

Managing the Invisible Hand

Markets, Farmers and International Trade

AN EXECUTIVE SUMMARY

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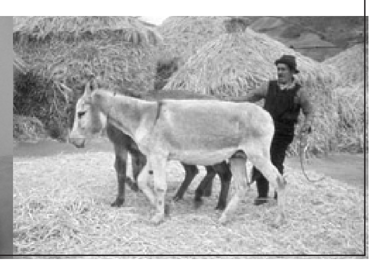
April 2002





Acknowledgements

The Canadian Foodgrains Bank financed this research project with the support of the Loewen Family Foundation and Defehr Foundation.

My heartfelt thanks to Stuart Clark, Senior Policy Analyst with the Canadian Foodgrains Bank; his support included foundation fundraising and the provision of critical commentary and ideas, but above all, believing the paper was important and needed to be written. It is due to his support and encouragement that this paper is here for you to read.

Dan McGuire and Emmett Dacey wrote background papers for the project. I am grateful to them both. André Lambelet edited the paper with his usual skill. Thank you, as always, for the advice and support.

My thanks too to Dale Wiehoff and Ben Lilliston for their encouragement and advice in getting the paper published. The Institute for Agriculture and Trade Policy has provided leadership for work on these issues for over fifteen years. I am grateful to Mark Ritchie and my colleagues for the daily immersion in ideas and debate that has brought this work into being.

Disclaimer

The Canadian Foodgrains Bank, a partnership of 13 Canadian church relief and development agencies, is pleased to provide support for the production of this report as part of its Global Food Policy Program. Together with its core program of food and food security programming, the Canadian Foodgrains Bank supports research and policy advocacy on global policy issues which affect the ability of hungry people to feed themselves. The influence of changing international grain markets on farmers in developing countries is one such issue.

The contents of this report are the work of its author and do not reflect Canadian Foodgrains Bank policy or the views of its supporters.

Introduction

Agriculture is central to food security, employment, and to building broad-based economic development. Trade, too, is an important development tool. Trade is not, however, an end itself. In fact, the promotion of trade liberalization, particularly as structured in the current Agreement on Agriculture (AoA), ignores basic elements of the global agriculture economy, specifically the concentration of market power by transnational corporations. The AoA will not successfully move us toward the underlying developmental goals articulated at the creation of the World Trade Organization (WTO), until it addresses market power and the question of monopoly and oligopoly power. Governments must take the lead to ensure more coherence between trade policy and the fulfillment of development objectives.

Multilateral negotiations for agriculture are at a critical moment. Between now and March 31, 2003, governments must draft revisions to the Uruguay Round Agreement on Agriculture. The framework for negotiations is set: negotiators will focus on export subsidies, then market access, then domestic support programs in three successive meetings. A final meeting will bring the pieces together at the end. Governments have agreed to address "non-trade concerns" (which includes food security) and "special and differential treatment" (which are the measures that favour developing countries) at each meeting.

The existing framework of the Agreement on Agriculture (AoA) provides many negotiators with the structure they want to fight about: export subsidies, domestic support to producers and agribusiness, and market access. While everyone agrees the 1994 agreement failed to do much to curb spending on agriculture in rich countries or to create market access opportunities, many maintain it at least provided the basis for further negotiations. This framework remains the most frequently cited positive outcome of the AoA.

To put it in simple terms, many believe there are only two things wrong with the AoA: the lack of political will to implement the agreement and the disproportionate capacity of rich countries to create exceptions to the rules for themselves. Both observations reflect abuses of power by developed countries and must be addressed. They are, however, not the only problems.

Even if the European Union ended all export restitution payments, the United States, Japan, and Europe ceased all payments to farmers, and all countries established duty-free market access for all agricultural products, agricultural market distortions would remain. Food security would not be guaranteed, nor would a decent livelihood for all those living from the land be assured. These reforms would not ensure the most efficient use of limited natural and genetic resources. Perhaps most concretely, market distortions would continue to disrupt developing countries' agriculture.

This paper argues that AoA ignores some of the basic elements of agriculture and therefore has perverse consequences.

