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WTO provisions in the context of responding to soaring food prices

Ramesh Sharma and Panos Konandreas¹
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¹ Ramesh Sharma is Senior Economist at the Trade and Markets Division of the Food and Agriculture Organization (FAO) and Panos Konandreas, formerly with FAO, is now a consultant at the Agency for International Trade Information and Cooperation (AITIC).

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ABSTRACT

This paper discusses certain WTO rules and provisions that have a bearing on response measures to the soaring world food prices. In doing so, it also reflects upon new rules that are being negotiated under the Doha Round, i.e. those that are now in the draft Modalities on agriculture. It is an opportune moment to discuss whether these new rules are adequate or whether further changes might be desirable in order to respond better to a future food crisis.

The paper discusses the following topics: i) role of import tariffs in cushioning the impact of high world prices of imported foodstuffs on the domestic market; ii) provisions on export prohibitions, restrictions and export taxation; iii) food aid; iv) export credits, export credit guarantees and insurance programmes; v) the Marrakesh Decision and the scope of food financing facilities to deal with difficulties in financing food imports; vi) provisions on State Trade Enterprises (STEs); vii) stockholding and domestic food distribution provisions; viii) diversion of food commodities for biofuel production; and (ix) trade facilitation to alleviate excessive costs and delays in the delivery of food imports which aggravate further crisis situations.

The paper notes that, in general, the relevant WTO rules – in the Agreement on Agriculture and elsewhere – do not constrain countries suffering from the high food prices from taking remedial measures. However, there are several issues on the extent to which such measures are effective for the country itself and also on the adverse effects they may have on third countries. Some of these problems are not adequately addressed in the new rules being negotiated under the Doha Round and it is now the time to reflect on these issues so that the new rules are more effective in responding to future food crises.

RÉSUMÉ

Le présent document examine certaines règles et dispositions de l'OMC qui peuvent influencer sur les mesures prises pour faire face à la flambée des prix des denrées alimentaires. Il se penche également sur les nouvelles règles qui font actuellement l'objet de négociations dans le cadre du cycle de Doha, c'est-à-dire celles qui figurent maintenant dans le projet de Modalités pour l'agriculture. Le moment est venu de déterminer si les nouvelles règles sont adéquates ou si d'autres changements seraient souhaitables pour être en mesure de mieux répondre, à l'avenir, à une nouvelle crise alimentaire.

Divers thèmes sont traités dans le document, à savoir: i) le rôle des droits d'importation dans l'atténuation de l'impact de la hausse des prix mondiaux des produits alimentaires importés sur le marché intérieur; ii) les dispositions concernant les interdictions et restrictions à l'exportation et les taxes à l'exportation; iii) l'aide alimentaire; iv) les crédits à l'exportation, les garanties de crédit à l'exportation et les programmes d'assurance; v) la décision de Marrakech et la possibilité de recourir à des financements des produits alimentaires afin de faire face aux difficultés rencontrées pour financer les importations alimentaires; vi) les dispositions concernant les entreprises commerciales d'État; vii) les dispositions relatives à la constitution de stocks et à la distribution de produits alimentaires nationaux; viii) le détournement des produits alimentaires pour la production de bioénergies; et ix) les facilitations commerciales susceptibles d'atténuer les surcoûts et les retards dans la distribution de produits alimentaires importés, qui viennent aggraver les situations de crise.

Le document fait remarquer qu'en général les règles pertinentes de l'OMC – dans l'Accord sur l'agriculture et dans d'autres instruments - n'obligent pas les pays touchés par la hausse des prix des denrées alimentaires à prendre des mesures correctives. Néanmoins, plusieurs questions se posent quant à l'efficacité de ces mesures pour le pays lui-même et aux effets négatifs qu'elles pourraient avoir dans des pays tiers. Certains de ces problèmes ne sont pas suffisamment pris en compte dans les

nouvelles règles en cours de négociation dans le cadre du cycle de Doha et le moment est venu de réfléchir à ces questions de manière à ce que les nouvelles règles permettent de résoudre plus efficacement, à l'avenir, les crises alimentaires.

RESUMEN

Este documento examina ciertas normas y disposiciones de la OMC en relación a las medidas para responder al aumento de los precios de los alimentos. Al mismo tiempo, contempla nuevas normas que se están negociando en el marco de la Ronda de Doha, es decir, aquellas que se insertan en el proyecto de Modalidades para la agricultura. Es un momento oportuno para analizar si estas nuevas normas son convenientes o si pueden necesitarse más cambios, para responder mejor ante una futura crisis alimentaria.

El documento examina los temas que se exponen a continuación: i) la función de los aranceles de importación de cara a amortiguar la repercusión de los elevados precios mundiales de los productos alimentarios importados en el mercado nacional, ii) las disposiciones sobre prohibiciones a la exportación, restricciones e impuestos de exportación; iii) la ayuda alimentaria; iv) los créditos a la exportación, las garantías crediticias a la exportación y los programas sobre seguros; v) la Decisión de Marrakech y el alcance de los mecanismos de financiación de los alimentos para superar las dificultades de financiación de las importaciones de los mismos; iv) las disposiciones sobre las Empresas comerciales del Estado; vii) las disposiciones sobre distribución de existencias y de alimentos nacionales, viii) la detracción de productos básicos para producir biocombustibles, y (ix) las facilidades comerciales para paliar costos excesivos y retrasos en la entrega de las importaciones de alimentos que agravan aún más las situaciones de crisis.

El documento señala que, por lo general, las normas relevantes de la OMC, tanto en el Acuerdo sobre Agricultura como en otros documentos, no ponen limitaciones a los países que experimentan precios elevados en cuanto a la toma de medidas correctivas. Sin embargo, existen diversas cuestiones relacionadas con la amplitud de la eficacia de dichas medidas para el propio país y con las consecuencias negativas que puedan suponer para terceros países. Algunos de estos problemas no se han abordado de forma conveniente en las nuevas normas que están siendo negociadas en el marco de la Ronda de Doha, y ahora es el momento de reflexionar sobre ellos, ya que las nuevas normas son más eficaces a la hora de afrontar futuras crisis alimentarias.

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I. INTRODUCTION

The purpose of this paper is to discuss certain WTO rules and provisions that have a bearing on response measures to the soaring food prices. Countries around the world facing difficulties due to high prices are taking a variety of response measures. Some of these response measures are policy instruments that are covered by the WTO rules. Where this is the case, there is also some concern that the WTO commitments might bind countries from pursuing the response measures. In other cases, existing rules may not be adequately binding, to the extent that one country's policy response may have adverse effects on other countries. Yet in other cases there are no rules developed at the WTO but such rules could help countries cope better when a similar food crisis emerges again in the future.

Before moving to discussing these topics, it is useful to recollect the context in which the rules governing agricultural trade was negotiated and concluded. The starting year was 1986 when the Uruguay Round was launched with the goal of *inter alia* extending GATT rules to agriculture also. Indeed, agriculture was never outside the GATT, officially. But some exceptions for agriculture that were negotiated in the 1950s, primarily to suit some domestic and trade policies of a handful of countries, meant that the regular GATT rules that applied to industrial goods did not apply to agriculture. This provided the legal cover to those who could afford – the rich countries – to apply import restrictions, subsidise production without limit and thus create structural surpluses of mainly temperate-zone products. These structural surpluses had to be disposed somehow, for which export subsidies and food aid turned out to be key instruments. This was an era of cheap food policy. But this came at the cost of others who did not participate in these subsidy wars or could not afford to do so, which included most developing countries.

By the mid-1980s, all this became unacceptable to the global community, and even to those that were engaged in these subsidy games, for budgetary or other reasons. That was when the Uruguay Round was launched, with the objective in agriculture of “the urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalances and instability in world agricultural markets” (Punta del Este Declaration launching the Uruguay Round in 1986).

Given the context and this objective, the focus of the Uruguay Round Agreement on Agriculture (AoA) was on limiting the policy space that countries had to over-produce with the help of protection and subsidies. The AoA made a considerable progress in this area and more is being done in the Doha Round.

Thus, by design, the AoA and its built-in agenda for the continuation of the reform process, was geared towards addressing problems of overproduction, typically originating in developed countries. Developing countries agreed to the same production restraining objectives of the AoA, although in practice the majority of them suffered from the opposite problem, i.e. underproduction, partly as a result of very little support to their agriculture, due to both direct and indirect taxation (Krueger *et al* 1988). For those developing countries with the potential to respond to new market opportunities, reduction of production elsewhere and strengthening of depressed prices was a positive development. However, although depressed prices have been the predominant state of world markets over the last 40 years, this has not always been the case and certainly not as it is seen by all participants in the world food market.

In fact, since 1970, i.e. over a period of about 40 years, there were five episodes of high food prices – spikes in world food prices and soaring food import bills. These were in 1974-76, 1980-82, 1988-90, 1995-97 and now, each crisis lasting for about 2 years for a total of 10 years, or about 25% of the time.

For the rest of the 75% of the time, world food prices and food import bills could be said to be on trend or depressed.

Suppose, for the sake of an argument, there are two sets of policies or rules that are most effective in the two different situations but not in both – one for cheap food era when the focus would be to prevent structural surpluses and circumvention of measures to dispose the surpluses, and the other for difficult times when efforts would be needed to encourage food production and assist needy countries and populations. Under this characterization, it would be right to say that the focus of the AoA rules on agriculture, and its continuation under the Doha Round, has been on addressing the problems of an era of cheap food – i.e. addressing the problems in the world food markets that apply 75% of the time.

An additional issue is whether this 75-25 characterization of the world food market would be valid in the future and whether the new rules being drafted under the Doha Round (based on the same premises and architecture of the AoA) would be effective in addressing all contingencies in the world food market. There are many commentators now who believe that the era of cheap food is over and the future would see much tighter food markets (due to population and income growth, constraints to productivity, biofuel etc.). In a scenario of tight markets, not only would food prices and food import bills be high, but also spikes would be more frequent, i.e. more frequent than once in 10 years or so as seen in the last 40 years. If that is the case, a legitimate question is whether WTO agricultural rules, designed for an era of cheap food, are adequate to address also the opposite problem of dear food and food crises.

To give an example, food aid has been historically a very common response measure to food crises – yet, food aid rules are negotiated in the WTO under the pillar of export competition where the key concern is the prevention of its misuse by food aid providers. But food aid also appears in the Marrakesh *Decision* as one response measure to help net food importers. But the primacy in the negotiations is on the former (export competition). In an era of cheap food, may be this was not an issue, but it might be one now. The issue then is how one frames rules that are good enough for both situations. This also applies to several other instruments.

For the reasons referred to above it is important to reflect on the new rules – those that are now in the draft Modalities on agriculture – to see how they might affect the ability of countries and the international community to respond to a situation of high food prices in the future, and whether some changes in the rules might be desirable.

In addressing the above issues, the paper discusses the following:

- (i) role of import tariffs in cushioning the impact of high world prices of imported foodstuffs on the domestic market;
- (ii) export prohibitions, restrictions and export taxation;
- (iii) provisions on food aid;
- (iv) export credits, export credit guarantees and insurance programmes;
- (v) the Marrakesh Decision and the scope of food financing facilities to deal with difficulties in financing food imports;
- (vi) provisions on State Trade Enterprises (STEs);
- (vii) stockholding and domestic food distribution provisions;
- (viii) diversion of food commodities for biofuel production; and
- (ix) trade facilitation to expedite the delivery of food imports.

