

# Putting food security before trade

The WTO and the conflict over food reserves

Thomas Fritz



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Thomas Fritz | FDCL | April 2014

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# 1. Introduction

The last ministerial conference of the WTO, held in Bali/Indonesia in December 2013, had been overshadowed by a controversy over food security between a group of 33 developing countries (G33) and industrialized countries. The G33 sought changes to the WTO's Agreement on Agriculture removing some of the constraints on the implementation of food reserves, a measure which gained more prominence following the food price crisis of the years 2007-2008. However, industrialized countries such as the EU and the US fiercely opposed this proposal claiming it would allow granting large sums of trade-distorting subsidies. In the end, WTO members found a compromise which enabled a successful conclusion of the conference. But from a food se-

curity perspective the interim solution agreed upon in Bali appears rather unsatisfactory.

This policy paper analyzes the background of the Bali controversy. It describes past experiences with food reserves managed by marketing boards in developing countries, their weakening following the debt crisis of the 1980ies, and the renewed interest in these instruments after the recent food price crisis. The paper provides an overview of WTO rules potentially constraining the implementation of grain reserves for food security purpose and analyzes the G33 proposal negotiated at the WTO conference. The final recommendations emphasize the need for WTO rules to be reframed in order to adapt to the changing agricultural economy and to facilitate food security.

## 2. Stabilizing prices: The role of food reserves and marketing boards

Marketing boards and national food reserves can play an important role in developing countries' food security strategy. State-owned marketing boards are buying crops from farmers at fixed prices, stocking grains and releasing them later according to the supply situation on the market. Their interventions aim at stabilizing prices of main food staples and at guaranteeing a remunerative income for local farmers, thereby benefitting consumers and producers alike. Some marketing boards also redistribute food to poor households or to food deficit regions within a country. Others extend their operations to the promotion of local food production by providing agricultural advice and farm inputs such as seeds or fertilizers or by extending credits to farmers.

The buffer stocks held by marketing boards are used to keep domestic food prices within

a fixed priceband, thus avoiding volatility, i.e., sharp rises or drops in prices. The floor price set by marketing boards supports agricultural producers and the ceiling price protects consumers. Usually, these parastatal agencies buy commodities at harvest when prices are low and release the stocks when prices are high. By offering farmers a secure outlet for their harvests, the procurement of grain reserves stimulates domestic food production and increases national self-sufficiency. This, in turn, reduces the need for food imports and helps governments to save foreign exchange which they otherwise would have to spend to fill their domestic food gaps on the international market. Consequently, marketing boards and food reserves contribute to protect domestic markets from price changes on the global market – an important benefit given recent price

spikes and increased volatility on international markets (see box 1).

However, beginning in the 1980ies marketing boards came under fire by international financial institutions (IFIs). Following the outbreak of the debt crisis, World Bank and IMF forced developing countries to implement structural adjustment programmes as a precondition for new loans. Part of IFI's conditionality was to cut support for domestic agriculture, open markets for food imports, and to switch from staple food production for local markets to cash crop production for export markets. Restructuring or dismantling marketing boards belonged to the prescriptions imposed by IFIs. In their views, marketing boards were inefficient, corrupt and a burden for states' budgets. One of their main arguments was that by procuring and redistributing grains marketing boards would 'crowd out' private traders, a view shared by the UN Food