The paper considers the nature of agricultural trade and trends in global agricultural production. It evaluates some of the public policy responses that have been tried to manage agriculture. And it argues that the framework set up by the AoA is flawed because it ignores:

- the inelastic nature of demand in agriculture:
  Food is essential to life, and should not be accessible only to those with purchasing power in the market.
- the relatively inelastic nature of supply in agriculture:
  Physical stocks are necessary to protect against weather-related production shortfalls, but the high cost of maintaining the stocks limits private sector interest in this service.
- the political and economic weakness of most farmers:
  Farmers are price-takers in the food system.
- the vertical integration of the agricultural system:
  Chemical companies (now dominant players in the seed business) are now linked to grain traders and food processors in a production chain where price becomes internal to the industry. The same companies buy,

ship, and mill grain, then feed it to livestock or turn it into cereal, often crossing several national borders in the process.

- the fact that countries do not trade; farmers do not trade: transnational agribusiness trades.

The paper proposes revisions to the WTO Agreement on Agriculture. These include:

1. Investigating and publishing the scale and scope of transnational agribusiness activities in member states. The WTO would ask governments to complete a standard questionnaire on transnational agribusiness activity. The WTO secretariat would then compile a composite view of this activity worldwide.
2. Evaluating the sources of market distortion, public and private, and discussing how best to address them.
3. Creating a WTO working group to discuss competition issues specifically related to agriculture.

Until multilateral trade rules take account of the concentration of market power in transnational agricultural trade, they cannot manage an open and fair trading system.

Agricultural trade rules need to take into account the rapidity of change in the whole agricultural sector, from seed production to food processing to retailing. At the very least, these rules must allow countries, particularly developing countries, the flexibility to block dumped agricultural products, protect food security and preserve the livelihoods of low-income farmers. Support for the inclusion of a Development Box in the revised AoA—a proposal described in the final section of the document—would be a step in this direction.

The models used by governments to predict the outcome of the Uruguay Round Agreement on Agriculture did not provide accurate results. They were wrong about the direction prices would take, wrong about who would get the increased exports and wrong about how farmers would respond to changes in support programmes. They failed to take into account these vital aspects of international agriculture. We need to—and can, this paper argues—go into the next round of negotiations better informed. In fact, we must: the lives and livelihoods of millions of people depend upon it.

Food Security, Rural Development and Globalization

Economic activity is ultimately valuable for its contribution to human welfare. Food security is one of the most basic elements of welfare—it is essential to human survival. Every person has an inalienable right to food. The primacy of food security is reflected in the frequent appearance of the term "food security" in WTO texts on agriculture, domestic agricultural legislation, UN declarations, and NGO advocacy efforts.

Analysts have shown agricultural development to be an effective way to generate employment and reduce poverty. This is not necessarily because agricultural development reduces poverty in itself, but because increasing incomes in rural areas has an immediate and significant knock-on effect by increasing demand for local goods and services, such as construction, clothes, and hired labour. Although farmers are rarely the poorest people in their societies, increasing their wealth reduces overall poverty because it boosts local employment. This is especially true when landholdings are equitably distributed.

Farmers' prosperity depends on their capital base (including access to land, water, credit, seed and animal stock) and their economic power (how much profit they can earn from the production of food). International trade, and globalization more generally, increasingly affect both these elements: access to resources and relative economic power.

The changes associated with globalization have spurred new international initiatives to develop stronger international regulations. In the agricultural sector, heightened concerns about food safety have led to trade disputes and then to new initiatives to develop internationally agreed-upon standards and norms that are politically acceptable to the people and companies affected.

In other cases, international policy prescriptions have shaped the direction of globalization. For example, through much of the 1980s and

1990s, international financial assistance was conditional on recipient countries reducing their tariff barriers, making their currencies convertible, servicing their debt obligations and increasing export production. These programmes prompted a shift towards export agriculture that has transformed the rural economies of many developing countries.

The Peculiarities of Agricultural Economics

Much of the writing and thinking that dominates discussions of international trade today is premised on the notion of comparative advantage. International trade in this theory is a tool to ensure efficient distribution of goods, allowing the lowest cost (used as a proxy for most efficient) producer to set world prices. The model sees market barriers such as tariffs and unfair advantages such as export subsidies as impediments to the free flow of goods—and thus as impediments to the maximization of welfare.

