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Implementing the Uruguay Round: Increased Food Price Stability by 2020?

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Following implementation of the Uruguay Round agreement, reductions in price support programs, mainly in developed countries, will lead to reductions in food surpluses and stocks. As the developing countries open up their markets to world price signals, they could be hurt by fluctuations in prices, especially in the event of shortfalls and high food prices, unless measures to alleviate instability are undertaken.

Instability of cereal prices in world markets arises predominantly from variations in production caused by weather, pests, and diseases, or variations in the supply of purchased inputs such as seed and fertilizer. Protectionist policies aggravate price fluctuations in world markets because they insulate domestic markets from variations in world supplies, and transmit to the world market the effects of variations in domestic production. When shortages occur, prices rise in world markets. To keep prices from also rising in domestic markets, bringing about a fall in consumption, countries may subsidize imports by reducing import taxes and restrict exports by raising export taxes. Conversely, if a fall in world market prices due to a surplus is not transmitted to the domestic market, domestic consumption will not expand nor production contract to help reduce the world surplus. In the long run, high domestic price supports combined with protectionist policies result in food surpluses that depress world prices.

Price Fluctuations Harm the Poor

Major cereal prices have fluctuated sharply in recent decades. In some years prices rose as much as 30 to 35 percent and in others they fell 27 to 32 percent. For example, wheat prices in October 1995 were about 30 percent higher than in 1994, and they continue to rise in 1996. Overall, during the period 1970-94, annual real prices of wheat fluctuated 44ápercent around the trendline and rice prices 32 percent. During 1970-80 prices of wheat fluctuated 46 percent and prices of rice 33 percent. During 1980-94 wheat prices fluctuated 19 percent and rice prices 14 percent.

Because poor people spend as much as 40 to 50ápercent of their food budget on cereals, excessive fluctuations in cereal prices have a significant impact on their food security. A 20 percent rise in cereal prices may reduce consumption of the poor by 10 percent, adversely affecting nutritional status. Conversely, low prices favor poor consumers, but they deplete the assets of producers and depress their long-run income.

As world food prices rise, the low-income, food-deficit countries cannot sustain the level of cereal imports they need without an increase in food aid, international indebtedness, or both. In normal years, food aid constitutes 10-15 percent of cereal imports of low-income, food-deficit countries.

Will the Uruguay Round Accentuate Instability?

The aim of the agreement reached in 1993 at the conclusion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) is to reduce protectionism. Two years into the six-year agreement, implementation is well under way but far from complete. When it is finished, the agreement should result in a reduction in import protection, export subsidies, and domestic support programs. At the end of the six-year period, agricultural protection should be reduced by 36 percent, export subsidies by 20 to 36 percent, and domestic support programs by 20 percent in developed countries and 13 percent in developing countries from the late 1980s--much less than the reduction required for trade in manufactures and the original aims of the GATT.

How much price instability will there be when the new trade regime is fully implemented at the end of the six-year period? A hypothetical analysis of the consequences of a 5ápercent across-the-board change in production from trend (with 1987-89 as the base period) found no significant difference in the degree of instability of prices after implementation. For example, a 5 percent fall in output, compared to the trend, resulted in a price rise of about 25ápercent for wheat, 50 percent for rice, and 24 percent for maize both before and after the Uruguay Round agreement. There are two reasons for the lack of significant impact: first, the reduction in protectionism and subsidies, as envisaged in the current agreement, is not very substantial; second, this scenario was based on the assumption that world stocks would remain the same as in the late 1980s. Clearly, this is not a realistic assumption.

World Food Stocks Are Declining

Stocks have been declining in the early 1990s. How much of this is due to implementation of the Uruguay Round agreement has not been determined. Even before the agreement went into effect in 1993, the European Union and the United States were constraining domestic support prices and introducing programs for the control or reduction of acreage in production. As late as 1986/87-1990/91, large cereal stocks held in developed, exporting countries constituted about 26 percent of the total amount of cereals used for both food and feed, according to the Food and Agriculture Organization of the United Nations (FAO). The ratio of cereal stocks to total utilization in exporting countries declined to 22 percent in 1992/93 and to about 15ápercent in 1994/95. These stocks played a major role in offsetting fluctuations in production and in prices, caused partly by protectionism.

