

Chapter 1 – Status of the Debate and Background Issues

While the issue of market regulation is not new—one can recall the common agricultural policy during the heyday of the levy/refund mechanism or during that of supply control through the setting of dairy quotas for each farm; one can also recall the establishment of international product agreements and the Common Fund—the debate around the notion of regulation is now situated in a new context that can be described rapidly as follows:

- No one—or almost no one—now denies that the market has a central role in organizing trade on all geographic scales, trade in which billions of farmers and consumers as well as millions of micro- or macro-businesses participate. It is no longer a matter of planning flows or setting prices. For everyone, markets must be able to “live their lives” and continue to be the breath of the economy. This does not prevent one from noting that market deficiencies and failures do exist, that markets can be manipulated, and that the most powerful and best organized actors can subjugate markets. Furthermore, everyone is aware that the economic field in which markets operate and “merchandise” is sold covers only some of humanity’s concerns and cannot be assimilated with the general interest. It is not the market’s job to be concerned with enforcing universal rights, the sovereignty of peoples and nations, the preservation of nature and the common heritage, etc. The expansionism of the market, which operates by turning “things” into “goods” and public goods into private goods, must be contained within the bounds that it is up to lawmakers to define and the public authorities to enforce. There can be, and often is, a contradiction between the dynamic of market expansion and respect for the general interest. There are limits to what is acceptable and what is not that must not be crossed and, in the field of agriculture and food, what is unacceptable is mass hunger, the degradation of the common heritage, and the massive exclusion of hundreds of millions of farmers towards economic and social nothingness. When things get out of hand on the small scale, they can be overcome with aid or social policy, but when there are massive, lasting and cumulative upsets and imbalances, one must envisage tackling the analysis and treatment of the causes of these unwanted changes.

- The globalization of agricultural markets and their financialization have increased in recent years. The integration of markets into a large global market has developed in line with natural market dynamics but also thanks to proactive policies to open geographic borders as well as the struggle against all obstacles likely to hinder trade. This integration was supposed to lessen the volatility of agricultural markets through offset mechanisms between deficit and excedent zones or periods. This assumption has not been confirmed in recent years. This market integration bluntly raises the question of the contagion of market ills, and the measures to take to protect

against them between two or more national markets and between one or more national markets and the global market. In recent years, market integration has been accompanied by strong financialization of agricultural trade. This trade was not of particular interest for international finance, which found more profitable and less risky prospects elsewhere. The crisis in financial markets, agricultural price volatility and the prospects of raising price levels generated strong speculation movements that themselves increase volatility. The instability of financial markets and the strong variations in exchange rates have become major elements in the instability of agricultural markets, and this does not simplify ways to address this instability. P. Chalmin has compared the attempts to stabilize agricultural markets to trying to stabilize the surface of water in a sink in a sailboat navigating a stormy sea! Agricultural markets are increasingly correlated to other markets, for example the energy market. Unable to hope for general stabilization, one must therefore evaluate to what extent it is possible to protect oneself from the instabilities of neighboring markets.

- Everyone, or nearly everyone, believes that the exaggerated volatility of prices and their excessive unpredictability have harmful, even dramatic, consequences for farmers and consumers. For farmers and producers near the poverty line, sudden price hikes or drops can have catastrophic consequences, as we indicated above. But for all farmers, this unpredictability greatly hinders farm innovation and investment, that is to say farm modernization, particularly when these investments require one to commit most of the household's assets or borrow heavily. When a farmer is at the edge of poverty, taking risks is neither responsible nor even possible. It is difficult to correctly measure the scope of the silent dramas occurring in the countryside when poor farmers are faced with the necessity of overcoming this rule of prudence. Because, in most countries around the world, countless peasants are in crisis. For instance, think of the "suicide belt," the districts around Andhra Pradesh and Karnataka in India. There, over the last ten years, several thousand peasants committed suicide, victims of the fall in cotton and groundnut prices and prisoners of the "debt trap" because they had to mortgage their last plots of land. The "center for social development" in Hyderabad mentions seventy suicides every week, 55% of which involving men between the ages of 31 and 45! The dramatic consequences of price volatility are now universally known. More and more experts admit that curing only its consequences without addressing its causes is insufficient. Of course, social and economic urgency – for instance, when many farms are all on the edge of bankruptcy – may call for social policies and safety networks. But beyond such situations, these policies that only mask problems are questionable. On the one hand, they alter market signals, sending producers erroneous information regarding scarcities. On the other, they are costly, with enormous budgetary outlays for the countries that can afford them, but out of reach for the less affluent countries that, indeed, would need them the most.

