

# **SAFEGUARDING** FOOD SECURITY IN VOLATILE **GLOBAL MARKETS**



EDITED BY  
**ADAM PRAKASH**



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# Safeguarding food security in volatile global markets

Edited by Adam Prakash

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## Chapter 17

# Global governance: international policy considerations

Panos Konandreas<sup>1</sup>

### Introduction

This chapter deals with international policy issues relevant to world price volatility in basic foodstuffs, particularly the extent to which multilateral trade rules are conducive to an environment of market stability. While it is widely recognized that achieving food security depends to a large degree on measures at the national, sub-national and individual household levels, the international context in which these policies are implemented is instrumental for the success or failure of national efforts. This is particularly the case during periods of volatile world prices, when international solidarity is needed and the trading behaviour of countries is critical on the ability of other countries to meet their own food needs.

By definition, world price volatility concerns not only the incidence of price spikes but also the opposite phenomenon of price collapses. In fact, we are able to discern episodes of high prices because we have had the experience of price troughs. While the concept of price volatility is clearly associated with both extreme events, food security concerns are often linked to episodes of high prices, i.e. when there is an immediate impact on peoples' ability to feed themselves. There is much greater visibility of the impact of high prices, which manifests itself in increased hardship for a large part of market-dependent households in poor countries, especially in politically-sensitive urban centres. However, the opposite episodes of depressed world prices, especially when prolonged, are also detrimental to food security because they slowly erode and displace otherwise viable domestic production, resulting in greater national dependency on the world market in the longer term. By and large, price spikes are a short-term concern: they affect consumers and are immediately visible. On the other hand, depressed prices are a longer-term problem: they first affect producers, but ultimately they contribute to the erosion of national food security.

Volatility in the world prices of agricultural commodities has been a perennial problem, and many approaches have been attempted to deal with it. Some aim at dealing with strictly short-term volatility, while others combine longer-term objectives, such as defending a floor price for producers (through minimum support prices) or containing excessive costs to consumers (through general or targeted food subsidies). By nature, most of the approaches are narrow and defensive in dealing with the symptoms of volatile prices by trying to mitigate their effects on domestic producers and consumers. These include border and domestic

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<sup>1</sup> Senior consultant (FAO).

measures that aim at preventing shocks in the world market from being transmitted to the domestic market. However, by insulating the domestic market from the world market, the residual world market of the commodity becomes more inelastic, and in the process, volatility becomes more acute.

The detrimental effects of acting alone in commodity trade policy have been understood for some time and the merits of countries acting collectively have been well appreciated. Also clear are the important trade-offs between the extra cost required to effectively insulate the domestic market when acting alone and the benefit from supporting a collective multilateral effort in dealing with price instability.

In this context, the multilateral negotiations under the General Agreement on Tariffs and Trade/World Trade Organization (GATT/WTO) have been the dominant force shaping the international policy environment in commodity trading during the past three decades. Although agricultural commodities are currently under the Multilateral Trading System (MTS) which governs trade in goods and services, the process of integration of agriculture in that system is not yet complete. In some ways, however, the implications of this integration of agriculture are much more profound than in other sectors, as the whole array of policy instruments that governments have at their disposal (both border and domestic measures) are subject to disciplines.

This chapter reviews the relevant provisions of the Agreement on Agriculture (AoA), the multilateral trade policy rules agreed under the Uruguay Round (UR) negotiations. Rules on agriculture fall under the three pillars of the AoA: domestic support, market access and export competition, all of which contain provisions of direct or indirect relevance to price volatility. In its present form the AoA has elements that have worked well and others that have not. Depending on how specific provisions are used in practice, they may either contribute to aggravating situations of price volatility or to mitigating its effects.

In reviewing the efficacy of existing provisions of the AoA, this chapter also considers proposals that are on the table as part of the ongoing Doha Round negotiations, and we assess the extent to which they may be more effective. By and large, trade concerns and the related WTO rules continue to centre on situations of depressed prices in the world market and on the need to reform border and domestic policies responsible for excess production. In general, the WTO rules are helpful in disciplining such policies and are likely to be more effective in the future.

The multilateral WTO rules hardly address the opposite case: high world prices and underproduction in several food-insecure countries and the factors that led to it. This asymmetry very much reflects the trade concerns in agriculture for the long term, characterized by oversupply and related policies that result in cheap food prices. This situation may not continue in the future, and cause the need for trade rules to be adjusted accordingly.

Other aspects of collective international action relevant to situations of high food prices are food aid and other mechanisms that could help net food-importing, developing countries alleviate the burden of excessive food import bills. Regarding food aid, while the imperatives for such assistance are largely humanitarian and not trade related, for a variety of reasons the disciplines on food aid have become effectively intertwined with WTO agriculture rules so that developments in both areas move together. Similarly, the possible mechanisms for providing food import financing to food-insecure developing countries that may potentially be adversely affected by high prices owing to trade reforms are also intertwined with the trade rules. Hence, the roles of food aid in respect to volatility in food commodity prices, as well as the prospect of implementing relevant food import financing mechanisms, are also discussed here.

## Imbalances in world food markets and WTO rules on agriculture

Agriculture became part of the overall disciplines governing trade in goods after the WTO came into force in 1995 with the conclusion of the Uruguay Round of multilateral trade negotiations. Although agriculture was never outside the GATT officially, certain exceptions for agriculture negotiated in the 1950s, primarily to suit domestic and trade policies of a handful of countries, meant that the regular GATT rules that applied to industrial goods did not apply to agriculture (Sharma, 2000a). This provided the legal cover for those who could afford it - mainly the rich countries - to apply import restrictions and subsidize production without limit, and thus create structural surpluses of mainly temperate-zone foodstuffs.

By the mid-1980s, world agricultural trade was in a state of disarray owing to the prevalence of these production and trade distorting policies in a number of developed countries.<sup>2</sup> Structural surpluses had to be disposed of somehow, and export subsidies and food aid turned out to be the key instruments to accomplish this. This was an era characterized by cheap food policy. However, while this state of affairs may have suited some countries - both exporters and importers who were subsidized - it came at the cost to longer-term food security prospects of several countries, particularly many developing countries which, as “beneficiaries” of cheap food, ignored the development of their own agriculture. The seeds of substantial shifts in consumption habits and greater dependence on world food markets had been sown. Also, the growing dependence of a large number of countries on a narrow basket of traded foodstuffs carried with it the risk of greater market volatility when the initial conditions of plenty that promoted this situation were no longer valid.

As trade wars escalated in the 1980s, calls for reforming world agricultural trade intensified in many countries (even in the perpetrator countries for budgetary or other reasons) and in the international community at large. It was against this backdrop that the Uruguay Round was launched in Punta del Este in 1986. In agriculture, the main aim of the negotiations was to address long-term imbalances by bringing more discipline and predictability to world agricultural production and trade, as well as to reduce instability in world agricultural markets. The market stabilizing effect of trade openness was expected to come about by, *inter alia*, greater price transmission to domestic markets and thus greater producer and consumer responsiveness to world price changes, more transparency and consistency on the part of governments in domestic measures (including stockholding) and trade policies, and increased confidence in the multilateral trading system as a secure source of supplies when needed.

The Uruguay Round AoA has been an important step in reforming world agriculture. However, recognizing past difficulties in bringing agriculture under multilateral disciplines, what was put in place was only the first step and left much to be desired, especially in measures dealing with world market volatility. By and large, the AoA rules responded to the perceived problems in world agricultural trade prior to the UR, which was a period characterized by overproduction owing to distorting policies in a number of developed countries. Thus the main thrust of the AoA rules was to limit the subsidization that had led to depressed prices. On the other hand, problems associated with underproduction and associated high prices were of less concern.

The benefits of a multilateral trading system depend on how trade participants adhere to the agreed rules. Many of the AoA rules were incomplete and not strictly enforceable. The ongoing Doha Round negotiations have tried to address some of these problems within

<sup>2</sup> See Johnson (1973), Hathaway (1997), Josling et al. (1996) and Tyers & Anderson (1992).



the existing architecture of the AoA. Yet as will be seen below, even assuming that the Doha Round comes to a conclusion by accepting what is on the table, significant asymmetry in the rules will remain regarding provisions dealing with exporting and importing country interests. In essence, the AoA - with or without Doha - remains a set of rules to discipline situations of overproduction and cheap food and much less to address difficulties that countries face in cases of global scarcity and high food prices.

A key consideration in judging the adequacy of the AoA rules, either those already in place or those that will emerge after the conclusion of the Doha Round, is the nature of world food markets in the years to come. Although depressed prices have been predominant in world markets in the past, this has not always been the case, certainly not in the eyes of all participants in the world food market.

In fact, since 1970, i.e. over a period of about 40 years, there have been six episodes of high food prices, i.e. spikes in world food prices and soaring food import bills. These were in 1974-76, 1980-82, 1988-90, 1995-97, 2007-08 and now (2010-?), each lasting for about two years for a total of 12 years, or about 30 percent of the time. For the remaining 70 percent of the time, world food prices and food import bills could be said to be on trend or depressed.

An additional issue is whether this characterization of the world food market as episodes of high and low food prices will be valid in the future. Many commentators<sup>3</sup> believe that the era of cheap food is over and the future will see much tighter food markets (owing to population and income growth, constraints to productivity, biofuels<sup>4</sup>, etc.). In a scenario of tighter world markets, not only will food prices and food import bills be high, but spikes may be more frequent, that is, more frequent than 30 percent of the time as has been the case in the last 40 years. If so, the legitimate question is to what extent WTO agricultural rules, designed primarily for an era of cheap food, are equally adequate to address the opposite problem of expensive food and food crises.

With this background in mind, our discussion of the WTO rules below is structured according to the two acute world price situations - periods of depressed world prices (cheap food) and periods of price spikes (expensive food). We also assess the effectiveness of existing rules in their actual application, drawing from recent and past experience as appropriate. The new rules envisaged under the Doha Round (as they presently stand in the Draft Modalities, see [WTO, 2008](#)) are also treated.

**WTO rules to defend against depressed world prices** There is a variety of reasons that world food markets are not always in balance. Aggregate food production can outstrip aggregate effective demand either because of technological change or through support policies in major producing countries. Additionally, prices may be under increased pressure in years of exceptionally good harvests. Often, when world prices are depressed, governments feel compelled to put policies in place that will cushion their adverse effect on domestic production.

In general, there are two broad categories of WTO compatible policy options against depressed world prices:

<sup>3</sup> See [OECD-FAO \(2010\)](#) and [Headey & Shenggen \(2010\)](#).

<sup>4</sup> An important new dimension in price trends and price volatility of agricultural commodity markets is the growing linkage with energy markets. First, there are direct own price links on the supply side; second, there is an indirect price transmission through substitutes on the supply side; and third, there is price transmission through the demand side. With rising energy prices and a growing degree of market integration of energy and agricultural feedstock markets, both the levels and variability of agricultural commodities will increasingly be determined by those of energy prices (see [Schmidhuber, 2007](#)).

- ▶ border measures, i.e. raising tariffs, as long as they are within the country's bound tariff commitments at the WTO;
- ▶ domestic support measures, i.e. providing price and non-price support to farmers, again within the bound levels of its WTO domestic support commitments.

## *Border measures*

### *Raising tariffs within bound ceilings*

The AoA introduced a fundamental change regarding border measures from a situation where a myriad of non-tariff measures impede agricultural trade flows to a regime of bound tariff-only protection<sup>5</sup> plus the commitment to gradually reduce such tariffs. All countries were obligated to bind their tariffs: developed countries had to use the tariffication process<sup>6</sup> while developing countries were able to offer “ceiling bindings” instead. Many developing countries opted for the latter choice and in the process bound their tariffs at relatively high levels in relation to the actual applied tariffs at the time, a situation described as tariff overhang (or “water” in the tariffs).

