



COMMITTEE ON WORLD FOOD SECURITY

Thirty-seventh Session

Rome, 17-22 October 2011

Item V

POLICY ROUNDTABLE – FOOD PRICE VOLATILITY

Table of Contents

	Paragraphs
I. CHALLENGES	1 - 5
II. KEY ISSUES	6 - 10
III. POLICY RECOMMENDATIONS	11 - 77
A. POLICY OPTIONS TO REDUCE FOOD PRICE VOLATILITY	11 - 55
<i>Investment to increase productivity and resilience</i>	11 - 19
<i>Regulation of agricultural commodity futures markets</i>	20 - 24
<i>Public food reserves and private storage</i>	25 - 35
<i>Domestic support and trade policies</i>	36 - 41
<i>Global food market information and transparency and international policy coordination</i>	42 - 47
<i>Curbing non food demand for crops and limiting waste</i>	48 - 55
B. POLICIES TO MITIGATE THE NEGATIVE IMPACT OF FOOD PRICE VOLATILITY	56 - 77

<i>Social protection safety nets</i>	56 - 62
<i>Risk management for producers</i>	63 - 68
<i>International compensatory mechanisms</i>	69 - 73
<i>Stabilizing food imports bills through market-based mechanisms</i>	74 - 77

Matters to be brought to the attention of CFS**The Committee:**

- i. Stresses the need for concerted international efforts to address the structural causes of food price volatility and ensure that its impacts do not undermine poor producers and consumers' right to food
- ii. Welcomes the report of the High Level Panel of Experts (HLPE) on Price Volatility and Food Security and recommends its consideration by all stakeholders*
- iii. Welcomes the Action Plan on Food Price Volatility and Agriculture of the G20 as a positive effort to address a number of the main causes and implications of food price volatility and recommends its endorsement by the G20 Summit to be held in November 2011
- iv. Urges stakeholders to take into account the assessment by FAO and other international organizations of the positive and negative effects of different policy responses to high and volatile food prices, as discussed in the series of regional and subregional consultations organized by FAO in 2011:

Actions to increase food production and availability and enhance resiliency to shocks

- a. Increase stable and sustainable public and private investment to boost agricultural productivity and rural development, with particular attention to smallholder agriculture
- b. Promote a significant expansion in funding for agricultural research and development, including by strengthening the current reform process of the CGIAR, supporting national research systems, and promoting technology transfer, knowledge sharing and capacity building through cooperation
- c. Support the development, or review, by Member Countries, of comprehensive national food security strategies which are inclusive of civil society and farmers' organizations and combine a range of policies across several sectors
- d. Urge Member Countries to explore incentives to reduce waste in the food system, including addressing post harvest losses

Actions to reduce volatility

- e. Support the Agricultural Market Information System (AMIS) to enhance food market information and transparency, and urge the participating international organizations, major private sector actors and governments to ensure the dissemination of timely and quality food market information products
- f. Acknowledging the need for countries to better coordinate responses in times of food price crises, support the establishment of the AMIS Rapid Policy Response Forum and request the CFS Bureau to decide upon and implement a mechanism for collaboration between that Forum and CFS
- g. Improve transparency, regulation and supervision of agricultural derivative markets
- h. Noting that a fair and predictable international trade in food is crucial for reducing excessive price volatility, maintain focus on building a transparent, accountable, fair and rules-based multilateral trading system taking into account food security concerns and, in that context, support the conclusion of the Doha Development Round
- i. Encourage reforms so that renewable fuels and feed stocks can be produced where it is economically, environmentally and socially feasible to do so, and traded more freely and recommend the development of contingency plans to

adjust, at least temporarily, policies that stimulate biofuel production or consumption when global markets are under pressure and food supplies are endangered

Actions to mitigate the negative impact of volatility

- j. Develop stable, long-term national social protection strategies and safety nets that can be leveraged and scaled-up in times of crisis. Reiterate, in this context, the mandate for an HLPE study on the matter, requesting its presentation to the 38th Session of CFS
- k. Recommend the use of national and local social safety nets and local purchase mechanisms, whenever appropriate, for the delivering of food aid, while taking time, market, production, institutional and other relevant factors into account
- l. Endorse efforts requested by the G-20 for WFP and other international organizations and partners to elaborate a proposal for a pilot program for small, targeted regional emergency humanitarian food reserves, consistent with annex II of the WTO agreement on agriculture
- m. Develop risk management instruments, recommend their mainstreaming into national food security strategies, and explore counter-cyclical compensatory mechanisms for vulnerable countries in the event of external price shocks. Attention should also be given to the inclusion of best practices and lessons learned for vulnerable small food producers
- n. Establish a consultative process in CFS to develop a code of conduct for the use of food reserves and their impact on price volatility, including a further assessment of the constraints and effectiveness of local, national and regional food reserves. The timing and exact nature of the process are to be determined by the Bureau in consultation with the Advisory Group and other stakeholders. A report on the status of this process is to be presented to CFS in October 2013
- o. Welcome the decision by the G-20 to agree to remove food export restrictions or extraordinary taxes for food purchased for non-commercial humanitarian purposes by WFP and not to impose them in the future, and urge all Member States to agree to the same principles
- p. Welcome international support for food aid in times of high and volatile food prices, including under the framework of the Food Aid Convention (FAC), and urge its maintenance through a collective effort
- v. Recommends that FAO, IFAD, WFP, WTO, the World Bank and other relevant international organizations and CFS stakeholders reinforce the policy dialogue among themselves and Member Countries with a view to enhance adoption and implementation of the above recommendations at all appropriate levels
- vi. Requests the CFS Secretariat to prepare, in collaboration with the Advisory Group and based on information made available by the relevant stakeholders, a general report on the state of implementation of all of the above recommendations and action points, to be presented to CFS at a date to be decided by the CFS Bureau.

