

# FOOD PRICES

## FROM CRISIS TO STABILITY

ON WORLD FOOD DAY 2011,  
let us look seriously at what causes  
swings in food prices, and do what  
needs to be done to reduce their  
impact on the weakest members of  
global society.

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## FOOD PRICES

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**BETWEEN 2005 AND 2008**, the world's staple food prices soared to their highest levels in 30 years. During the last 18 months of that period, maize price increased by 74 percent while that of rice almost tripled, climbing a whole 166 percent.

Food riots broke out in more than 20 countries. Editorialists decreed the end of cheap food. But then, after peaking in June 2008, prices slumped again - falling 33 percent in six months - largely as a vast financial and banking crisis threw the global economy into recession.

The downturn was short-lived, however. In 2010 grain prices shot up 50 percent and continued to soar into 2011 before starting to dip somewhat in the second quarter of 2011. And at that point what would happen next was very much an open question.

Economists believed, however, that the kind of price roller-coasters experienced since 2006 are likely to recur in the coming years. In other words food price volatility - the technical term for the phenomenon - has probably come to stay.

That is not good news. Price swings, upswings in particular, represent a major threat to food security in developing countries. Hardest-hit are the poor. According to the World Bank, in 2010-2011 rising food costs pushed nearly 70 million people into extreme poverty.

**"FOOD PRICES - FROM CRISIS TO STABILITY"** has been chosen as this year's World Food Day theme to shed some light on this trend and what can be done to mitigate its impact on the most vulnerable.

At the level of net food importing countries, price spikes can hurt poor countries by making it much more expensive for them to import food for their people. In 2010 the world's Low Income Food Deficit Countries (LIFDCs) spent a record US\$164 billion on food imports, representing a rise of 20 percent on the year before.

At the level of individuals, people living on less than US\$1.25 a day may need to skip a meal when food prices rise. Farmers are hurt too because they badly need to know the price their crops are going to fetch at harvest time, months away. If high prices are likely they plant more. If low prices are forecast they plant less and cut costs.



## > FOOD PRICES

**RAPID PRICE SWINGS** make that calculation much more difficult.

Farmers can easily end up producing too much or too little. In stable markets they can make a living. Volatile ones can ruin them while also generally discouraging much-needed investment in agriculture.

Recognizing the major threat that food price swings pose to the world's poorest countries and people, the international community, led by the G20, moved in 2011 to find ways of managing volatility on international food commodity markets. Under the presidency of France's Nicolas Sarkozy, the world's 20 largest economies agreed that any strategy directed to that purpose should have the protection of vulnerable countries and groups as its main priority.

Today's turbulent commodities markets contrast sharply with the situation that characterized the last 25 years of the twentieth century. Between 1975 and 2000 cereal prices remained substantially stable on a month-to-month basis, although trending downwards over the longer term. For despite rapid population growth - world population doubled between 1960 and 2000 - the Green Revolution launched by Dr Norman Borlaug in the 1960s helped food supply to meet and even exceed demand in many countries, including India, thanks to the work of M. S. Swaminathan, then Director of the Indian Agricultural Research Institute.

In fact there was, in the Western Hemisphere at least, an over-abundance of food, caused in no small part by the generous subsidies which OECD countries paid to their farmers. But the picture today is a very different one. The global market is tight, with supply struggling to keep pace with demand and stocks are at or near historical lows. It is a delicate balance that can easily be upset by shocks such as droughts or floods in key producing regions.

In order to decide how, and how far, we can manage volatile food prices we need to be clear about why, in the space of a few years, a world food market offering stability and low prices became a turbulent marketplace battered by sudden price spikes and troughs.

# FROM CRISIS TO STABILITY

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**THE SEEDS OF TODAY'S VOLATILITY** were sown last century when decision-makers failed to grasp that the production boom then enjoyed by many countries might not last forever and that continuing investment was needed in research, technology, equipment and infrastructure.

In the 30 years from 1980 to date the share of official development assistance which OECD countries earmarked for agriculture dropped 43 percent. Continued under-funding of agriculture by rich and poor countries alike is probably the main single cause of the problems we face today.

Contributing to today's tight markets is rapid economic growth in emerging economies, which means more people are eating more meat and dairy produce with the need for feedgrains increasing rapidly as a result. Global trade in soymeal, the world's leading protein feed for animals, has grown 67 percent over the past 10 years.



**POPULATION GROWTH**, with almost 80 million new mouths to feed every year, is another important element. Population pressure is compounded by the erratic and often extreme meteorological phenomena produced by global warming and climate change.

A further contributing factor may be the recent entry of institutional investors with very large sums of money into food commodity futures markets. There is evidence to suggest that food prices may have surged partly as a result of speculation. But there is considerable debate over the issue.