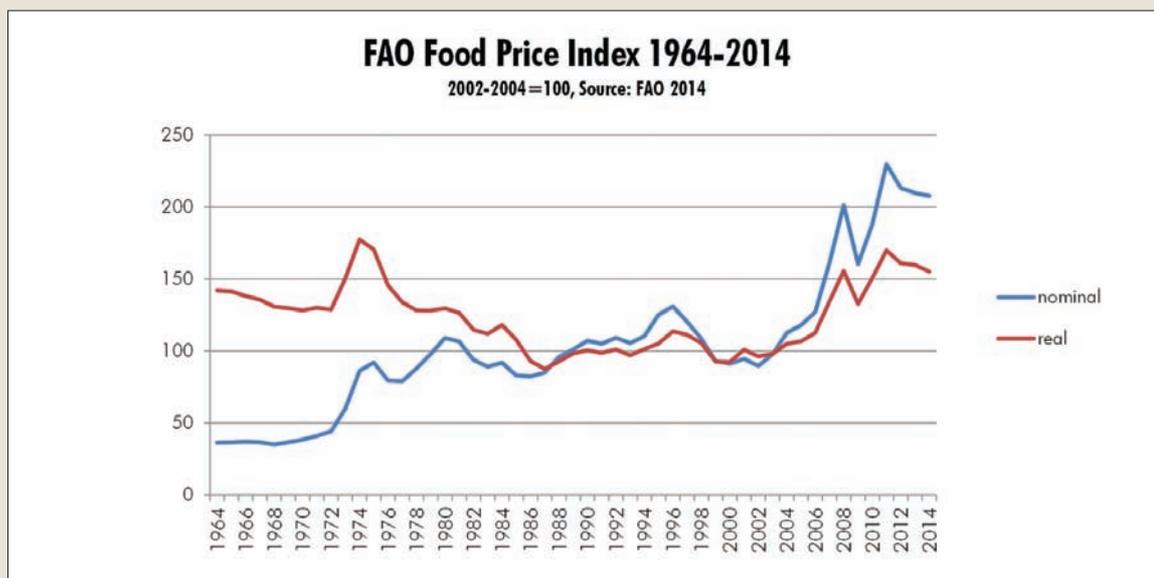
and Agriculture Organization FAO up to the present day. "The uncertainty over governments' decisions on the quantity and the price at which food will be released results in 'crowding out' the private sector", claims a FAO briefing paper on marketing boards during the 2007-2008 price spike.<sup>2</sup>

Following IFI's advice, indebted governments started to restructure their marketing boards. Many were privatized, some commercialized and others stripped of important tasks such as price controls, farm credits, input and food subsidies. In many cases, buffer stocks were drastically scaled down to become mere emergency food reserves (also called strategic grain reserves) only capable of meeting the most urgent needs in localized food crises or after natural disasters. However, the promises of higher efficiency, improved production and lower prices often didn't materialize. Private traders proved

## Box 1 Rising and volatile food prices

Beginning in 2007, food prices reversed their three-decades-long depression and shot up sharply, with two peaks in 2007 and 2008 (see: figure). Experts believe that at least in the medium term prices will remain higher and more volatile. This change poses a severe risk for all those developing countries having lost their food self-sufficiency in the wake of structural adjustment programmes and trade liberalisation imposed by international financial institutions and

Western donors since the 1980ies. Nowadays, 79 developing countries are net-food importers mainly purchasing staple foods like cereals, oilcrops and dairy products on the world market, with cereals the single most important item. Due to the price spikes, these countries are facing rapidly rising import costs. Their cereal import bill alone increased almost four-fold in the period 1994-2012, although the imported volumes grew by only 70 percent.<sup>1</sup>



particularly unwilling to invest into sufficient storage and transport capacity which would have cut into their profits. As the void left by the withdrawal of marketing boards remained unfilled, price volatility sharply increased in many countries. In addition, cutting off access to agricultural credits, subsidized fertilizers and improved seeds lowered the crop output of farmers and caused domestic price jumps. These negative experiences with structural adjustment led some governments in the Global South to reverse neoliberal reforms, reinstate price controls and resuscitate marketing boards (see box 2). Public food stocks are particularly widespread in Asia and Africa. Over 90 percent of Asian countries and 70 percent of African countries maintain public reserves, whilst in Latin America it's only roughly a third of the countries.<sup>6</sup> Several of the parastatal marketing boards still go beyond only holding limited emergency reserves by maintaining buffer stocks for price stabilization. The current trend towards higher and more volatile food prices reinforces governments' interest in marketing boards and food reserves to regain food self-sufficiency. Consequently, after the food crisis of 2007-08, several countries started to expand their food stock capacities.