* The HLPE Report on Price Volatility and Food Security and The Summary and Recommendations for Policymakers (CFS:2011/3 Add.1) should be considered along with this background document.

I. CHALLENGES

1. The world faces renewed concerns about rising food prices and food security and nutrition. The last year has been marked by a continuation of the extreme price volatility in global food markets, as grains prices soared to the level they were at the peak of the 2008 food crisis.

2. Concerns about high food prices and extreme volatility linger. The high prices of 2008 pushed an additional 80 million people into hunger, increasing the number of hungry and malnourished to one billion. Food price surges did and can dramatically reverse earlier progress in reducing hunger - towards both the 1996 World Food Summit target (reducing by half the number of hungry people in the world by 2015) and the first Millennium Development Goal (halving the proportion of hungry people in the world).

3. Volatility in food prices challenges the fundamental human right to adequate food. High and volatile prices not only increase, but also deepen poverty and food insecurity. The impact of food price volatility falls heaviest on the poorest – especially the urban poor and the landless – who may spend as much as 75% of their income on food. The diets of the poor also often lack diversity so the scope for switching to less expensive foods can be limited. As richer consumers are able to maintain more or less the same level of food consumption, price surges result in increasing inequity in the distribution of food.

4. High food prices also reduce poor net food consuming households' purchasing power and can lead to irreversible harm. They reinforce poverty traps, as both physical and human capital is eroded and spending on education and health care is cut. Poor food consumers are not the only group to suffer. For poor food producers, higher prices have, in principle, a positive effect and present an opportunity for overcoming poverty. However, price volatility increases uncertainty and deters the investments essential to increasing food production and reducing vulnerability. Even at the national level, increasing and volatile food import bills threaten exchange reserves, disrupt development budgets and slow growth and development.

5. Food prices are likely to remain volatile. Given the overall growth in world incomes, the demand for food is less price sensitive, leading to price volatility and higher incidences of price surges threatening the food security and nutrition of millions of poor people. The policy challenge is to increase productivity growth, particularly for small producers, to improve resilience to shocks, to promote market access and better functioning food markets and to design effective and coherent policies that, where possible, reduce volatility and limit its negative impacts. The High Level Panel of Experts on Food Security and Nutrition (HLPE) Report on Price Volatility to the Committee on World Food Security (CFS) and the Interagency Report on Food Price Volatility to the G20 are efforts to tackle the policy challenge of managing the risks associated with volatile food prices, ultimately to protect the most vulnerable.

II. KEY ISSUES

6. Food prices are expected to remain high. Growing population and income in emerging and developing countries significantly strengthens the demand for food. By 2050 the world's population is expected to have reached about 9 billion people and the demand for food to have increased by between 70% and 100%. Support policies leading to increased demand for crops by the biofuel sector in developed countries also contribute to strengthening the demand. On the supply side, the rate of growth in agricultural production is expected to fall to 1.5% between now and 2030 and further to 0.9% between 2030 and 2050, as compared with 2.3% per year since 1961. If the rate of growth of agricultural production does not keep pace with demand, there will be upward and continuing pressure on prices. With the supply-demand balance already tight, an external shock can result in significant food price surges and extreme volatility.

7. Beyond market fundamentals, there is a consensus that an additional set of drivers also affect food prices. These drivers can be identified by linkages between the agricultural and the energy markets and macroeconomic factors which strengthen the incentive of financial institutions to enter in agricultural commodity futures markets. These forces together can render agricultural markets much more vulnerable to shocks. Especially during the 2007-08 period, the concurrence of so many drivers, such as high oil prices, monetary expansion and low interest

rates, in conjunction with crop production decreases around the world, gave rise not only to an unprecedented price surge, but also to significant volatility. Policies can also result in extreme price surges. For instance, export restrictions implemented by major exporting countries can result in substantial price increases, rendering the global food market unreliable as a source of food.

8. Food security is a complex and multidimensional issue. At times, when food security is threatened by global food price volatility, there is need for both international and national responses. For example, increased coordination of policies at the international level can ensure effective and rapid responses to food price surges. At the national level, there is a need for comprehensive national food security strategies that take into account the country's specificities and characteristics, and that address both the food supply and access dimensions of food security. Such strategies should include policies that reduce food price volatility and measures that mitigate its impact especially on vulnerable populations, benefiting both consumers and producers. Such strategies should be evidence based, developed and implemented in an inclusive manner with the participation of civil society, farmers' organizations and the private sector.

9. Increasing investment in agricultural productivity growth is central to reducing food price volatility at both international and national levels. Other policy solutions that directly reduce food price volatility in the global markets include the removal of policy distortions, such as restrictions on imports and exports or biofuel subsidies and mandates. Better and timely food market information to governments, producers and consumers can calm markets and reduce the likelihood of price surges. Enhanced transparency in agricultural commodity futures markets can enhance their price discovery and risk transfer functions and decrease volatility in the short term. In times of food price surges, compensatory mechanisms can assist food deficit low income countries to meet increased food import bills.