A large tariff overhang implies greater flexibility in increasing tariffs up to the bound levels in years of depressed prices. As long as this policy is applied on a Most Favoured Nation (MFN) basis, it is compatible with WTO rules.

In general, African countries have afforded themselves much more room between bound and applied tariffs. Bound tariffs for agricultural products in Africa average some 80 percent, compared with average applied tariffs of 17.7 percent (2009), leaving an average overhang of over 60 percent. Another region with ample room between bound and applied tariffs (over 50 percent) is Central America and the Caribbean, followed by Asia (36 percent) and Latin America (30 percent). At the other extreme, the newly acceded countries (NACs) in the European region have very little room to manoeuvre (with an overhang of just 3 percent).

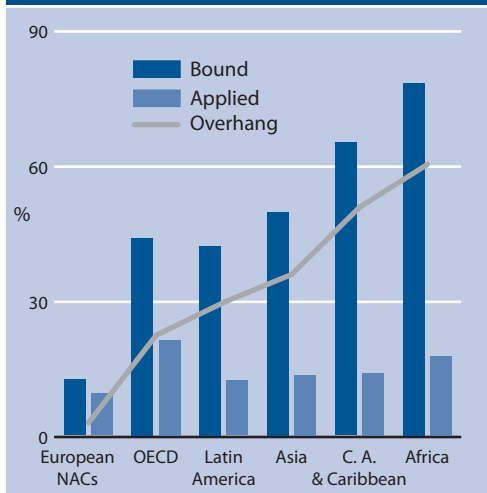
In general, all of the NACs in all regions have very little flexibility in raising tariffs because their tariffs are bound at levels very close to those actually applied. Figure 17.3 reflects the diversity of country situations for the different regions. It is clear that in every region there are countries where the option of increasing applied tariffs is limited. Even in Africa, with its large overall tariff overhang, there are several countries with very little flexibility in increasing tariffs without violating their WTO obligations. It is these countries that may be in need of other instruments (safeguards) to allow them a certain degree of protection in years of depressed world prices (more on this below).

In practice, even for countries that have ample flexibility in raising tariffs, such a policy may have its limitations. Higher tariffs imply higher prices received by domestic producers but also higher prices paid by domestic consumers; often such policies are politically unpalatable. Many developing countries with large numbers of poor households resist a policy of imposing higher taxes on food, even in years of depressed prices. There are, however, some possible remedies for this dilemma, whereby customs revenues generated from tariffs could be used to target food-insecure households. This option requires good administrative capacity to identify households in need (thus minimizing leakages) and infrastructure to implement resource transfers in a cost-effective manner.

<sup>5</sup> As per Article 4.2 of the AoA, “Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 and Annex 5.” Article 5 covers the Special Safeguard (SSG) clause of the AoA (see below) and Annex 5 provides for certain exemptions under very specific circumstances and with an obligation of increased minimum access commitments.

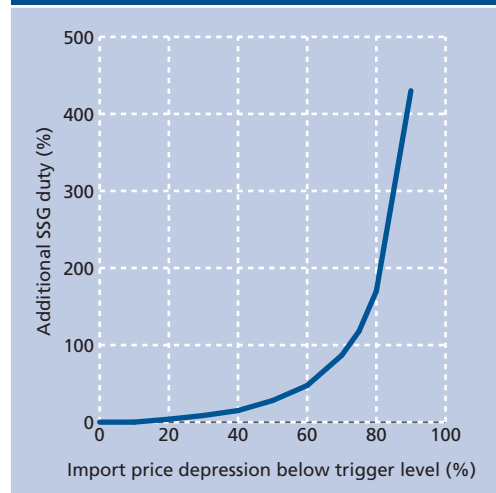
<sup>6</sup> Specific procedures for calculating the tariff equivalent of all non-tariff measures.

Figure 17.1: Average bound, applied tariffs and tariff overhang by region



Source: Compiled by the author based on World Tariff Profiles 2010 (WTO).

Figure 17.2: Additional SSG duty depending on import price depression



Source: Konandreas (2008b).

### *Possible use of the Special Safeguard (SSG) Clause*

Binding tariffs through the tariffification process, where tariffs serve as the only means to regulate imports, represented a threat to some countries that feared that the outcome would be a flood of imports that would hurt domestic production. This concern brought about Article 5 of the AoA that established provisions to invoke temporary duty increases, above the bound levels, on specified agricultural products. In order to invoke this safeguard, three conditions had to be met:

1. the product in question must have been subjected to the tariffification process;
2. the product must have been designated in the country Schedule as an “SSG product”;
3. the criteria for either a price-based trigger or a volume-based trigger must have been met.

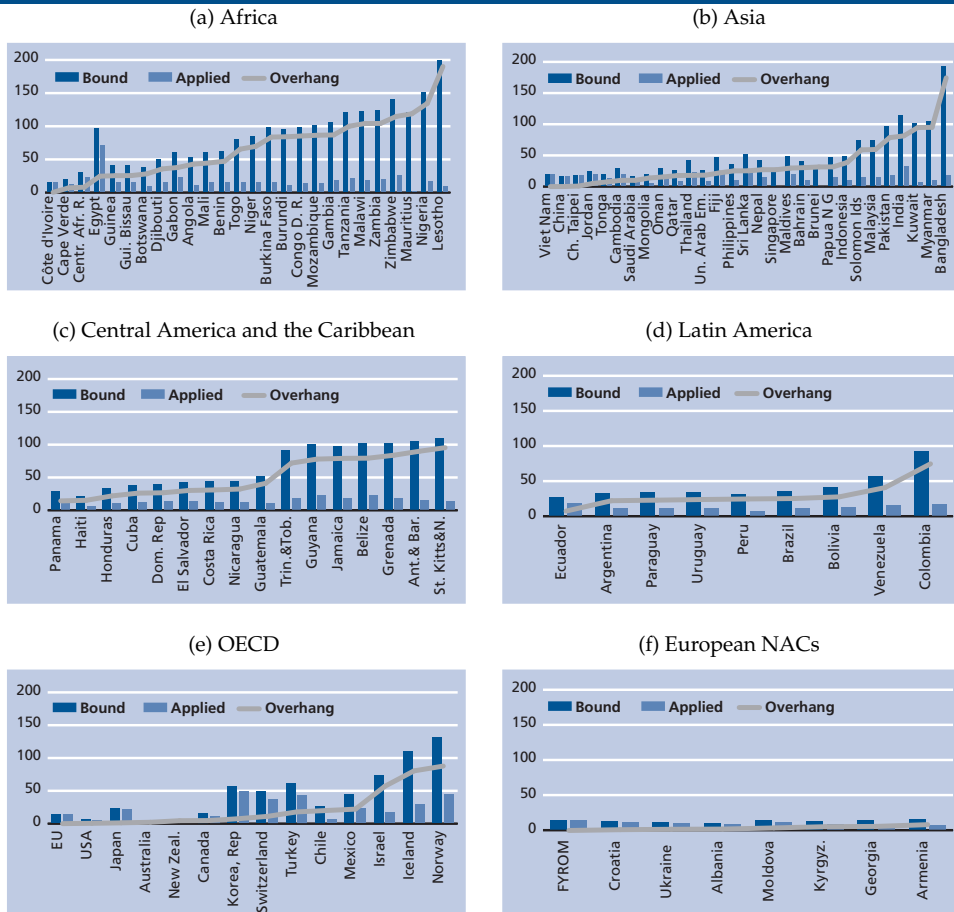
Thirty-six WTO members reserved the right to make use of the SSG provision, which could only be used for a limited number of products in each case. As the majority of developing countries did not tariffify, only a few of them had access to this provision.

**Price-based SSG:** The basic idea of the price-based SSG is that additional duties (over the bound rate) are allowed when import prices fall below an established trigger level. The trigger price is fixed (based on the 1986-88 reference price) while the remedy is variable (depending on how much actual import price drops below the reference price).

The formula for calculating the permitted level of the additional duty is somewhat complex and works like a variable levy - the greater the decline in the import price below the trigger level, the higher the duty - but it offsets only a part of the fall in the import price (see Figure 17.2).<sup>7</sup> This means that domestic prices are not entirely insulated from the effects of depressed world market prices.

<sup>7</sup> For example, with a trigger price \$100/tonne and an import price \$20 per tonne, the extra SSG duty would

Figure 17.3: Agricultural tariff overhangs in different regions

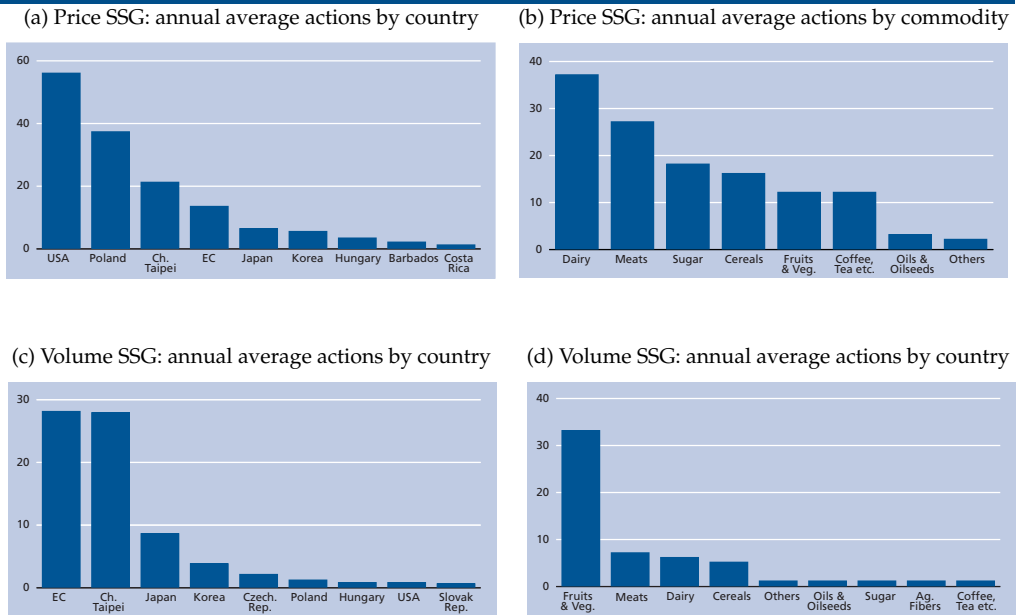


**Volume-based SSG:** in the price-SSG, the basic idea of the volume-SSG is that additional duties (over the bound rate) are allowed when there is a surge in imports relative to an established trigger level of imports. Unlike in the price-SSG, here the trigger volume level of imports is variable and the remedy is fixed. The trigger level is higher (and the probability of using the trigger is less): the greater the three-year average level of imports, the lower the share of imports in domestic consumption, and the faster the growth in domestic consumption (Sharma, 2000b).

The maximum additional duty permitted cannot exceed 30 percent of the normal level of duty in effect during the year in which the volume-SSG is invoked. Also, the additional

amount to 170 percent (\$34 per tonne), which implies a domestic price of \$54 per tonne (20+34). Even with that large extra duty, the domestic price is still 44 percent below the trigger level. Of course, the SSG extra duty comes into effect after the bound tariff is applied. Assuming a bound tariff of 100 percent for the commodity in question, then the SSG extra duty on top of the bound tariff would bring the domestic price to USD74 per tonne (20+20+34). In order for the domestic price to remain at the trigger level of \$100 per tonne, a bound tariff of 230 percent would have been required.

