INSTITUTE FOR AGRICULTURE AND TRADE POLICY

Stabilizing Agriculture Markets

WTO RULES AND FOOD RESERVES

World Trade Organization (WTO) rules governing agriculture do not actually make the operation of a grain reserve impossible, but they do create uncertainties. It is time for governments to think again about the framework for agricultural trade rules.

1. Financing a Reserve

It costs money to establish and run a public reserve. The Agreement on Agriculture (AoA) has different rules for different kinds of public spending on agriculture. Its starting assumption is that public support to agriculture should be provided in ways that do not distort trade or production. The rules do not accommodate market failures inherent to agriculture, and they only address some of the distortions introduced by various actors in the market (i.e., the rules focus on distortions made by governments but ignore those evident in the private sector). But the AoA rules do allow certain exceptions, which in practice open the possibility of significant public investment in agriculture.

The exceptions include programs considered too small to matter (under the so-called de minimis requirements), production-limiting programs and an allowance for other trade-distorting support that was based on how much a country was spending in the first place. The AoA creates both higher allowances and more exceptions for developing countries. Measures aimed at encouraging agricultural and rural development, or that target low-income or resource-poor producers, for example, are allowed for developing countries. Establishing and operating a reserve could be done in such a way as to meet these requirements.

The de minimis rules are calculated based on the size of a country's agriculture sector. For example, in 2009 Mali had a GDP of US$15.52 billion, 45 percent of which (US$7 billion) was generated from agriculture. Under the de minimis rules, Mali could spend nearly US$700 million (10 percent of its total agricultural production) on agriculture. That would be nearly half of the government's annual budget.

Food reserves wouldn't necessarily all be held in physical storage. They could also include a land set-aside program to hold productive capacity in reserve. Under the AoA as it is now, payments to farmers to limit production are not constrained. The proposals now provisionally accepted by WTO members as part of the Doha negotiations propose a cap on spending on such programs. A cap would not hurt existing programs, but might pose problems should governments decide to reintroduce set-asides in some form in the future.

The primary producers for export of many grains are developed countries—the United States for wheat and maize; France, Australia and Canada for wheat. If these countries were to jointly manage a global reserve, land set-aside policies could again be important. These, and the public payments needed to operate the reserve, would represent spending that would demand modification of the existing AoA rules and likely abandoning the revisions proposed in the Doha talks.

A further category of exceptions to public spending on agriculture is found in Annex 2 of the AoA (the Green Box), which allows governments to maintain public stocks, so long as the stocks are bought at "current market prices." If the government is a major buyer or seller (or both) then its price may be the market price. This category does not count the other costs associated with a price support program, such as storage costs. It only counts the gap between government-determined and market prices.

2. Governing the reserve

If the country creates a company to oversee the reserve, that State-Trading Enterprise (STE) would face specific regulations under WTO law that require it to operate by purely commercial criteria. The rules concerning government procurement could also affect the management of a public reserve.

The company might not be required to abide by the WTO limits if the grain reserve does not involve international trade. Yet even without engaging directly in trade, if the reserve

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is a big buyer and seller in the domestic market, it is likely that existing and would-be trade partners will monitor the reserve's behavior very carefully. While the rules put the onus on STEs to operate from purely commercial considerations, it is possible to argue that the kinds of objectives a government might have in mind, including the need to limit price volatility, are also commercial considerations that would help to keep risk to manageable levels.

The Doha proposals on STEs would curtail future attempts to establish a public monopoly over exports among any large exporter. They do not preclude the establishment of a grain reserve. There are also proposals to create exemptions for STEs in developing countries that have less than 5 percent share of world trade.

3. Price Interventions

To limit price volatility, a reserve can use stocks to affect supply by buying and releasing stock. Trade policy is also important in the management of a price band: The point of tariff quotas, for example, is to control supply on domestic markets through the application of tiered tariffs. If a reserve is intended to limit downward pressure on prices, then its administrators need to operate a price band, under which tariffs are automatically applied (or stocks are acquired or released) when prices stray from determined floors or ceilings. Price bands are illegal under WTO law. But they are not impossible to operate on a de facto basis.

The AoA allows WTO members to continue to operate more than one tariff level for the same product because of the gaps that exist between the maximum bound tariffs and the actual applied levels. As long as a country was careful to bind its tariff above the level usually applied, some room to maneuver is automatically created. However, a set tariff does not vary according to price (as a variable levy would). Under the rules, a country may not raise the tariff above the bound level and any change to the applied level has to be notified. The point of the WTO rules is to eliminate the gap between bound and applied tariffs, though the politics have so far made that impossible. Such an ad hoc system, however, does little to advance either public or commercial interests. Allowing a more interventionist tariff system, while guarding against erratic or short-term political interests, would be both doable and desirable.

4. Managing Volumes

WTO rules prefer markets to respond to price signals rather than volume levels. At the WTO, volume-based variable levies are illegal and volume-based tariffs have largely been replaced with ad valorem (value-based) equivalents. A grain reserve establishes a physical stock of food. That grain has to be bought and sold to keep the stock fresh, to avoid waste and to ensure appropriate levels are maintained. Governments need policies to decide the conditions under which grain from the reserve is released and how it is disposed of or sold.

Managing stock rotation (and total volume) is one of the biggest challenges a reserve will face. It is something an open market does very well, making a public reserve look clumsy by comparison. But the market ignores so-called externalities that should in fact be at the top of a government's priorities. These include the costs of environmental pollution, the limits on natural resources and the importance of meeting demand that is not backed by purchasing power.

Time for a new agricultural trade framework?

The AoA rules reflect their origins by focusing on curbing overproduction—an issue that is still relevant, but hardly the central challenge confronting the vast majority of developing countries.

Trade negotiators should amend the AoA so as to establish a framework of rules that:

- Allows the operation of price bands for food under multilaterally agreed norms;
- Explicitly acknowledges the need to stimulate production in many developing countries;
- Acknowledges the inherent weaknesses of the private sector in many developing countries and the concomitant importance of public authorities;
- Tackles the problem of unduly concentrated market power in global commodity markets;
- Recognizes the specificities of agricultural economics and the limitations of free-trade economics as they apply to the sector;
- Gives a clear and unambiguous place for governments' obligation to realize the universal human right to food, including the need to regulate markets if food security is thereby enhanced;
- Allows governments to develop policies that encourage surplus capacity to produce food, but that keeps that surplus in reserve rather than fully exploited.

This summary is drawn from "Trade and Food Reserves: What role does the WTO play?" by Sophia Murphy, Institute for Agriculture and Trade Policy/Misereor/Heinrich Böll Stiftung/EcoFair Trade Dialogue, September 2010.