



April 4, 2011

## HIGH FOOD PRICES AND FOOD PRICE VOLATILITY: WHAT ROLE FOR POLICY?

### 1. Outlook for Higher and More Volatile Prices

The International Food Policy Research Institute (IFPRI) recently concluded that it is “reasonable to expect prices to remain high in the years to come (especially as economies recover from the financial crisis).”<sup>1</sup> IPC endorses the view that the long-term trend of real food prices could remain lifted on a wave of strong consumer demand in emerging markets, policy-driven demand for biofuels and long lead-times for a supply response by farmers worldwide. It is also likely that food prices will remain volatile around their trend in the near future. Fixed biofuel mandates keep stock levels low and contribute to increased volatility. In an already tight market and with stocks running low, both supply and demand shocks can lead to drastic price peaks. Policy responses, notably export restrictions, have brought further instability to the market place as well as depressed producer prices in exporting countries.

Higher prices importantly stimulate increased production, which leads to lower prices, but higher levels of public and private investment in sustainable agricultural intensification will also be required to spur productivity. High prices, in particular sudden and steep price peaks, however, drive millions of people to reduce their intake of food, and many more to reduce the nutritional quality of their diet.

As the international community examines how best to respond to both higher and more volatile prices, IPC’s membership offers the following observations and recommendations.

### 2. Starting points for a policy debate

In debating the policy options for managing the current volatility of food prices, IPC promotes a number of starting points. Most important is to differentiate between high agricultural prices and extreme price volatility.

#### *Higher Prices Play An Important Role...*

- Higher prices are an important signal to the market and are required to trigger a needed supply response to rising demand. They also enable producers to recover added farming costs arising from higher fuel, fertilizer and transport costs. Expanded grains supply and a replenishing of stocks are major factors that will contribute to a dampening of price peaks in the future.

Increased and sustained investment in sustainable agricultural intensification and improvements to agricultural infrastructure are required. The challenge is not only to increase production, but to do so in a way that addresses serious environmental challenges, such as land degradation, soil erosion and inefficient use of water. Adoption of best practices to close the yield gap in developing countries is urgent, as is an ongoing commitment to research and development.

<sup>1</sup> Shenggen Fan and Derek Headey, Reflections on the global food crisis: How Did It Happen? How Has It Hurt? And How Can We Prevent the Next One? (Washington DC: International Food Policy Research Institute, 2010)

...***But Care Must Be Taken To protect The Most Vulnerable.***

- Higher – and particularly suddenly higher - food prices present significant burdens to poor consumers. Governments should seek to protect the vulnerable in ways that do not impede the required supply response and provide targeted assistance to those most in need, rather than resort to market policies. Lower import tariffs can also decrease the domestic price of food in importing countries.

It is important to consider policy responses to mitigate the impact of sudden price peaks on the poor, yet higher food prices may also spur development in poor rural areas, as farm surplus and upgrading of farming activity creates new rural demands for labor. A recent CEPR/World Bank study found that under favorable conditions, even net buyers of food can benefit from higher prices because of induced long run structural changes and spillover effects.<sup>2</sup> **The challenge for policymakers is to assist vulnerable consumers in such a way that does not impede the positive spin-off from elevated producer prices in terms of global food security and development.**

***The International Trading System Must Be Strengthened...***

- A rules-based, non-distorted and flexible global trade system ensures that food can move from areas of surplus production to areas experiencing food deficits. Deeper integration of countries and communities in regional and international markets contributes to more stable food supplies, and spurs development. Trade liberalization and trade facilitation remain important components of a program of action on global food security. The Doha Development Round should be swiftly concluded in order to lock in important agricultural policy and trade reforms and to pave the way for the WTO membership to more fully tackle other pressing issues.
- “Policy shocks,” i.e. sudden decisions of exporters’ governments to curtail shipments and of importers to vastly expand purchases on the international market, have contributed strongly to the overshooting of prices in the grains markets. The announcement of wheat export restrictions, for example, has led countries to import wheat in order to build up stock-holdings in an already tight market.<sup>3</sup> This calls for a rebalancing of rights accorded under international trade rules to exporters and importers.