These nine topics are discussed in turn. The last section summarizes the main observations.

II. SELECTED TRADE-RELATED RESPONSE MEASURES

(i) *Role of import tariffs in cushioning the impact of high world prices of imported foodstuffs on the domestic market*

Lowering or eliminating import tariffs is the most common measure that governments take to stabilize domestic prices of imported goods when world market prices rise (and raising tariffs when world market prices fall). This has been the case this time also. Approximately half of the governments in the 77 countries surveyed recently lowered or eliminated import tariffs on cereals when world market prices soared (FAO 2008). The scope of this policy response is limited, however, as applied tariffs for most food commodities are generally on the lower side, e.g. 10-20%, and the most these tariffs can be lowered to is zero percent or duty free. On the other side, tariffs can be raised up to the WTO bound level, which can be much higher (and even exceeded if there are safeguards that can be resorted to).

Table 1 shows the extent of the price rises for cereals and vegetable oils in the last three years. In 2007, prices rose by between 27 to 63%, and further by between 40 to 105% in early 2008. Compared with the 2006 levels, prices were higher in early 2008 by between 88 to 160%. Obviously, applied tariffs need to be reduced markedly in 2007 and 2008 to stabilize domestic prices at the level of 2006.

Table 1: World market prices of cereals and vegetable oils (2006 to 2008)

Food	World market price (US\$/t)			----- % rise in prices -----		
	2006	2007	2008 1/	In 2007 rel. to 2006	In 2008 rel. to 2007	In 2008 rel. to 2006
Rice	217	275	563	27	105	160
Wheat	200	266	407	33	53	104
Maize	122	164	230	34	40	88
Palm oil	478	780	1170	63	50	145
Soy oil	599	881	1403	47	59	134
Simple average	323	473	755	46	59	134

1/ For 2008, Jan-May averages. Rice is Thai A1 variety.

Source: FAO

It is a common knowledge that despite having relatively high WTO bound tariffs, applied MFN tariffs on basic foods are relatively low in a majority of the developing countries, for a variety of reasons including the political economy considerations of affordable food, as well as loan conditionality. Statistics on applied tariffs for 2008 are not available in public domain but the data for 2006 show that this is the case generally. Annex 1 shows 2006 applied tariff rates for about 60 LIFDCs² and Table 2 summarizes the averages. It is clear that tariffs on basic foods were already relatively low in 2006, in the range of 8 and 14% for the five basic foods, but less than 10% when peak tariffs for about 10 countries are excluded from the list. For the three cereals, the average was 11%, but only 6% for about 50 LIFDCs when some peak cases are excluded.

The point being made here is that most of these countries did not have high enough applied tariffs in 2006 to be able to stabilize domestic prices in 2007, let alone in early 2008. Assuming that the domestic price for any given year, P_d , is determined as $P_d = P_w * (1+t)$, where P_w is world price and t is

² Low Income Food Deficit Countries, a category maintained by FAO for the prioritization of food security interventions and also used by the World Food Programme in the allocation of food aid. A country in the LIFDC category has to meet simultaneously two criteria: per capita income below the "historical" ceiling used by the World Bank to determine eligibility for IDA assistance, and have a net deficit in basic foodstuffs (i.e. gross imports less gross exports) averaged over the preceding three years. Some 82 countries are presently LIFDCs.

Table 2: Simple average tariffs on some basic foods for LIFDCs in 2006^{1/}

	Wheat	Rice	Maize	Soy oil	Palm oil
Simple average for 61 LIFDCs	8%	13%	12%	12%	14%
Simple average for about 50 LIFDCs (after excluding 10 cases of high tariff rates)	4%	8%	6%	9%	9%

1/ For 14 of the 61 LIFDCs, tariff rates are for 2005.

Source: TRAINS/WITS (see Annex 1 for details).

tariff, one can calculate the level of the tariff, t , that will be required in, say, 2007 or 2008, when world prices have increased, to stabilize domestic prices at the level of 2006. These computed tariffs are large *negative* numbers – which means that the 10% or so tariffs of 1996, when reduced to zero, could counterbalance only a part of the price rise of 2007, and not at all thereafter during early months of 2008 when prices soared to even higher levels.

This is a simple and obvious point but worth stressing, in view of the many commentators on soaring food prices urging that countries reduce import tariffs as a response. Most recent updates on policy responses show that even countries like India and Morocco that had high tariffs on cereals and oils in 2006 (as per Annex 1) have eliminated import duties.

(ii) *Export prohibitions, restrictions and export taxation*

Faced with soaring food prices, several countries have taken measures to limit the export of foods, including through bans and taxation. Of the 60 LIFDCs covered in a recent survey, about a quarter resorted to such measures (FAO 2008). The effects of export restrictions are obvious – domestic price rise is contained, consumers benefit, producers lose, while world prices rise further. One other important and undesirable outcome could be for food importers to lose faith in the world markets and consider self-sufficiency policies.

In the WTO Agreement on Agriculture (AoA), this subject is covered under Article 12 on ***Disciplines on export prohibition and restrictions***. This Article stipulates the following:

1. Where any Member institutes any new export prohibition or restriction on foodstuffs in accordance with paragraph 2(a) of Article XI of GATT 1994, the Member shall observe the following provisions:
 - (a) 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;
 - (b) 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 comprising such information as the nature and the duration of such measure, and shall consult, upon request, with any other Member having a substantial interest as an importer with respect to any matter related to the measure in question. The Member instituting such export prohibition or restriction shall provide, upon request, such a Member with necessary information.
2. The provisions of this Article shall not apply to any developing country Member, unless the measure is taken by a developing country Member which is a net-food exporter of the specific foodstuff concerned.

Paragraph 1 of GATT Article XI³ indeed requires that there can be no prohibitions or restrictions on exports other than through duties and taxes. This restriction also covers quotas and licenses. In this sense, Article XI appears quite restrictive (although export taxation is not prohibited). However, Paragraph 2(a) makes an important exception to this general rule, by stating that Paragraph 1 shall not apply to “export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party”.

By virtue of the important link to paragraph 2(a) of GATT Article XI (note “in accordance with” in paragraph 1 of AoA’s Article 12), the AoA essentially permits the institution of export prohibitions or restrictions on basic foodstuffs to relieve domestic critical shortages of foodstuffs. Both the terms “critical shortage” and “temporary” are, however, not defined anywhere. Temporary could mean months or even a year or more.

Thus, essentially, current WTO rules allow countries to use export restrictions when they face a domestic shortage. Export taxation was never disallowed, and this tax could be prohibitively high because it is not bound anywhere, unlike import tariffs. Therefore, the two obligations called for in Article 12 of the AoA, i.e. giving due consideration to others’ food security needs and advance notification and consultation if asked for, are useful to some extent for exerting some moral restraint on the exporter, but may not mean anything in concrete terms.

Article 12(2) of the AoA exempts developing country Members from the general rule in 12(1), unless they are *net food exporters* of the specific foodstuff in question. Many developing countries are now significant exporters of basic foodstuffs and it would appear that they would also have to adhere to the general provisions of 12(1); however, in practical terms this may mean very little. There is no list of net food exporting developing countries at the WTO (and for specific products), nor, alternatively, criteria to define a net food exporter (e.g. which foodstuffs to be covered, net exporter position over what base period, etc). While the converse list of *net food importing developing countries* exists as a WTO category (based on self-designation and subject to verification of the relevant data) that has been constructed for the purpose of the Marrakesh Decision (see below) and nowhere it is implied that a country not belonging in this latter category automatically belongs to the net food exporter category.

In the 10 July 2008 draft Modalities (WTO 2008b), the issue of export taxes and export prohibitions and restrictions is touched upon under Part V on *Other Issues*. On export taxation, there is only a heading (no text), and that within square brackets, called [Differential Export Taxes]⁴.

On export prohibitions and restrictions, paragraph 161 states the goal: “In order to strengthen the existing disciplines on export prohibitions and restrictions of Article XI. 2 (a) of GATT 1994, Article 12 of the Agreement on Agriculture shall be modified to include the following elements.” There are six such elements (in paragraphs 162 to 167), but only two appear somewhat concrete. One is eliminating by the end of the first year of implementation existing export prohibitions and

³ The relevant paragraphs of GATT Article XI: *General Elimination of Quantitative Restrictions* are as follows:

1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

2. The provisions of paragraph 1 of this Article shall not extend to the following:

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

⁴ This concept of “differential export taxes” was first mentioned in the July 2004 text, but without defining the word “differential”, and under the heading “issues of interest but not agreed”. The 2005 Hong Kong Declaration merely repeated the July 2004 text.

restrictions in foodstuffs and feeds under Article XI.2 (a) of GATT 1994 (paragraph 166). The other reads as follows: “Any new export prohibitions or restrictions under Article XI.2 (a) of GATT 1994 should not normally be longer than 12 months, and shall only be longer than 18 months with the agreement of the affected importing Members” (paragraph 167). The rest of the provisions (paragraphs 162 to 165) are about prompt notification of the measures, with reasons, and better surveillance by the Committee on Agriculture.

The issue of export prohibitions, restrictions and export taxation was addressed in several proposals during the early phase of the negotiations on agriculture (around 2000-2001). Japan’s negotiating proposal (WTO 2000) was the most detailed, and focused on “rules and disciplines on exports” and on “redressing the imbalance between rules and disciplines applied to agricultural exporting countries and those applied to importing countries”. The reference here to “imbalance” is to contrast the weak rules on exports compared to well-defined and binding rules on imports, thus potentially to the detriment to food security of food-importing countries. Japan proposed the following measures:

- tariffify all export prohibitions and restrictions (by replacing them with export taxes);
- bind all export taxes (and for products subject to export tax, establish quotas in which a certain amount of exports - a certain proportion of domestic production - will be exempt from the export tax);
- where temporary and short-term measures to restrict exports become necessary before export taxes are introduced, clarify the disciplines applied on such emergency measures used in order to adjust the volume of exports.

Further rules were also proposed for such **emergency measures**:

- establish strict requirements for the application of such emergency measures;
- introduce consultations with other Members as a prerequisite for imposing emergency measures, and clarify the measures to be taken when the consultations do not result in a satisfactory solution;
- obligate Members, when introducing emergency measures, to maintain the proportion of exports to domestic production at the level of the preceding x years, in order to allow importing countries to secure the necessary level of imports; and
- limit the duration of such emergency measures.

In addition, Switzerland had called for eliminating all export restrictions on agricultural products, and the binding at zero of all export tariffs (with flexibility to the LDCs). The Republic of Korea also proposed prohibiting exporting countries from imposing export restrictions, and prohibiting the use of export taxes. Several other proposals had called for improved disciplines on export restrictions and taxes. Thus, in contrast to the current Article 12, export taxation was also very much on the negotiating table.