As a consequence, more and more experts believe that the very causes of the price volatility must be tackled, and, to this end, one must first determine what they are. In chapter 2, the corresponding theory has been revisited. A distinction has been made between two sorts of causes: exogenous and endogenous. Then, in chapter 3, actual policies put in operation in fourteen countries have been evaluated in the light of the

above analysis in order to see to what extent the latter correspond to reality. Finally, chapter 4 describes the actions that have (or could have) been envisaged at the international level. The conclusion is that to improve consumer safety and enable the modernization of agriculture, it is therefore appropriate to envisage placing limits on price volatility—that is to say, negotiate the price ceilings and floors that will determine the bands or ranges that are acceptable for both producers and consumers and sufficiently wide to allow markets to live their lives as markets. To be accepted by all the parties present, these bands/ranges must be negotiated with all the actors concerned. These are sensitive negotiations because these actors usually have conflicting interests, all the more as wisdom would dictate that the bands not be too different from the price levels practiced in international markets if one wants to avoid excessive external pressure and the emergence of a black market economy. Once the ceilings and floors have been set, an authority will still need to have the power and resources to keep prices within acceptable ranges. And, to do so, this authority must have a range of tools that allow it to intervene on both the supply of products—that is to say primarily on national production, imports and de-stocking—and on demand, that is to say first on national consumption, export, stocks and the diversification of agricultural products toward non-food uses. A panoply of measures must, in this way, make it possible to improve the predictability of price changes so as to limit disruptive and self-fulfilling anticipations, a major source of volatility. We shall analyze this panoply of instruments, regulations and measures throughout this study, keeping in mind the fact that cures for the causes of price volatility will not cure other ills. For example they will be inactive in fighting inequalities. The reduction of inequalities requires other cures, for example agrarian reform if the crucial question is land access, or policies supporting poor producers incomes or the most deprived consumers, or fiscal policy allowing wealth redistribution.

- After the food crisis in 2008, the need for market regulation and the necessity of fighting price instability have been accepted by a growing percentage of experts and decision-makers, but doubts remain as to the public authorities' real power to intervene on the factors of market instability, as do fears about government leaders' ability to resist—in certain socio-political situations—the temptation to use this power and these regulatory instruments to serve private, even personal, interests rather than use them to defend the general interest. We shall see that the rigor with which regulatory actions are implemented, the objective and predictable conditions that trigger these actions, and the democratic control of leaders and their actions are decisive, and that for each of these questions, measures must be taken to ensure the credibility of market regulation policies. Nevertheless, these doubts and fears, while they inspire caution, must not cancel the need to fight market instability. Let us say, first, that all the actors concerned by agricultural markets—and even other actors that provide no value added and therefore in theory have no place in these markets—intervene in these markets and do so according to their own interests. This being the case, one can wonder why a public authority mandated to defend the general interest could not intervene to avoid the serious consequences for consumers when prices rise above the ceiling, or the serious consequences for producers when prices fall below the floor price. While we acknowledge this mandate for the political authorities, two questions that we have not

asked remain: that of the authorities' real power to intervene, and that of corruption in the use of regulatory instruments.

Taking into account regulatory bodies' real power and the existence of safeguards to avoid abuses of power is decisive for the design and choice of regulatory instruments. Indeed, at present, there are numerous limits to the affirmation of national sovereignty and, even more, to the emergence of a real international authority; and the safeguards that could emerge as opposition forces are deficient. This is the "policy space" issue being weakly debated in international negotiations.