Lastly, distortive agricultural and protectionist trade policies bear a significant part of the blame. In addition, with agriculture now substantially part of the wider energy market, any shock to the latter - such as unrest in a producing country - can have immediate repercussions on food prices.

Responding to food price volatility therefore involves two different kinds of measures. The first group addresses volatility itself, aiming to reduce price swings through specific interventions while the other seeks to mitigate the negative effects of price swings on countries and individuals.

One measure frequently invoked under the first heading is the setting up of an internationally held food stock able to intervene on markets to stabilize prices. But FAO's view is that such a stock would be of dubious value, as well as expensive and difficult to operate. Also, government intervention in food markets discourages the private sector and hinders competition.



**ON BIOFUELS**, FAO favours abandoning current distortive subsidies and policies or at least making them more flexible and ensuring that bioenergy is produced in the countries and with the crops best suited to such production.

Greater policy coordination in international food trade can reduce volatility by helping maintain an assured flow of goods. FAO supports the multilateral negotiations under the World Trade Organization and the elimination of trade-distorting agricultural subsidies in rich countries. Countries should also agree to refrain from operating export restrictions when their domestic supplies are threatened (as several did in 2007-2008) or adopt reinforced rules on the issue.

On speculation, FAO's research suggests that while this might not trigger price movements, it could exaggerate their size and duration. Authorities in the United States of America and European Union are looking into the possibility of improving the regulatory framework of futures markets. But care must be taken because futures markets play a vital role in offsetting price risk and in price discovery, while investors also bring fresh liquidity into the sector.

**MORE AND BETTER INFORMATION** is needed to allow greater transparency in trade on futures markets. This would help ensure that governments and traders make informed decisions and avoid panic or irrational reactions. The efforts made by some countries to address transparency in futures markets are welcome.

As to mitigating the effects of volatility, national or regional safety nets, possibly featuring emergency food reserves, can help assure food supplies to needy and vulnerable population groups during crises. Poor consumers can also be assisted with cash or food vouchers and producers helped with inputs such as fertilizer and seeds.

Market-based mechanisms can help low-income developing countries to meet higher food import bills. At country level, governments can protect themselves from food price increases through a variety of financial arrangements such as call options, which would give them the right to buy food at a set price even months ahead, regardless of how the market has moved in the meantime. At international level, compensatory facilities can help low-income developing countries meet escalating food import bills. Concessional financing facilities such as those provided by the IMF helped countries contend with the balance of payments problems that soaring food prices provoked in 2007-2008.

Ultimately though, stability in the food market depends on increased investment in agriculture, particularly in developing countries, where 98 percent of the hungry live and where food production needs to double by 2050 to feed growing populations.

Investment in infrastructure, marketing systems, extension and communication services, education, as well as in research and development, can increase food supply and improve the functioning of local agricultural markets, resulting in less volatile prices. In this way, markets can work for the poor people who bear the burden of food price volatility.

The level of net investments required is around US\$83 billion a year which would help millions of people around the world escape poverty and help restore long-term stability to agricultural markets. □

## SAFETY NETS AT WORK

**MEXICO'S OPORTUNIDADES PROGRAMME** - Following the food price crisis of 2008, the Mexican government undertook a major expansion of its existing *Oportunidades* programme, a targeted scheme providing cash to poor families on condition that children attended school and family members regularly visited health centres.

The programme had been introduced in 1997 when it was realized that direct food subsidies, such as tortilla price support, were expensive and not very effective in reducing poverty (it was calculated that administrative costs amounted to 40 percent of the total).

To shield poor people from soaring prices, *Oportunidades*' budget was increased from 39 to over 42 billion pesos while the number of beneficiaries went up by a million to a total of five million.

Selection of beneficiary families is made according to strict eligibility criteria. Cash transfers, made on a monthly basis, increase with the school grade and are also higher for girls in middle school. Families now receive an average of 665 pesos (US\$57) a month.

Although the programme did not fully compensate for the increased food prices, it did provide one Mexican family in four with major protection against the turmoil in food markets. It has also been credited with improving the health of children and adults, and raising nutrition and school enrolment levels.



## BOOSTING DOMESTIC PRODUCTION

**THE CASE OF THE PHILIPPINES** - Several countries, including China, Indonesia, Malaysia, the Philippines, Malawi, Nigeria and Senegal, are now boosting domestic food production as their strategic response to high food prices. For example, the Government of the Philippines, which used to be the world's largest rice importer, is seeking to achieve rice self-sufficiency by 2013. The government is intending to cut imports from more than two million tonnes last year to less than one million this year following the launch of an intensified production programme that is expected to result in a 15 percent increase in the summer harvest and achieve self-sufficiency in two to three years' time.