However, in the enthusiasm for open markets, the necessary role of public oversight tends to be overlooked or downplayed. For markets to work at all, governments must enforce laws to avoid the creation of cartels and reneging on contracted commitments. They must ensure information on supply and demand flows easily and provide customs officials to control borders.

In the discussion aired at the WTO, trade expansion quickly becomes a proxy for development and economic growth. The Director General of the WTO, Mike Moore, along with many developed country delegations at the WTO, has adopted the language of development as the reason for global trade rules. However, a growing number of commentators reject the conflation of trade expansion and economic growth.

There are gaps between market economics and meeting basic human needs. Meeting effective demand for food is not the same as ending hunger and malnutrition. The market cannot reflect the demand of consumers who do not have the purchasing power to be present in the market.

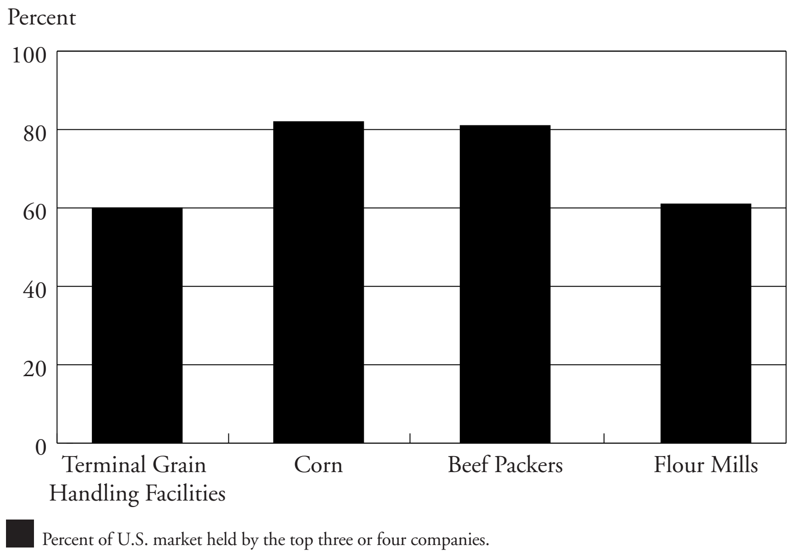
Neither demand nor supply of food is as sensitive to price as most products because food is not like most products. People need to eat to survive, and will spend everything they have to avoid starvation. However, once basic caloric needs are met, demand drops off sharply. Supply of many cereals comes once or twice a year at harvest time, even though people need food every day of the year. Supplies of basic grains cannot be timed to meet consumer demand—they must be stored against future need. Moreover, despite the increasingly sophisticated technology available to farmers in developed countries, weather remains an all-important and unpredictable determinant of supply, and thus of price.

The relatively inelastic nature of both supply and demand in agriculture complicates the operation of the market. Almost all governments, whatever their political persuasion, intervene in the market to ensure that most people are fed. While the current push for fully liberalized trade markets for agriculture ignores this fact, in practice the AoA is full of exemptions for public spending on agriculture. This is not only a recognition of the political impossibility of banning such programmes, but perhaps an acknowledgment of the role well-designed public action can play in correcting market failures.

Transnational Agribusiness and Market Power

A handful of large grain companies—among them Cargill, Continental, Louis Dreyfus, André and Bunge—play a central role in the food system. The UN Conference on Trade and Development estimated in 1986 that 85-90 percent of global trade was

Concentration in Agricultural Markets in the U.S.



60% of terminal grain handling facilities are owned by four companies: Cargill, Cenex Harvest States, ADM and General Mills. 82% of corn exporting is concentrated in three companies: Cargill, ADM and Zen Noh. Beef packing is dominated by an 81% share among four companies: Tyson, ConAgra, Cargill and Farmland Nation. 61% of flour milling capacity is owned by four companies: ADM, ConAgra, Cargill and General Mills.

Source: Heffernan, William with Hendrickson, Mary and Gronski, R. (2002), *Consolidation in the Food and Agriculture System*, Report to the National Farmers' Union, U.S.A.

controlled by these five companies. They remain dominant today. Each of the companies is present in dozens of countries, across all continents.