Figure 17.4: Experience in the use of the price and volume SSG: 1995-2006



Source: Konandreas (2008b).

duty may not be levied beyond the end of the year in which it has been imposed, and it cannot be applied to imports taking place within tariff quotas.

**Using the SSG:** Overall, countries have made limited use of the SSG, but where it has been used it is highly concentrated to a handful of countries and commodities.

Four Members of the WTO accounted for 87 percent of all price-SSG actions during the period 1995-06, while four WTO Members accounted for 93 percent of all volume-SSG actions during the same period. In terms of the commodities acted upon, again four commodities accounted for 77 percent of all price-SSG actions and 92 percent of all volume-SSG actions during the same period. As expected, the great majority of countries that resorted to the SSG were developed countries because they had access to this instrument, having used the tariffication process in converting non-tariff barriers to ordinary tariffs, as discussed above. In addition, the majority of products acted upon concerned temperate-zone products.

#### *Resorting to the general GATT safeguards*

In addition to the SSG which, as noted, has limited applicability for the majority of developing countries, there are several generally applicable GATT safeguards. These include: anti-dumping, countervailing duties and emergency safeguards.

**Anti-dumping (AD):** Dumping is defined in general terms as the sale by a private firm of an exported product in a foreign market at a price below that at which the same product is usually sold in its home market. The basic GATT provision dealing with anti-dumping (AD) is Article VI of GATT 1994 on Anti-Dumping and Countervailing Duties. The Uruguay

Round Agreement on Implementation of Article VI of GATT 1994 (commonly known as the “AD Agreement”) further elaborates the basic principles set forth in Article VI and provides details regarding the investigation, determination and application of the AD duties.

To apply an AD duty, three conditions must be met:

1. a determination that dumping has occurred (including an estimate of the dumping margin, i.e. the difference in prices);
2. that a domestic industry is suffering from, or threatened with, material injury; and,
3. that the dumping is the cause of the injury.

The “injury test” is crucial, i.e. the dumped imports caused or threatened material injury to an established industry in the importing country. Other important rules are that the AD duty must not exceed the margin of dumping, and that the duty must be imposed on a non-discriminatory basis on imports from all sources found to be dumped and causing injury. Members with AD legislation are required to maintain independent “judicial, arbitral or administrative tribunals” to permit prompt review of administrative actions concerning final AD determination and to maintain the AD duties.

**Countervailing (CV) duties:** The thinking about countervailing duties is similar to that of AD, but while AD is aimed at unfair competitive activity by a private exporting firm, countervailing action is aimed at unfair practices resulting from government subsidies (both domestic and export subsidies). Otherwise, most of the procedural requirements are fairly similar. Two articles of the GATT deal with this subject: Article XVI on Subsidies (the source of the problem) and Article VI on Anti-Dumping and Countervailing Duties (the remedy). The Uruguay Round Agreement on Subsidies and Countervailing Measures (commonly known as the “CV Agreement”) expands these articles substantially by providing a host of definitions (e.g. what constitutes a subsidy), describing the types of subsidies from the standpoint of CV actions (non-actionable, prohibited and actionable subsidies) and detailing the procedures and rules. Countervailing measures are a unilateral remedy taken by a Member, but they may only be applied after an investigation by that Member and a determination that the criteria set forth in the CV Agreement are satisfied. The substantive criteria require that a Member shall not impose a CV measure unless it determines that there are subsidized imports, injury to a domestic industry, and a causal link between the subsidized imports and the injury, as in the AD case.

**Emergency safeguards** The basic GATT provision dealing with emergency safeguards is Article XIX on Emergency Action on Imports of Particular Products. In practice, Article XIX was little used and much abused; it gave rise to such “grey area” measures as voluntary export restraints, orderly marketing agreements and similar other measures. The Uruguay Round Agreement on Safeguards (commonly known as the “SG Agreement”) was negotiated “to re-establish multilateral control over safeguards and eliminate measures that escape such control”.

The guiding principles of the SG Agreement are that safeguard measures pursuant to Article XIX: must be temporary; may be imposed only when imports are found to cause or threaten serious injury to a competing domestic industry; must (generally) be applied on an Most Favoured Nation (MFN) basis; be progressively liberalized while in effect; and, the Member imposing them must pay compensation to the Members whose trade is affected.

Emergency safeguards *differ from the AD and CV* measures in some important ways:

- ▶ First, they are not conditioned upon an “unfair” practice, i.e. there need not be dumping or subsidizing going on. Rather, they are predicated upon the argument that a suffering industry needs protection to adjust itself to the external shocks (e.g. import surges).
- ▶ A second feature of the provisions is that safeguard actions may be taken very rapidly if critical circumstances are deemed to exist (by contrast, provisional AD and CV duties can only be imposed after a preliminary investigation that provides an opportunity for all interested parties to comment and present evidence).
- ▶ A third distinguishing feature is that quantitative import controls can be used, whereas in the case of AD and CV measures only additional duties are permitted;
- ▶ Finally, another important difference is that, unlike AD and CV actions, compensation is required. The SG Agreement has laid down specific rules on “compensation” or “offsetting action” by maintaining “a substantially equivalent level of concessions”.

For several developing countries, this last requirement for compensation may severely limit the scope for using emergency safeguards under the SG Agreement. Given the often small volume of their trade and its higher degree of concentration, they would not have much to offer in terms of trade concessions elsewhere.

#### *Creating new defence mechanisms under the Doha Round*

Proposals on border measures under the Doha Round aim to increase market access through a formula approach to tariff cuts while at the same time limiting its general application through exemptions. The general formula is based on a “tiered” approach which implies higher cuts for high tariffs. A different formula applies to developing than developed countries, which implies smaller overall cuts (see below). What is most important, however, are the special provisions envisaged on market access. These include Sensitive Products (SnPs) for both developed and developing countries and Special Products (SPs) and the Special Safeguard Mechanism (SSM) exclusively for developing countries.

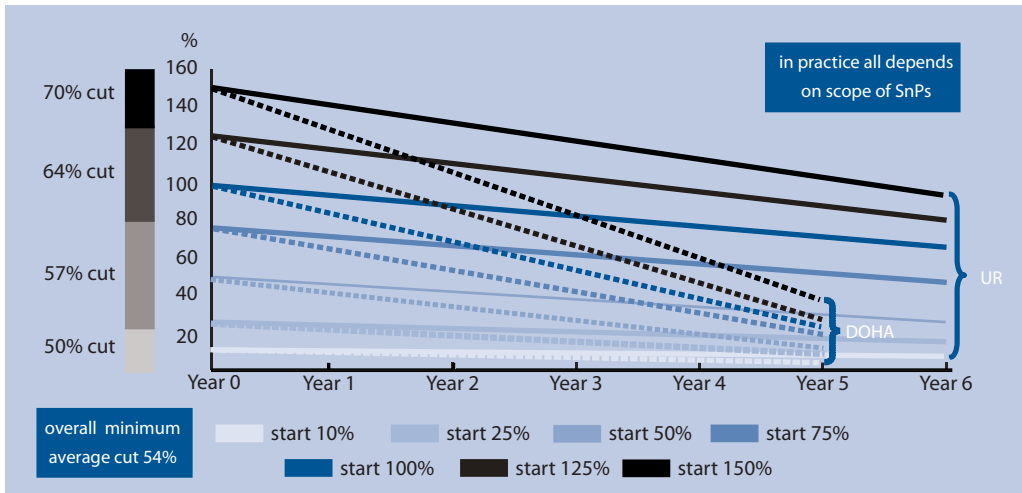
**Tariff cuts:** The “tiered” formula approach in the Draft Modalities is a compromise reached after consideration of the very ambitious (such as the “Swiss”) and less ambitious (such as UR) formulations. The main ingredient is that the cuts for higher tariffs would be higher and there is also clear differentiation on the cuts between developed and developing countries (Figure 17.5). Developed countries would have to meet a minimum average cut of 54 percent while developing countries a maximum average cut of 36 percent (these are overall averages, i.e. taking also into account the lesser cuts because of the application of SnPs and SPs provisions discussed below).

**Sensitive Products (SnPs):** Designating some products as sensitive in order to address non-trade concerns has been a longstanding demand of several WTO Members (mainly developed countries). Several issues remain unresolved in the Draft Modalities, including the number of SnPs (the latest proposal was up to 4 percent of tariff lines), the size of the additional quota for such products (the latest proposal was no less than four percent of domestic consumption, with some adjustments depending on current bound tariffs, and the extent to which the tariff cut for a sensitive product deviates from the general formula tariff cut).

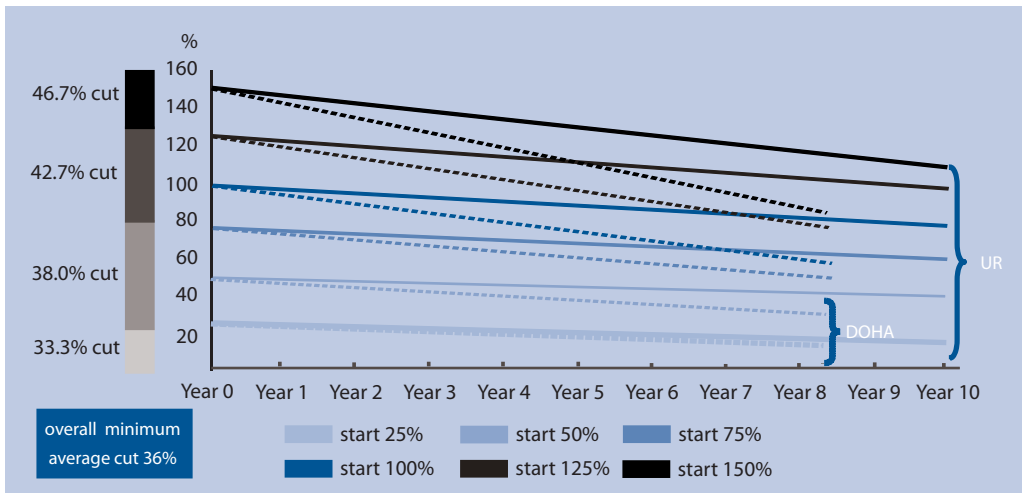
**Special Products (SPs):** The driving force behind SPs has been the G33 group of developing countries. As in the case of SnPs, several issues remain unresolved, including: the total number of SPs (tariff lines at the six-digit HS level), those not subject to tariff cut, and the tariff reduction rate for the rest of the SPs.

Figure 17.5: Proposed tariff cuts under the “tiered” approach of the Doha Round

(a) Developed countries



(b) Developing countries



Source: Compiled by the author, based on WTO (2008).

In search for a compromise, at the July 2008 Mini-Ministerial meeting the WTO Director-General proposed 12 percent of tariff lines as the total number of SPs, of which 5 percent would have no tariff cut, with an overall average cut of 11 percent for all SPs. This has been incorporated in the December 2008 Draft Modalities text although a number of developing countries reserved their position regarding these numbers.

As in the case of SnPs, SPs are seen as a divisive element of market access because this flexibility could potentially cover many important agricultural products and markedly



undermine the overall level of ambition on market access. On the other hand, the proponents of SPs view it as a key development instrument for ensuring food security, rural development and livelihood security.

**Special Safeguard Mechanism (SSM):** The SSM has been a thorny issue in the negotiations all along, and was allegedly the cause of the collapse of the WTO negotiations in July 2008. There were sharp differences in views on the SSM, *inter alia*, its product coverage, setting the threshold level for triggering volume-based SSM and setting the level of remedy.