In conclusion, the latest text of the draft Modalities, as well as the earlier versions, suggest that the status quo on this issue is likely to continue. Given their absence from both Article XI of the GATT and Article 12 of the AoA, the chances that export taxation would be brought under the rules appear slim. Secondly, and this is more important, it is also unlikely that Article 12 of the AoA would delink from that important exception to export restrictions (paragraph 2(a) of Article XI of the GATT), i.e. the one that permits restrictions to relieve critical domestic shortages of foodstuffs in the domestic markets. As long as export restrictions are justified under this paragraph, the disciplines under Article 12 of the AoA will remain weak. And thirdly, it is also unlikely that the developing countries that are significant net food exporters will accept tighter disciplines for themselves. But it is also possible that the present environment of soaring prices might put some pressure on the agricultural negotiators to revisit the proposals for some concrete provisions.

It is not clear to what extent any of the WTO Members that resorted to export prohibitions or restrictions during the recent past gave *due consideration to the effects of such prohibition or*

restriction on importing Members' food security, as stipulated in Article 12 of the AoA. There has not been any formal consultation in the WTO Committee on Agriculture on the scope and duration of the measures that have been put in place or on the possible adverse effects on other Members that may have a substantial interest as importers of food commodities subject to such export prohibitions or restrictions. The danger of a weak Article 12 is real, however, namely to raise doubts about the world market being a reliable source of food supplies (Konandreas 2008). Strengthening Article 12, beyond what is envisaged in the draft Modalities text, and making non-compliance actionable on the part of affected WTO Members should be a priority under the current Doha Round.

(iii) *Food aid*

The existing disciplines on food aid under the AoA are contained in paragraph 4 of Article 10 on the ***Prevention of Circumvention of Export Subsidy Commitments***. It is clear that the incorporation of food aid disciplines under this article was meant to avoid abuse of food aid and particularly situations where it could be provided in terms and conditions that would circumvent export subsidy commitments of Members. Thus, the tenor of Article 10.4 is basically to limit the provision of food aid to what it was considered to be genuine food aid with minimum adverse effects on third parties⁵.

In essence, paragraph (a) of Article 10.4 calls upon donors to ensure that “the provision of international food aid is not tied directly or indirectly to commercial exports of agricultural products to recipient countries”. How this is to be ensured is spelled out in paragraph (b) which states that “international food aid transactions, including bilateral food aid which is monetized, shall be carried out in accordance with the FAO ‘Principles of Surplus Disposal and Consultative Obligations’, including, where appropriate, the system of Usual Marketing Requirements (UMRs)” Paragraph (c) of Article 10.4 stipulates that “such aid shall be provided to the extent possible in fully grant form or on terms no less concessional than those provided for in Article IV of the Food Aid Convention 1986.”

While the tenor of the above disciplines appears restrictive, in practice the current rules are not binding to constrain the provision of food aid in any way, volume-wise or type (in-kind or in cash). Essentially, these disciplines are more of the nature of guidelines than binding rules and this was one of the main reasons that the Doha Round negotiations on food aid have been intense and so much inclined towards tightening the rules on food aid.

The Principles of Surplus Disposal represent a code of conduct for governments in the provision of food aid. In the main, they seek to ensure that food and other agricultural commodities which are exported on concessional terms result in additional consumption for the recipient country and do not displace normal commercial imports; and similarly, that domestic production is not discouraged or otherwise adversely affected. While the Principles are not a binding instrument, they represent a commitment by signatory countries. They have helped governments to focus on their responsibilities as parties to transactions on concessional terms and to avoid potential difficulties and disagreements.

The interests of exporting countries are protected by the undertaking that such disposals should be made without harmful interference with normal patterns of international trade, by assurances against resales or trans-shipment of commodities supplied on concessional terms, and by the introduction of the concept of "additional consumption" which is defined as consumption which would not have taken place in the absence of the transaction on concessional terms. The mechanism for assuring such additionality is the “Usual Marketing Requirements” (UMR), a concept adopted by FAO in 1970. The

⁵ The other reference to food aid in the Uruguay Round agreements is in the Marrakesh *Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries*. Food aid, together with export credits and food financing facilities, are the response measures envisaged under this *Decision* to help LDCs and NFIDCs facing short-term difficulties related to importing adequate foodstuffs on reasonable terms and conditions (more on the *Decision* below).

UMR is a commitment by the recipient country to maintain a normal level of commercial imports of the commodity concerned, in addition to the commodity supplied in the concessional transaction. In principle, the interests of recipient countries are safeguarded by the emphasis placed on “additional consumption” and the avoidance of disincentive effects on domestic production.

While food aid has been an important instrument of surplus disposal for several producing countries and also an important source of supply for recipient countries in the past, its role since the mid 1990s has been on the decline (Konandreas 2007). With the disappearance of large surpluses in major donor countries, food aid has declined over the past two decades, due mainly to falling apparent surpluses among the major donors (US, EU, Canada, Japan and Australia). Food aid is no longer a major part of aid and agricultural trade, being less than 5% of all ODA and under 2% of total developing country food imports. In large part, food aid has lost its importance both as an indirect price support in donor countries and as a policy instrument in development assistance. However, these overall trends mask some recipient country situations where food aid continues to be an important source of supply and also some important trends in the destination and use of food aid.

The second trend concerns food aid use. Emergency food aid, which is defined as food aid provided for direct distribution at times of severe food shortages, now constitutes nearly two-thirds of the total food aid. Programme food aid, which in large part represents balance of payments support, has fallen to 15-20% of total food aid flows from a high of 60-70% at the beginning of the 1990s. The remaining portion of food aid is used in support of project activities, either for distribution to targeted groups for development purposes or for monetization to fund other food security-related work, and channeled through WFP, NGOs and other charitable bodies.

Yet another trend concerns the channeling of food aid. Largely because of the changed nature in the use of food aid (for emergencies, as discussed above) an increasing share of total food aid is now channeled multilaterally (through the WFP) and NGOs and a much reduced share bilaterally.

Emergency food aid is considered to have the least market distorting effects, because it is usually delivered directly to those who would not otherwise be able have access to food. They are most likely to consume the food aid they receive rather than sell it in the market (thus this type of assistance represents largely additional consumption and has minimum trade displacement effect or disincentive effects on domestic production). The same can be said about project food aid, to the extent that adequate care is taken for identifying the beneficiaries and having in place effective mechanisms for targeting them. Programme food aid, on the other hand, is considered to be the most market distorting, since all of it is monetized in the open market, augmenting the supply in the recipient countries and depressing market prices.

As for the future, the new rules that would govern food aid are those being negotiated under the Doha Round, as part of the new AoA. The latest proposals on the table are contained in Annex L of the 10 July 2008 draft Modalities text (WTO 2008b). The main elements of the new disciplines are discussed below.

First, several general disciplines are proposed to be applicable to all food aid transactions, no matter what the intended use of the food aid. All food aid should be: a) needs-driven; b) in fully grant form; c) not tied directly or indirectly to commercial exports of agricultural or other goods and services; d) not linked to market development objectives; and e) not re-exported (except when absolutely required to meet an emergency situation in some other countries). Three additional guidelines are also stipulated as regards taking fully into account local market conditions: i) refrain from providing in-kind food aid where this would cause an adverse effect on local or regional production of the same or substitute products; ii) food aid providers encouraged to procure locally or regionally to the extent possible; and iii) make best efforts to move towards more cash-based food aid.

While all food aid transactions should conform to the general disciplines ((a) to (e) above), further rules are distinguished on the basis of whether the situation is one of an emergency or non-emergency.

Food aid in **emergency situations** (whether cash or in-kind) is placed under a Safe Box (akin to Green Box in domestic support disciplines), in the sense that this will not be contested. For this, the key requirement is the declaration of an emergency by the recipient country or by the UN Secretary-General, **or** emergency appeal by the recipient country or specified agencies.⁶ In either case, a needs assessment is required, coordinated under the auspices of a relevant UN agency, including the WFP and the two Red Cross Societies.⁷ A positive needs assessment means that food aid belongs to the Safe Box. Moreover, there shall be **no monetization** for food aid inside the Safe Box, except for LDCs where there is a demonstrable need to do so for the sole purpose of transport and delivery. Such monetization shall be carried out solely within the territory of the recipient LDC⁸ such that commercial displacement is avoided or, if not feasible, at least minimized. Food aid that is in conformity with these provisions may be provided as long as the emergency lasts subject to an assessment of continued genuine need as a result of the initial onset of the emergency. The relevant multilateral agency shall be responsible to make or convey such determination.

The requirements for *in-kind* food aid in **non-emergency situations**, i.e. outside the Safe Box, in addition to meeting the above general disciplines, are as follows: a) should be based on a needs assessment carried out by agencies as above; b) provided to redress food deficit situations which give rise to chronic hunger and malnutrition and, accordingly, such food aid shall be **targeted** to meet the nutritional requirements of **identified** food insecure groups; and c) provided with the objective of preventing or minimizing commercial displacement.

Monetization of in-kind food is a contentious issue because of its negative effects on markets and incentives. On this, the May 2008 Modalities had two options within square brackets - “prohibited” and “permissible” (under some conditions). In the 10 July text, these brackets were removed, and the text now reads roughly as follows: monetization of in-kind food aid shall be prohibited except where it is necessary to fund: i) internal transportation and delivery of food aid to LDCs and NFIDCs; ii) for the procurement of agricultural inputs to low-income or resource-poor (LIRP) producers in the LDCs and NFIDCs; and iii) to meet direct nutritional requirements of these very Members. A fourth purpose – but in brackets – is [to fund activities that may have humanitarian development objectives but only where they are directly related to the delivery of the food aid to developing country recipients in developing countries]. It is further said that monetization shall be carried out within the territory of the recipient LDCs and NFIDCs.⁹ Additionally, commercial displacement shall be avoided or, if not feasible, at least minimized.

As a commentary on these Modalities texts, one issue is the characterization of what constitutes an emergency because this determines whether food aid belongs to the Safe Box or not. For example, is the current situation of soaring food prices an emergency? The draft Modalities do not define an emergency.

⁶ The agencies named for emergency appeal are: a relevant UN agency, including the WFP and the UN Consolidated Appeals Process; the International Committee of the Red Cross and the International Federation of Red Cross and Red Crescent Societies; a relevant regional or international intergovernmental agency, a non-governmental humanitarian organization of recognized standing traditionally working in conjunction with the former bodies.

⁷ “Needs assessment should be done with the involvement of the recipient government and may involve a relevant regional intergovernmental organization or an NGO, but while the latter bodies may be so involved, this is in a context where they are in coordination with the relevant United Nations agency or ICRC/IFRCRCS as the case may be. A needs assessment shall not have standing for the purposes of access to the safe box under these provisions unless it has been conducted in such a coordinated manner, and has obtained the demonstrable consent or approval of the latter multilateral agencies.”

⁸ In the case of a landlocked Member, additionally for the transport/delivery from the extra-territorial continentally contiguous port of final unloading to the destination territorial border.

⁹ The previous footnote on landlocked countries is repeated here also.