These multi-billion dollar operations have broadly diversified interests. Cargill, for example, owns a huge financial services unit, alongside its salt, steel, cotton, seed, and fertilizer businesses. For grain traders, profit is a percentage of sales—higher prices are fine, especially if the trader controls a good supply, but a high volume of sales at a lower prices is also profitable. In fact, because the grain companies have a significant interest in keeping the barges, rail cars and ships they own busy, higher volume may at times be more important to the companies' bottom-line than higher prices.

Neo-classical economics recognizes that undue market power, whether as a monopoly supplier or monopsony buyer, will undermine the welfare-creating potential of a given market. Where a monopoly or near-monopoly is in place, the industry must be regulated to control profit levels and restore economic equilibrium. For example, privately owned and operated utility providers often have a monopoly but their profits are capped at a publicly regulated maximum to avoid price gouging. However, the WTO rules for agriculture ignore the presence of this potential for market distortion.

The economist Susanna Davies, writing in 1986, raised questions that seem to have remained otherwise invisible in the literature on agricultural trade. Davies argued that the dominance of the largest grain traders should be treated as a given. She then asked how assumptions about grain markets and the way they operate should be adjusted to take into account this dominance. Unfortunately, debate at the WTO has overwhelmingly emphasized governments, farmers and, to a lesser extent, consumers. Companies are nowhere mentioned.

Vertical integration in the food and agricultural sector of the United States and the European Union deserves international attention because it overturns the assumptions that have impelled governments to embrace trade agreements and to change their agricultural policies to increase dependence on imported food. To date, few corporate mergers or joint ventures have received public scrutiny outside the country in which they are headquartered. This needs to change.

While suppliers are increasingly global in their reach consumers remain tied to local markets. Their purchasing power is measured in ringgits, dinars, or pesos, rather than in U.S. dollars. International trade may increase the choice of products available to consumers, but will not necessarily deliver those products at low cost, especially in local terms. The decline in prices for commodities has not necessarily translated into cheaper food for consumers.

Public Policy Responses : The Agreement on Agriculture

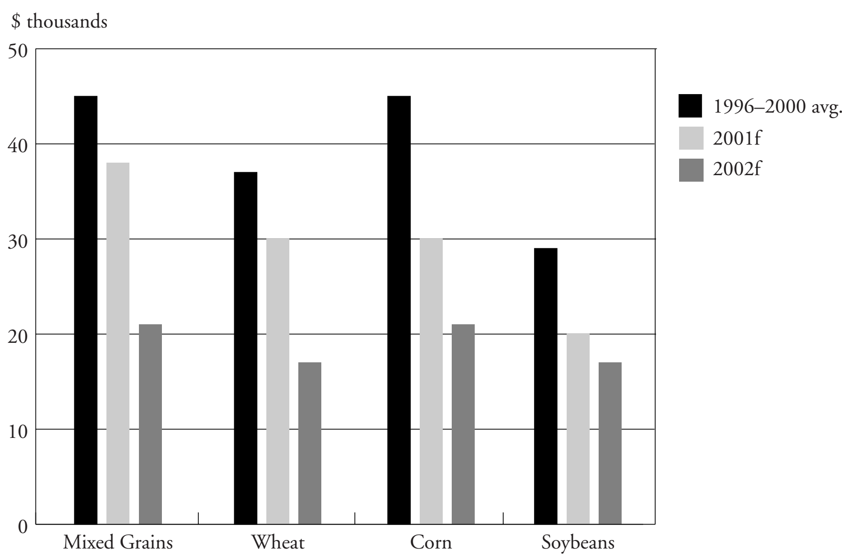
The World Trade Organization rules are designed to address national policies that distort global markets for agriculture. In particular, they are intended to curb subsidy use and to remove trade barriers. What the rules do not address, except obliquely by reference to state-trading enterprises, is market power and the question of monopoly and oligopoly power. This oversight means much of the modeling from academics, and the rhetoric surrounding different negotiating positions taken by national delegations, miss essential aspects of the agricultural sector in most countries.

Farmers, Trade and Public Policy

Most agricultural policy is enacted in the name of farmers, and farmers are often the object of criticism made of developed countries farm policies. However, farmers are the weakest link in the chain that brings food from the field to the table. They are price-takers, dependent on highly concentrated industries for their inputs and for the sale of their products. Farmers in Mexico and the Philippines who depend on maize for their livelihoods do not compete with farmers in the United States but with the companies that export grain to their countries—companies, incidentally, that are the prime beneficiaries of U.S. farm policy.