Concerning product coverage, the December 2008 Draft Modalities text states that the SSM shall have no *a priori* product limitations as to its availability, i.e. it can be invoked for all tariff lines in principle. The volume-based SSM shall be applied on the basis of a rolling average of imports in the preceding three-year period ("base imports"), with additional duty being triggered when the volume of imports during any year exceeds 110 percent of the base imports. The maximum additional duty that may be imposed on applied tariffs shall not exceed 50 percent of the current bound tariff (or 50 percentage points, whichever is higher) applicable when the volume of imports exceeds 135 percent of base imports.

Regarding the additional duty, the major difference all along was on whether the total duty (already applied plus SSM duties) could exceed pre-Doha bound tariff levels. On this issue the December 2008 Draft Modalities text states that SSM additional duty (whether price or volume related) are subject to the limitation that the pre-Doha bound tariff is respected as the upper limit and shall prevail as such. However, for LDCs this limitation is relaxed so that they may breach a pre-Doha bound tariff, provided that the maximum increase over a pre-Doha bound tariff does not exceed 40 *ad valorem* percentage points or 40 percent of the current bound tariff, whichever is higher.

Unfortunately, the original rationale of introducing the SSM under the Doha Round has been somewhat lost in the process of protracted negotiations. The SSM was supposed to be a means to provide temporary protection to those commodities threatened by short-term external shocks but which are otherwise competitive under normal conditions. Implicit in the need for this instrument is the notion that other means of protection are not available or practicable, i.e. countries had a small margin between an already applied tariff and the bound level and limited means to provide compensatory domestic support to farmers.

This is demonstrated in Figure 17.6, where two countries are contrasted: country A, with a high bound tariff and ability to support farmers through various forms of domestic measures, and country B which has a low bound tariff and limited means to provide domestic support. When the world market is at its average level, farmers' earnings are above cost of production in both countries. However, in a situation of substantial drop in the world market price, farmers in country B would be unable to remain in business. It is clear that the basic parameters of a rational and effective SSM are the level of bound tariffs (or better yet the difference between bound and applied rates, reflecting the remaining flexibility in raising tariffs) and the ability to compensate farmers through resource transfers.

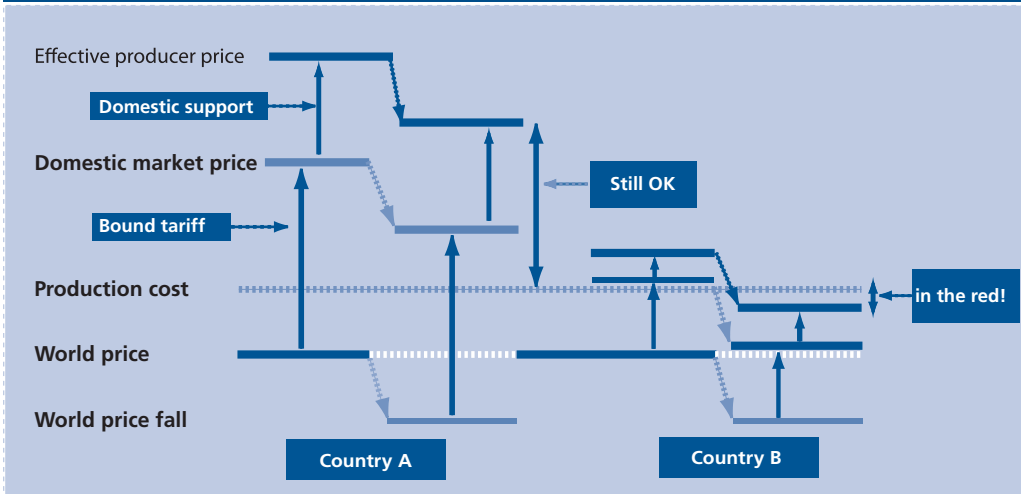
## *Domestic support*

### *Ample flexibility under existing disciplines*

The basic rationale for disciplining domestic support under the AoA

was the fact that such support has been the main source of trade distortions. It was recognized that unless production is contained, the effect of border measures would not be effective in practice. However, it was also recognized that not all domestic support is

Figure 17.6: Need for the SSM: low bound tariffs and limited capacity for domestic support



Source: Konandreas (2008b).

necessarily bad. Hence, the basic approach in the AoA was to discipline only support that distorts production and trade (the traffic lights approach or the different colour “boxes”). The first step was to define what was permissible and not subject to reduction commitments. By implication, the rest had to be disciplined.

All countries may support domestic producers through “Green Box” measures, that is with policies considered to have no, or minimal, trade-distorting effects or effects on production and trade. These include, *inter alia*, general services to agriculture such as research, pest and disease control, as well as direct payments to producers, such as de-coupled income support, income insurance and safety-net programmes. Also included in the “Green Box” are food security stocks and domestic food aid programmes (discussed below).

Developing countries are also exempted from reduction commitments for a special category of production support policies, namely: generally available investment subsidies; agricultural input subsidies generally available to low-income or resource poor producers; and support to producers to encourage diversification from the growing of illicit narcotic crops (Article 6.2).

The “Blue Box” exempts support provided to farmers under production-limiting policies as an incentive to reduce production. Policies are placed in this category when they are accompanied by a commitment requiring farmers to limit production (to 85 percent of the base period level).

Measures that are neither Green, Special and Differential Treatment (SDT) nor Blue, are “Amber” (production and trade distorting) and are subject to reduction commitments. Typical policies under this category include:

- ▶ Product specific support (PSS), which typically includes state procurement at guaranteed administered prices for specific crops in excess of parity levels.
- ▶ Non-product specific support (NPSS), which typically includes subsidies for credit and inputs such as fertilizers, irrigation, or seeds, and aims to reduce the cost of production but does not explicitly target specific crops.

Both types of support are disciplined by the Aggregate Measurement of Support (AMS) ceiling levels, i.e. production and trade distorting support that countries have claimed in their schedules for the base period. Excluded from reduction commitments are PSS and NPSS that are less than the *de minimis* level (5 percent of the farm-gate value of production for developed countries and 10 percent for developing countries). Stockholding is also an option used by countries to support domestic producers in periods of depressed prices as well as to defend against high prices in years of short supplies. The related AoA provisions on stockholding are discussed in the following section.

### *Re-instrumentation of support under the Doha Round*

In general, the proposals for reducing domestic support under the Doha Round continue to provide considerable flexibility for developing countries to support their farmers (Figure 17.7). At the same time the focus of further reform is on the large subsidizing countries that would have to undertake substantial reduction commitments in all forms of non-exempt domestic support. Several Organisation for Economic Co-operation and Development (OECD) countries legitimized production and trade distorting support under the Uruguay Round and, moreover, have the ability (through government funding) to continue making use of such measures. The architecture of the AoA, in terms of its specific instrumentation, technically allowed plenty of room for these countries to meet their legal obligations, while actually pursuing similar distorting policies as before.<sup>8</sup> Several loopholes in this area would be closed under the Doha provisions.

### *Using existing flexibility by food-insecure developing countries*

Do the AoA disciplines on domestic support pose a problem for developing countries? In general, the answer is no. Aside from some specific instances, the AoA disciplines are not presently constraining developing countries.<sup>9</sup> But why is this the case? There are two possible reasons: either their commitments are not too stringent, or actual support to agriculture is too low. By and large, the answer is the latter; actual support of agriculture in food insecure developing countries is desperately low.<sup>10</sup>

Historically, while countries have tended to tax agriculture in their early stages of economic development, successful take-off to sustained agricultural growth was achieved through a judicious mix of subsidies, pricing policies and border measures, as well as through other institutional and infra-structural support measures. This policy mix changes over time, depending on the stages of economic development of each country. In terms of specific measures pursued, after the early stage of infrastructural support to the sector, “coupled” rather than “decoupled” policies have been most effective in rapidly raising agricultural productivity and production.

For example, it has been amply substantiated by OECD analysis that input subsidies are the most production/trade distorting policies (even more so than product-specific output

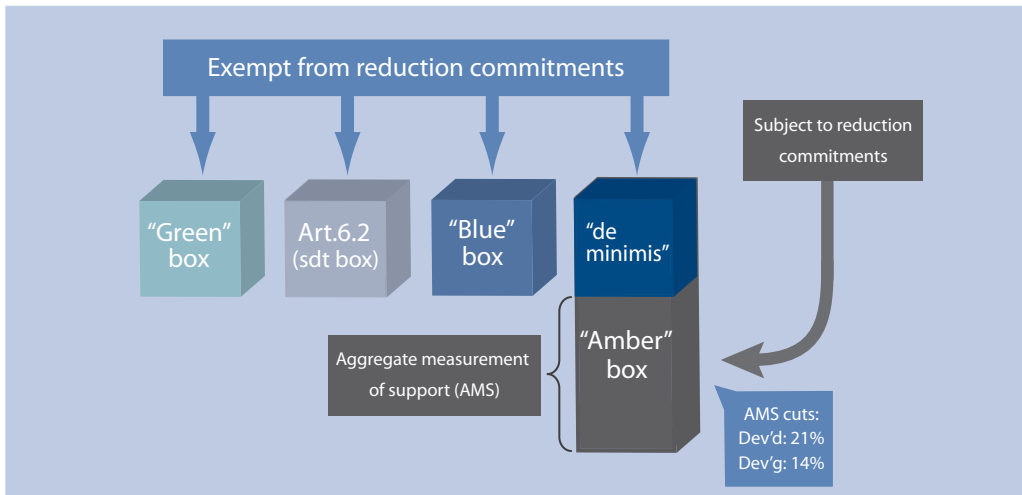
<sup>8</sup> Some OECD countries exploited the loopholes of the AoA, and although they implemented the letter of their commitments, they did not always respect them in spirit. For example, domestic support reduction commitments were met, but support was shifted from the disciplined to the non-disciplined categories. Thus, overall support in OECD has not been reduced by much.

<sup>9</sup> For example, see Sharma (2002).

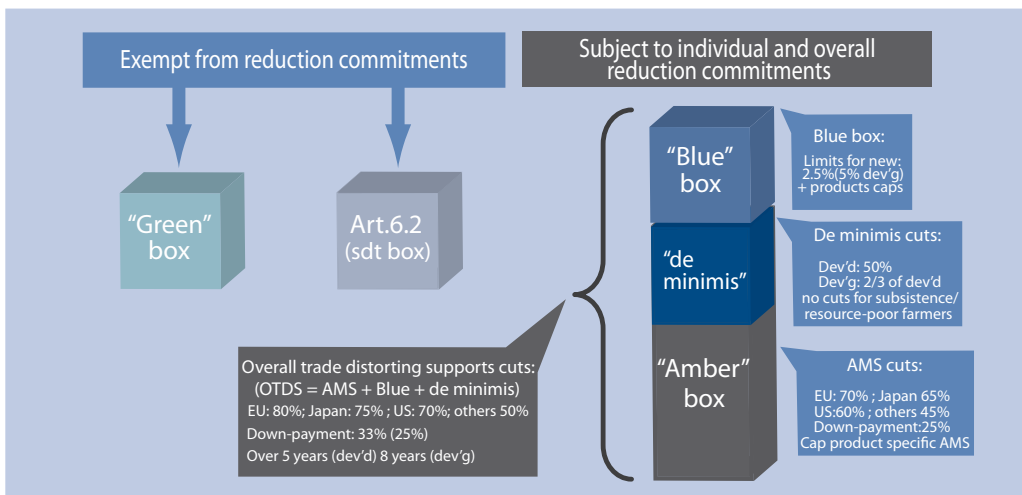
<sup>10</sup> In the aggregate, developing countries as a whole account for less than 10 percent of agricultural subsidies, and these are basically accounted for by the better-off among them. In many instances farmers in poor countries are taxed instead of subsidized. In fact, in many developing countries, agriculture was taxed directly and indirectly in the past, as documented in Krueger et al. (1988).