10. At the national level, developing countries need information systems to monitor food markets, assess hunger and malnutrition, provide early warning and target assistance effectively. Social safety nets can reduce the impact of food price surges on the most vulnerable consumers. Food reserves can be linked to such social safety nets but can also be utilized to directly stabilize market prices in national markets. Other policies that can mitigate the impact of food price volatility on producers include market based risk management instruments. Such risk management strategies can also be adopted by countries to stabilize their food import bills.

III. POLICY RECOMMENDATIONS

A. POLICY OPTIONS TO REDUCE FOOD PRICE VOLATILITY

Investment to increase productivity and resilience

11. Volatile prices and their effect on the livelihood of the poor is the result of 20 years of under-investment in agriculture and neglect of the sector. By 2050 the world's population will have increased from the current 6.8 billion to 9.1 billion. This represents a 34% increase over the next 40 years. These particular estimates suggest that in the future, with the supply of food not growing at the same pace with demand, upward pressure on prices will be a principal attribute of world food markets.

12. Investing in agricultural productivity growth and resiliency, as well in agricultural and food market institutions, is central to addressing food price volatility. For the majority of poor countries a healthy agricultural sector is essential to reduce vulnerability to international price volatility, to overcome hunger and poverty and to also provide the platform for wider economic growth. Analysts suggest that Gross Domestic Product (GDP) growth arising from agriculture is almost four times as effective in reducing poverty as GDP originating outside the sector. Agricultural productivity growth increases not only resilience to shocks, but also acts as a multiplier in local economies, eventually leading to higher rural wages and vibrant rural markets

where farmers and workers spend their earnings. Such investment should give attention to the needs of smallholder farmers and women farmers in particular who make up about half of smallholder farmers in the world.

13. Increasing public investment in transport and productive infrastructure, as well as in human capital, is central in stimulating productivity. Improving infrastructure, in particular rural roads and market facilities such as warehouses, storage facilities and market-information systems are important in reducing transport costs and integrating smallholders to markets. Investing in, and improving irrigation facilities, and market institutions and mechanisms will result in increased quantities of food produced, better quality and more stable prices. Improvements in extension, education, health and nutrition are also important elements of a comprehensive policy approach to increase productivity, enhance food security and the welfare of smallholders. It is essential that women farmers are equally reached and served.

14. Improving agricultural innovation systems, building capabilities, and scaling up successes are priorities for strengthening the capacity of smallholders to produce more efficiently and deliver on food security and nutrition. Agricultural research is increasingly being delivered by the private sector with technologies being developed for larger, commercial farming operations. The adoption of such technologies requires increased management skills and knowledge on the part of the farmers. As a result, there is limited access to such innovative technologies by small farmers in developing countries. There is need to improve technological innovation and global dissemination of technology specific for, and well targeted to small-scale agriculture. Smallholders need to be at the centre of innovation systems and help shape the R&D agenda so that crops and livestock products that matter to them as producers and consumers receive adequate attention. Women farmers need to feature more prominently in these systems than they have so far. Innovations should address women farmers' unequal access to inputs and services to enhance their potential to increase production.

15. There is also need to support the development of technologies and provide the appropriate incentives to address challenges specific to climate change and sustainable use of resources, such as land and water. Participatory extension activities towards sustainable agricultural intensification should target small farmers as the ability to respond to volatile environmental conditions requires innovation and management skills at the farm level.

16. The amount required in developing countries to support this expansion in agricultural output and ensure food supplies for the world in 2050, amount to an average annual net investment of USD 83 billion (in 2009 USD). This total includes investment needs in primary agriculture and necessary downstream services such as storage and processing facilities, but does not include public goods like roads, large scale irrigation projects, electrification and others.

17. However, the share of official development assistance destined for agriculture has fallen to as little as 3.8% and, given the investment needs, it remains inadequate. The capacity of the poorer developing countries to fill the investment gap is limited. The share of public spending on agriculture has fallen to an average of around 7% in developing countries, even less in Africa. National governments will have to contribute significantly.

18. Above and beyond, official development assistance and public expenditure on agriculture, governments should shape an enabling environment for the private sector, including smallholder farmers, to increase investment, thus achieving productivity growth and enhanced resilience on which long term food security will depend. Private sector investment needs to be encouraged at all stages in the value chain – upstream of the farm, in seed and fertilizer production and distribution, and downstream in storage, processing, marketing and distribution. Non competitive markets characterized by the development of cartels, or structures with few traders or suppliers should also be tackled.

19. To facilitate private sector investment, developing and less developed countries will need to support the introduction of effective governance systems and institutions, stable

macroeconomic conditions, sound structural and financial policies, human capital development and public services. It is also crucial that an enabling legislative and policy environment for small producers' organizations is created. A variety of institutional and organizational arrangements have emerged to address smallholders' constraints. These arrangements enable small farmers to integrate in markets that provide an array of services from enhancing access to product markets, access to information, financial services and technologies, to facilitating participation in policy making. Such organizations can also assist in shaping national agricultural development and food security strategies that are country-owned and led, evidence-based and inclusive.