WFP and some other humanitarian agencies have their own definitions of an emergency. WFP's definition was adopted in 2005, after revising previous definitions¹⁰. Soaring food price is not listed as an emergency, but it may qualify under (d) – severe food access or availability conditions resulting from sudden economic shocks. Likewise, slow-onset events leading to sudden economic crises – a characterization mentioned elsewhere in the WFP document on emergencies – may render current soaring food prices as an emergency. The very last paragraph in the WFP definition points to flexibility – “emergency interventions will continue to be based on assessed needs, also taking into account other criteria”. However, this is far from precise to form a basis for a WTO rule.

If the present situation is not characterised as an emergency, then food aid provided in response to high food prices would be outside the Safe Box and subject to the tighter disciplines ((a) to (c)) above, as well as those on monetization. This essentially means that a country suffering from high food prices can not receive in-kind food and monetize or undertake open market sales in order to reduce domestic prices. This is prohibited even for the LDCs. Instead, it is essential that recipient countries have in place a food distribution programme precisely targeted to clearly identified food insecure groups to redress food deficit situations which give rise to chronic hunger and malnutrition. Note that chronic food insecurity, as against transitory insecurity, is also covered. Many countries do not have such programmes currently, and it is not possible to put in place such schemes in a short period when a food crisis begins. Therefore, those wishing to benefit from in-kind food aid during food crises would need to have some scheme in place and running, so that the scheme can be upscaled when a crisis unfolds.

A third issue is monetization. It is a very sensitive issue because of its potential to disrupt local markets and to generate disincentives to local production. There are many studies on this topic (see for example Clay et al 1996; Barrett and Maxwell 2005). Therefore, disciplines on monetization are to be welcomed.

However, clarifications will be needed on three of the four exceptions made to the prohibition of monetization in the July 2008 text, as listed above. One is the procurement of agricultural inputs to LIRP producers. The term LIRP was first coined in Article 6 of the AoA in connection with domestic subsidies, but remains undefined. As a result, there is nothing that will prevent a country from saying that many, e.g. say 20%, of its farmers are LIRP. And it could further claim that their requirements of agricultural inputs are large. This could justify fairly large-scale monetization of food aid, thus

¹⁰ Definition of emergencies endorsed by WFP Executive Board in 2005 (see WFP 2005):

“For purposes of WFP emergency projects, emergencies are defined as urgent situations in which there is clear evidence that an event or series of events has occurred which causes human suffering or imminently threatens human lives or livelihoods and which the government concerned has not the means to remedy; and it is a demonstrably abnormal event or series of events which produces dislocation in the life of a community on an exceptional scale. The event or series of events may comprise one or a combination of the following:

- a) sudden calamities such as earthquakes, floods, locust infestations and similar unforeseen disasters;
- b) human-made emergencies resulting in an influx of refugees or the internal displacement of populations or in the suffering of otherwise affected populations;
- c) food scarcity conditions owing to slow-onset events such as drought, crop failures, pests, and diseases that result in an erosion of communities and vulnerable populations' capacity to meet their food needs;
- d) severe food access or availability conditions resulting from sudden economic shocks, market failure, or economic collapse - and that result in an erosion of communities' and vulnerable populations' capacity to meet their food needs; and
- e) a complex emergency for which the Government of the affected country or the Secretary-General of the United Nations has requested the support of WFP.

WFP's emergency interventions will continue to be based on assessed needs, also taking into account any other considerations or criteria that may be decided upon by the Executive Board consistent with the organization's rules, regulations and mandate”.

essentially opening up a window for market distortions. Also unclear is the third point ... monetization .. “to meet direct nutritional requirements of these Members”. These requirements, e.g. in terms of food gaps, could be substantive when computed and could justify large-scale monetization. The fourth exception in that list, “to fund activities that may have humanitarian development objectives”- albeit in brackets now – is very vague and could as well provide a legal cover for large-scale monetization. Therefore, all in all, these proposals require more thinking so that the scope for monetization is genuinely constrained to what is most essential, given the well known negative effects that monetization.

Besides these potential difficulties, three other aspects of the Modalities could be contentious or problematic in the future: i) the emergency appeal by a recipient country itself, because of a moral hazard problem; ii) the question of who qualifies as “non-governmental humanitarian organization of recognized standing traditionally”; and iii) the issue of some other food insecure countries, e.g. those in FAO’s list of LIFDCs, missing out from the special treatment currently limited to the LDCs and NFIDCs.

(iv) *Export credits, export credit guarantees or insurance programmes*

There were no specific rules developed and prescribed in these areas in the AoA itself and Members were asked to work towards developing relevant disciplines (Article 10.2 of the AoA). In the Doha Round, negotiations in these areas focused on tightening the rules so as to prevent circumvention of export subsidy commitments. At the same time, there was a need for doing something for the LDCs and NFIDCs, in view of the Marrakesh Decision where Ministers agreed to “ensure that any agreement relating to agricultural export credits makes appropriate provision for differential treatment in favour of LDCs and NFIDCs”. The data show that historically both the LDCs and NFIDCs have not accessed much of the global total of agricultural export credits, mainly reflecting lack of access and not lack of importance of this financing. Indeed, export credits were found to be very useful for importing foodstuffs by countries facing short-term liquidity problems during the financial crises in Asia and Latin America.

In the 10 July 2008 draft Modalities text (Annex J), “export credits, export credit guarantees or insurance programmes” – collectively called “export financing support” – were listed as follows:

1. direct financing support, comprising direct credits/financing, refinancing, and interest rate support;
2. risk cover, comprising export credit insurance or reinsurance and export credit guarantees;
3. government-to-government credit agreements covering the imports of agricultural products exclusively from the creditor country under which some or all of the risk is undertaken by the government of the exporting country; and
4. any other form of governmental export credit support, direct or indirect, including deferred invoicing and foreign exchange risk hedging.

The provisions, to be agreed, shall apply to all “export financing entities” that are either government agencies or private entities with government participation in any form, receive government support or provide insurance or guarantees.

There are two elements of the export financing support schemes that will be disciplined: **maximum repayment term** and **premium rates**. On the former, the general rule is to limit the maximum repayment term for export financing support to no more than 180 days. On the latter, the fundamental principle proposed is that export credit guarantee, insurance and reinsurance programmes, and other risk cover programmes shall be **self-financing** by the interest rate charged. The relevant language reads as follows: “Where premium rates charged under a programme are inadequate to cover the operating costs and losses of that programme over a previous [4] [5]-year rolling period, this shall, in and of itself, be sufficient to determine that the programme is not self-financing.”

Two forms of SDT provisions are included in the draft Modalities. The first is for the developing countries *as providers* of export financing support. They will have a phase-in period of four years (only 3 years in 19 May Modalities) within which to reach the same 180 days as above (with 360 days in year 1, and 270 days by year 3 and 180 days by year 4). The second SDT is for the LDCs and NFIDCs *as beneficiaries* for whom the repayment period will be between 360 and 540 days for the acquisition of basic foodstuffs (note, only basic foodstuffs). In addition, should one of these LDCs and NFIDCs face **exceptional circumstances** which still preclude financing normal levels of commercial imports of basic foodstuffs and/or in accessing loans granted by multilateral and/or regional financial institutions, the repayment term can be extended (beyond the 540 days).¹¹ The extension is subject to the standard AoA monitoring and surveillance provisions.

Note that there is no SDT for developing countries in general as beneficiaries. Note also that the term “exceptional circumstances” is not defined, which could be a divisive issue during the implementation. Exceptional circumstances were, however, elaborated in the July 2007 text¹², but not included in the Modalities texts since February 2008.¹³

In the present context of soaring food prices and associated difficulties in importing foods, the following three considerations appear pertinent if the Modalities are revisited. First, the Modalities could characterize and clarify “exceptional circumstances”, using the language in the July 2007 text as one basis. This definition could also be harmonized with the definition of “emergencies” in the food aid section¹⁴. Second, there may be a need for considering concessional payment term (interest rate) also under exceptional circumstances, rather than the repayment period only, as the former could be more valuable for low income countries. Third, the limitation of the SDT to LDCs and NFIDCs would miss out some other food insecure countries, in FAO’s list of LIFDCs, although the latter always have the option to accede to the WTO list of NFIDCs, as they meet the basic criterion of being net food deficit countries.

¹¹ In May text, this was “to meet humanitarian needs for basic foodstuffs”, which is deleted in 10 July text.

¹² The July 2007 text (WTO 2007) reads as follows:

“At the request of an importing developing country Member, in exceptional circumstances which can not be adequately covered otherwise by international food aid, commercial export credits or preferential international financing facilities, Members may provide, ad hoc temporary government financing arrangements to underwrite agricultural export credits that are not otherwise in conformity with the terms of conditions of paragraph 3.4(b) to (g). The importing developing country member concerned shall notify the Committee on Agriculture in writing of the circumstances which justify more favourable terms than are permitted under the relevant provisions of this Article, together with details of the product(s) concerned so that interested exporting Members shall have the opportunity to respond. Members shall provide ex ante notifications on the more favourable terms provided in for such exceptional circumstances. The maximum repayment term for exceptional circumstances temporary government financing arrangements shall not exceed 360 days” (para 8 of Annex D of July 2007 text).

¹³ It is somewhat surprising that this (detailed) characterization of “exceptional circumstances” was deleted altogether in recent texts because there was such a language in the July 2004 framework agreement itself (WTO 2004, para 26): “In exceptional circumstances, which cannot be adequately covered by food aid, commercial export credits or preferential international financing facilities, ad hoc temporary financing arrangements relating to exports to developing countries may be agreed by Members”, but without undermining commitments made on general provisions on export subsidies, and to be based on criteria and consultation procedures to be established”.

¹⁴ Indeed, the draft Modalities of July 2006 (document TN/AG/W/3) used the phrase “emergency situations” in this context, and defines an emergency as “a sudden, significant and unusual deterioration in a developing country Member’s economy and its ability to finance current imports of basic foodstuffs, and which may have far reaching consequences such as social deprivation or unrest” (para 13 of Annex I of the text).

(v) *The Marrakesh Decision and the scope of food financing facilities to deal with difficulties in financing food imports*

The Marrakesh *Decision* was included in the Uruguay Round agreement because of the recognition that certain vulnerable countries that depend on the world market for a substantial part of their basic food needs may face additional difficulties in financing such foodstuffs as a result of the implementation of the AoA. Partly because of the near impossibility in establishing a clear link between financing difficulties and the implementation of the AoA, as stipulated in the *Decision*, there has been very little progress in implementing the *Decision*, despite efforts the countries concerned have made over the years, with the support of international organizations such as UNCTAD and FAO. The *Decision* itself is not being re-negotiated in the Doha Round, but as discussed already, food aid and export credits are, under the *export competition* pillar of the AoA. The draft Modalities for these instruments refer to the *Decision* in the context of providing Special and Differential Treatment in favour of the LDCs and NFIDCs.

That many LDCs and NFIDCs have balance of payments difficulties even in normal times and face additional short-term difficulties in financing normal levels of commercial imports of basic foodstuffs in more difficult times, such as when food prices soar in the world markets, is hardly disputed. In 2002, FAO had undertaken a detailed analysis of the difficulties with food financing in abnormal times, in the context of the Marrakesh Decision (FAO 2003). Among other things, this study noted that unlike in the past when STEs dominated food purchases abroad, food imports are now largely undertaken by private traders. This has not helped financing food imports when needs surge. This is largely because the private sector – working in an environment of inter alia high risks, underdeveloped banking services and the extra collateral demand this entails – lacks finance and guarantees which the STEs used to enjoy in the past.