Figure 17.7: Domestic support under Uruguay Round and proposals under the Doha Round

(a) Uruguay Round



(b) Doha Round



Source: Compiled by the author, based on WTO (2008).

support policies, see Tanagermann, 2005). It is obvious, therefore, that if curtailing output can best be achieved by suppressing these most distorting production and trade policies, the same policies need to be encouraged when the imperative is to increase output, which is the case in many food-insecure developing countries.

It follows that predominantly agrarian food-insecure developing countries should not only be exempted from reduction commitments under the AoA, but also encouraged and assisted in increasing support to agriculture. Moreover, unlike agriculturally developed countries that increasingly favour de-coupled "Green Box" policies, increased support for

agriculture in food-insecure developing countries may initially have to come in the form of coupled support, in particular as “smart” input subsidies to achieve rapid increases in output of basic foodstuffs. There is also another important consideration that makes input subsidies a superior policy in food-insecure developing countries. In countries where a large part of the population spends most of its income on food, an input subsidy does not penalize poor consumers (which is the case in an output support policy) while it provides an incentive to farmers (by reducing production costs).

There are certain concrete implications of the above for the negotiations. On the defensive side, even though current subsidies in food-insecure developing countries hardly get close to even the 10 percent *de minimis* levels allowed under the AoA (separately for product-specific and non-product specific support), this legal cover for trade-distorting support should be maintained. This is all the more important considering that these countries hardly have any other “entitlements” to production/trade distorting support under the AMS, which is largely the prerogative of developed countries.

Another provision in the existing AoA that has proven very useful for food-insecure developing countries is the SDT clause of Article 6.2. This is well-suited to food-insecure developing countries where a large part of the farming population is resource-poor.

However, because domestic support costs money that many developing countries do not have, tariffs are their option of choice. FAO analysis has shown that tariffs in developing countries play a role in domestic market stability and for affording some protection to domestic producers in years of low world prices (Sharma, 2002). For this reason, food-insecure developing countries should preserve some of the flexibility they presently have in the form of high bound tariffs to defend against external volatility, partly emanating from policies in OECD countries, the reform of which is likely to be slow. Those developing countries that have little room in terms of high bound tariffs, may seek more generous treatment under the special provisions of SPs and the SSM. However, to be effective and transparent these provisions would need to be designed not as blunt, across the board instruments, but in relation to the problems they are meant to address, as was suggested above in regard to the SSM.

Overall, it may be said that the WTO disciplines, both border and domestic support measures, allow most developing countries considerable flexibility in defending against situations where domestic producers are threatened by depressed world prices. Often however, they are constrained by how much use they can make of the policy space they have because of food security and resource constraints.

## WTO rules to defend against spikes in world prices

Besides the downside risk owing to depressed world market prices, there is also the case of upside risk when prices soar, as seen in 2007-08 as well as during the current 2010-11 marketing year. During such years countries usually put in place policies to support consumers by lowering import tariffs to make foodstuffs more affordable in the domestic market, releasing supplies from stocks, increasing levels of food aid, targeting specific vulnerable groups, etc.

WTO rules are generally permissive as regards policies that are directed towards supporting consumers. This is understandable because such support, although market distorting (it generally leads to higher overall food consumption than otherwise), is nevertheless trade-enhancing and thus does not impinge on the export interests of trading

Table 17.1: World market prices of cereals and vegetable oils (2006 to 2008)

	World market price (US\$/t)			% rise in prices		
				In 2007	In 2008	In 2008
				rel. to	rel. to	rel. to
Food	2006	2007	2008 <sup>1</sup>	2006	2007	2008
Rice	217	275	563	27	105	160
Wheat	200	266	407	33	53	104
Maize	122	164	230	34	40	88
Palm oil	478	780	1170	63	50	145
Soy oil	599	881	1 403	47	59	134
Simple average	323	473	755	46	59	134

Note: January-May 2008 for cereals and January-April 2008 for oils. Thai A1 variety of rice.  
Source: Sharma & Konandreas (2008).

partners. On the other hand, the lack of tight disciplines in this area reveals the asymmetry of the WTO rules as regards the interests of exporting and importing countries. In general, any policy that is trade enhancing (i.e. it leads to strengthening world prices) is hardly disciplined, even when it is detrimental to the food security concerns of other countries, unlike the tighter disciplines on trade-restricting policies, as we have seen above.

## *Border measures*

### *Limited help from reducing applied tariffs*

Table 17.1 shows the extent of price increases for cereals and vegetable oils during the last period of a spike in world prices. In 2007, prices rose by between 26 and 63 percent, and later by between 40 percent and 105 percent in early 2008. Compared with the 2006 levels, prices were higher in early 2008 by between 88 percent and 160 percent.

Lowering or eliminating import tariffs is the most common measure governments take to stabilize domestic prices of imported goods when world market prices rise. Approximately half of the countries surveyed by FAO lowered or eliminated import tariffs on cereals when world market prices soared in 2006-08 (FAO, 2008). However, the scope of this policy response is limited. Applied tariffs on basic foodstuffs were already relatively low in 2006, in the range of 8 to 14 percent for the five basic foodstuffs listed in Table 17.1, or even less than 10 percent when peak tariffs for about ten countries are excluded from the list (Table 17.2).<sup>11</sup> For the three cereals, the average was 11 percent, but only 6 percent for Low-Income Food-Deficit Countries (LIFDCs) when some peak cases are excluded.

The point being made here is that most food-insecure developing countries did not have high enough applied tariffs in 2006 to be able to use this option to stabilize domestic prices in 2007, let alone in 2008. The level of the tariff reduction that would have been required in, say, 2007 or 2008, when world prices increased significantly, to stabilize domestic prices at the level of 2006 would have been much larger than the applied tariffs (10 percent or so)

<sup>11</sup> This is owing to political economy considerations for affordable food, as well as loan conditionalities in some countries.

Table 17.2: Simple average tariffs on basic foodstuffs for LIFDCs in 2006 (percent)

	Wheat	Rice	Maize	Soy oil	Palm oil
LIFDCs (61 countries)	8	13	12	12	14
LIFDCs (excluding 10 countries of high tariff rates)	4	8	6	9	9

Note: For 14 countries, tariff rates are for 2005.

Source: Sharma & Konandreas (2008).

prevailing in 2006. Even reducing applied tariffs to zero would have counterbalanced only a part of the price rise of 2007, and not at all during the early months of 2008 when prices soared to even higher levels, unless countries resorted to import subsidization (i.e. negative tariffs), which most of them could not afford.<sup>12</sup>

### *The imprudence of export prohibitions, restrictions and export taxation*

While import subsidization is a prohibitively expensive policy for importing countries to stabilize domestic food prices, export taxation and prohibition is fiscally advantageous and politically attractive for exporting countries to pursue in the face of high world prices that threaten their food security. In fact, when faced with soaring food prices in 2006-08, several countries took measures to limit the export of basic foodstuffs, including through taxation and/or outright export bans. Approximately one-quarter of the countries surveyed by FAO resorted to such measures (FAO, 2008). The potential effects of export restrictions on third countries, especially net food-importing countries, can be serious. While the rise in domestic prices may be contained somewhat in the countries imposing export restrictions, the burden is carried by other countries and world prices rise further, turning a surmountable situation into a potentially full-blown crisis.

What is the role of WTO rules in this respect? In the AoA, the relevant provisions are covered under Article 12 (Disciplines on Export Prohibition and Restrictions).<sup>13</sup> However, paragraph 1 of Article 12 makes an important qualification in its application by linking it (“in accordance with”) to paragraph 2(a) of GATT Article XI according to which “export

<sup>12</sup> Assuming that the domestic price ( $P_d$ ) for any given year is determined as  $P_d = P_w * (1 + t)$ , where  $P_w$  is world price and  $t$  is the initial applied tariff, then the tariff reduction that would leave the domestic price unchanged can be calculated from the following equation:  $P_w * (1 + t) = (P_w + \Delta P_w) * (1 + t + \Delta t)$ , by solving for  $\Delta t$ . If the absolute value of  $\Delta t$  is greater than  $t$ , then an import subsidy equal to the difference would be required to counterbalance an increase in world price by  $\Delta P_w$ .

<sup>13</sup> The relevant paragraphs of Article 12 of the AoA are as follows:

1. Where any Member institutes any new export prohibition or restriction on foodstuffs in accordance with paragraph 2(a) of Article XI of GATT 1994, the Member shall observe the following provisions:

(a) the Member instituting the export prohibition or restriction shall give due consideration to the effects of such prohibition or restriction on importing Members’ food security;

(b) before any Member institutes an export prohibition or restriction, it shall give notice in writing, as far in advance as practicable, to the Committee on Agriculture comprising such information as the nature and the duration of such measure, and shall consult, upon request, with any other Member having a substantial interest as an importer with respect to any matter related to the measure in question. The Member instituting such export prohibition or restriction shall provide, upon request, such a Member with necessary information.

2. The provisions of this Article shall not apply to any developing country Member, unless the measure is taken by a developing country Member which is a net-food exporter of the specific foodstuff concerned.

prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party” are permitted. Neither “critical shortage” nor “temporary” is defined. Critical shortage is presumably at the discretion of the country imposing the export restriction, and temporary could mean months or even a year or more.

Paragraph 2 of Article 12 exempts developing country Members from the general rule in paragraph 1, unless they are “net food exporters” of the specific foodstuff in question. Many developing countries are now significant exporters of basic foodstuffs and it would appear that they would also have to adhere to the general provisions of paragraph 1, however, in practical terms this may mean very little. There is no list of net food-exporting developing countries at the WTO (for specific products) nor criteria to define a net food-exporter (e.g. which foodstuffs to be covered and over what base period). While the converse list of “net food-importing developing countries” exists as a WTO category (based on self-designation and subject to verification of the relevant data), it has been constructed for the purpose of the Marrakesh Decision (see below) and nowhere it is implied that a country not belonging in this latter category automatically belongs to the net food-exporter category.

Thus, essentially, current WTO rules allow the use of export restrictions when countries face domestic shortage. Export taxation was never disallowed, and this tax could be prohibitively high because, unlike import tariffs, it is not bound anywhere. If requested, the two obligations called for in Article 12 of the AoA, i.e. giving due consideration to the effects of such prohibition or restriction on importing Members’ food security and providing advance notification and consultation, are useful to some extent for exerting some moral restraint on the exporter, but they may not actually mean anything in concrete terms.

It is not clear to what extent any of the WTO Members that resorted to export prohibitions or restrictions during the recent past have given due consideration to others’ food security needs. There was no formal consultation in the WTO Committee on Agriculture (CoA) on the scope and duration of the measures that were put in place or on the possible adverse effects for other Members who may have had a substantial interest as importers of food commodities subject to such export prohibitions or restrictions.

The asymmetry in WTO application of disciplines to imports and exports has been pointed out during the current negotiations on agriculture, and several countries have proposed stronger rules in this area. Japan’s negotiating proposal was the most comprehensive (WTO, 2000). It focused on rules and disciplines on exports and on redressing the imbalance between rules and disciplines applied to agricultural exporting countries and those applied to importing countries. The reference to imbalance is to contrast the weak rules on exports compared with well-defined and binding rules on imports. In addition, Switzerland had called for eliminating all export restrictions on agricultural products and the binding at zero of all export tariffs (with flexibility for the less developed countries, LDCs). The Republic of Korea also proposed prohibiting exporting countries from imposing export restrictions and also prohibiting the use of export taxes. Several other proposals called for improved disciplines on export restrictions and on binding export taxes.