Regulation of agricultural commodity futures markets

20. Futures markets are an integral part of the food market system that perform two important functions. They facilitate the transfer of price risk, and they contribute towards price formation. Over the 2005–2011 period, agricultural futures prices increased dramatically and the question as to whether food price surges is a phenomenon similar to a 'speculative bubble' lingers in the minds of many analysts and observers. This period also witnessed a significant increase in commodity futures trading, as well as the entry of a new class of traders composed of financial investors, such as pension funds, banks and sovereign wealth funds. These investors regard commodity futures as assets, comparable to traditional asset classes such as equities, bonds and real estate. As a rule, they passively invest in commodity futures, taking long term positions, 'buying and holding' them, as opposed to short term positions taken by the traditional speculators who buy and sell rapidly.

21. The debate on the impact of speculation on food price volatility offers no concrete conclusion. Some analysts suggest that the entry of financial investors in commodity futures markets has little effect on prices. Other analysts point out that the large amount of money invested in agricultural commodity futures by financial investors can destabilize prices away from their equilibrium, as this is determined by supply and demand. It is likely that such speculative activity in futures markets amplifies price volatility in the short term only. Longer-term equilibrium prices, however, are ultimately determined in cash markets where buying and selling physical commodities reflects the fundamental supply and demand forces.

22. In spite of the on-going debate, there is widespread agreement that both risk transfer and price formation functions of agricultural commodity futures markets will improve with appropriate regulation across all futures exchanges and markets. In particular, there is need for more information on transactions across futures markets. Detailed trading data is necessary to enable participants to monitor information about who is trading, the frequency and the volume of transactions. Such information exists in some commodity exchanges, however, in an aggregate form which makes the identification of various participants difficult. There is also need for greater transparency across over-the-counter (OTC) markets, where transactions take place off the regulated commodity exchanges.

23. Significant improvements in the regulation of futures markets have already been decided or are under consideration. In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) has mandated a tightening of financial market regulation to improve transparency and reduce the risk inherent in the over-the-counter (OTC) derivatives trade. In the European Union, the Commission has adopted a proposal for regulation of OTC derivatives trading and is currently reviewing several key directives that regulate financial markets including the Market Abuse Directive and the Markets in Financial Instruments Directive.

24. Speculators are willing to take on the risk of future price fluctuations and gain a premium. Adequate regulation should improve, not ban, speculative trading in order to improve the performance of food markets. The debate on regulatory measures is on-going at national and international levels. Some exchanges already apply position limits on commodity futures

contracts and monitor futures contract trade against physical quantities. A number of practices aiming to improve transparency and market functioning include:

- Establish a trade depository to register OTC contracts, and bring all sufficiently liquid OTC derivatives on to commodity exchanges
- Use of speculative position limits on commodity futures contracts to effectively minimize the possibility that participants, such as large financial institutions and funds, influence the market
- Use of limits on inventories held in delivery warehouses by non-commercial entities to limit market manipulation possibilities
- Ensure that changes in regulation are adopted across commodity exchanges and across countries in order to avoid the migration of participants.

Public food reserves and private storage

25. Since the 2008 food price crisis, there has been renewed interest in the potential role of public food reserves in a market environment characterized by volatile food prices. The HLPE Report on Price Volatility and the Interagency Report on Food Price Volatility to the G20 both address the potential of public food reserves. However, their recommendations on food stocks differ significantly, with the former putting forward proposals for the use of buffer stocks and the latter stressing the need to use food reserves for humanitarian purposes only.

26. National food buffer stocks that seek to stabilize domestic prices are one type of public food reserve. These mechanisms rely on a combination of food stocks, domestic procurement to defend a floor price, food releases to rein in price increases and trade measures that shield domestic markets from world market price fluctuations. A number of rice producing Asian countries rely on a combination of rice buffer stocks and a trade monopoly to shield their domestic markets. In Africa, in spite of a shift to liberalized marketing systems during the 1990s, buffer stocks remain a central characteristic of the food markets in a number of countries.

27. The experience with food buffer stocks is mixed. In Asian countries, buffer stocks have been used to stabilize prices and provide the confidence to farmers to make the necessary investments and raise productivity. In Africa, frequent, discrete and largely unexpected changes in stock operations tend to increase uncertainty and discourage the entry of traders. This hinders the development of competitive food markets with negative consequences for food security especially in times of international price surges.

28. Stabilizing prices through buffer stocks is a policy option that requires significant resources. Domestic procurement, food releases from buffer stocks and trade programmes require a line of credit, as well as continuing budgetary allocations to cover any operational losses occurring in the domestic and international trading. From the WTO perspective, expenditures associated with the acquisition and holding of reserves for food security and humanitarian purposes qualify under the WTO Green Box. However, the utilization of stocks in support of price stabilization mechanisms can be considered as trade distorting.

29. In times of crisis the cost of buffer stock operations may be prohibitive, as costs escalate in line with increases in prices. In addition, buffer stocks set to defend against price surges are not effective. A buffer stock can only be released in the market where it was bought. Once its stock is exhausted, there are no further means to curb the price surge. In general, buffer stocks, given sufficient finance, are more effective in moderating downward price movements than price surges. In addition, buffer stocks set to defend against price surges can also be vulnerable to speculative attacks. If speculators perceive that the stocks held by the stabilization agency are insufficient to maintain the pre-determined lower price level, they will compete to buy the entirety of the stock in order to take advantage of likely profits.

30. At the international and regional levels, buffer stock mechanisms are also subject to high costs and the criticisms for limited effectiveness in containing price increases. However, as countries attempt to achieve self-sufficiency and build their stocks, proposals for international and regional food reserves should be examined, as they could preserve global production efficiency with different types of food being produced where it is economically and environmentally feasible to do so.

