- Focus on a few, key politically sensitive products, where having no defense would be an obstacle for trade liberalization, and would not undermine the credibility of a special safeguard mechanism.
- Easier to monitor.