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# **DID THE WTO PLAY A ROLE IN THE FOOD CRISIS?**

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## 1.0 BACKGROUND

For the past 50 years agriculture in the developed world could be described by the following stylized facts: 1) the declining real price of agricultural output; 2) the movement of labour out of primary agriculture; and 3) low measured returns to resources employed in agriculture. As a result, almost all developed countries provide considerable support and protection to the agricultural sector to correct for perceived market failures and to transfer income to a sector that appears to be chronically plagued by low returns. The result of these market trends and policy responses has given us a 21<sup>st</sup> Century agriculture, in the developed world, that is highly capital and energy dependent. It has also given us an agricultural sector that has grown dependent on the transfer of funds from taxpayers and consumers to underpin farm asset values. For a brief period in the mid-1970's the world faced rapidly rising primary commodity prices that exacerbated inflation and briefly changed the policy debate from "farm" to "food" policy.<sup>1</sup> We appear to have entered another such period although opinions are mixed as to whether we are facing a protracted period of rising real food prices, or a temporary spike in prices similar to the one in the 1970's.

The policy situation for agriculture in the developing world differs greatly from that in the developed world. First, while consumers in the developed world spend 10-15 percent of their incomes on food it is not uncommon for food expenditures to reach 50 percent in the developing world (FAO 2008). Second, primary agriculture in the developing world remains labour intensive. Third, most developing countries have to cope with a large fraction of their population that can be characterized as the "urban poor". As a result, agricultural policy in developing countries has often involved explicit or implicit taxes on primary agriculture with the revenue being used to fund food subsidies for the urban poor.<sup>2</sup>

While it is impossible to summarize world agricultural policy in two paragraphs and the reader can no doubt think of exceptions the descriptions given above are useful in understanding the way international institutions have evolved and their role in the current food crisis.

## 2.0 THE ROLE OF THE WTO

Beginning in 1947 the developed world began a long but steady journey towards multilateral trade liberalization under the auspices of the General Agreement on Tariffs and Trade (GATT). To a large extent agriculture was excluded from the liberalization process until the Uruguay Round of trade negotiations that began in 1986. It is worth recalling that in 1986 grain and oilseed prices were at record lows; corn prices on the Chicago futures market were \$US59/mt, soybean prices \$178/mt and wheat prices

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<sup>1</sup> Older Canadians will recall the heated exchanges between the late Beryl Plumptre who headed the Canadian Food Prices Review Board, for 28 months beginning in May 1973, and then Agricultural Minister Eugene Whalen.

<sup>2</sup> Not all policy interventions will generate revenue, e.g. an export ban.

US\$92/mt compared to US\$155/mt for corn, US\$505/mt for soybeans and US\$275/mt for wheat in June 2008. The world was holding more than one-third of a year's production of wheat in storage and more than 40 percent of a year's production of corn in storage. The developed world was engaged in the competitive subsidization of agricultural exports in an attempt to dispose of products no one wanted. Developing country exporters were caught in the cross-fire of a battle between developed country treasuries. This was all taking place against a backdrop of huge budget deficits in Canada and the United States and rapid growth in spending on the Common Agricultural Policy in the EU. The level and massive growth in spending on agriculture, in all three nations, was unsustainable.

As a result, the Uruguay Round of trade negotiations were launched in the fall of 1986 and the liberalization of agricultural trade was at the top of the negotiating agenda. Rich countries wanted an international agreement to improve market access and to put limits on export and domestic subsidies. For the most part developing countries shared in these goals although there was some concern for the least developed food deficit countries that might face higher import prices as a result of the agreement. After eight years of difficult negotiations the UR was brought to a close with an Agreement on Agriculture (AoA) that put limits on domestic and export subsidies, provided some additional market access but more importantly put in place a framework for future trade liberalization (WTO 2003). The Uruguay Round also resulted in the creation of the World Trade Organization (WTO) and the first round of trade negotiations under the WTO was launched in 2001 (Doha Development Agenda (DDA)). Again, agriculture has figured prominently in the negotiations with developing countries feeling the disciplines on rich country agricultural policies introduced in the AoA have done little to open markets for developing country agricultural exports. Developing countries are looking for considerably larger concessions from the developed world during the DDA. The "pillars" of the agricultural negotiations contained in the AoA were maintained in the DDA; namely, 1) export competition; 2) domestic support; and 3) market access.