- Limits to the affirmation of national sovereignty and the emergence of an international authority exist. First, there are the WTO agricultural trade agreements, which serve as the keystone of and baseline for all trade agreements, and which determine what is forbidden and permitted when it comes to trade and public agricultural policy. Then, there are the conditions, notably those that address market openness, imposed by international financial institutions during the negotiation of loans and the repayment of public debt, and during the distribution of international aid. Next, there are the quality of statistics and the ability to analyze very imperfect data and predict changes in the markets. Finally, there is the poverty of public instruments able to allow regulatory action: customs administrations and border control agencies, agencies in charge of verifying compliance with the rules by the various market actors, law enforcement, storage infrastructures, etc.

- The corruption of regulatory instruments exist as well. Market interventions to avoid market instability and keep prices within acceptable bounds create opportunities for corruption or insider trading, especially when intervention decisions—public purchase or sale decisions, allocation of import or export permits, cession of production quotas, etc.—are unpredictable.

Issues Addressed by the Study and Organization of the Study

Should state intervention be limited to creating a conducive environment for private activities through the provision of public goods such as infrastructures and political and economic stability, or are direct interventions of the state on markets sometimes desirable? In particular, is it necessary to allow a real improvement of food security in the world's poorest countries? Or are more market-friendly interventions, such as warrantage or insurance subsidies, possibly combined with ex-post compensation for poor consumers, better suited to the situation.

Is the direct intervention of the state on markets feasible? Or are the difficulties, costs and inefficiencies associated with public interventions combined with the positive impacts on stability expected from trade liberalization in a favorable market environment sufficient to give up direct public intervention? How can the adverse effects of direct interventions on markets be minimized? What conditions need to be met? What modalities will be most appropriate for specific contexts? What kind of institution building should be envisaged?

Several instruments exist. They were extensively analyzed in a study undertaken last year (Galtier *et al.*, 2009) which proposed a typology (Box 1). It is possible to distinguish between public and private instruments and between instruments aiming at minimizing price variability or its consequences. Theoretically, each source of price instability should be treated by a specific instrument. Most of the time, however, it is impossible to apply this recommendation because of the complexity of price formation and the relationships between markets. In reality, various sources of instability generated in several markets are inextricably combined, one reinforcing the other and generating cumulative disequilibriums that spread from one market to another.

In the current study, we will discuss the main controversies related to direct public intervention in markets, first concentrating on theoretical arguments (Section 2) and then comparing theory with reality by analyzing several national experiments used to try to determine the main factors of success and causes of failure (section 3). Finally, the question of what could be done at the international level will be addressed in Section 4.

Box 1 : Instruments for Handling Food Price Instability: A Typology

Galtier *et al.* (2009) proposed a framework to describe the different instruments available to handle food price instability. Based on followed objectives and forms of governance, four categories were identified. The objectives sought can be to stabilize prices or manage price risk; forms of governance can be market-based or public.

	Stabilize Prices	Manage Price Risks
Market-based	A-instruments	B-instruments
Public	C-instruments	D-instruments

The central tenet of A-instruments is that the arbitration of market actors causes prices to be homogenized over time, space and between products, which will lower their instability. They include the construction of storage infrastructures, the development of quality standards, and the creation of warehouse receipt systems or exchanges.

Also based on the market, B-instruments are intended to limit the effects of price instability on incomes by enabling economic actors to cover themselves against the risks linked to price variability (futures contracts) and harvests (insurance).

C-instruments aim to stabilize prices by controlling production (input subsidies), regulating imports and exports (variable taxes and subsidies, quotas, bans), and using public stocks.

D-instruments enable household incomes to be supported during periods of high prices (targeted social transfers).

The conclusion of the study is that the strategy based on a combination of A, B and D instruments has not stood the test of time. A-instruments are not enough to solve the chronic price instability problem, which remain unchanged. Private risk management instruments are used very rarely, and safety nets do not successfully prevent the deterioration of vulnerable households' nutritional status. The authors argue for the use of a combination of instruments to fight against agricultural price instability according to its sources.