In Africa, countries such as Zambia, Kenya and Malawi maintain important buffer stocks of maize, while Nigeria, Ghana and Rwanda established new food reserve agencies (in 2007 and 2010 respectively). Algeria, Morocco and Mauritania, too, expanded their storage capacities after the food price crisis. On the Asian continent, Bangladesh, India, Pakistan, China, Indonesia, the Philippines and Vietnam traditionally hold large buffer stocks for price stabilization, particularly in the rice and maize markets. And Sri Lanka and Lao PDR set up new rice reserve projects in reaction to the recent price spike.<sup>7</sup> In Latin America, Bolivia, Honduras, Nicaragua and Venezuela maintain food stocks as part of

## Box 2

### A short history of BULOG

For more than 45 years now, the National Food Logistics Agency BULOG (Badan Urusan Logistik) has been at the heart of Indonesia's rice policy. Set up as a state agency in 1967, BULOG supported domestic agricultural production and achieved Indonesia's self-sufficiency in rice in 1984. The main instruments applied were price floors for producers and price ceilings for consumers. Through its vast network of warehouses, BULOG bought and stored rice and other crops from farmers which it then sold and distributed according to the supply situation on the market. BULOG's interventions were combined with government measures to protect the domestic market (import tariffs) and to support agricultural production (dissemination of high-yielding rice varieties, provision of fertilizers, investment in rural infrastructure and irrigation). During this era, rural poverty fell by half, followed by an important improvement of food security.<sup>3</sup>

But after the outbreak of the Asian crisis in 1997, Indonesia had to seek financial assistance by the IMF. The Fund exerted pressure on the government to restructure BULOG and limit public interventions in the rice market. Following the IMF advice, the government liberalized food trade, allowed rice imports, scaled down BULOG and removed fertilizer subsidies. However, farmers who suffered from higher input costs and competition from rapidly increasing imports fiercely opposed the liberalization policy. Finally, in 2004, the government changed course by again curbing rice imports and reinstating support for domestic production. The trade ban helped to shield Indonesia from the upward pressures of the international rice market during the 2007-08 price spike.<sup>4</sup> In 2012, Indonesia's acting president Yudhoyono announced to revitalize BULOG by extending the list of commodities controlled by the agency. Besides rice, BULOG shall also secure the supply of sugar, corn, meat and soy.<sup>5</sup> Although throughout its history BULOG often suffered from corruption, particularly under Suharto's rule, the agency's food reserves nevertheless succeeded in stabilizing the domestic rice price and in improving Indonesia's food security.

public procurement and distribution systems of subsidized food. In 2007, Ecuador created a new public agency for strategic food reserves (Unidad Nacional de Almacenamiento). Already in 2003, Brazil reintroduced public stocks and revitalized the national food supply company CONAB which purchases food from family farms at guaranteed prices (see box 3, page 6).<sup>8</sup>

### Box 3

#### Brazil's Food Acquisition Programme

Brazil's marketing board CONAB procures food from family farms at administered prices through the Food Acquisition Programme (PAA - Programa de Aquisição de Alimentos), an important pillar of Brazil's successful 'Zero Hunger' strategy. Some of the acquired stocks are commercialized later on, others are donated to food insecure families. The programme uses different purchasing schemes and forwards large part of the acquired stocks to public agencies and social organizations supporting people with limited access to food. From 2003 to

2010, some 2 billion US-Dollars were spent to purchase 3 million tonnes of food. In the period 2008-2010, the programme involved approximately 160,000 family farms per year. By procuring a broader range of crops, the Food Acquisition Programme also promotes the diversification of family farms' production. It supports the recovery and commercialization of traditional crop varieties, thus contributing to the preservation of agricultural biodiversity, traditional knowledge and a more diversified diet among the poor.<sup>9</sup>

## 3. Limiting policy space: WTO rules on food reserves

The procurement of food stocks by marketing boards became a hotly debated issue in the World Trade Organization WTO, overshadowing its ninth ministerial conference in Bali in December 2013. The reason is that due to the changing economic environment with rising and more volatile food prices, several developing countries fear that their existing and new policies to reinvest in agriculture and address food security might come into conflict with WTO commitments. There are several WTO rules potentially discouraging food security policies such as grain reserves, particularly those governing domestic support, market access and state-trading enterprises.