...and **Biofuel Policies should be re-evaluated.**

- Fixed mandates and subsidies for grain and oilseed-based biofuels can amplify price volatility by drawing down stocks and should be reconsidered. At a minimum, policy should introduce greater flexibility and more price-responsiveness in the supply of biofuels. Removing trade distortions to and investing in research and development of advanced and second-generation biofuels will contribute to more effectively reducing reliance on fossil fuels without jeopardizing food security.

**3. IPC Position on the G20 agenda on food price volatility**

IPC welcomes a discussion of the policy options to address food price volatility within the G20.<sup>4</sup> Policy areas highlighted by the French presidency are reproduced in the shaded areas below, followed by the position of IPC’s membership:

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2 Aksoy, Ataman and Bernard Hoekman. 2011. *Food Prices and Rural Poverty*. World Bank and CEPR, available at [http://siteresources.worldbank.org/INTRANETTRADE/Resources/Pubs/Food\\_Prices\\_Rural\\_Poverty.pdf](http://siteresources.worldbank.org/INTRANETTRADE/Resources/Pubs/Food_Prices_Rural_Poverty.pdf)

3 Headey, Derek. 2011. Rethinking the global food crisis: The role of trade shocks. *Food Policy* 36: 136-146

4 Communication from the French presidency of the G20. See [www.g20-g8.com](http://www.g20-g8.com), follow priority 3 - Combating commodity price volatility

<b>French Presidency of the G20</b> <b>1</b>	<b>Increased transparency for physical commodity markets.</b> The lack of reliable international data concerning supply and demand trends on commodities markets hampers price formation and increases volatility. Improved information about the level of commodities stocks would also represent a real step forward.
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- IPC strongly shares this analysis and encourages a far better information system on commodity stocks, including reserves, held throughout the world. As reported stocks decline, it is increasingly important to have greater transparency on all stock levels.

<b>French Presidency of the G20</b> <b>2</b>	<b>Improved regulation for commodity financial markets.</b> There is no harmonised regulation for these markets, and some of them do not have a basic set of rules governing market abuses and price manipulations. Efforts are underway in the United States and in Europe. The goal of the French presidency is to define a common set of rules for both commodity and financial markets.
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- While there may be scope for some new policies, IPC is cautious with regard to commodity regulation that might interfere with the functioning of the global food markets. There are too many examples of well-intended regulations that went astray. Well designed futures markets are a critical instrument for the functioning of the agricultural sector – in particular during times of volatility –allowing farmers and agribusiness to stabilize returns, to reduce the operational risk of price changes in the time between planting and harvesting and to plan ahead. There may, though, well be a case for creating more transparency regarding the nature and volume of transactions on futures markets for commodities, and for better international harmonization of regulation. While IPC welcomes reforms to stabilize the financial sector, no reason is seen to treat food-related futures with greater precaution than derivatives of other commodities.

<b>French Presidency of the G20</b> <b>3</b>	<b>Stronger hedging instruments to provide better protection for the poorest populations against excessive price volatility.</b> As chair, France will explore ways in which the poorest countries may benefit from new financial insurance instruments to protect themselves from price hikes and events that affect harvests.
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- The development of new insurance instruments, to be used by importing country governments to cope with macroeconomic impacts may be useful.
- Improved access to markets, efficient storage capacity and warehouse receipt systems can provide protection for smallholders from price volatility.
- At a more general level, IPC promotes the wider establishment and enhancement of social safety nets, with international financial assistance where necessary.