31. Past experience from international stock management schemes is largely, but not entirely negative and there is little evidence that buffer stock stabilization resulted in any significant reduction in price volatility. International schemes, such as those characterizing the International Commodity Agreements, require continuing commitment and are vulnerable to changing market conditions. Regional stocks, such as the ASEAN Food Security Reserve, established in 1980 with an initial stock of 50,000 tonnes of rice, have been used infrequently, if at all.

32. In spite of the arguments against the use of buffer stocks, a number of analysts suggest that national food reserves can play a vital role in reducing food price volatility and the high human, political and economic costs of price surges. Such costs may necessitate revisiting the role of food reserves in the current new context of increased food price volatility. Policy experts should learn from past experience in order to design innovative solutions for food reserves, including the use of call options, to improve their effectiveness, while at the same time reducing their costs.

33. At their meeting on 23 June 2011, the G20 Ministers of Agriculture called on interested international organizations to develop a code of conduct for responsible emergency food reserves management, compiling a set of voluntary principles and good practices. At the same time, the HLPE Report on Price Volatility suggests that there is need for increased international coordination of storage policies. Although past experience suggests that managing international stocks schemes is difficult due to its high information and coordination costs, additional efforts to explore forms of international coordination may be necessary.

34. One possibility would be to establish small, strategically positioned humanitarian emergency food reserves at the regional level, linked upstream to effective early warning systems and downstream to social protection safety nets. It is important that such emergency food reserves are integrated in national and regional food security strategies with well-defined rules in terms of replenishment and triggering mechanisms. At the request of G20 Ministers of Agriculture, the World Food Programme and other International Organizations are preparing a feasibility study, costs-benefit analysis and proposal for a pilot regional emergency humanitarian food reserve system in West Africa, in close cooperation with ECOWAS and its Member States. The study, analysis and proposal will provide a valuable blueprint for a regional system of food reserves that can capitalize on economies of scale, spread the risk across a region, and provide effective assistance to vulnerable groups in times of crisis.

35. Efforts to design food reserve systems will benefit from further analysis, the evaluation of current practices and the examination of innovative solutions to enhance the well-functioning of national or regional stocks and to improve their effectiveness in mitigating the negative effects of food price surges without distorting market behaviour. Past and ongoing work, such as the study on the ECOWAS pilot humanitarian food reserves system, would provide valuable inputs in this regard. It is recommended that CFS initiates such a process assessing the role of food reserves in the context of price surges and volatility with the ultimate objective to develop a set of voluntary principles for the management of food reserves.

Domestic support and trade policies

36. Strengthening the integration of developing and vulnerable countries with the international market is of paramount importance for development. Historically, farm subsidies

and protection in some OECD countries have been seen as a deterrent to investment in agriculture in developing countries, thus increasing their vulnerability to international price shocks. Policies that distort production and trade in agricultural commodities stimulate production in areas where it would not otherwise occur and discourage competitive producers elsewhere. This leads to both inefficiency and long run food insecurity. Despite on-going reforms there are still significant barriers to trade in agricultural commodities both among developing countries and between developing and developed countries.

37. During the price surge episodes of 2008 and 2010, a number of emerging economies and developing countries implemented export restrictions in an attempt to lower domestic prices and ensure domestic food security. In general, export bans can lower domestic food prices and are seen as supporting consumers. However, export restrictions by both large and small exporters can harm traditional trading partners. Food export bans restricting humanitarian food aid are particularly pernicious and harm the most vulnerable. Concerted implementation of export restrictions by major exporters renders the international market unreliable as a source of food. While the right of sovereign countries to enhance food security is not questioned, the more countries implementing such policies, the more world price instability will increase, potentially causing problems for those countries that do not resort to any stabilization policies.

38. Existing trade rules negotiated in times of low and stable food prices offer little protection against soaring prices and volatility and may even exacerbate them. The asymmetry between current disciplines on import and export measures is arguably over-permissive of export restrictions which shatter confidence in international markets. Current draft modalities in the WTO Doha Development Round do not seem to address that asymmetry. More predictable and less discretionary policies would convey clearer information and render panic and hoarding less likely, resulting in less uncertainty.

39. Building a transparent, accountable and rules-based multilateral trade system to guarantee food access for every country is now a major challenge for the international community. It is important that such a system improves market access, while at the same time addressing public policy concerns regarding both food security and the heterogeneity of the World Trade Organization member states, taking into account special needs of poor and vulnerable countries. Special Safeguard Mechanisms can protect smallholders in developing countries against surges of subsidized agricultural imports which can devastate their livelihoods. Such safeguards can encourage producers in developing countries to invest in their small farms and earn a stable income.

40. There is need to:

- Significantly improve market access by reducing trade distorting domestic support, especially by developed countries
- Eliminate export subsidies in order to shape a level playing field in the international market and increase efficiency
- Address food export bans, or extraordinary taxes on humanitarian aid supplies
- Maintain and strengthen appropriate safeguards for developing countries, especially the most vulnerable ones, to improve their efficiency and competitiveness and strengthen their integration in the international markets.

41. In order to achieve more transparency and predictability, there are also proposals to strengthen the WTO provisions on exports:

1. An obligation to submit a notification to the WTO Committee on Agriculture, prior to instituting any new export prohibition or restriction on foodstuffs. Such notifications should be supported by detailed data and analysis demonstrating the reasons for instituting such measures and how trading partners of that Member may be affected
2. Upon receipt of such notification to the WTO Committee on Agriculture, there should be an obligation to respect a mandatory consultation period (say of a period of one

- month) with potentially affected countries prior to the export restriction being implemented
3. An obligation to spell out explicitly the duration of an eventual measure, stipulating a maximum period of its application (e.g. 3 months).