However, there is resistance on these issues from other WTO Members, and it is questionable whether stronger disciplines on export prohibitions, restrictions and export taxation can materialize under the Doha Round. Article 12 of the AoA will remain weak as long as there is a link to paragraph 2(a) of GATT Article XI. However, at the minimum, existing Article 12 should be strengthened in some important ways:

- ▶ First, an obligation to submit a notification to the WTO CoA prior to instituting any new export prohibition or restriction on foodstuffs. Such notifications should be supported by detailed data and



analysis demonstrating the reasons for instituting such measures and how trading partners of that Member may be affected;

- ▶ Second, upon receipt of such notification to the WTO CoA, there should be an obligation to respect a mandatory consultation period (say of one month) with potentially affected countries, again prior to the export restriction being implemented; and
- ▶ Third, an obligation to spell out explicitly the duration of an eventual measure, stipulating a maximum period of its application (e.g. three months).

The current price spike in world food prices (2010-11), again partly related to export prohibitions by some key exporting countries, may provide additional incentives to fix some of the problems with export prohibitions and restrictions along the lines suggested above, within the ongoing Doha Round negotiations.<sup>14</sup> Beyond the food security concerns of net food-importing countries, weak WTO rules in this area are also detrimental to the multilateral trading system itself. It raises doubts about the world market being a reliable source of food supplies and puts under question the credibility and impartiality of efforts to reform world agricultural trade (Konandreas, 2008a).

### *Stockholding and domestic food aid*

Stockholding operations, with their objective of providing minimum support to farmers while also helping consumers through food distribution schemes, have been a very common response to domestic and international market instability in the past. While such schemes often proved costly and not always effective, and many countries have moved away from such interventions, their appeal is clear from the point of view of vulnerable countries as they offer some degree of protection against domestic and external shocks.

What do the WTO rules say about such measures? The relevant provisions in the AoA are under paragraph 3 and paragraph 4 of Annex 2 of the AoA (the "Green Box")

As regards public stockholding, the general provisions in paragraph 3 of the "Green Box" ("public stockholding for food security purposes") stipulate that: the accumulation and holding of such stocks should form an integral part of a food security programme identified in national legislation; the volume and accumulation of such stocks shall correspond to predetermined targets related solely to food security; and the process of stock accumulation and release shall be financially transparent, including being carried out at current market prices. Specifically for developing countries, footnote 5 of paragraph 3 relaxes this general provision, whereby public stocks for food security purposes may be acquired and released at administered prices, provided that the difference between the acquisition price and the external reference price is accounted for in the AMS.

As regards subsidized distribution, the general provisions in paragraph 4 of the "Green Box" ("domestic food aid") stipulate that eligibility to receive food aid shall be subject to clearly-defined criteria related to nutritional objectives; that such aid shall be in the form of direct provision of food to those concerned or the provision of means to allow eligible recipients to buy food either at market or at subsidized prices; and that the financing and administration of the aid shall be transparent, including food purchases by the government made at current market prices. Specifically for developing countries, the provision of

<sup>14</sup> Renewed calls for strong disciplines on export restrictions are being made following temporarily halting of exports of wheat and other grains by the Russian Federation and Ukraine in the latter part of 2010 in order to protect supplies for their own people. For example, Caroline Spelman, UK Environment Minister, argued that no country should be allowed to interfere with the global food commodity market ("Halting food exports should be illegal", The Guardian, January 5, 2011). See also Diaaz-Bonilla & Ron (2010).

foodstuffs at subsidized prices with the objective of meeting food requirements of urban and rural poor in these countries on a regular basis at reasonable prices should be considered to be in conformity with the provisions of this paragraph.

In the Draft Modalities, the conditions regarding the acquisition of stocks for food security purposes, including for use in domestic food aid programmes, are further relaxed (WTO, 2008). The Draft Modalities text excludes from the AoA disciplines the acquisition of foodstuffs at subsidized prices with the objective of “supporting low-income or resource-poor producers”, “fighting hunger and rural poverty” and “in relation to lowering prices to more reasonable levels”. These additions provide more flexibility to the existing provisions of the AoA for developing countries, which stipulate that only the provision of food can be at subsidized prices but not its acquisition.

A number of developing countries, especially in Africa, have stockholding policies for price stabilization or targeted food distribution. These programmes are not known to have been constrained by the current AoA disciplines (AMS and/or *de minimis* limits). This may, however, change in the future in response to recent experiences of soaring food prices, with more countries putting in place such schemes. In this connection, the additional flexibility provided in the new AoA rules is a positive development, even with the requirement that the acquisition of stocks must be tied to the objective of supporting low-income or resource-poor producers, a situation generally prevalent in food-insecure developing countries. Therefore, for all practical purposes, public stockholding and related domestic subsidized distribution programmes in food-insecure developing countries are WTO-compatible for as long as they form an integral part of a food security programme and are targeted to those in need, both of which are laudable objectives.

### *State Trading Enterprises*

Closely related to public policy for food security is the role played by State Trading Enterprises (STEs), an issue also under negotiation in the Doha Round. The main concern about STEs all along has been the risk of their operations undermining the other disciplines on export competition (export subsidies, food aid and export credits). Thus the Draft Modalities text includes provisions for the elimination of, in parallel and in proportion to the other provisions on export competition, all forms of subsidization of such STEs.

In general, these concerns apply more to exporting STEs and not to importing STEs for basic foodstuffs, the latter being mostly the case for developing countries. The draft text also contains SDT provisions under which STEs in developing country Members would not be constrained by the envisaged disciplines, to the extent that their state trading activities have social objectives (such as domestic price stability, food security and rural development) and/or also to the extent that their STEs are too small to have an effect on world markets and are not otherwise inconsistent with other WTO rules. These SDT provisions would in principle allow developing countries to maintain their STEs, although their contribution to alleviating the adverse effects of food price volatility would depend on how effectively they pursue their stated social objectives.

### **WTO provisions on behalf of third countries**

In addition to the multilateral rules on production and trade policy and related commitments largely reflecting national interests of domestic producers and consumers discussed above,

there are also other commitments made individually or collectively by WTO Members that have important implications for other countries in their efforts to deal with price volatility. These include particularly export financing support, international food aid and possible assistance under the Marrakesh Decision of the Uruguay Round.<sup>15</sup>

### *Export financing support*

Under this heading are provisions on export credits, export credit guarantees or insurance programmes. There are no rules regarding these instruments in the existing AoA, but WTO Members had agreed to work towards developing relevant disciplines (Article 10.2 of the AoA). By and large, negotiations under the Doha Round on these issues focused not so much on how related provisions can be made more effective in helping food-insecure countries in financing needed food imports, but on preventing circumvention of export subsidy commitments.<sup>16</sup>

In the Draft Modalities text, measures under export financing support (comprising export credits, export credit guarantees or insurance programmes) are described as follows:

1. Direct financing support, comprising direct credits/financing, refinancing and interest rate support;
2. Risk cover, comprising export credit insurance or reinsurance and export credit guarantees;
3. Government-to-government credit agreements covering the imports of agricultural products exclusively from the creditor country under which some or all of the risk is undertaken by the government of the exporting country; and,
4. Any other form of governmental export credit support, direct or indirect, including deferred invoicing and foreign exchange risk hedging.

The provisions to be agreed shall apply to all “export financing entities” that are either government agencies or private entities with government participation in any form, or that receive government support or provide insurance or guarantees.

There are two elements of the export financing support schemes that would be disciplined: *maximum repayment term* and *premium rates*. For the former, the general rule is to limit the maximum repayment term for export financing support to no more than 180 days. For the latter, the fundamental principle proposed is that export credit guarantees, insurance and reinsurance programmes, and other risk-cover programmes shall be *self-financing* by the interest rate charged.<sup>17</sup>

Beyond these general provisions, there also arose a need to address the concerns of the LDCs and the net food-importing developing countries (NFIDCs) in view of the Marrakesh Decision where Ministers had agreed to “ensure that any agreement relating to agricultural export credits makes appropriate provision for differential treatment in favour of LDCs and NFIDCs.” Historically, both the LDCs and NFIDCs have not accessed much of the global total of agricultural export credits, mainly reflecting lack of access and not a lack of need for this import financing mechanism. One important SDT provision in the Draft Modalities concerning LDCs and NFIDCs as beneficiaries of export financing is the repayment period

<sup>15</sup> “Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries”.

<sup>16</sup> This is understandable, considering the principle agreed by WTO Members to undertake commitments in all areas of direct and indirect export subsidization, including export credits and food aid, in parallel with the elimination of export subsidies.

<sup>17</sup> The relevant text reads as follows: “Where premium rates charged under a programme are inadequate to cover the operating costs and losses of that programme over a previous 4-year rolling period, this shall, in and of itself, be sufficient to determine that the programme is not self-financing.”

that will be between 360 and 540 days for the acquisition of basic foodstuffs.<sup>18</sup> In addition, should an LDC or NFIDC face “very exceptional difficulties”<sup>19</sup> which preclude financing normal levels of commercial imports of basic foodstuffs and/or in accessing loans granted by multilateral and/or regional financial institutions, the repayment term can be extended (beyond 540 days) to meet humanitarian needs for basic foodstuffs. This is, however, subject to notification and review.

It may be noted that there is no SDT provision for all developing countries as beneficiaries of export financing, only for LDCs and NFIDCs. On the other hand, there is an SDT provision applicable to all developing countries as providers of export financing support. They will have a phase-in period of four years after the first day of the implementation period to fully implement the maximum repayment term of 180 days (with 360 days for export financing arrangements concluded in years 1 and 2 and 270 days in year 3). This could prove useful in broadening the possibilities of developing countries in sourcing imports of basic foodstuffs under favourable terms, including during periods of distress in view of high world food prices.

### *International food aid*

The origins of food aid date back to the early 1950s, when the accumulation of food surpluses (mostly cereals) in North America gave rise to the idea that these surpluses could be “disposed of” to help countries experiencing food shortages. This led to the establishment of the FAO Principles of Surplus Disposal,<sup>20</sup> administered by the FAO Sub-Committee on Surplus Disposal (CSSD) (see [FAO 2001a](#)).

The CSSD, together with the Food Aid Convention (FAC), which broadened the donor base of food aid and established criteria for its provision and use, were the key institutional bodies governing food aid and were explicitly recognized as such in the Uruguay Round AoA (see below). Food aid thus became part of the WTO rules governing trade in agricultural products. While this may have implied better adherence to CSSD and FAC guiding principles (as they were now part of the binding WTO system), it also brought with it certain inertia to change, in the sense that food aid rules could no longer move independently from the rest of the rules governing agriculture. Indeed, as for the whole package of issues on agriculture being negotiated under the Doha Round, there has been an impasse in the arrangements governing food aid, although it is widely recognized that the situation on the ground necessitates important changes in the provision and use of food aid.<sup>21</sup>

### *Existing provisions*

The existing disciplines on food aid under the AoA are contained in paragraph 4 of Article 10 on the Prevention of Circumvention of Export Subsidy Commitments. It is clear that the incorporation of food aid disciplines under this article was meant to avoid abuse of food

<sup>18</sup> It should be noted that this SDT for LDCs and NFIDCs concerns only the acquisition of basic foodstuffs and not all other food and agricultural commodities.