In view of this, the analysis, in addition to making a number of recommendations for strengthening current food financing environment and instruments in the LDCs and NFIDCs, was generally supportive of a dedicated finance facility such as the proposed Revolving Fund (discussed below), subject of course to sound rules of operation and checks and balances.

Food financing facilities was one of the four response measures envisaged in the Decision.¹⁵ The relevant paragraph reads as follows: “Ministers recognize that as a result of the Uruguay Round certain developing countries may experience short-term difficulties in financing normal levels of commercial imports and that these countries may be eligible to draw on the resources of international financial institutions under existing facilities, or such facilities as may be established, in the context of adjustment programmes, in order to address such financing difficulties”. A subsequent sentence in the Decision mentions IMF and World Bank, and presumably for this reason much attention has been drawn to the emergency facilities maintained by these agencies.

Among the facilities, the one closest - both in spirit and content - to that envisaged in the *Decision*, and the one that has attracted the most attention in subsequent discussions, is the IMF’s Compensatory Financing Facility (CFF), which has an excess cereal import bill component also.¹⁶ During the earlier years of the Uruguay Round implementation, some debate has taken place on the appropriateness of the CFF for the purpose of the *Decision*. In this process, a group of the LDCs and NFIDCs concluded that the CFF was not appropriate, and this led them to propose in 2001 a new, dedicated food financing facility.

¹⁵ Unlike food aid and export credits (the other two response measures in the *Decision*), financing facility, however, is not a negotiating topic in the Doha Round (nor was addressed by the Uruguay Round, except in an indirect manner through the *Decision*).

¹⁶ World Bank also has several instruments for emergencies, like Import Rehabilitation Loan and Emergency Recovery Credit/Loan, but these are not as closely linked to the issue of excess import bills as the CFF is.

What follows revisits this literature, covering: i) two IMF facilities (the CFF and a new facility established in 2005); and ii) the proposed dedicated Food Import Financing Facility.

IMF's CFF and the new Exogenous Shocks Facility of 2005. The **CFF** was created in 1963 and the cereal import element added to it in 1981, following increased volatility of food prices in the 1970s. It was initially for a fixed term of four years only. The IMF Board had rejected this idea in 1978, out of concern that it was inappropriate for the Fund to single out food imports as a balance-of-payments problem, but reconsidered upon receipt of requests from among others the World Food Council and FAO. The CFF was further streamlined in 2000. Its main features, as of 2001 following the streamlining, were as follows: i) the purpose of the CFF is to help members cope with **temporary** export shortfalls and high cereal import costs that create an overall balance-of-payments need. Commodity price shocks that do not create a temporary balance-of-payments need would not qualify for compensation; ii) it is a non-concessional facility and there are access limits; iii) as most borrowers have usually balance-of-payments problems that extend beyond the temporary shock, other Fund arrangements and conditionalities invariably applied to borrowing from the CFF.

There has been very little use of the cereal element of the CFF. In the period from January 1993 to September 1999, there were six purchases by four countries (Algeria, Bulgaria, Moldova and South Africa). None of these countries however is an LDC or an NFIDC, the potential beneficiaries of the *Decision*. During the 1995-97 period of cereals price spike, only Algeria and Bulgaria made a purchase under the cereal element.

Commentators had all along pointed to the limitations of the CFF in financing excess food import bills, for reasons noted above (balance of payments, need to take into account export earnings, conditionality, non-concessionary nature etc.). IMF's own evaluation of 2004 also made similar arguments (IMF 2004).¹⁷

In November 2005, IMF established a new facility - **Exogenous Shocks Facility** (ESF), within its Poverty Reduction and Growth Facility (PRGF) Trust. One consideration taken was to address the absence of concessional instruments other than the PRGF in the Fund's financial assistance to low-income members facing exogenous shocks (CFF is non-concessional). The ESF is designed to provide concessional financing to low-income countries that are experiencing exogenous shocks but do not have a PRGF arrangement in place (for those with a PRGF arrangement in place, the Fund can enhance its support for dealing with shocks by augmenting the resources available under that arrangement).

To what extent low-income countries suffering from a shock like high food prices will make use of the ESF is yet to be seen, as there was no ESF during the cereal price spike of 1995-96, nor during the food crisis of 2002-03 in Southern Africa. In both these cases, the CFF itself was little used. As of late 2007, no country has requested assistance under the ESF. But for now, ESF remains IMF's main financing facility relevant for most LDCs and NFIDCs in the context of food-related shocks.

A Food Import Financing Facility (FIFF). Concluding, for reasons as noted above, that the CFF was not appropriate for addressing the "short-term difficulties" as foreseen by the *Decision*, a group of 16 LDCs and NFIDCs proposed in 2001 (WTO 2001) creating a new dedicated facility as one pillar of the *Decision* based on the analysis by FAO of a **revolving fund** (FAO 2001).

The proposal was to create a revolving fund from which LDCs and NFIDCs would borrow as loan short-term finance in the event of soaring food import bills. The initial capital requirement for the

¹⁷ See also *Submissions by the International Monetary Fund on CFF to WTO Panel on Marrakesh Decision*, Annex 5 of the Panel Report (WTO 2002).

revolving fund was set at US\$1.2 billion, based on the estimate in the FAO simulation study. The way the fund will operate would not require donors to contribute fully to the fund but will make available extra funds as required up to the limit. Funds will be released to eligible countries based on some trigger mechanism and there will be checks and balances so that the fund is not exhausted.

In November 2001, at the WTO Ministerial Conference at Doha, a decision was taken by the WTO to establish an *Inter-Agency Panel on Short-Term Difficulties in Financing Normal Levels of Commercial Imports of Basic Foodstuffs*. As the name of the Panel suggests, its terms of reference were limited to two things: i) assessing existing facilities like the CFF; and ii) examining the feasibility of the revolving fund. The Members of the Panel were nominated by the respective heads of the FAO, IMF, IGC, World Bank and UNCTAD.

The Panel issued its report in June 2002 (WTO 2002). It did not express its verdict on the revolving fund in a concrete manner, one way or the other. It recommended that the feasibility of an ex-ante financing mechanism aimed at food importers should be explored further. The Panel collected, through a questionnaire, views of several WTO Members (views available in the Panel report). All developed countries that responded – the potential donors to the fund – were not supportive of the idea of the fund. FAO and UNCTAD elaborated further on how the proposed facility could work in practice and developed a complete proposal for the creation of a Food Import Financing Facility (FIFF) (FAO 2003). The FIFF was supposed to be a market-based instrument to provide credit guarantees to importing agents/traders of LDCs and NFIDCs to meet the cost of excess food import bills. Although this was seen favourably by many countries, there was no concrete interest for a practical follow up. Very little has been pursued in the WTO since then on the revolving fund or similar alternatives.

Whether the debates that took place in the WTO during 2000-02 – and in the early years of the implementation of the Uruguay Round - on the *Decision* and the idea of a dedicated FIFF will be revived now in an environment of soaring food prices is yet to be seen. Interestingly, that was also the period when food prices in the world markets were low, and that might also be a reason for the lack of interest on the *Decision*.

A functional instrument along the lines of the FIFF would have provided some relief to the affected countries now, had it been in place. It would also have reassured them about the world market being an affordable source of food supplies. It is time to re-examine the rationale for this proposal and how it could be implemented in practice.

(vi) *Provisions on State Trade Enterprises (STEs)*

Existing multilateral rules applicable to STEs are contained in **Article XVII: State Trading Enterprises** of GATT 1994¹⁸. The Uruguay Round Understanding on the Interpretation of GATT Article XVII defines STEs 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.”

¹⁸ Article XVII requires that STEs act in accordance with the general principles of non-discrimination prescribed in the Agreement. Specifically, paragraph 1(b) requires that purchases or sales involving imports or exports be made “solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of other contracting parties adequate opportunity ... to compete for participation in such purchases or sales”. An exception is provided for STEs with an import monopoly, which is not the subject of a concession under Article II, provided that transparency obligations are met.

About 75% of the STEs notified to WTO under GATT Article XVII are involved in agriculture¹⁹. The prevalence of STEs in agriculture “stems from the belief that state trading is an appropriate means by which governments can meet agriculture-related policy objectives” (WTO 1995). Most of the STEs that play a significant role in global markets and almost all of the export-oriented enterprises are based in developed countries. In spite of the trend toward privatization in recent years, STEs remain important economic agents in developing countries, although few are large enough to influence international markets.

Whether an STE is concerned with imports or exports it influences the degree to which it may distort trade. For exporting STEs the concern revolves around the competitive advantages that they might gain from their special rights and privileges and their official status. They may be able to cross-subsidize export sales from the proceeds of their monopolistic rents and may also use domestic price pooling to facilitate discretionary pricing in world markets. Additionally, they may have: greater certainty regarding sources of supply as a result of their legal mandate, and thus more scope for concluding discriminatory long-term agreements with importing countries; greater scope for predatory pricing on account of their access to short-term government subsidies; and the possibility of benefiting from discriminatory interest rates and other government subsidies.

With respect to importing STEs, concerns focus on the extent to which they distort or restrict market access. The monopoly status of some STEs may make it difficult to ascertain whether imports are determined by market demand or by government policy or constraint. There could thus be discrimination, for example, with respect to the allocation of tariff rate quotas (TRQs) or the control of grades and standards. Where the same enterprise has the capacity to influence prices and quantities traded both domestically and internationally, there is strong potential for concealing the true costs and returns of its activities and hence of disguising the degree of market distortion. Reforms that reduced the monopoly power of importing STEs and increased the transparency of their operations could overcome these concerns.

In the draft Modalities of 10 July 2008, proposed disciplines on STEs are included in Annex K and take as a starting point the definition in the Uruguay Round Understanding on the Interpretation of GATT Article XVII, mentioned above. The main thrust of the proposed disciplines is to limit the risk of STEs undermining the aims of the other components of the export competition pillar (export subsidies, food aid and export credits). Thus the proposed text includes provisions for the elimination, in parallel and in proportion to the other provisions on export competition, of all forms of subsidization of such STEs, including, inter alia, preferential access to capital or other special privileges with respect to government financing or re-financing facilities, borrowing, lending or government guarantees for commercial borrowing or lending, at below market rates, and government underwriting of losses, either directly or indirectly.

¹⁹ In the agricultural sector the most common type of STEs are statutory marketing boards (or authorities) which have any or all of the following objectives: domestic price stabilization, market regulation, and control and promotion of exports. They are usually producer-controlled, state-sanctioned monopolies with exclusive authority for a wide range of market interventions, such as the regulation and purchase of domestic output, setting consumer and producer prices, controlling domestic distribution, and conducting foreign trade. They typically have control over the movement, pricing, quality standards, and marketing of the agricultural products they cover. Other types of STEs generally have a narrower range of objectives and make fewer market interventions. Fiscal monopolies, for example, are largely concerned with the control of the production, marketing and distribution of commodities for which there are tax or public health implications, such as salt, tobacco and alcohol. Canalizing agencies have monopoly rights for the import or export of a specific product with the objective of stabilizing domestic prices or domestic supplies or rationing foreign exchange.

