



Global Food Price Crisis— Trade Policy Origins

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The current spike in global food prices has deep roots in decades of trade-distorting policies that have encouraged inefficient agricultural production in rich countries and discouraged efficient production in developing countries. High-income countries have historically protected their domestic producers and subsidized inefficient production—most recently biofuels—and dumped surpluses onto global markets. In turn, developing countries have often used trade and other domestic policies to simultaneously tax and protect their agricultural sector, with the net effect in many countries of taxing farmers. Overall, the world has suffered from declining agricultural prices, overproduction in high-income countries, and underproduction in poor countries. This has resulted in thinner global agricultural markets than otherwise would be the case, more volatility, and lower overall reserve supply capacity and food security. This note discusses the trade policy origins of the global food price crisis. A companion note reviews the trade policy options to deal with the crisis.

World Trade Policies: A Taproot of the Crisis

While several factors beyond trade policy have combined to produce an upward global food price spiral, including high energy and fertilizer prices, depreciation of the U.S. dollar, biofuel production, changes in food buffer stocks, droughts, and increased world demand (World Bank 2008a), the current food crisis has deep historical roots in the distortions of the world trading system. Governments around the globe have intervened in food and other agriculture markets for decades, particularly through trade policies. Trade-distorting policies have taken the form of specific and ad-valorem tariffs that are sometimes linked to quantities of imports (that is, tariff rate quotas); quantitative restrictions or prohibitions on imports and exports; and domestic producer supports and export subsidies for farm products. Countries have also availed themselves of additional restrictions in the form of safeguard protection in case of import surges.

The trading system in agriculture is further distorted and segmented by the existence of various trade agreements, whereby preferential tariff rates and/or market access conditions are offered on a reciprocal or nonreciprocal basis to a subset of partner countries. Overall, with differing in-quota and out-of-quota tariff rates for agriculture products, many of them specific or compound rather than just ad valorem, and with a wide array of preferential bilateral tariffs in place in most countries, the trading system in agriculture is nontransparent, discriminatory, and highly distorted.

Trade restrictiveness across products and countries tends to show a clear pattern: richer countries tend to have higher barriers to trade in agricultural products. This is a phenomenon that initially emerged in the late 19th century and has been a persistent feature of global trade policy ever since: the higher the level of development of countries, the lower the overall trade restrictiveness, and the higher the level of trade restrictiveness in agriculture (World Bank 2008b). Nontariff

measures (NTMs) tend to be more prevalent in high-income and upper-middle-income countries and to play a less important role in lower-middle-income and low-income countries. For higher-income countries, NTMs account for about two-thirds of total restrictiveness. While NTMs capture policies that do not necessarily have a protectionist intent—product standards are a major example—they do have the overall effect of restricting trade.

Agricultural trade restrictions and direct subsidies in high-income countries are a major source of support for producers. For 20 years the Organisation of Economic Co-operation and Development (OECD) Secretariat has been publishing annual estimates of producer support to farmers in OECD member countries. These Producer Support Estimates (PSEs) provide a transparent set of numbers that allow monitoring over time of the extent to which farmers are being assisted by governments through myriad direct payments and agricultural market price support policies. Although PSEs have fallen in some OECD countries since 1999–2001 (for example, Japan and the United States), they have increased in the European Union (EU), the Republic of Korea, and a number of other countries (figure 1). Support to producers in high-income countries was estimated at US\$268 billion in 2006, accounting for 27 percent of farm receipts (OECD 2007).