<sup>19</sup> Note also that the term “very exceptional difficulties” is not defined, which could be a divisive issue during implementation.

<sup>20</sup> The “Principles” is a code of international conduct adopted by the FAO Council in 1954, encouraging the constructive use of surplus agricultural commodities and at the same time safeguarding the interest of commercial exporters and local producers.

<sup>21</sup> This includes in particular the growing requirements of protracted emergency situations and the need for flexibility of food-related assistance to better respond to these needs. Emergency food aid now constitutes nearly four-fifths of the total food aid. See [Konandreas \(2010\)](#).

aid, particularly in situations where it could be provided in terms and conditions that would circumvent export subsidy commitments.<sup>22</sup>

In essence, paragraph (a) of Article 10.4 calls upon donors to ensure that “the provision of international food aid is not tied directly or indirectly to commercial exports of agricultural products to recipient countries.” How this is to be ensured is spelled out in paragraph (b) which states that “international food aid transactions, including bilateral food aid which is monetized, shall be carried out in accordance with the FAO “Principles of Surplus Disposal and Consultative Obligations”, including, where appropriate, the system of Usual Marketing Requirements (UMRs)”, while paragraph (c) stipulates that “such aid shall be provided to the extent possible in fully grant form or on terms no less concessional than those provided for in Article IV of the Food Aid Convention 1986.”

While the tenor of the current disciplines appears restrictive, in practice they are mere guidelines rather than strictly binding rules that would constrain the provision of food aid in any way. This was one of the main reasons that the Doha Round negotiations on food aid have been intense and so inclined towards tightening the rules on food aid.

Over time there have been important improvements in the food aid system in terms of assessing more precisely the specific needs of recipient countries and responding to them with more flexibility as regards the resources needed and the complementary measures to be taken. However, the system is not yet free from its legacy dating back more than five decades when the notion of “surplus disposal” was first introduced and when food aid policies were driven, by and large, by the supply availabilities in donor countries. Complete de-linking from donor surplus supplies has yet to be attained. As a consequence, food aid still remains highly variable and an uncertain resource, with commodity prices, stock levels and shipping costs playing a key role.

The precarious and unpredictable nature of food aid is more evident during periods of high price volatility. As food prices rise, food aid declines (Figure 17.8).<sup>23</sup> This inverse relationship is anticipated as food aid is expressed in monetary terms in donor national budgets. Hence, a given amount of funds translates to less quantity under a situation of rising prices. Overall, whether in normal years or years of dear food, the role of food aid has declined considerably since the mid-1990s, although it remains a critical source of supply for some food-insecure countries.

### *New disciplines under the Doha Round*

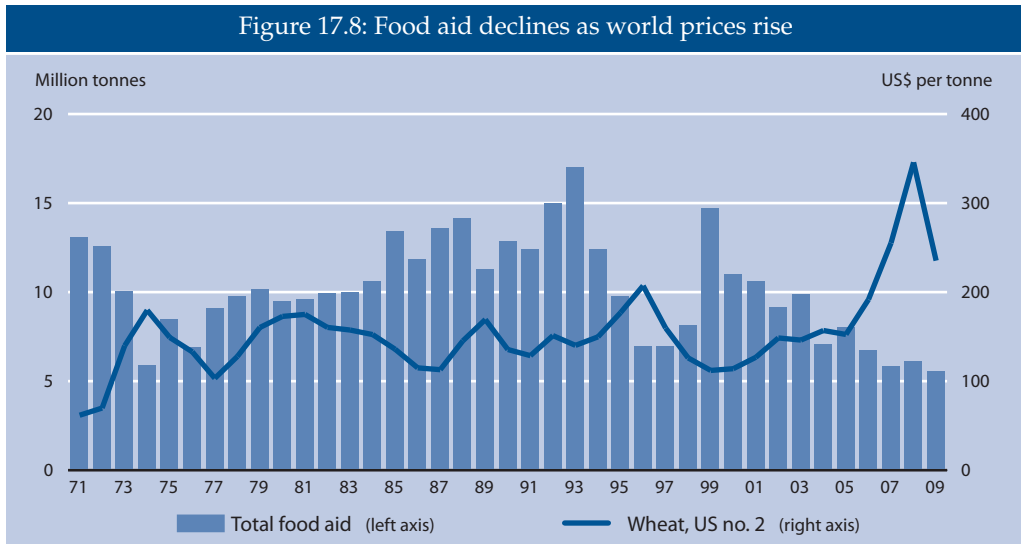
As for the future, the rules that would govern food aid are those being negotiated under the Doha Round, as part of the new AoA. First, several “general disciplines” are proposed to be applicable to all food aid transactions, no matter what the intended use of food aid, in particular: needs-driven; in fully grant form; not tied directly or indirectly to commercial exports of agricultural or other goods and services; not linked to market development objectives; and, not re-exported (except when absolutely required to meet an emergency situation in other countries).<sup>24</sup>

<sup>22</sup> The other reference to food aid in the Uruguay Round agreements is in the Marrakesh “Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries”. Food aid, together with export credits and food financing facilities, are the response measures envisaged under the Marrakesh Decision to help LDCs and NFIDCs facing short-term difficulties related to importing adequate foodstuffs on reasonable terms and conditions (more on the Marrakesh Decision below).

<sup>23</sup> The correlation coefficient between the volume of total food aid shipments and the world price of wheat (taken as a proxy of food prices in general) over the 1971-2009 period is -0.59.

<sup>24</sup> Three additional “guidelines” are also stipulated as regards taking fully into account local market conditions: i) refrain from providing in-kind food aid where this would cause an adverse effect on local

Figure 17.8: Food aid declines as world prices rise



Source: Based on FAO and WFP data.

While all food aid transactions should conform to the general disciplines above, further rules distinguish between emergency and non-emergency situations. Food aid in emergency situations (whether cash or in-kind) is placed under a “Safe Box” (akin to “Green Box” in domestic support disciplines) in the sense that such transactions will not be contested. However, food aid in non-emergency situations, i.e. outside the “Safe Box”, would be under stricter disciplines, in particular: based on a needs assessment; provided to redress chronic hunger and malnutrition; targeted to identified food insecure groups; and, its provision would minimize commercial displacement.

The most contentious part of the new food aid disciplines is the monetization of in-kind food, whereby it may be permissible under well-defined and monitorable circumstances.

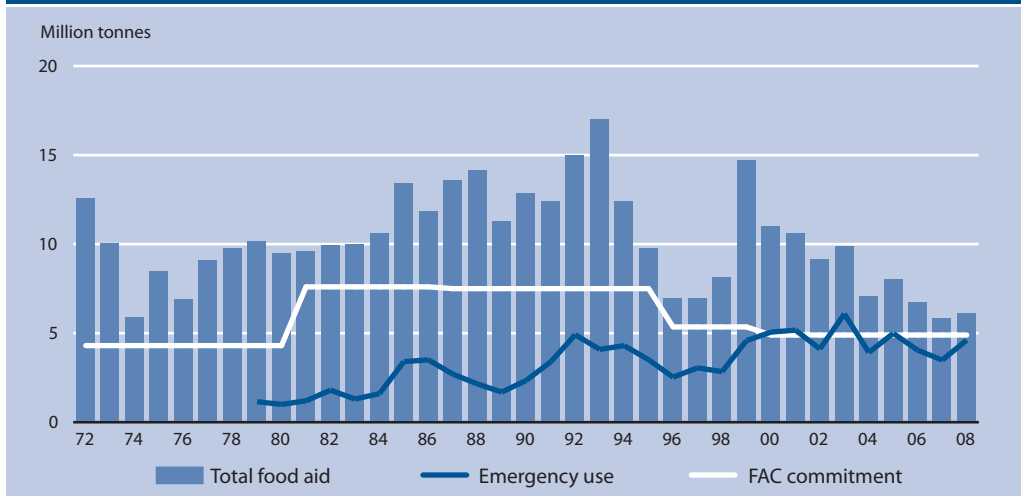
While the above provisions generally represent considerable progress within what is politically feasible, the Doha Round is still in suspense and nothing can be agreed independently from the rest of agriculture and non-agriculture issues. Meanwhile, the international community is anxious to see progress in food aid and to better respond to the changing food security situation on the ground.

#### *Growing emergency needs and limited role of food aid in high price years*

The first priority of food aid is responding to the rapid increase in humanitarian relief and crisis-related emergency situations. The number of emergency operations during the 2001-10 nearly doubled compared with the 1980s and the demand for emergency food aid has also doubled, standing on average at 4.55 million tonnes during the period 2001-08 compared with about half that amount in the 1980s. At the same time, following the WTO agreement in 1995, total food aid availability has declined considerably, in parallel with the aggregate minimum commitment under the FAC, which was adjusted downwards by over two million tonnes and now stands at some 4.895 million tonnes. As a result, emergencies absorbed

or regional production of the same or substitute products; ii) food aid providers encouraged to procure locally or regionally to the extent possible; and iii) make best efforts to move towards more cash-based food aid.

Figure 17.9: Total food aid, emergency use and FAC commitments



Source: Konandreas (2010).

nearly 80 percent of total food aid in 2008 compared with well below 20 percent up to 1990 (Figure 17.9).

Therefore, on average, there is only a small positive margin between aggregate minimum FAC commitments and aggregate emergency needs (an average of 345 000 tonnes during 2001-08). It follows that to the extent that all commitments under the FAC were for the exclusive use of emergency operations, these resources would just about suffice, although this average margin could not to be counted upon all the time. As shown in Figure 17.9, in at least three of the last eight years, emergency needs for food aid alone were above the aggregate minimum commitment under the FAC.

But there are other legitimate needs in addition to emergencies. Besides programme food aid, which is declining rapidly and enjoys little support for a variety of reasons, there are genuine needs of vulnerable groups in food-insecure developing countries, which averages 1.35 million tonnes during 2001-08. By and large these involve multi-year projects to address the needs of chronically food-insecure people, and there is very little room for reducing such resources without inflicting hardship to the dependent target populations.

It follows that, based on present FAC commitments and genuine emergency and project food aid needs, there is little flexibility to allow a permanent and inconsequential diversion of resources from FAC minimum commitments to address additional difficulties facing countries during periods of high price years. Moreover, it is during such years that commitments under the FAC are barely above the minimum, and also during such years that nutritional interventions become imperative as more people fall below the poverty line.

The conclusion is that under the present aggregate minimum commitment of the FAC, diverting food aid resources away from their prioritized use may seriously compromise the timely availability of resources for meeting pressing emergency needs as well as the needs of chronically food insecure populations. The present FAC offers little room for providing any relief to countries facing difficulties from high food prices. It follows that serious consideration should be given in the renegotiation of the FAC to raising its aggregate minimum commitment (see below).

### *The need for strengthening the Food Aid Convention*

While the stalemate at the WTO has prevented the conclusion of the new FAC, expediting its renegotiation to better meet its objectives has been the focus of attention by the international community for some time. In connection with this, the FAO has put forward some concrete ideas for desirable amendments to the FAC, especially in order to better respond to growing emergency and other humanitarian needs. These proposals would have to take onboard, *inter alia*, the substantial progress that has been made so far under the Doha Round negotiations, as well as the realities on the ground concerning food aid needs and modalities for its provision. As an incremental process, with one instrument improving upon what has already been agreed by the other, the provisions of the new FAC would then have to be incorporated and “legalized” under the eventual Doha Round agreement.