<p><b>French Presidency of the G20</b></p> <p><b>4</b></p>	<p><b>Better prevention and management of food crises.</b> Growth in the supply of agricultural products in emerging countries is a first response, and one encouraged by France. Over and beyond this however, the most recent food crises have pointed to the lack of an international body that is sufficiently reactive to provide a collective response from governments, and to channel unilateral measures (export restrictions) that might prove to be counterproductive. The use of strategic and emergency food stocks to prevent and deal with food crises should be better coordinated at the international level.</p>
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### *Expanding Food Supply*

- IPC absolutely encourages investment in **sustainable agricultural intensification**, in particular in developing countries, where farmers in large-scale and smallholder settings alike should be assisted to increase yields in accordance with local conditions. Agricultural growth supports employment and income opportunities, thus helping to reduce poverty which is the dominant cause of hunger.
- Increased productivity requires significant public and private spending on agricultural research and development. Inputs and agronomic practices must help address environmental constraints and challenges. The best of existing and yet to be developed technology and practices will be required to address weather, pest and disease-related obstacles, conserve a shrinking natural resource base and reduce waste in the food supply chain.
- Given the pressure on public budgets, governments are well advised to leverage their funds effectively with those of the private sector. For countries and communities to move away from subsistence agricultural economies – where poverty and uncertainty perpetuate hunger – to well-functioning commercial agrifood systems – where farmers can afford needed inputs and reach cash markets – the **for-profit sector** needs to be engaged. Private sector engagement is also critical for the “scaling-up” of development projects financed by governments, and for continued progress and results after government funding is reduced or withdrawn.<sup>5</sup>

### *International Governing Body*

- Most important in the short run is a better co-ordination among existing bodies, and among national governments, in particular with regard to strengthening the collection and dissemination of food production and consumption related data. The Committee for World Food Security could become a more relevant body if Governments decide to make it an effective forum.

### *Export restrictions*

- IPC supports the analysis of FAO on the harmful impact of export restrictions which “provoke more uncertainty and disruption on world markets and drive prices up further globally, while depressing prices domestically and hence curtailing incentives to produce more food.”<sup>6</sup> International food and agricultural trade rules should provide greater supply assurances. At a minimum, an agreement to exempt food aid purchases from export restrictions should be included in the Doha Development Round.

<sup>5</sup> See forthcoming Chicago Council Global Agricultural Development Initiative publication prepared by IPC

<sup>6</sup> FAO Initiative on Soaring Food Prices. 2011. Guide for Policy and Programmatic Actions at Country Level to Address High Food Prices. Rome

- Vulnerable groups in exporting countries should not be protected from sudden price spikes through export restrictions which impede a badly needed supply response. Targeted support measures, such as work-for-food programs and food vouchers should be expanded.

### *Reserves*

- IPC does not believe that efforts at building and managing systematic reserves can effectively stabilize prices, as has been witnessed for a range of agricultural commodities during the second half of the 20<sup>th</sup> century.<sup>7</sup> Apart from the geo-political tensions and high costs that hindered such schemes, it also proved difficult to predict equilibrium prices, agree on a release price, questions of location, quantities required and quality grades.
- Although it is most efficient to rely on trade for production shortfalls, reserves for food security purposes, rather than stabilizing prices, however, may make sense for countries or regions that are not sufficiently linked to international markets.

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7 See, for example, ICAC 2011. A Brief History of Government Efforts to Reduce Volatility in Cotton and Other Agricultural Commodity Prices Through International Agreements. International Cotton Advisory Committee. Available at [http://www.icac.org/meetings/2011/price\\_volatility/english.html](http://www.icac.org/meetings/2011/price_volatility/english.html).

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### **About IPC**

The International Food & Agricultural Trade Policy Council promotes the role of trade in creating a more open, equitable, productive and sustainable global food & agricultural system. IPC makes pragmatic trade policy recommendations to help solve the major challenges facing the global food & agricultural system in the 21st century—the need to promote global food security, to sustainably increase productivity, and to contribute to economic growth and development.

IPC convenes influential policymakers, agribusiness executives, farm and civil society leaders, and academics from around the world in order to clarify complex issues, foster broad stakeholder participation in policy deliberations, and build consensus around pragmatic policy recommendations. More information about the organization and its membership can be found on our website: [www.agritrade.org](http://www.agritrade.org).