Global food market information and transparency and international policy coordination

42. The food price episodes of 2008 and 2010 have exposed a number of weaknesses in the process of market information and the coordination of actions and policy responses. These include:

- Lack of reliable and up-to-date information on crop supply, demand, stocks and, especially, export availability from countries and regions; lack of clear and comprehensive indicators of current market conditions
- Uncertainty and lack of transparency that resulted in hoarding, panic buying and sub-optimal policy choices
- Lack of an effective and credible mechanism for issuing alerts concerning deteriorating food situations
- Lack of effective policy recommendations and policy coordination
- Lack of clear links between information, alerts and response.

43. The result is limited preparedness on the part of governments and the international community to respond rapidly and effectively to threats to food security. Building on and complementing existing systems, improvements in global market information could be achieved through the G20 collaborative food information and policy initiative, namely, the Agricultural Market Information System (AMIS). Such initiatives aim to improve data reliability, timeliness and frequency as well as enhancing policy coordination in times of crisis.

44. Participation in AMIS would be open to all countries. However, early efforts will focus on the main market players which account for the greater part of world food production, consumption and trade. AMIS would also involve a joint Secretariat, housed in FAO, comprising of international organizations with capacity to collect, analyse and disseminate information on a regular basis regarding the food situation and outlook, as well as food policies. The structure of AMIS would include two groups to effectively perform two important functions: a Global Food Market Information Group would be responsible for food market information collection and analysis, while the promotion of international policy coordination would be the objective of a Rapid Policy Response Forum.

45. The Global Food Market Information Group would cover the study of production, stocks, trade, utilization and prices, including futures prices. In more detail, it could:

- Provide continuous, quality, reliable, accurate, timely and comparable information regarding the supply and demand position and its probable short term development
- Promote the improvement of the statistics and information
- Collect and analyze information on national policies and their international effects.

46. The AMIS Rapid Policy Response Forum would enhance policy dialogue and promote policy coordination when the market situation and outlook indicates a high food security risk. Its actions would be as follows:

- Receive and assess information and analyses from the AMIS Secretariat on the current global market situation and outlook and issue regular statements on the ensuing implications for food security
- Promote early exchange of key information on and discussion of prevention and responses to crises among policy-makers and assist in mobilizing wide and rapid political support for appropriate policy response and actions on issues affecting agricultural

production and markets in times of crisis, without seeking influence on the humanitarian responses

- Work closely with the CFS to promote greater policy convergence and strengthen policy linkages at the world level.

47. AMIS will consist of a standing network of countries and organizations focusing exclusively on food price volatility, combining both political will and strong technical expertise to increase market information, enhance transparency and promote dialogue on appropriate actions in times of crisis. It is proposed that the Rapid Policy Response Forum collaborates closely with CFS, providing briefs to the Bureau and Advisory Group of the CFS on market and food security assessments, as well as on appropriate policy options so that CFS has all relevant information to promote greater policy convergence and strengthen policy linkages at global level.

Curbing non food demand for crops and limiting waste

48. At the international level, crop prices are progressively more related to oil prices. Increases in the price of oil enhance ethanol's competitiveness relative to petrol and strengthen its demand. Since both biofuel and food or feed sectors utilize the same input, for example grain or sugarcane, increases in the production of ethanol reduce the supply of food and result in increases in its price.

49. This strong integration between the agricultural commodities and energy markets means that if oil prices are high and a crop's value in the energy market exceeds its value in the food market, crops will be diverted to the production of biofuels which will increase the price of food to an extent determined by biofuel demand.

50. Sudden changes in the price of oil can be abrupt and may cause increased food price volatility. Support to the biofuel industry has created a growing demand for certain crops, competing with food demand for available food or feed supplies, thus resulting in increasing prices. For example, subsidies to first-generation biofuel production lower biofuel production costs and, therefore, increase the dependence of crop prices on the price of oil. There is a need to reconsider such support policies.

51. There are proposals to remove provisions of current national policies that subsidize, or mandate biofuel production or consumption and improve access by opening international markets. The elimination of both subsidies and trade barriers will result in biofuels being produced where it is economically feasible to do so. Other proposals call for more flexible measures that take account of the impact of biofuels on the availability and price of food. According to these proposals, countries that support their biofuel sector, develop plans to adjust policies that stimulate biofuel production or consumption when global food markets are under pressure, so that demand for food or feed by the biofuels sector is weakened.

52. On the supply side, post-harvest losses and waste combine to reduce the availability of food by a very large percentage globally. FAO estimates that poorly developed systems for handling, storage, packaging, transporting and marketing of agricultural products in developing countries results in losses ranging between 15% and 50%. Addressing post-harvest losses is an effective way to dramatically increase food supply in developing countries.

53. Assistance to farmers, cooperatives and community grain storage initiatives is an important first step in reducing post-harvest losses and increasing resilience, as well as addressing emergency needs and reducing domestic food price volatility by allowing farmers to market beyond harvest season. At the village level, there are clear advantages to collaboration in storage in order to aggregate sufficient amount of produce, reduce storage and transport costs and attract traders.

