Price Volatility and Food Security

Tim Josling

Theme

- Price volatility is clearly a key cause of food insecurity
- Governments are under pressure to react by reducing price variability
- The impact on food security is primarily a matter of the appropriate response by individual governments, within the constraints that they face
- Governments can back up domestic policies with bilateral and multilateral agreements that facilitate actions at the border

Price volatility contains information to market participants.

- The main policy issue is how to preserve the useful information without incurring excessive cost
- For producers, price swings encourage shifting to commodities that are in short supply and away from those that are oversupplied.
  - But where the swings are within seasons then supply response is limited
  - The additional costs associated with uncertainty are likely to dominate any benefits from price signals
- For the marketing chain, price rises reward the holders of inventories and this may lead further speculative behavior. Similarly losses occur when prices fall, making the holding of private stocks risky
- Entry of speculative funds from outside the sector can exacerbate the price swings but also provide useful liquidity

Price volatility contains information to market participants

- Consumers with adequate income can switch consumption patterns and even benefit from such flexibility
- Those with limited income and few choices in consumption can be hit hard by price variability
- A market open to international trade can dampen price volatility and reduce the cost of uncertainty: the information is spread across a wider market and more agents can react to offset extremes
- Costs associated with price variability are also more widely shared: trade can spread instability

There are several “good” ways to manage price volatility:

- Improving information in the market, including making transparent the stock holdings of market participants
- Assisting farmers with access to risk management tools, so that some part of the costs of instability are absorbed by the government or passed to other market actors
- Ensuring that physical markets have adequate infrastructure both in terms of transport facilities and financial liquidity

There are several “good” ways to manage price volatility:

- Running appropriate stock policies that match the cost of holding stocks with the benefits that can be had by holding reserves
- Reducing the negative impact of speculative activity by outside agents
- Providing consumers with access to imported foods free of taxes that exacerbate the price shocks
- Cushioning the impact of price fluctuations (and hence real incomes) on the poor and particularly vulnerable consumers

There are several actions that exacerbate the volatility of markets and reduce the information value of prices

- Setting fixed prices for producers over a multi-year period blocks the flow of basic information to suppliers: farm income stability comes at a high price
  - Income fluctuations can be managed by insurance schemes
  - Direct payments can be a useful transition from fixed prices to “full” price responsiveness
- Tight regulation of futures markets can starve those markets of the liquidity necessary to fulfill their function
- Government intervention in the marketing process can distort signals and lead to anti-social behavior and overtly political decisions

There are several actions that exacerbate the volatility of markets and reduce the information value of prices

- Excessive government stocks can drive out private stocks and lead to politicization of market management
- Fixing consumer prices can make supply shortages worse and even harm poor consumers without access to subsidized foods
- Action at the border, by varying import tariffs, limiting exports and “panic buying” by government agencies, can lead to more market instability and uncertainty
- Moreover, international discussions about collective food security disciplines can be undermined by such behavior

Collective actions

- Collective action through international agencies and institutions can support desirable domestic policies and restrain less appropriate responses to price volatility
- This suggests that international action on food security could focus on six components:
  - Improvement of information on stock levels and other key aspects of product availability. The AMIS information sharing is a successful move in this direction. More transparency with respect to food and agricultural policies would also help

Collective actions

- Facilitating farmer access to instruments for risk management, including tools appropriate for small farmers who may not have access to sophisticated hedging instruments. Intergovernmental agencies are currently emphasizing this aspect of good practices as an alternative to fixed producer prices.
- Improving market infrastructure including roads and port facilities as well as ensuring that this infrastructure supports regional and international flows of foodstuffs and input items. Donors can help in making sure that financial and technical assistance is available for these crucial improvements. Storage facilities are an important aspect of market infrastructure.

Collective Action

- Encourage countries to reduce tariff and other barriers to imports at times of high prices. International incentives could also make it easier for countries to resist pressures to increase such tariffs when prices fall
- Shielding poor consumers by means of instruments that do not involve across-the-board subsidies. International assistance is already promoting the use of direct income support for poor and vulnerable consumers and that will also have benefits for local farmers
- Agreeing on rules that limit the use of export curbs and taxes so as to keep trade flowing at times when it is most useful. Exporting countries should be encouraged to find alternative ways of reaching internal objectives

Comments Welcome

Contact josling@stanford.edu