Why is all this ancient history important? It is important because the WTO sets the rules for trade among countries. As the rule setting body it would seem reasonable to expect the WTO to specify how nations are allowed to react during a "food crisis". As will be discussed below the WTO does have rules governing what members must do when they impose trade restrictions in response to higher world market prices but these rules are very weak and impose few constraints on what a member is allowed to do. This outcome could only result from two possible conditions: 1) member nations could not agree upon appropriate rules; or 2) most members did not think it was important to have any effective rules. Given 50 years of declining farm prices it is possible that not many members considered rules to govern trade during high price periods to be an important item on the negotiating agenda.

Before turning to a discussion of the "rules" it is useful to document the crucial policy instruments and what their role has been in the current market situation.

The typical trade and domestic policy instruments such as tariffs, export subsidies, market price supports, and deficiency payments have the effect of: 1) lowering world market prices; 2) raising domestic prices for producers; and 3) making domestic prices more stable and world market prices less stable.

When world prices increase it is a signal that producers should produce more and consumers should restrict consumption. For the most part the policy instruments mentioned above are not a problem in this “high price” environment because domestic counter-cyclical price/margin support policies will typically “disengage” as prices go up, or in the case of a tariff amplify the price increase.

In a high price environment it is a different set of policy responses that are problematic. Perhaps the most extreme policy response is an export ban. Export bans on rice by several major rice exporters resulted in world rice prices increasing more than they would have in the absence of the bans. In addition, the announcement of an export ban by a significant exporter is a signal of a food shortage and can result in panic buying and hoarding both in the home country and abroad, making a bad situation even worse. Why would a traditional exporter ban exports? Generally, it is to make the commodity available to the urban poor at a lower price and to save tax dollars where consumption of the commodity is subsidized. Unfortunately, it sends a negative signal to producers in the home country and can result in smuggling from a country where exports are restricted to one where they are not. Export restrictions are partial bans and have the same market effects as a ban but the negative effects are somewhat muted.

Export taxes can also be used to restrict exports and from a taxpayer’s perspective have the advantage of raising revenue. Many developing countries use export taxes to provide “effective protection” to their domestic processing industries (Houck 1986). Brazil has imposed an export tax on soybeans for years to encourage the processing of soybeans in Brazil, and the export of oil and meal rather than beans. Still, when export taxes are raised to 65 percent as Brazil did on soybeans it has much the same effect as an export ban.

Another policy response often used by developing countries in a high price environment is to lower applied tariffs.<sup>3</sup> In most situations the unilateral lowering of an applied tariff would be applauded. Unfortunately, when it is done when world prices are high it results in more consumption and less production in the home country, causing world prices to increase even more. Perhaps this would be a small price to pay if the applied tariff remained at the new lower rate, but WTO rules allow the importer to raise its applied tariff when prices moderate – again sending exactly the wrong market signal when world prices decline. In these examples, an importer is using changes in its applied tariff to mute world price signals.

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<sup>3</sup> The level of bound tariffs is what is negotiated in the WTO but many developing countries apply tariffs well below the bound rate. Countries are allowed to adjust their tariffs as long as they do not exceed their bound level.

The FAO (2008) conducted a survey of 77 developing countries and discovered that about 50 percent have reduced tariffs in response to higher food prices, 55 percent have used price controls or consumer subsidies to reduce the transmission of world prices to domestic consumers and 25 percent have imposed some type of export restriction. Only 16 percent of the countries took no policy action. On average, only about one-third of world price changes have been allowed to pass-through to domestic producers and consumers in the FAO's survey of developing countries.

### 3.0 WTO RULES ON EXPORT PROHIBITIONS AND RESTRICTIONS

What are the current WTO rules governing a countries response to higher world market prices? This turns out to be a fairly complicated question. The starting point is Article XX (part (i) and (j)) of GATT 1994 *General Exceptions* which states that as long as the measures concerned do not result in "arbitrary or unjustifiable discrimination among countries, or a disguised restriction on trade" countries are allowed to use measures:

*(i) involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan; provided that such restrictions shall not operate to increase the exports or the protection afforded to such domestic industry,...*

*(j) essential to the acquisition or distribution of products in general or local short supply; provided that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products...*

The next stop is Article XI (part 2(a)) of GATT 1994 *General Elimination of Quantitative Restrictions* which states that the general prohibition on the use of export restrictions does not apply if:

*(a) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party.*

Finally, these general provisions were modified by Part VI, Article 12 of the AoA which deals with *Disciplines on Export Prohibitions and Restrictions*. It states that when a Member institutes a new export prohibition or restriction on food in accordance with Article XI (2a):

*(i) 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;*

*(ii) 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...*

Interestingly these provisions do not apply to developing country Members, unless the measure is taken by a developing country Member which is a net-food exporter of the specific foodstuff concerned. While GATT/WTO legal scholars could debate the exact constraints these rules put on Members it seems clear that countries are able to do what they want and face only a rather weak reporting rule.