What can farmers do to manage this situation? For developing country

Average net cash income by farm business type: major crops



From USDA, Farm Economy Outlook, January 2002. On-line at www.er.usda.gov/multimedia/farmeconomyjan02 governments considering how best to respond to their food security needs and their concern to support sustainable livelihoods for their farmers, it is invaluable to consider other marketing and production models. The debate should not be over public/ private ownership but how best we can realize our objectives for agriculture and rural development.

One immediate proposal before governments at the WTO is the Development Box. This proposal reflects the widely-shared concern that current trade rules reduce vital policy flexibility for the majority of countries that cannot afford to support their agricultural sector with direct payments. The proposed measures include an exemption for staple foods from minimum import requirements; the right to maintain, and if necessary increase, tariffs as protection against distorted prices on international markets and to safeguard the livelihoods of low-income producers; and a moratorium on further domestic support reduction commitments until developed countries have made very significant reductions in their support levels.

Conclusion

Trade negotiators cannot hope to anticipate every development with perfect rules. That is why a permanent multilateral trade-negotiating forum, the WTO, was established: to allow trade rules to respond as circumstances change.

As trade negotiators review the existing rules for international agricultural trade, they ought to keep a few central points in mind.

First, we must remember why we engage in trade. Trade is a tool that ought to serve the fundamental objective of maximizing human welfare. Human welfare depends on all people having access to a nutritionally adequate diet at all times. Insofar as international trade serves this goal—by increasing the supply of good-quality food at affordable prices; by generating foreign exchange for investment in economic development; by creating livelihoods for people, especially those living in poverty—then it serves our objectives and should be encouraged. Trade, however, is not an end in itself.

Second, we must keep in mind that agricultural economics has distinct characteristics—characteristics not reflected in the assumptions that underlie the Uruguay Round Agreements and the AoA. Among these characteristics is the relative inelasticity of demand and supply. Furthermore, because food is vital to human survival, governments must intervene in the market to ensure that people are able to obtain adequate food. Public policy is thus an inevitable component of any economic framework for the agricultural sector.

Third, the assumptions in the AoA are not well supported by empirical experience. Companies trade—not farmers or countries. The globalized food system, the part of the food system that international trade is about, is largely managed by a few enormous private firms. These companies and their practices are at least as significant as the public policies that affect agricultural production and international agricultural trade, not least because of their influence on the public policies in question, yet the multilateral trade rules ignore them.

Fourth, about 90 percent of agricultural production is for domestic use. The grain that is traded internationally comes from relatively few countries; supplies are dependent on weather patterns, which makes prices volatile. The AoA's emphasis on reducing public stockholding has exacerbated this volatility, and undermines the stated goal of providing reliable and affordable supplies to the developing countries that must import food to feed their people.

Assessments of the Uruguay Round Agreement on Agriculture show that many of the promised benefits of liberalized agriculture have yet to materialize; they may not materialize at all. The promise made to developing countries that the AoA disciplines would end problems such as the dumping of agricultural products at less than cost of production prices in world markets has proven hollow. However, this is not simply because export subsidies and domestic payments to farmers continue. It is the structural result of an agricultural sector where transnational agribusiness have the power to set prices. The level playing field promoted by trade liberalizers will have to include some kind of handicap to ensure that transnational agribusiness pay the real costs for the grain they process, ship and sell. This is precisely the role of public policy, and should be the task assigned to trade negotiators at the WTO in Geneva.

In the longer run, the challenges posed by environmental limits on our resources, especially on land and water, and the need to protect genetic diversity, are providing an incentive for a different model for agriculture. In developed countries, this means a move to create an alternative to the centralized industrial production model that has so many hidden costs. In the developing world, this could be an alternative path for the development of agriculture that avoids the pitfalls of industrial agriculture, and protects a decentralized distribution of the benefits of production.

Governments need to take on these problems more directly. The current review of the Agreement on Agriculture is an opportunity for change. It is hoped this paper has provided a clear argument as to why more of the same will not be enough. We can and must do better.

About the Author

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Photos on the cover and pages 1, 4, 5, 6, 9, and 10 are courtesy of the
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