The suggested specific improvements of the FAC include (Konandreas, 2010):

- ▶ Incorporating agricultural inputs into the FAC. This does not imply bringing into the FAC long-term assistance to developing countries in general, but small quantities of inputs that are part and parcel of the emergency response to crisis-affected countries in order to expedite their recovery and thus avoid a continuing dependence on outside food assistance.
- ▶ Raising the FAC minimum commitments. Adequate funding for the FAC in relation to the situation on the ground is not only defensible from the humanitarian point of view, but it makes good economic sense compared with the alternative of having to resort to ad hoc and expensive last minute emergency operations because of an inability to plan ahead.
- ▶ Broadening the FAC donor base. Together with raising the minimum commitments of existing Members, efforts should be made to broaden the FAC donor base by bringing new donors formally into the FAC.
- ▶ Earmarking and prioritizing FAC resources to emergency operations. Donations under the FAC should be earmarked exclusively for emergency operations and the needs of genuine nutrition intervention projects.
- ▶ Introducing flexibility in funding arrangements. The new FAC should allow more flexibility in annual donor contributions, through carry-forward and carryover, to give donors a degree of flexibility in inter-year shifting of contributions to better respond to variable needs.
- ▶ Ensuring compatibility with WTO rules. Certain provisions of the FAC need to be brought in line with existing rules and what may be eventually agreed under the Doha Round, including definition of eligible recipient countries and targeting food related assistance, especially to resource-poor farmers in developing countries.

### *The Marrakesh Decision and food financing facilities*

The Marrakesh Decision was included in the Uruguay Round agreement because of the recognition that certain vulnerable countries that depend on the world market for a substantial part of their basic food needs may face additional difficulties in financing such foodstuffs as a result of higher prices from the implementation of the AoA.

### *Lack of progress in implementing the decision*

Partly because of the near impossibility to establish a clear link between financing difficulties and the implementation of the AoA, there has been very little progress in implementing the Decision, despite efforts the countries concerned have made over the years with support of international organizations. The Decision itself is not being re-negotiated in the Doha Round, but as discussed already, food aid and export credits are, which are two of the four mechanisms<sup>25</sup> for helping LDCs and NFDCs under the Decision.

<sup>25</sup> The other two draw on food financing facilities and technical and financial assistance to improve their agricultural productivity and infrastructure.



It is hardly disputed that many LDCs and NFIDCs have balance of payments difficulties even in normal times, and face additional short-term difficulties financing normal levels of commercial imports of basic foodstuffs in more difficult times, such as when food prices soar in the world markets. In the context of the Decision, FAO had undertaken a detailed analysis in 2002 of the difficulties for LDCs and NFIDCs in financing food imports (FAO, 2003). Among other things, the FAO analysis noted that unlike the past, food imports were now largely undertaken by private traders and this had not always helped financing food imports when needs surged. This is largely because the private sector - working in an environment of high risks, underdeveloped banking services and the extra collateral demand this entails - lacks finance and related guarantees which importing government agencies used to enjoy in the past.

As regards possible assistance from food financing facilities, the relevant paragraph of the Marrakesh Decision reads as follows: “Ministers recognize that as a result of the Uruguay Round certain developing countries may experience short-term difficulties in financing normal levels of commercial imports and that these countries may be eligible to draw on the resources of international financial institutions under existing facilities, or such facilities as may be established, in the context of adjustment programmes, in order to address such financing difficulties”. In relation to “international financing institutions”, the Decision explicitly mentions the IMF and the World Bank, and for this reason much attention has been drawn to related facilities maintained by these agencies.

Among the facilities, the one closest - both in spirit and content - to that envisaged in the Decision, and the one that has attracted the most attention in subsequent discussions is the IMF’s Compensatory Financing Facility (CFF), which encompasses a cereal import bill component.<sup>26</sup>

#### *IMF’s CFF and the new exogenous shocks facility of 2005*

The CFF was created in 1963, and the cereal import element was added in 1981 following increased volatility of food prices in the 1970s.<sup>27</sup> The CFF was further streamlined in 2000. Its main features since the streamlining have been as follows:

- ▶ the purpose of the CFF is to help members cope with *temporary* export shortfalls and high cereal import costs that create an overall balance-of-payments need. Commodity price shocks that do not create a temporary balance-of-payments need do not qualify for compensation;
- ▶ it is a non-concessional facility and there are access limits; and,
- ▶ as most borrowers usually have balance-of-payments problems that extend beyond the temporary shock, other Fund arrangements and conditionalities invariably apply to borrowing from the CFF.

There has been very little use of the cereal element of the CFF. In the period from January 1993 to September 1999, there were six purchases by four countries (Algeria, Bulgaria, Moldova and South Africa). None of these countries, however, is an LDC or an NFIDC. Commentators had all along pointed to the limitations of the CFF in financing excess food import bills, for reasons noted above (balance of payments, need to take into account export earnings, conditionality, non-concessional nature, etc.). The IMF’s own evaluation of 2004 also reached similar conclusions (IMF, 2004).

<sup>26</sup> The World Bank also has several instruments for emergencies, like the Import Rehabilitation Loan and Emergency Recovery Credit/Loan, but these are not as closely linked to the issue of excess import bills as is the CFF.

<sup>27</sup> Relevant research at the time was partly influential in IMF’s decision to extend the CFF to cover cereals (see Konandreas et al. 1978).

In November 2005, the IMF established a new facility, the Exogenous Shocks Facility (ESF) within its Poverty Reduction and Growth Facility (PRGF) Trust. The ESF is designed to provide concessional financing to low-income countries that are experiencing exogenous shocks but do not have a PRGF arrangement in place (for those with a PRGF arrangement in place, the IMF can enhance its support for dealing with shocks by augmenting the resources available under that arrangement).

As of late 2007 no country had requested assistance under the ESF, despite the difficulties many were experiencing in financing food imports owing to the already high food prices at the time. In September 2008, IMF's Executive Board approved modifications to the ESF that provided for faster and higher access, made the facility easier to use, and enhanced its flexibility. These modifications took effect in November 2008 and based on the experience since then, the ESF has become a much more useful instrument for countries facing difficulties in financing food imports.

Immediately following the modifications introduced to the ESF, several countries sought and received assistance under this facility. Since December 2008, some 12 countries applied for and received loans.<sup>28</sup> In the aggregate, the loans approved for these 12 countries amounted to some USD 1.25 billion. Financing terms under the ESF are equivalent to a PRGF arrangement and are more concessional than under other IMF emergency lending facilities.<sup>29</sup> The ESF remains the IMF's main facility relevant for most LDCs and NFIDCs facing difficulties in financing food imports because of external price shocks.

#### *Food Import Financing Facility (FIFF)*

During the earlier years of the Uruguay Round implementation, some debate had taken place on the appropriateness of the CFF for the purpose of the Marrakesh Decision. Concluding, for the reasons noted above, that the CFF had major limitations in addressing "short-term difficulties" as foreseen by the Marrakesh Decision, a group of 16 LDCs and NFIDCs proposed in 2001 the creation of a new, dedicated financing facility (WTO, 2001).

The proposal (based on (FAO, 2001b) analysis) was to create a "revolving fund" from which LDCs and NFIDCs would borrow short-term loans in the event of soaring food import bills. In November 2001, at the WTO Ministerial Conference at Doha, a decision was taken by the WTO to establish an Inter-Agency Panel on Short-Term Difficulties in Financing Normal Levels of Commercial Imports of Basic Foodstuffs. The terms of reference of the Panel were limited to assessing existing facilities like the CFF, and to examining the feasibility of the revolving fund.

The Panel Report did not express its verdict on the revolving fund in a definite manner (WTO, 2002).<sup>30</sup> It recommended that the feasibility of an *ex ante* financing mechanism aimed at food importers should be explored further. Developed countries - the potential donors to the fund - were not supportive of the idea. FAO and the United Nations Conference on Trade and Development (UNCTAD) elaborated further on how the proposed facility could work in practice and developed a proposal for the creation of a Food Import Financing Facility, FIFF (FAO, 2003). The FIFF was supposed to be a market-based instrument to provide credit

<sup>28</sup> Comoros, Congo DR, Dominican Republic, Ethiopia, Kenya, Kyrgyz Republic, Malawi, Maldives, Mozambique, Senegal, St Lucia and the United Republic of Tanzania.

<sup>29</sup> ESF loans carry zero annual interest rate until 2011 (0.25 percent thereafter), with repayments made semi-annually, beginning 5.5 years and ending 10 years after the disbursement (see [www.imf.org/external/np/exr/facts/esf.htm](http://www.imf.org/external/np/exr/facts/esf.htm)).

<sup>30</sup> The Members of the Panel were nominated by the respective heads of the FAO, IMF, IGC, World Bank and UNCTAD.

guarantees to importing agents/traders of LDCs and NFIDCs to meet the cost of excess food import bills. Although it was seen favourably by many countries, there was no concrete interest for a practical follow up. Very little has been pursued in the WTO since then on this issue.

In retrospect, had it been in place, a functional instrument along the lines of the FIFF would have provided some relief to the affected countries during the recent periods of soaring food prices. It would also have reassured them about the world market being an affordable source of food supplies. The rationale for this proposal remains valid.

## Concluding remarks

The desire to reduce uncertainty and volatility in world food prices and to reap the benefits from trade liberalization were the main reasons that brought agriculture into the regulatory framework of the WTO. The distorting policies in the agricultural sector, both at the border and in domestic markets, were targeted for reform and new rules and disciplines were agreed upon representing a fundamental shift in agricultural trade and food policy. By and large, border protection and domestic agricultural policies ceased to be subject to arbitrary decisions of individual countries and were placed under multilaterally agreed disciplines.

Yet, the AoA was only a very partial and incomplete first step in disciplining agricultural trade and adequately addressing the concerns of both exporting and importing countries, especially in periods of market volatility. In particular, as it has been demonstrated during recent periods of food price spikes, existing rules and disciplines are far from being fully effective and the Doha Round is not likely to change this situation drastically.

Comparing the two extreme cases of food price swings, the WTO rules and disciplines are much less effective in situations of high world market price years than they are in cases of depressed prices. This asymmetry is largely a consequence of the original objective of the multilateral trading system that aimed at disciplining situations leading to depressed prices in world markets adversely affecting exports. Thus, domestic and export subsidies, as well as import barriers, have been the target for reform, while policies that have to opposite effect (such as export taxes and prohibitions) have been largely tolerated.

This chapter argued that to the extent that the fundamentals of world food markets have changed, the multilateral rules must adjust accordingly to be able to address trade issues that may arise also in periods when food is dear. This would also add to the credibility of the MTS and foster an environment conducive to more trade openness on the part of importing countries, to the extent the latter are assured that the world market is a reliable source of supply, both in periods of plenty and in periods of relative scarcity.

Besides addressing certain imbalances and weaknesses of the trade rules, this chapter also pointed out the mechanisms envisaged in the AoA to help LDCs and NFIDCs facing difficulties in financing basic foodstuffs. Most notable is the need for an effective implementation of the Marrakesh Decision and the specific instruments therein. The Decision was a wise and insightful complement to the reform process in agriculture. A renewed effort is necessary to translate the good intentions of the international community into a functional instrument.

Ultimately, dealing with price volatility is the preoccupation of national governments and individual households within countries and cannot be addressed at the international level. However, the international policy environment, the multilateral trading system and the rules that govern it can be highly supportive and help countries mitigate the effects of extreme price

swings. More symmetry in the rules in addressing problems of both exporters and importers, more predictability in the application of the rules and a more faithful implementation – not only of the letter but also of the spirit of the agreed rules – removes an uncertainty in the market and allows countries to focus on interventions with more confidence about the expected results.

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