54. Private sector storage investments in developing countries, either on-farm, in villages or on a larger scale, are constrained by poor policies, insufficient public support and poor enabling environments. This makes farmers reluctant to undertake such improvements, compelling them to tolerate quite high post-harvest losses.

55. There is a need for policies to facilitate access to credit for storage improvements by farmers, cooperatives and private traders and provide the necessary technology and training to minimise post-harvest losses. There is also a need for training to build specialized storage management skills both for farmers' associations and cooperatives as well as for the private sector.

B. B. POLICIES TO MITIGATE THE NEGATIVE IMPACT OF FOOD PRICE VOLATILITY

Social protection safety nets

56. In an environment of rapidly increasing food prices, the provision of subsidized food or cash to the poor through safety nets improves their ability to cope with increased food expenditure and prevents households from selling assets that are important for their well-being, such as animals, or from reducing expenses on important activities, such as health and education. These safety nets should also provide a specific focus on nutrition, given the increased risks on health and nutritional status in times of crisis.

57. It is important that safety nets can be scaled-up rapidly, delivering assistance in a flexible manner, in terms of cash or food depending on market conditions. Scaling up takes place by increasing the transfer per capita or by adding new beneficiaries. However, safety net expansion presents significant difficulties, highlighting the need for contingency planning. Firstly, the safety net programme should have the administrative capacity to expand. Secondly, if the expansion takes place through the addition of new beneficiaries who have become vulnerable due to the food price increases, additional targeting mechanisms should be employed.

58. Well-targeted programmes are difficult to design and often are integrated into the existing social safety net system. Targeted food safety nets such as child nutrition schemes, job and asset creation and school feeding programmes help vulnerable people to cope with price volatility or other shocks and can be, given the budget, scaled up relatively easily in a crisis.

59. Quick targeting may also be achieved through combinations of geographical, demographic and self-targeting criteria. Linking the transfers to certain conditions, as for example, supporting pregnant and lactating women and children under two years of age, provides both a targeting method and a mechanism for mitigating the short term impact of the shock while simultaneously reducing long term adverse consequences.

60. Flexible and diversified assistance, based on a range of transfers is a critical tool to address food insecurity and mitigate the negative effect of food price surges on the vulnerable. Such transfers can be made in the form of cash, food vouchers, or food. Targeted cash transfers or food vouchers are appropriate where food markets function and improved access to food is the objective of the intervention. They can also foster local food market development by providing greater incentives to the private sector to engage in higher volume, more stable marketing channels, thus achieving economies of scale. If private traders are unable to scale-up the distribution of food, or for example, local markets are isolated, cash transfers can result in food price inflation. In such situations, food distribution is more appropriate, as it increases availability without exerting additional upward pressure on local market prices.

61. Finally, such mechanisms ought to have a counter-cyclical budget so that operations can be scaled-up when prices surge and scaled-down subsequently. Such budget requirements present significant difficulties, highlighting the need for assistance from the international community to food deficit low income developing countries, which may not be able to meet such expenditures in times of crisis.

62. Food price surges undermine the existing food price arrangements in the ongoing negotiations of the Food Aid Convention (FAC) which specifies an annual guaranteed minimum amount of food and food related resources to recipient countries in response to food emergencies and other situations, such as the provision of assistance to safety nets. The FAC provides about 5 million tonnes of food per year in donors' collective commitments. However, during the ongoing negotiations, proposals have been put forward to allow individual donor country commitments to be expressed in terms of value, rather than in terms of food quantities in order to enable governments to budget accurately their FAC commitments. With high and volatile prices projected for the next decade, such a practice will transfer the risk of volatile prices onto the food assistance recipient countries. There is need to minimize this risk, through market-based risk management instruments, while retaining the collective commitment to provide specific amounts of food.

Risk management for producers

63. Risk management for producers in developing and emerging economies faces important challenges. The vulnerable population is made up mainly of geographically dispersed smallholders with limited access to markets and knowledge. This results in high operational costs for risk management programmes, in addition to weak demand for risk management instruments. There are also significant constraints on the development of insurance and financial markets, and often institutional capacity is low with no established commodity exchanges. Risk management mechanisms for vulnerable producers depend on the nature of the risk, which may be related to weather or to pests and diseases affecting crops or animals, or may be economic, relating to prices of inputs and outputs.

64. Considerable effort and research is being invested in developing innovations such as weather index-based crop insurance to enable smallholder producers to protect themselves against weather-related risks. The underlying concept is that farmers are paid whenever rainfall or temperature is so high or so low that it is likely to cause a significant fall in crop yields, or whenever droughts, frost, or precipitation cross specific thresholds. Index-based insurance presents a number of advantages as it is based on an independently verifiable weather index that allows insurance companies to efficiently transfer part of their risk to international markets or to re-insurers. However, in order to be effective, index-based insurance requires a number of conditions to be in place. The index chosen must be strongly correlated to local yields and there must be a network of local weather stations network and weather data collection systems. There is also need to overcome information problems to stimulate demand for such instruments. Farmers and other stakeholders should have a clear understanding of how weather index insurance works.

65. Protection against price risks for farmers is also subject to similar problems. In addition to poor access to markets and knowledge, farmers produce quantities that are too small to make participation in futures markets worthwhile. Even if aggregated across producers, through farmers' organizations, production is subject to problems of standardization and quality. Moreover, few developing countries have commodity exchanges where farmers and other market participants can hedge against price fluctuations.