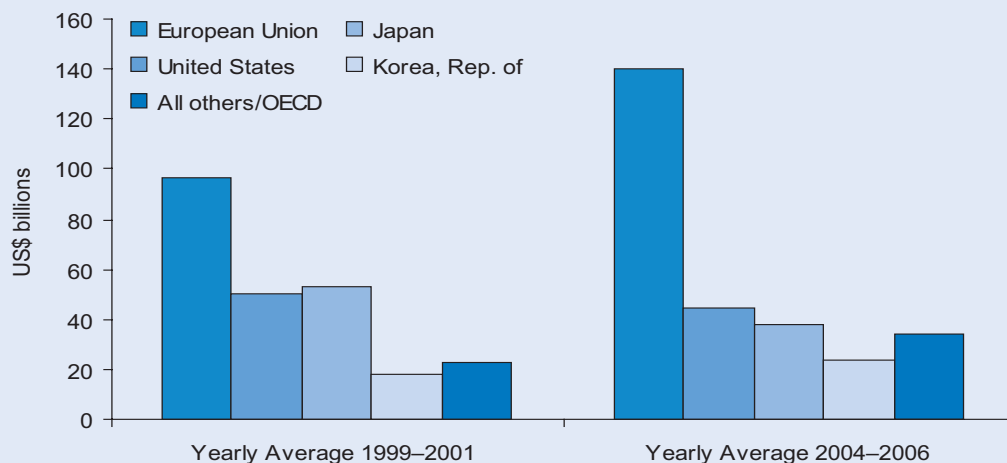
Trade-induced distortions have historically been more pronounced for a number

of commodities currently experiencing a price surge, such as rice. While support based on commodity output has been shown to be (1) the most distorting of production and trade; (2) a relatively inefficient means of increasing farm household income; and (3) most damaging to the environment, some commodities, especially rice, sugar, and milk, continue to be heavily supported through price protection policies and payments based on output (OECD 2007). Border measures such as tariffs not only increase the domestic price of these commodities but reduce domestic consumption, and the resulting impact on domestic production and consumption in the protected markets means that these tariffs also reduce the world price for these goods, disadvantaging producers in other countries.

Developing countries have also put in place trade policies that are highly restrictive of trade in agricultural products. All geographic regions have policies that are more restrictive of trade in agricultural products than manufactures, although the levels of trade restrictiveness in agriculture differ widely across regions. Countries in South Asia have on average a level of trade restrictiveness in agriculture similar if not higher than that observed in high-income countries. At the other extreme, Sub-Saharan Africa has the lowest level of agriculture trade restrictiveness in the world.

In addition to trade barriers, many developing countries, especially low-income

Figure 1: Producer Support Estimates for OECD Members, 1999–2006



Source: OECD (2007)

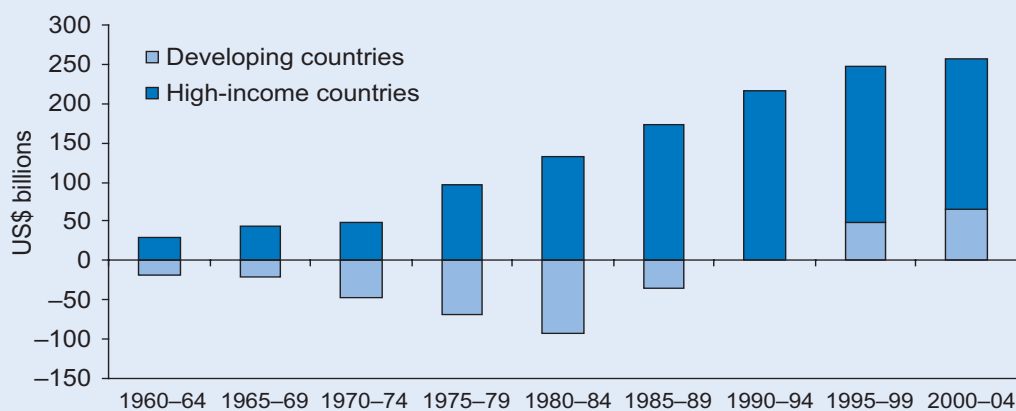
countries, have had agricultural policies that effectively taxed their farmers. The extent of taxation measured by nominal rates of assistance (NRAs) was of the order of 20 percent from the mid-1950s to the mid-1980s. Since then it has not only diminished, but, on average, has become slightly positive (figure 2). In Africa there has been the least tendency to reduce the taxing of farmers—the average NRA has been negative in all 5-year periods except in the mid-1980s when international prices of farm products reached an all-time low in real terms. While taxing agriculture has been detrimental to farmers (and the more recent trend toward a more neutral policy stance for agriculture relative to other sectors of activity is therefore to be welcomed), going beyond this and emulating OECD members by starting to subsidize agriculture has contributed to further distorting global trade in agriculture.