The draft Modalities text also contains **special and differential treatment** provisions under which STEs in developing country Members²⁰ which enjoy special privileges to preserve domestic consumer price stability and to ensure food security (or, irrespective of these conditions, in cases where that STE has less than 5% share in world exports of the product concerned) shall be permitted to maintain or use export monopoly powers to the extent that they would not be otherwise inconsistent with other provisions of this Agreement and other WTO Agreements.

It would appear from these provisions that, in general, developing countries would not be constrained by the envisaged disciplines to the extent that they have social objectives for their state trading activities - such as domestic price stability, food security and rural development, and/or also to the extent that their STEs are small to have an effect on world markets.

Whether state trading is the appropriate mechanism for a developing country to use in pursuit of its objectives in the agricultural sector continues to be an open question. Case studies point to various situations in which state trading has been beneficial, though clearly it has not always been the case. In some countries, reducing state involvement in domestic agricultural marketing has improved the performance of the agricultural sector. In general, STEs in developing countries have become increasingly open with regard to their pricing policies, and many now “share” markets with private traders. However, the market for agricultural commodities is often not perfectly competitive; hence some form of collective trading entity may be desirable to increase local bargaining power and enable developing countries to offset the monopolistic behaviour of private sector agents. Also, the prevalence of market failures in many developing countries, particularly in the provision of agricultural inputs, credit, and marketing services, could justify a continuing role for state involvement in agricultural markets.

Given the open nature of the debate regarding the benefits of state trading, the new rules for STEs envisaged in the draft Modalities text appear to be in the right direction by allowing developing countries the option of using STEs, especially in the absence of significant trade distortions.

(vii) Stockholding and domestic food distribution provisions

Stockholding operations have been a very common response to domestic and international market instability in the past with the objective to both provide a minimum support to farmers and also to help consumers through food distribution schemes. While such schemes often proved to be costly and not always effective, and many countries have moved away from such interventions, their appeal is clear from the point of view of vulnerable countries as they offer some degree of protection against domestic and external shocks.

What do the WTO rules say of such measures? In the AoA, there are two relevant provisions, both placed under Green Box: i) *public stockholding for food security purposes* (para 3); and ii) *domestic food aid* (para 4).

For developing countries, the relevant provision on **public stockholding for food security purposes** is in footnote 5 of para 3. This footnote permits developing countries to implement governmental stockholding programmes for food security purposes, including programmes under which stocks of foodstuffs for food security purposes are acquired and released at administered prices. The condition placed in the AoA is that the difference between the acquisition price and the external reference price is accounted for in the Aggregate Measurement of Support (AMS).

²⁰ As with other parts of the Modalities, LDCs would not be required to undertake any commitments on STEs to the extent that the use of monopoly power of such STEs would not be otherwise inconsistent with other provisions of the AoA and other WTO Agreements.

In the July 2008 draft Modalities, this last condition is further qualified as follows: *“However, 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.”* Currently, not many developing countries have stockholding policies for price stabilization or targeted food distribution (although many have schemes for food security reserves), nor are they known to have been constrained by the current AMS limits. This may, however, change in the future in response to the soaring food prices, with more countries putting in place such schemes, or the AMS limits biting further. In that case, this provision with larger policy space (even if the acquisition of stocks is additionally tied to the objective of supporting low-income or resource-poor producers) could come handy for those developing countries for whom product-specific AMS (e.g. for rice, maize etc.) might come closer to the limit.

The provision on **domestic food aid** is covered in paragraph 4 of the Green Box. A footnote to this para defines domestic food aid as the provision of foodstuffs at subsidised prices with the objective of meeting food requirements of urban and rural poor in developing countries on a regular basis at reasonable prices. The draft Modalities text has qualified further this para by excluding from the AMS disciplines *“the acquisition of foodstuffs at subsidised prices when procured generally from low-income or resource-poor producers in developing countries with the objective of fighting hunger and rural poverty.”* This addition provides more flexibility to the existing provisions of the AoA which stipulated that only the provision of food can be at subsidised prices but not the purchases, which, it had stated, *“shall be made at current market prices”*.

The concern here, as with all Green Box measures in Annex II, is that expenditures (or revenue foregone) in relation to the provision of domestic food aid to sections of the population in need is not trade distorting. This paragraph confirms that a programme of this nature is consistent with the Green Box criteria, subject to the following requirements: *eligibility to receive the food aid shall be subject to clearly-defined criteria related to nutritional objectives; such aid shall be in the form of direct provision of food to those concerned or the provision of means to allow eligible recipients to buy food either at market or at subsidised prices.* For all practical purposes, therefore, domestic food aid programmes are WTO-compatible.

Two other issues that have important implications for the current food crisis, although outside the scope of the AoA, are discussed below. The first concerns the diversion of considerable quantities of food commodities for biofuel production and the second concerns the dead weight in the world market of grains (and other commodities as well) due to considerable and avoidable delays in the handling and transport, especially in the case of landlocked countries.

(viii) Diversion of food commodities for biofuel production

Agricultural prices have always been affected by energy prices, as the cost of energy affects directly the cost of agricultural production through the prices of agricultural inputs, i.e. fertilizer, pesticides, diesel, etc. used in farming. Higher energy prices, translate into higher input prices and thus, other things being equal, reduced use of such inputs resulting in reduced output and hence higher output prices. Konandreas (1976) provides some analytical issues on the determination new equilibrium price of grains following an exogenous change in the price of energy.

The demand for agricultural commodities as feedstocks for biofuel production has added to these “traditional” links between energy and agricultural commodity prices. The mechanism is basically through a direct price transmission effect from energy markets to agricultural markets. Schmidhuber (2006) is a thorough discussion of these points. Thus, as prices for fossil fuels reach or exceed the energy equivalent of agricultural products (i.e. when higher energy prices make an agricultural product competitive for energy production), the energy market creates additional demand for such agricultural products. Given that demand from the energy sector is large, it sucks up the agricultural feedstock that becomes competitive in the energy market and thus raises feedstock prices. Effectively, through this

mechanism, fossil fuel prices represent a floor price for agricultural commodities used as feedstocks into energy production.

This price effect is not unabated, however. The effect weakens as the extra demand for a particular agricultural feedstock drives its price up to a point where it becomes too expensive for biofuel production. If agricultural prices rise faster than energy prices then the agricultural feedstocks concerned price themselves out of the energy market. Thus, effectively, although the prices of the feedstocks used in biofuel would “chase” energy prices, the latter represent a ceiling price for the agricultural commodities in question.

These floor and ceiling prices apply not only to the crops directly used as feedstocks to energy production but also to other crops competing for resources on the supply side. Higher price for a given feedstock (e.g. maize) attracts more resources in its production and, thus, fewer resources are devoted to competing crops. The supply of the latter is reduced driving up their prices. Conversely, lower energy prices would amount to reduced demand for the agricultural commodity used in energy production, thus releasing resources devoted to its production for use by other competing commodities, eventually driving down their prices as well.

Biofuels have a role to play in the global efforts to meet energy needs, mitigate environmental effects and climate change, and in promoting development. Rising prices for fossil energy have made a growing number of agricultural commodities competitive feedstocks for the energy market. The emerging biofuels market is a new and significant source of demand for some agricultural commodities such as sugar, maize, cassava, oilseeds and palm oil²¹. The extra demand has been instrumental in boosting global agricultural commodity prices in general and has been a contributing factor to the recent rise in food prices. The potential demand from the energy market is so large that it could reverse the secular downward trend of real prices of agricultural commodities over the last 40 years as a result of saturated demand and continuous productivity increases in the sector.

However, there is a danger of going overboard. While food commodities (and first generation feedstocks in general) have the potential to contribute to meeting part of growing global energy needs, the extent to which they are used in energy production should be rationalized on the basis of global criteria and not on short-sighted domestic agricultural policy considerations. From this perspective, sugarcane has the highest potential, both in terms of the economics involved as well as in terms of a substantial net energy and environmental balance²². To the extent that the use of food commodities in biofuel production is based on sound economics, the danger of adverse effects on the food sectors are reduced. In fact, in those cases the use of food commodities in biofuel production can have a stabilizing effect on commodity prices.

However, much of the diversion of food commodities to biofuel production in developed countries is currently policy driven²³ and is difficult to justify from an economic perspective. It is also hardly

²¹ Among all major foodstuffs, the additional demand for maize (a feedstock for the production of ethanol) and rapeseed (a feedstock for the production of biodiesel) has had the potential for the strongest impacts on prices. For example, out of the near 40 million tons increase in global maize utilization in 2007, almost 30 million tons were absorbed by ethanol plants alone, mostly in the United States, the world's largest producer and exporter of maize. Over thirty percent of the country's maize harvest in 2008 is forecast to be diverted to ethanol distilleries, which amounts to over 12 percent at the global level. In the EU, the biodiesel sector is estimated to have absorbed about 60% of member states' rapeseed oil output in 2007, which amounts to about 25% of global production and 70% of global trade in the commodity in 2007.

²² A similar case can hardly be made for other food-based feedstocks (maize and wheat in particular).

²³ For example, US processors and growers received support worth about US\$6-7 billion in 2006, and those in the EU about US\$4.7 billion.

justifiable from the additional net energy gained, or even from the alleged contribution to reducing green-house gases²⁴.

The relevant additional question is to what extent such policies are compatible with WTO rules. These issues are addressed in detail in *inter alia* IPC (2006). There are market access issues, issues relating to domestic subsidies to promote the production or consumption of biofuels, as well as issues on the consistency of domestic regulations and standards (e.g. those mandating use of biofuels) with WTO rules on technical barriers to trade.

A main problem as regards **market access** as well as domestic subsidization is the classification of biofuels. Biofuels do not have consistent tariff classification. For example, ethanol is considered an agricultural good under the harmonised system of classification (HS Chapter 22) used by the WTO and thus falls under the disciplines of the AoA, while biodiesel is considered an industrial good (HS Chapter 38) and thus it falls under NAMA. This distinction can have significant implications regarding consistency in negotiations of reduction of tariff rates and also on the treatment of subsidies. The lack of a consistent classification for biofuels and, more precisely, a classification targeted at a substance's use and not its origin, may impede efforts to liberalise tariffs on biofuels. While there may be good reasons (e.g. environmental and energy security considerations) to differentiate tariffs of different substances when used as fuels, but not when they are destined for other uses, the present classification does not facilitate such differentiation.

As already mentioned, **subsidies** have been crucial to the economic viability of biofuels. They take different forms: production subsidies (e.g. \$1/gallon Volumetric Tax Credit for biodiesel produced from virgin oils or fats in the U.S.; or the 36 cents/liter production subsidy for biodiesel in the U.K.); consumption subsidies (e.g. various exemptions from gasoline tax that EU members grant to biofuel purchasers as per the 2003 EU Directive); and subsidies to biofuel feedstock producers (usually as part of general programmes of agricultural support, e.g. agricultural input support).