The WTO Agreement on Agriculture (AoA) contains specific rules to limit 'trade distorting domestic support'. However, certain support measures are deemed minimally or non-trade distorting and are allowed under the so-called Green Box of the AoA, amongst which also public stockholding for food security purposes, as long as governments' purchases are made at current market prices and the sales at no less

than the current prices. But if these stocks are acquired or released at administered prices, then the difference between the administered price and an external reference price has to be accounted for in a country's calculation of its domestic support, the so-called Aggregate Measurement of Support (AMS). Yet, according to the AoA's de minimis-provisions, certain levels of support may be exempt from the calculation of the AMS. For developing countries, 10 percent of the value of product-specific support and another 10 percent of the value of non-product-specific support may be exempt.

But several developing countries, particularly India, now fear they might exceed their de-minimis-levels and risk costly WTO complaints when undertaking their stockholding programmes. The reason for this concern is that the external reference price stipulated in the AoA is based on the prices of 1986-1988, which are far lower than current prices for agricultural commodities. In some cases, particularly staple foods, prices increased three or

four times compared to the 1986-1988 period when the AoA was negotiated. Accordingly, the gap between the administered price at which a government presently procures food and the AoA's reference price can be significant. Such a large price difference would then have to be used as a basis for calculating the amount of subsidies. Due to this outdated reference price, stockholding programmes could easily exceed a country's allowed de-minimis level of domestic support.<sup>10</sup>

During the Uruguay Round when the AoA was negotiated, developing countries' subsidies were relatively small, so that the de-minimis level was regarded as a generous threshold unlikely to be exceeded by the large majority of developing countries. But due to rapid growth especially in the more advanced economies, this situation has changed today. And it is expected that domestic agricultural support in the Global South might be growing even more in the years to come. If the product-specific administered prices continue to rise compared to the WTO's outdated reference price, developing countries may now be forced to notify their market price support granted under stockholding programmes and risk violating WTO commitments when exceeding their de-minimis limits. The UN-Special Rapporteur on the Right to Food, Olivier De Schutter, fears that "many new food security policies are likely to be classified as trade-distorting support (e.g. fertilizer subsidies and other forms of price support)". For countries already close to their de-minimis limits "it would entail perhaps less spending on existing forms of domestic support. This of course is not desirable if existing spending had a positive food security impact."<sup>11</sup>

The support price calculation foreseen in the AoA is even more problematic. In its Annex 3 it says, "market price support shall be calculated using the gap between the fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price".<sup>12</sup> Consequently, the calculation of market price support has to be based not on the volume a government actually procures, but on the entire production that is 'eligible' for such support. An expert group convened by the South Centre concludes that "even if a government procures only a small portion of a product from producers, they have to calculate the AMS supports as if they had provided price supports for the entire domestic production of

that product."<sup>13</sup> Together with the unrealistically low reference price of 1986-88, this provision puts developing countries in danger of reaching or exceeding their permitted de-minimis limits of domestic support.

Other WTO provisions may also constrain the implementation of food reserves, for instance the rules on state-trading enterprises (STE), as many countries establish marketing boards in the form of state-owned enterprises to manage their food reserves. The WTO's 'Understanding on the Interpretation of Article XVII' defines state-trading enterprises as "governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports." So, even if a marketing board isn't directly involved in international trade, it might come under scrutiny when its purchases or sales are deemed to have an 'influence' on imports or exports. Furthermore, Article XVII of the WTO's General Agreement on Tariffs and Trade (GATT) requires that state trading enterprises "make any such purchases or sales solely in accordance with commercial considerations". Yet, the main objectives of many marketing boards are clearly non-commercial: procuring commodities and stabilizing prices to support domestic farmers and ensure food security.<sup>14</sup>