There is an opportunity to strengthen the rules on export restrictions during the DDA. In fact, in Canada's initial negotiating position on agriculture announced in August 1999 (AAFC 1999), well before the formal start of the DDA, Canada indicated that it would seek agreement on rules to effectively discipline export taxes and export restrictions on agricultural products. Canada argued it would seek "a ban on the inclusion of food aid and feedstuffs in national security trade embargoes; and a ban on export restrictions that would reduce the proportion of the total supply of an agricultural product permitted to be exported compared to the proportion prevailing in a previous representative period." Still in a WTO background document prepared in early 2001 it was noted that only five countries had explicitly mentioned export restrictions in their negotiating proposals (WTO 2001b). To provide a flavor of these proposals Switzerland (WTO 2000a) argued for the elimination of all export restrictions on agricultural products and the binding of all export taxes at zero; Korea (WTO 2001a) argued for more effective disciplines on export taxes as did the Cairns Group (WTO 2000b); Japan (WTO 2000c) tabled a more comprehensive proposal to convert all export prohibitions and restrictions to export taxes that would be bound and reduced, plus the development of rules that could be used in the application of emergency measures; and the United States (WTO 2000d) argued that export taxes used to gain a competitive advantage or for supply management purposes should be eliminated.<sup>4</sup> It is impossible in this brief note to chronicle the entire negotiating history of export prohibitions and restraints, except to say it does not appear to have been a negotiating item given much attention.

Chairman Falconer's *Revised Draft Modalities for Agriculture* tabled on 19 May 2008 represents the outcome of nearly seven years of negotiating activity during the Doha Round and what most observers feel is close to the final negotiated text. Section V (c) deals with *Export Prohibitions and Restrictions*. The new rules would augment Article 12 of the AoA by adding provisions that would require Members to<sup>5</sup>:

- Eliminate any existing prohibitions and restrictions in foodstuffs and feeds under Article XI.2 (a) of GATT 1994 by the end of the first year of the implementation period.
- Any new prohibitions and restrictions under Article XI.2 (a) should not normally last more than 12 months.

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<sup>4</sup> Export taxes are illegal under the U.S. Constitution.

<sup>5</sup> The author has paraphrased the exact text.

- Members should notify the Committee of Agriculture within 90 days of the measures coming into force, and the Member should provide the reasons for introducing and maintaining the measures.

Essentially, the notification requirements contained in the AoA would be strengthened and the restrictions time limited but the use of export prohibitions and restrictions would remain largely unconstrained.

Why should this matter to Canada? Canada is one of the most trade dependent countries in the world. As such, it is in our best interest to have food importers turn to the international market to meet their food security needs rather than pursuing import substitution policies. Nothing destroys an importers faith in the international marketplace more than an exporter who slams the sales door shut during periods of tight supplies. The developed countries of the world should pledge not to use export prohibitions, restrictions, embargoes or export taxes on food.

How to deal with export prohibitions and restrictions from the perspective of a developing country is more difficult. It is useful to break the discussion into developing country food exporters and developing country food importers. For a developing country food exporter high commodity prices hurt the urban poor however from a macroeconomic perspective the terms of trade are likely to move in the exporters favor and the government might be able to afford the higher cost of short-run food subsidies for the urban poor. The situation for the developing country net food importer is considerably more desperate because not only do they face the cost of feeding the urban poor but also declining terms of trade. In an environment of rapidly rising food prices and declining terms of trade; printing money is often the only policy option; followed by inflation, political unrest and self-sufficiency policies.

The WTO needs to develop export restriction policies that would apply to developing countries that would discourage “beggar-thy-neighbor” policies, most likely by binding and reducing export taxes and through some sort of “sharing” agreement.

The negotiations in the DDA have also resulted in a new set of rules that would apply to food aid. The primary purpose of the new rules is to discourage countries from using food aid as a disguised export subsidy – supplying large quantities of food aid during periods of low international prices and restricting the supply of food aid when prices are high (Cardwell, Fridfinnson and Rude 2007). There is also agreement that Members should move towards providing untied cash-based food aid and food should be purchased from local sources whenever possible.

#### **4.0 CONCLUSIONS**

When high prices or natural calamities result in starvation and political unrest in the developing world emergency food aid is the best short run response. However, over a longer time frame it is important to have in place international rules that allow the market

to function to help alleviate food shortages rather than making them worse. Given Canada's trading position we have a huge stake in getting these rules right. Although the future of the Doha Round is unclear there is still time to make a start on developing better rules for export prohibitions, restrictions and export taxes that would serve the world better in times of shortage. A first step would be effective disciplines on the use of export taxes, and export restrictions and embargo's.

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