Certain types of subsidies may be consistent with WTO trade law, as long as such subsidies do not affect the relative competitive position of domestic producers vis a vis foreign producers. This may include, for example, subsidies to consumers to switch from conventional fuels to biofuels for environmental or energy security reasons, or subsidies to research and development for more efficient production technologies²⁵. However, subsidies for the domestic production of biofuels fall under one or another of the WTO agreements.

At the most general level, the Subsidies and Countervailing Measures Agreement of the WTO (SCM) prohibits outright two kinds of subsidies: export subsidies and domestic subsidies contingent upon use of domestic products over imported products. While export subsidies are normally not an issue as biofuel produced is consumed locally, the second category of subsidies, contingent upon the use of domestic products, can be an issue²⁶. A dispute can be raised under the SCM if the following three conditions are met: (i) a subsidy entails a "financial contribution" by a government²⁷ and a "benefit"

²⁴ The potential positive effects emanating from use of agricultural feedstocks for biofuel production, may have been largely overstated. See, for example, Konandreas and Schmidhuber (2007).

²⁵ Government subsidisation has been crucial to the economic viability of the biofuels industry since its inception and will continue to be vital to further establish biofuels, given that they are in competition with an established – and often also subsidised – petrochemical industry. However, greater clarity about the degree to which these subsidies conflict with WTO rules and a closer look at potential cross-subsidisation of byproducts are needed.

²⁶ The need to clarify how biofuels subsidies should be treated by the WTO has been given a new urgency by the WTO dispute filed in January 2007 by Canada against US subsidies for maize (corn). Canada has been joined by several countries, including the key biofuels producers Brazil and the European Union. Brazil explicitly cited the US's subsidies for maize-based ethanol as a reason for joining the dispute.

²⁷ Financial contributions explicitly include situations other than direct cash payments, such as provision of goods and services or tax breaks where the government foregoes revenue "otherwise due". An additional issue is upstream and

which confers a competitive advantage on the recipient, (ii) the subsidy is “specific” to particular industries or firms; and (iii) the subsidy causes “adverse effects” to domestic producers of the importing country of a like product in competition with the imported subsidised product.

In addition to the SCM, if biofuels or the feedstock used in its production fall within the classification of the AoA (products under HS Chapters 1-24 (less fish and fish products)) then its provisions apply. While subsidies under the ‘amber box’ category are subject to limits (total AMS), there are other important exceptions, including under the ‘green box’ (minimally-trade distorting subsidies) for public policy purposes, including R&D or environmental programmes. There is no real clarity as to whether biofuel subsidies could qualify to fall under the ‘green box’ and whether this is done consistently by all WTO members.

Finally, **domestic regulations and standards** further complicate the picture and these have gained importance as border measures and domestic subsidization are increasingly placed under control. Many of these internal regulations and standards concerning biofuels could have an impact on trade, as for example: mandates to use particular percentages or quantities of biofuels either in fuel blends or for specific purposes (such as in bus or taxi fleets), and restrictions or limits on the amount or kinds of biofuels that can be contained in blends with conventional fuels; specifications of the properties or performance characteristics of particular biofuels or the materials they must be derived from.

Most domestic regulation and standards are meant to serve legitimate public objectives, but they can be more trade-restrictive than needed to achieve the stated policy objectives and in some cases they are intentionally designed to benefit domestic interests. In addition, the increasing recognition that biofuels’ environmental benefits vary greatly, depending on the feedstocks and their production methods, the conversion processes and the transportation used, has raised additional questions about the intentions of such internal regulations and standards and about efforts to unconditionally define biofuels as environmental goods.

In a nutshell, existing WTO rules governing biofuel trade, domestic subsidization and related regulation and domestic standards are not transparent and leave considerable room for ambiguity and incoherence in policy responses by WTO Members. The extra demand for food commodities generated by the biofuel sector could be either a blessing or a threat to the food system. It presents an opportunity if it is rationalised on the basis of global objective criteria and not on short-sighted domestic agricultural policy considerations. To the extent that economic considerations underpin the use of food commodities as feedstocks in biofuel production, this development could have a stabilizing effect on food markets through the market mechanism discussed above whereby energy prices act as a ceiling as well as a floor price for food commodities. The direct link to the energy sector could also stem the long-term downward trend in agricultural prices and provide the incentive for investment in agriculture, especially in the food insecure countries.

On the other hand, if rich countries intervene indiscriminately in the market through subsidies and border protection and/or impose certain regulations on how biofuels are to be produced and used (e.g. mandatory blending requirements) such that production/use of biofuels goes beyond economic considerations, the potentially stabilizing effect of the biofuel sector on food prices (the ceiling and floor prices mentioned above) would not only be absent but there would be more volatility in the food market. Clearly, this would not only amount to an adverse effect on food security but also be akin to a new agricultural support system to the detriment of developing countries, as their producers may fail to benefit (they are excluded from developed countries’ biofuel markets) and as their consumers still face higher food prices.

downstream subsidies. One firm or industry may receive the financial contribution but the benefit that flows to an upstream or downstream industry is the concern. For example, a subsidy paid to domestic feedstock producers might be challenged by foreign biofuels producers on the grounds that it results in a lower price of feedstock to domestic producers.

These are important considerations not only from a food security perspective but also from the point of view of supporting the multilateral trade reform process at the WTO. Besides the ethical issues involved, as some have correctly stressed, there are also questions about the coherence of the multilateral trading system as a whole and whether what is done in one agreement (i.e. domestic subsidization disciplines under the AoA) may not be as effective if there are loopholes elsewhere in the WTO agreements. This apparent incoherence of the trade rules would need to be corrected.

(ix) *Trade facilitation to expedite the delivery of food imports*

Finally, one other issue aggravating the current food crisis is constraints in the movement of food supplies from ports and across borders. The speed with which food supplies move in ports and across borders to reach the markets of importing countries is of great concern, especially for vulnerable landlocked countries. The longer it takes to move supplies, the greater the inventories have to be in the destination, the higher the storage and transaction costs for traders, and the higher the price paid by the final consumer.

Border-related costs are both direct, such as expenses related to supplying information and documents to the relevant authority, and indirect, such as those arising from procedural delays, lost business opportunities and lack of predictability in the regulations. Such “hidden” costs of trade are high – as much as 15% of the value of the goods traded in some cases (OECD 1995a; OECD 1995b). It has been argued that the welfare benefits from more efficient customs procedures could be as high as those from reducing tariffs.

Beyond the tangible benefit from facilitating trade, lower transport costs can have important micro-economic multiplier effects leading to higher wages, thereby having a direct impact on poverty reduction. Facilitating and broadening the range of exports and imports of a country can reduce the vulnerability of its economy to exogenous shocks, and also contribute to a positive impact on Foreign Direct Investment (FDI) brought about by the greater predictability of the country’s trading practices.

Essentially, everyone stands to gain from making the process of trade easier. Governments gain because efficient border procedures make them able to process more goods and improve control of fraud, thus increasing government revenue. Businesses gain because if they can deliver goods more quickly to their customers they are more competitive. And consumers gain because they are not paying the costs of lengthy border delays.

If a truck full of grain waits at the border for a week, ultimately the customer is paying: first because the grain is not in the local market and prices are pushed up by the short-term imbalance created between local supply and demand. The consumer also bears the cost of the truck being idle and off the road and unproductive during that time. Studies indicate that even modest reductions in trade transaction costs, such as lengthy border procedures, translate into significantly increased trade. This is true for both rich and poor countries, but developing countries would show higher relative trade gains because of the relative inefficiency of their current systems and because agrofood and small and medium enterprise (SME) trade, which are most severely affected by inefficient procedures are central for the economy of these countries²⁸.

However, this is a problem for all trading nations, and finding ways to make the whole process of

²⁸ OECD research shows that developing countries stand to gain two thirds of total world welfare benefits from trade facilitation. But if trade facilitation were to be undertaken by OECD countries alone, developing countries would stand to lose.

trading simpler and smoother – trade facilitation – is a key element of the Doha Round²⁹. In the WTO context, the Trade Facilitation agenda of the negotiations concerns are limited to a wide range of activities at the border such as import and export procedures (e.g. procedures relating to customs, licensing and quarantine); transport formalities; payments, insurance and other financial requirements.

Improved trade facilitation is crucial for food security and could alleviate considerably the adverse effects of global food crisis such as the one currently experienced. Trade facilitation could shorten the transit time significantly and therefore there is urgency in making quick progress in the WTO negotiations in this area. “If any group of countries has a profound and unarguable interest in a solid WTO Trade Facilitation (TF) agreement and the technical assistance/capacity building support that would go with it, then it must be the landlocked countries, especially the 30 or so developing nations among them” (AITIC 2008a). While the difficulties faced by these countries have long been recognized (e.g., Article V of the GATT), this recognition has not always led to any practical easing of conditions for goods passing through neighbouring territories and frontiers.

No comprehensive draft legal text of the negotiations on trade facilitation exists formally (AITIC 2008b), but the elements for such a document can be reasonably inferred from the WTO secretariat documentation on a compilation of elements for an agreement (WTO 2008a). The measures proposed relate to the three GATT articles underlying the negotiations on trade facilitation, namely: Article X (publication and administration of trade regulations), Article VIII (fees and formalities) and Article V (freedom of transit). Other important elements include extensive new provisions on the clearance and release of shipments and the use of risk management techniques in shipment inspections. There also envisaged provisions on special and differential treatment, technical assistance and capacity building.

While the scope of the negotiations on trade facilitation is likely to be wide and comprehensive, an eventual agreement on this issue would only address part of the problem. In parallel with the negotiations, much has to be done on the ground to build and improve physical and institutional infrastructure necessary to expedite the delivery of food and other essential imports. These are essential, in addition to improved policies, regulations and customs practices that help speed the passage of goods to and from ports and inland frontiers. Prioritising Aid for Trade resources to support such infrastructure could have a very high pay-off in alleviating the adverse effects of possible future food crisis.

III. SUMMARY

This paper discussed certain WTO rules and provisions that have a bearing on response measures to the soaring food prices. In doing so, it also reflected upon new rules that are being negotiated under the Doha Round, i.e. those that are now in the draft Modalities on agriculture and in other agreements. It is an opportune moment to discuss whether some changes in these rules might be desirable to facilitate a more effective response to possible future food crisis.

The main instruments and related WTO provisions identified in the paper fall under three general categories as regards their effect on the countries undertaking such measures themselves or by the international community on their behalf, their possible impact on the world market of food commodities and their possible unintentional effects on third countries. In the first category are defensive measures that are, however, trade enhancing and have no adverse effects on the functioning of the world market or the ability of other countries to participate on equal terms in that market. An example of such measures is reduction of import tariffs. Second, defensive measures that are trade restrictive and have as an immediate effect the aggravation of the situation in the world market, thus, worsening the ability of other countries to meet their food import needs. Export prohibitions and

²⁹ Trade facilitation in its broadest sense, can be defined as any measure, or set of measures, that aims to increase the cost-effectiveness of international trade transactions.

restrictions is an example of measures under this category. Finally, the third category comprises measures which are relatively neutral and on the whole have a positive effect on the country pursuing such a measure (or on behalf of which it is pursued), lessen the short-term pressure on the world market and thus indirectly are beneficial to third food importing countries. An example here is domestic stockholding operations. These and other measures that have been identified were discussed in turn in the previous section.