In addition, to be fully effective, marketing boards need some kind of framework regulating the volume of agricultural imports. Marketing boards' stockholding operations aim at defending a price band, but cheap imports could put downward pressure on prices, thus undermining those interventions. Ideally, stockholding would be complemented with the application of a system of tiered tariffs such as tariff rate quotas. But although tariff rate quotas are allowed under the WTO, only a minority of developing countries adopted them, in part because they require substantial administrative capacity, which many countries lack. What is more, using such measures to defend a price band is illegal under WTO law. The AoA's Article 2 prohibits, inter alia, "quantitative import restrictions, variable import levies, minimum import prices". Therefore, marketing board operations setting a minimum import price to defend a price band may be challenged before the WTO's dispute settlement mechanism.<sup>15</sup>

## 4. Controversy in Bali: The G33 proposal on stockholding

At the WTO's ministerial conference in Bali in December 2013, the group of 33 developing countries (G33), led by India, sought changes to the Agreement on Agriculture removing constraints on the implementation of grain reserves for food security purposes. Their main demand was that the acquisition of food stocks by developing countries to support poor farmers should not be included in their calculation of domestic support, the Aggregate Measurement of Support (AMS).

To this end, the G33 referred to a proposal they already tabled at the WTO in 2012, suggesting the following amendments to the AoA's Annex 2 (the so-called Green Box): "acquisition of stocks of foodstuffs by developing country Members with the objective of supporting low-income or resource-poor producers shall not be required to be accounted for in the AMS." In addition, when developing countries procure foodstuffs at "subsidized prices" from poor producers, there shall be "no requirement for the difference between the acquisition price and the external reference price to be accounted for in the AMS." According to the G33, these amendments should complement the AoA's permission to provide food for urban and rural poor at subsidized prices.<sup>16</sup>

The G33 proposal would remove the constraint on food reserves posed by the outdated reference price and the ensuing risk of developing countries to exceed their de-minimis limits. However, industrial countries such as the US and the EU fiercely opposed the G33 demands, a controversy which threatened to derail the Bali talks. On the other side, India in particular defended the proposal, fearing the country might breach its de-minimis limit once it starts implementing its new National Food Security Act

adopted in September 2013. The food security bill aims to provide two thirds of India's population with subsidized food acquired at administered prices (see box 4). Yet, industrialized countries rejected the G33 proposal on the grounds that it could allow developing countries to provide unlimited amounts of trade-distorting subsidies to their farmers. Referring to India's food security act, EU's Trade Commissioner Karel De Gucht said, the "discussion at stake is how do you make sure that the food security programme does not distort the agriculture market."<sup>17</sup>

The Bali negotiations focused on a possible 'peace clause' safeguarding developing countries' stockholding programmes against WTO disputes only for a limited time of four years, provided these create no or minimal trade distortions. India's Minister of Commerce Anand Sharma, however, rejected the time-limited 'peace clause' arguing a permanent, not a

### Box 4 India's National Food Security Act

India's new food security act, signed into law in September 2013, aims to provide approximately two thirds of India's 1.2 billion people with subsidized food acquired at administered prices. Under the bill, 75 percent of the rural population and 50 percent of the urban population, some 820 million people, will be entitled to five kilograms of grains per person and month at subsidized prices (rice, wheat and millet). To operationalize the bill, the Food Corporation of India (FCI) will increase the procurement and storage of grains and the Public Distribution System (PDS) will extend the coverage of beneficiaries. After its implementation, about half of the recipients' grain requirements may be provided by the Public Distribution System. The food security act is not a completely new initiative, but rather a consolidation and partial extension of various food-related programmes already in place. Its costs have been estimated at an additional two billion US-Dollars.<sup>18</sup>

temporary solution was required.<sup>19</sup> In the end, WTO members agreed to an interim solution protecting developing countries' stockholding programmes under several conditions from WTO challenges until a permanent solution is found. The permanent solution shall be adopted by the 11<sup>th</sup> ministerial conference envisaged for 2017.<sup>20</sup>

However, the practical value of the interim solution might be very limited as it stipulates a host of onerous conditions and complex notification requirements. First, in its paragraph 2, the decision taken in Bali limits the protection from WTO challenges to public stockholding programmes "existing as of the date of this Decision".<sup>21</sup> Although developing countries may still introduce new food reserves, they do not benefit from this peace clause because only those programmes already in place are covered. Therefore, initiating new grain reserves to stabilize prices may still be challenged before the WTO dispute settlement body.

