Some Policy Options for Global Commodity Markets

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Commodity markets are subject to considerable price volatility because the supply of and demand for these products have low price responsiveness and are subject to substantial shocks, particularly from yield variability. Infrequent but relatively intense price spikes associated with low levels of stocks create acute problems for the poorest people, who frequently spend up to 75 percent of their incomes on staple foods. In this situation, a case can be made for individual countries to insulate their domestic prices from world price volatility by imposing export restrictions or lowering import tariffs. The available evidence on price movements suggests that many countries actively do this. If all countries do it to the same extent, the result is merely to increase the volatility of world prices enough to completely offset the attempted stabilization of domestic prices—rendering the policy completely ineffective. The fundamental problem is that price insulation—unlike policies such as using trade to diversify sources of supply and demand, or incentives to increase storage—cannot reduce overall volatility, but merely redistribute it between countries. The result is a collective action problem: from a national perspective refraining from taking action to insulate markets means experiencing the greater volatility of world prices. The solution is some form of cooperative policy under which countries agree to limit the use of policies that generate negative spillovers. As theory suggests that quantitative export restrictions are among the worst type of insulating policies, this paper will discuss alternative policy options towards disciplining the use of such policies. The paper will discuss policies that affect global food markets as well as national policies affecting global prices of – and access to – other commodities, and, more generally, linkages between possible cooperative solutions (international disciplines) on the use of national policies that affect commodity markets and related policies such as export taxation, the treatment of export cartels, and state-trading.