Local Palay rice production for the first half of the year is set to reach more than 7.6 million tonnes due to the expansion in harvested area and an increase in average yields from 3.6 tonnes per hectare last year to 3.8 tonnes per hectare in 2011. Successful implementation of irrigation system repairs, establishment of more post-harvest facilities, and construction of farm-to-market roads particularly in Mindanao, southern Philippines, are part of an intensification programme planned to take the Philippines' rice production to 17.46 million tonnes this year.

The Philippines played a major role in the Green Revolution. In 1960 IR8, the hybrid rice variety that was to end recurrent famines in many parts of Asia, was developed at the International Rice Research Institute, established by the Philippines government and the Ford and Rockefeller Foundations in Los Baños. With the new, high-yielding variety, rice production quickly doubled in the country and it became a net exporter. But subsequent production increases failed to keep pace with demand from a fast-growing population. By 1990, the country was importing 600 000 of tonnes, which by 2008 had grown to 2.5 million tonnes.

## IMPROVING INCOMES THROUGH CREDIT WARRANTAGE

**THE CASE OF NIGER** - An ingenious financing scheme designed to raise the income of African smallholder farmers has been so successful it is to be scaled up in Niger, where it was pioneered, and extended to neighbouring countries. Like many African smallholders, Niger's farmers had long been penalized by having to sell their produce immediately after harvest - when prices are lowest.

First step was to help them form farmers' groups. Then the groups were helped to get credit through a local version of the *warrantage*, or inventory credit system, used by European farmers in the nineteenth century.

Under the system, rather than selling their harvest at once, farmers use it as collateral for a bank loan. With the money they can buy essential inputs for the next planting and also hold on to their produce until the lean season - when prices climb.

A study of the Niger project carried out in December 2009 found that participating farmers were able to increase their income by between 19 and 113 percent in six months. And since they were able to buy better seeds and fertilizer, their yields went up - by between 44 and 120 percent.

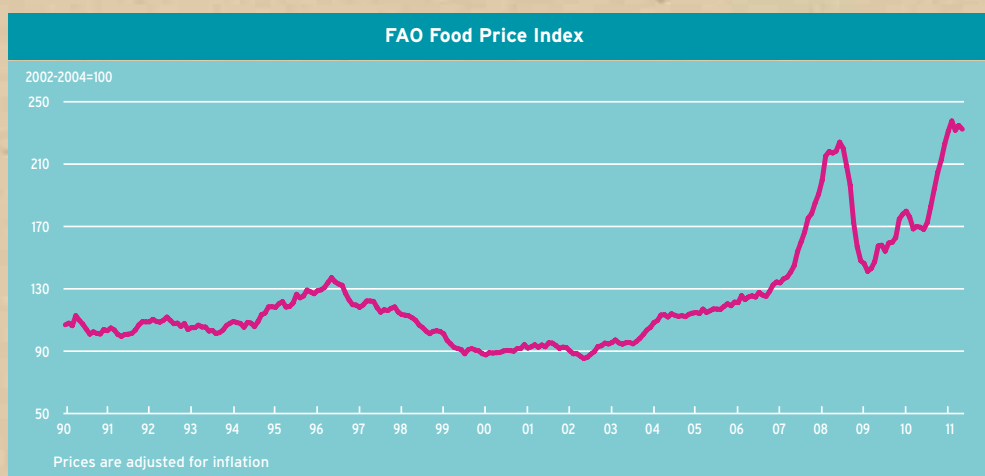


## FAO'S CONTRIBUTION

- Under its Initiative on Soaring Food Prices, launched in December 2007, FAO has helped distribute key inputs such as seeds and fertilizer to poor farmers in some 90 of the countries hardest hit by price volatility.
- Recently FAO, together with the OECD, led a team of nine international organizations in preparing a series of recommendations for the French Presidency of the G20 on how to manage food price volatility so as to protect the most vulnerable.
- FAO monitors and analyzes the causes of food price volatility in global and national markets, through its Global Information and Early Warning System and publications like *Food Price Index*, *Food Outlook* and *Food Price Monitor*.
- FAO published recently the *Guide for Policy and Programmatic Action at Country Level to Address High Food Prices* and embarked on the organization of a series of regional and subregional seminars to help countries make informed decisions and support the design of country-level/national action plans.
- Increased investment in agriculture should be one of the main responses to high food prices. In 2010, FAO assisted governments to programme over US\$5 billion of investment by development banks to agriculture.
- In 2010, FAO delivered US\$800 million in emergency and technical cooperation assistance in over 70 countries.

## FAO FOOD PRICE INDEX 1990–2011

NEW ERA OF FOOD PRICE VOLATILITY ENDS LONG PERIOD OF STABILITY.



(Source: FAO)



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