By the end of the implementation period, public stocks will be reduced as a result of reductions in domestic price support programs. Private stocks may rise in response to incentives provided by wider price differentials in the marketplace. But FAO estimates that the rise in private stocks is not likely to compensate fully for the fall in public stocks; a net fall in total world stocks is expected between now and 2020. The developed, exporting countries will experience the largest declines in stocks held.

Developing Countries Must Adjust to Changes

Developing countries will be affected by the reduction in price supports in two principal ways. First, a fall in food aid availability is likely as food surpluses are reduced. Overall, development assistance is expected to decline, and distribution is likely to shift to an emphasis on nonfood rather than food aid, because nonfood aid is seen as a form of development assistance, while food aid is seen as a way of disposing of food surpluses. Food aid commitment has already fallen under the new Food Aid Convention of 1995 from 7.5 million metric tons to 5.4 million metric tons, largely because the United States has reduced its share of the commitment by one-half. Second, the developing countries have significantly opened up their domestic markets to price signals in world markets as part of their overall policy of economic reforms, market liberalization, and privatization. They are gradually reducing their reliance on large publicly held stocks for stabilizing domestic prices. As a result, they are more exposed than before to the effects of price instability in the world market.

Price fluctuations in world markets will persist because world production fluctuations are, after all, the most dominant cause of price instability. The moderating or cushioning impact on world price instability that used to be exercised by varying world cereal stocks has been reduced by a substantial decline in cereal stocks in recent years. World price instability, if fully transmitted to domestic markets, especially in low-income, food-deficit developing countries, may raise domestic price instability in these countries to a higher level than prevailed when domestic price stabilization policies were in place, prior to market liberalization.

Under these circumstances, developing countries may resort to a mainly trade-based policy for stabilizing cereal prices, implemented through taxes and subsidies on trade. This scheme would operate within a price band large enough for profitable private trade, around a long-run trend level of world prices, combined with a minimum, critical level of public stocks held. Under the Uruguay Round agreement, however, such a policy may be constrained because developing countries are obliged to indicate in advance the maximum level at which they will "bind" tariffs. But since a majority of developing countries have fixed ceilings way above the currently applied rates, they can vary tariffs as long as they stay below the ceiling. It is not clear whether they can subsidize imports, since, in principle, they are not restricting trade but promoting it. New export subsidies, however, are prohibited, and existing export subsidies are to be reduced over time.

At the same time, developing countries are permitted under the agreement to operate food security stocks, buying and selling them at administered prices. An excess of support, however, putting the floor price above the market price, would be considered a subsidy. When all subsidy measures are combined, the aggregate measure of domestic subsidy must not be higher than 10 percent. But developing countries can undertake subsidized food distribution targeted toward the poor.

Policy Options for the Future

The Uruguay Round agreement can be an instrument for helping the developing countries to achieve food security by 2020 and to assure access to basic food for all. Steps need to be taken to ensure that developing countries, with assistance from the international community, are able to deal with the adverse effects of high food price instability. The following policy actions should be considered.

- Ensure that major cereal suppliers and importers--the developed countries and a few high-income developing countries--do not seek to insulate their domestic markets from the effects of production fluctuations at home or abroad, thus throwing the burden of adjustment onto the international market.

- Promote international agreement among developed and developing countries on measures to ensure that adequate amounts of stocks (public or private, or both) are held, so that excessive price increases at times of acute food shortage can be contained as well as steep declines due to sudden world surpluses.

- Ensure that low-income, food-deficit countries have access to food supplies when prices rise sharply through food aid under a renegotiated food aid convention and financing facilities under the auspices of international financial institutions.

- Re-examine the current provisions of the Uruguay Round agreement to explore whether and under what circumstances developing countries may use, within well-defined guidelines, trade policy instruments to stabilize severe fluctuations in real domestic prices, for example, through the use of tariffs and subsidies.

As experience with implementation of the Uruguay Round agreement accumulates, these and related policy options need to be taken up for further consideration in the next round of trade negotiations expected to start at the end of the current six-year period.

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