In principle, **import tariffs** have a role to play in reducing the domestic price of imported foodstuffs during years of high world market prices. However, it was noted that applied import duties on basic foodstuffs are generally low. They were already low in 2006, in the 5-10% range, in a majority of low-income food-deficit countries, and so could counterbalance only a small part of the large increases in food prices in the world markets experienced in 2007 and much less in early 2008 when prices soared further. In view of the small margin in reducing import tariffs, the effect of this measure on the world market and on third countries is small.

Export prohibitions, restrictions and export taxation are technically legal under the WTO rules. The current rules in the Agreement on Agriculture (AoA) do not prevent countries from imposing export restrictions; and export taxation is not even disciplined at all. Such measures were taken by many countries during recent months, in general without much regard to the rather weak restraining provisions of the related WTO rules. The effects on the world market were direct and immediate, i.e. an already tight market situation got worse to the detriment of net food importing countries. Although several countries proposed for the Doha Round stronger rules in this area, the chance that this will happen is slim. The danger of weak rules in this area is real, however, namely to raise doubts about the world market being a reliable source of food supplies. The present environment of soaring food prices might induce a revisit to the proposals for strengthening the current weak provisions in this area beyond what is envisaged in the draft Modalities text of 10 July 2008. In addition to this being desirable for world food security, there are important positive implications for the multilateral system itself.

On **food aid**, current provisions of the AoA are essentially more of guidelines than rules that bind the provision of food aid. They have not constrained in any way the provision of food aid. As for the future, based on the draft Modalities of the Doha Round, the provision of food aid other than for emergencies is likely to be effectively disciplined. This is generally a desirable outcome, as there were many instances of food aid circumventing export competition provisions in the past to the detriment of other exporters and farmers in the recipient country itself. But there are some areas where the rules and languages in the draft Modalities need to be improved. One is the characterization of the emergency situation (e.g. whether that could include cases of soaring food prices in the world market), which could be a contentious issue in future food crises. The provision that makes in-kind food aid in non-emergency situations legal only when food is targeted to clearly identified food insecure population groups is similarly a marked improvement over the current practice. Many countries do not currently have targeted food distribution schemes – this provision will require that such schemes are put in place if in-kind food aid is to be used. Lastly, there is a problem with the 3-4 exceptions made in the Modalities to monetization of in-kind food aid. These exceptions are not precise enough and could lead to large-scale monetization, essentially thwarting the overall goal of preventing commercial displacement and negative effects on local production. Therefore, this section needs to be improved markedly.

On **export credits, export credit guarantees or insurance programmes**, there were no specific rules prescribed in the AoA, but development of such rules was part of its built-in agenda. The envisaged disciplines for the future under the draft Modalities text would constitute a tighter set of rules than what presently practiced. As in the case of food aid, such tighter disciplines are generally a good thing as they would ensure that more assistance in the form of export credits, export guarantees or insurance programmes would be channeled to countries more in need. Nonetheless, certain improvements could be made in the draft Modalities text, notably defining clearly what are “exceptional circumstances” when the special treatment for the LDCs and NFIDCs is triggered, and in considering concessional

payment terms (interest rate) also under exceptional circumstances, rather than simply the repayment period.

On the provisions in the **Marrakesh Decision** for the international community to respond to short-term difficulties faced by LDCs and NFIDCs in financing normal levels of commercial imports of basic foodstuffs “*during the reform programme leading to greater liberalization of trade in agriculture*”, not much has been achieved in implementing such provisions. Existing financing facilities referred to in the *Decision* – of which IMF’s Compensatory Financing Facility (CFF) is perhaps the most pertinent one - have been of little use due to major difficulties in accessing them, and efforts by the countries concerned to see established a dedicated food financing facility have not been successful. The *Decision* being outside the three-pillar architecture of the AoA is not being directly negotiated under the Doha Round, although the difficulties faced by the LDCs and NFIDCs are recognized. A functional instrument along the lines of the Food Import Financing Facility (FIFF), elaborated by UNCTAD and FAO, would have provided some relief to the affected countries under the present food crisis, had it been in place. It would also have reassured these countries that they could have the means to access the world market when they face difficulties, and the latter continues to be an affordable source of food supplies. The rationale of this proposal, its market-based modalities of operation and what safeguards may be needed for its practical implementation need to be re-examined.

On **State Trading Enterprises (STEs)** the main concern all along has been the risk of their operations undermining the other disciplines on the export competition pillar (export subsidies, food aid and export credits). Thus the proposed Modalities text includes provisions for the elimination, in parallel and in proportion to the other provisions on export competition, of all forms of subsidization of such STEs. In general, these concerns apply more to exporting STEs and not to importing STEs for basic foodstuffs, mostly the case of developing countries. The draft text also contains **S&D** provisions under which STEs in developing country Members would not be constrained by the envisaged disciplines, to the extent that they have social objectives for their state trading activities - such as domestic price stability, food security and rural development, and/or also to the extent that their STEs are small to have an effect on world markets and are not otherwise inconsistent with other WTO rules. These S&D provisions would in principle allow developing countries to maintain their STEs, although their contribution to alleviating the adverse effects of food crisis would depend on how effectively they pursue their stated social objectives.

Stockholding and domestic food distribution programmes have often been policies of choice for many developing countries in the past, and a common response to domestic and international market instability, with the objective to both provide a minimum support to farmers and also to help consumers through food distribution schemes. The existing AoA rules allow these instruments although there could be limitations in their application depending on bound levels of the disciplined part of domestic support (AMS). Under the draft Modalities text, these restrictions are relaxed considerably, making the conditions for stockholding and related public food distribution programmes less stringent than before. This may be of value in the future if, in response to uncertainties about soaring food prices, more countries opt for putting in place such schemes. It may be noted that the short-term effect of these programmes to the world market is generally positive, as it allows countries to depend less on the world market when prices are high, thus limiting further price increases in the world market. By the same token, third food importing countries benefit from such operations as well and, in fact, they are free riders as they do not share any of the costs involved.

Existing WTO rules governing **biofuel production and trade** are not transparent and leave considerable room for ambiguity and incoherence in policy responses by WTO Members. The extra demand for food commodities generated by the biofuel sector could be either a blessing or a threat to the food system. It presents an opportunity if it is rationalised on the basis of global objective criteria and not on short-sighted domestic agricultural policy considerations. To the extent that economic considerations underpin the use of food commodities as feedstocks in biofuel production, that development could have a stabilizing effect on food markets, whereby energy prices act as a ceiling as

well as a floor price for food commodities. The direct link to the energy sector could also stem the long-term downward trend in agricultural prices and provide the incentive for investment in agriculture, especially in the food insecure countries.

On the other hand, if rich countries intervene indiscriminately in the market through border protection, domestic subsidies and the imposition of certain regulations on how biofuels are to be produced and used – measures not based on sound economic considerations - the potentially stabilizing effect of the biofuel sector on food prices would not only be absent but there would be more volatility in the food market. These are important considerations not only from a food security perspective but also from the point of view of supporting the multilateral trade reform process at the WTO. In particular, it raises questions about the coherence of the multilateral trading system as a whole and whether what is done in one agreement (i.e. domestic subsidization disciplines under the AoA) may not be as effective if there are loopholes elsewhere in the WTO agreements. This apparent incoherence of the trade rules would need to be corrected.

Finally, **trade facilitation** is yet another issue with important implications for mitigating the adverse effects of food crisis. The speed with which food supplies move in ports and across borders to reach the markets of importing countries is of great concern, especially for vulnerable landlocked countries. The longer it takes to move supplies, the greater the inventories have to be in the destination, the higher the storage and transaction costs for traders, and the higher the price paid by the final consumer. Current indications suggest that the scope of the negotiations on trade facilitation is likely to be wide and comprehensive and is likely to go a long way in the harmonization of policies, regulations and improved customs practices that help speed the passage of goods to and from ports and inland frontiers. In parallel with the negotiations, much has to be done on the ground to build and improve physical and institutional infrastructure necessary to expedite the delivery of food and other essential imports. Prioritising Aid for Trade resources to support such infrastructure could have a very high pay-off in alleviating the adverse effects of possible future food crisis.

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Annex 1: Applied import duty (%) on basic foodstuffs in 2006^{1/}

	Country	Wheat	Rice	Maize	Soy oil	Palm oil
1	Afghanistan	3	3	3	4	4
2	Albania	2	2	2	0	0
3	Angola	2	7	2	10	10
4	Armenia	0	0	0	10	10
5	Azerbaijan	0	15	5	1	2
6	Bangladesh	6	6	0	6	6
7	Benin	5	10	5	20	17
8	Bosnia and Herzegovina	3	0	8	5	0
9	Botswana	2	0	-	10	-
10	Burundi	-	5	5	5	5
11	Cambodia	7	7	0	7	7
12	Cameroon	10	20	29	30	30
13	Cape Verde	5	5	10	5	3
14	Chad	10	20	-	30	-
15	China	65	65	60	9	9
16	Congo, Dem. Rep.	5	10	9	20	16
17	Congo, Rep.	10	20	29	30	30
18	Cote d'Ivoire	5	10	5	20	10
19	Egypt, Arab Rep.	2	2	2	2	6
20	Equatorial Guinea	-	20	30	30	30
21	Eritrea	2	2	2	10	10
22	Ethiopia	5	5	5	25	25
23	Georgia	12	11	12	0	0
24	Ghana	10	10	20	20	20
25	Guinea	5	12	5	20	20
26	Guinea-Bissau	-	10	5	20	17
27	Honduras	0	2	15	15	5
28	India	100	-	60	45	100
29	Indonesia	2	-	0	0	0
30	Kenya	0	-	49	0	1
31	Kyrgyz Republic	0	10	5	10	5
32	Lao PDR	5	5	5	5	10
33	Lesotho	-	0	-	10	-
34	Madagascar	5	0	10	7	5
35	Malawi	0	10	0	12	11
36	Mali	5	10	5	20	15
37	Mauritania	0	20	6	5	1
38	Moldova	10	0	5	0	0
39	Mongolia	5	5	5	5	5
40	Morocco	65	118	18	3	4
41	Mozambique	3	7	3	4	11
42	Nepal	10	10	10	10	10
43	Nicaragua	0	61	12	6	9
44	Niger	5	10	5	20	15
45	Nigeria	5	50	5	20	50
46	Pakistan	5	10	5	-	-
47	Papua New Guinea	0	0	0	8	8
48	Philippines	4	50	21	7	15
49	Rwanda	5	8	5	30	30
50	Senegal	5	10	5	10	16
51	Sri Lanka	3	-	3	28	28
52	Sudan	25	0	10	40	40
53	Swaziland	1	0	0	10	10
54	Tajikistan	5	5	5	7	5
55	Tanzania	0	25	47	7	11
56	Togo	5	10	5	20	14
57	Uganda	0	-	49	2	11
58	Uzbekistan	5	5	5	5	5
59	Yemen	0	0	5	7	6
60	Zambia	10	15	14	15	15
61	Zimbabwe	5	15	25	7	27
	Simple average	8	13	12	12	14

^{1/} For 14 countries, tariffs are for 2005.

Source: TRAINS/WITS.

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