Second, the decision only covers support for "traditional staple food crops", further defined as "primary agricultural products that are predominant staples in the traditional diet of a developing Member".<sup>22</sup> From a food security perspective, this is a very unpractical constraint as it prohibits adding further crops to marketing board operations facilitating a more diversified diet amongst the poor. It would quite to the contrary be desirable for marketing boards' food redistribution to integrate not only a small number of grains, but also pulses, vegetables or fruit.

Third, a country wishing to benefit from the Bali decision must have notified to the WTO that "it is exceeding or is at risk of exceeding" its de-minimis limit. In addition, it must have

fulfilled its domestic support notification requirements, has to provide detailed information on each of its stockholding programmes and must ensure that these do not distort trade. Taken together, these provisions will probably have a serious dissuasive effect on developing countries considering new food security programmes. Many will lack the capacity to fulfill all these obligations. What is more, the requirement to notify a potential breach of the de-minimis limit may actually act as an invitation to other WTO members to put a reserve programme under tightened scrutiny, thus limiting a developing country's policy space even more.

Fourth, the protection against legal threats awarded in the Bali decision only relates to commitments taken under the Agreement on Agriculture. Complaints against grain reserves could still be based on other WTO rules such as the ones on state-trading enterprises, on the prohibition of price bands and on the Agreement on Subsidies and Countervailing Measures (ASCM).

Due to all these limitations, the Bali compromise doesn't offer a practical solution for developing countries now trying to reinvest in domestic agriculture and to further food security. Only a minority of more advanced developing countries, if it all, might be able to comply with the onerous conditions contained in the Bali decision. At the same time, providing all the required information threatens to unduly limit the policy space necessary to shape adequate and effective stockholding programmes. How the permanent solution foreseen in the declaration will actually look like remains to be seen. Yet, the sharp controversy on the G33 proposal seen at the Bali conference doesn't offer much cause for optimism.

## 5. Conclusion:

# Putting food security before trade

The ongoing controversy on stockholding and marketing boards shows that the dominant members of the WTO continue to ignore the lessons to be learnt from the recent food price crisis. Faced with the risk of higher and more volatile food prices, developing countries need to increase public investment in agriculture as well as their regulatory capacities to achieve food security. They have to reduce their dependence on international markets by fostering their own agricultural production base. In this regard, market price support, stockholding and redistribution of subsidized food proved to be important elements of successful food security strategies around the world, irrespective of occasional shortcomings when these measures were not properly designed.

The UN-Special Rapporteur, Olivier De Schutter, points out: "Food reserves are a crucial tool, not just in humanitarian crises, but in the everyday struggle to provide stable income to farmers and to ensure a steady flow of affordable foodstuffs for poor consumers."<sup>23</sup> Although preventing surplus stocks from being dumped on world markets would still be necessary, the "risks of trade distortions must not be exaggerated". As long as food stocks are bought for domestic distribution, such policies should not be blocked. De Schutter also stresses the double standards enshrined in WTO law: "It should not be forgotten that

developed countries are able to subsidize their farmers to the tune of more than US\$ 400 billion per year, without breaching WTO rules."<sup>24</sup> Domestic support should therefore also be allowed to reach smallholders in developing countries.

Enabling food security programmes involving price support, grain reserves and marketing boards basically requires a reframing of WTO rules. The purpose of these rules must be to facilitate food security policies, not constraining them, even if this means a potential barrier to trade. In particular, WTO members should ensure the following:

- The establishment of food reserves must not be defined as trade-distorting support, when these programmes serve the needs of poor farmers or food-insecure consumers.
- Non-commercial objectives of state-trading enterprises engaged in stockholding, such as price stabilization benefitting vulnerable producers and consumers, have to be respected.
- For marketing boards and food reserves to be fully functional, governments must be granted the flexibility to insulate domestic markets from the volatility of global markets by regulating the volumes and prices of imports.

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