The combined impact of these trade-distorting agriculture policies has been to displace and reduce the efficiency of agriculture production globally. While trade measures are introduced for a wide range of domestic motives (for example, economic, social, environmental, security), they are mostly welfare reducing—both in the country applying them and in the rest of the world—relative to direct first-best policy instruments for achieving those domestic objectives (Bhagwati 1971). In distorting the incentives producers and consumers would otherwise face, they are also welfare-redistributing and inherently discrimi-

natory. By promoting less efficient production in developed countries at the expense of investment in generally more efficient production in developing countries, both global agriculture production and world food prices have been kept artificially low, and domestic food prices in protected markets have been kept artificially high. Policies in developing countries have, until recently, generally taxed agriculture to channel resources into manufacturing, with the result that investment in increasing supply has not been adequate to provide for rapid responses to global price spikes. Furthermore, because agricultural production has taken place in relatively inefficient, thin, and insulated markets, global trade in food products is less resilient to exogenous shocks and less able to handle volatility in terms of trade and output.

More recently, biofuel policies in high-income countries, which consist of import duties, subsidies, tax credits and legislative mandates, have had the effect of further distorting global agricultural trade and contributing to the global food price crisis. Biofuel production in the United States from food crops such as maize and soybean oil and in the EU from rapeseed and sunflower seeds oil have fuelled the rise in food prices by increasing the demand for these food crops and shifting land out of other crops. In the last three years, 5 million hectares of cropland that could have been used for wheat have gone to rapeseed and sunflowers for biofuels in major wheat producers, including Canada,

Figure 2: Gross Subsidy Equivalents of Assistance to Farmers in Developing and High-Income Countries, 1960 to 2004 (current US\$ billion per year)



Source: Anderson et al. (2008).

the EU, and the Russian Federation. Increased demand for biofuels is estimated to account for 70 percent of the increase in corn prices and 40 percent of the increase in soybean prices (IMF 2008). At the same time, oil prices likely would have been higher in the absence of these biofuels, making overall judgments more complex. However, these subsidies do not promote economic efficiency as an offset to their inflationary impact.

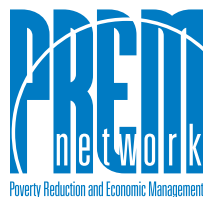
Lastly, the introduction of export restrictions on agricultural products by many large net food exporters has compounded the crisis. The world's major non-OECD exporters of wheat (that is, Argentina, Ukraine, Russia, and Kazakhstan) and rice (that is, Vietnam, India, and China) have introduced various types of temporary export restrictions in an attempt to decouple domestic markets from global markets and rein in domestic food prices. These restrictions usually have major adverse economic and social effects because they tend to (1) distort prices and the allocation of resources, therefore impeding investment and the supply-side response; (2) prevent local farmers from receiving the higher world market price for their production, therefore slowing the reduction of poverty in rural areas where most poor people live; (3) displace local production to crops that are not subject to export restrictions, therefore aggravating the very food security and price concern that justifies the measure in the first place; (4) cut local production from global buyers and distribution chains, therefore jeopardizing future reentry in once-secure markets; (5) create space for illegal trade, therefore fuelling corruption and other governance malpractices; (6) exacerbate the rise and fluctuations of global food prices, therefore creating a vicious incentive for trading partners to follow suit, curb exports, and hoard; and (7) harm the multilateral trading system, therefore weakening the security of poor and vulnerable coun-

tries. As more countries implement export controls, world prices go up substantially—up to 20 percent—due to export restrictions, with particularly harmful effects in the case of rice (Ivanic et al. forthcoming).

The global food price crisis is taking place in the context of a historically highly distorted and poorly resilient trading system in agriculture. Many of the trade policy options for dealing with the current crisis aim at correcting these distortions. These options are explored in the companion note, *Global Food Price Crisis—Trade Policy Options*.

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