66. There is need to significantly support pro-smallholder innovations in financial markets. Public investment in increased institutional capacity and adequate technical assistance and training is necessary, as the private insurance sector faces high set up costs and barriers. Innovative products, such as index insurance often require public-private partnerships, or public

investment in the development of data gathering and analytic capacity. If index insurance is to scale up, governments and donors will need to intervene more actively to provide an enabling environment and facilitate the development of insurance markets. However, in general, it has been proven extremely difficult to target smallholders directly in a cost-effective manner for use of financial risk management tools.

67. Food markets in many developing countries are not well-integrated with established commodity exchanges rendering financial hedges ineffective and subject to high levels of basis risk (the lack of correlation between exchange-trade prices and local prices). There is need to encourage regional commodity exchanges in developing countries so that contracts and risk management tools are linked to local conditions thus improving market functioning and the transfer of risk.

68. Warehouse receipts systems can help small producers manage risks. They may also improve a country's private storage capacity and lead to more competitive markets. The principle of warehouse receipts is that farmers or traders can deposit amounts of staple food of a stated quantity and quality in a secure warehouse and obtain evidence of ownership. Warehouse receipts programmes can contribute towards reducing storage losses, moderating price volatility and facilitating access to finance, as the evidence of ownership can be used as collateral to obtain credit. In this manner, warehouse receipts can assist smallholders to better manage risks, while at the same time promote efficient private trade.

International compensatory mechanisms

69. In times of crisis, compensatory facilities are important mechanisms assisting countries to avoid major fiscal deficits, and lower the cost of imported food, while maintaining key social assistance programmes. One of the major international responses to commodity market volatility in the past has been compensatory financing, such as that provided through the European Union's *Système de Stabilisation des Recettes d'Exportation (STABEX)* to ACP countries and the *Compensatory Financing Facility* of the International Monetary Fund (IMF). Both programmes aimed to provide compensatory finance to help countries avoid a negative impact on growth from sharp commodity price changes. Neither has been used extensively probably because of insufficient funding in the first instance and excessively high interest rates in the second.

70. During the 2008 price surge, a number of countries which experienced significant increases in their food and fertilizer import bills resorted to the *Exogenous Shock Facility (ESF)* of the IMF. ESF provided for liquidity to mitigate the negative impact of exogenous shocks on developing countries' balance of payments, international reserves position and inflation. Since 2009, the IMF established three facilities to allow for significantly more financing and more concessional terms: the *Rapid Credit Facility*, providing disbursement without programme-based conditionality; the *Standby Credit Facility* for short-term financing and adjustment needs caused by policy slippages or shocks; and, the *Extended Credit Facility* which also includes arrangements to provide rapid support for food and fuel price shocks.

71. Such facilities could be strengthened or expanded to enable a country to finance food imports when the need arises, rather than to compensate balance of payment losses after the fact. Mechanisms, such as the *Global Food Crisis Response Programme (GFRP)* of the World Bank which is targeted to the poorest and most vulnerable countries and efforts for a broader crisis window under the International Development Association should be supported.

72. An additional option for consideration is a food financing facility, as foreseen by the Marrakesh Decision and the World Trade Organization (WTO) Ministerial Conference at Doha. On the basis of analysis by FAO and UNCTAD, a proposal has been developed to create a *Food Import Financing Facility (FIFF)* through which less developed and net food importing countries would have access to short-term finance in the event of soaring food import bills.

73. A FIFF would enable a country to finance food imports when the need arises, rather than to compensate balance of payment losses after the fact, and would be based on the international community providing conditional guarantees, rather than finance. Trigger conditions could involve a level of food import bills that are predicted to go above a certain threshold compared to normal. The FIFF could also benefit from guarantees from a number of developed countries which would enable it to borrow from the international bank and capital markets.

Stabilizing food imports bills through market-based mechanisms

74. Innovative market-based mechanisms, such as the use of futures markets to guarantee timely food imports at more stable prices, provide protection against food price volatility. Nevertheless, such options involve the establishment of institutions at national level and the building up of technical expertise.

75. The principal instruments that could be used to stabilize food import bills are futures and options contracts or over-the-counter (OTC) instruments. Financial institutions, usually international banks, intermediate such hedging instruments to governments. By buying futures contracts, a government which wishes to protect itself against a possible grains price surge, 'locks in' the grain purchase price. The major advantage to the hedging government is that the cost of food imports is known more or less accurately at the time the hedge is initiated. In practice, futures may not be a useful instrument for governments since there is an unknown liability associated with taking a futures position each time the government hedges. If market prices move down against a government that has bought futures contracts, the government will be responsible for paying, to the market counterparty, the difference in price movements.

76. An alternative to hedging with futures contracts is hedging with option contracts, which allow a government to secure price protection at a certain level in return for a fixed premium which is usually paid in advance. Call options are physical commodity hedges, which integrate price protection into a physical import agreement. For importers, a call option has the effect of putting an approximate ceiling price on the contracted food quantities. A ceiling price is particularly attractive if the intention is to hedge against a price. A major advantage of the call option strategy is that it has a market price. Unlike hedging with futures, the cost of protection is known in advance. Purchasers can decide on the level and duration of protection that they require or can decide that the cost is too high.

77. Significant investment is needed to overcome the lack of technical expertise on the use of hedging instruments in low income countries. Many governments are not focused on ex ante management of food price shocks and are not assessing food price risk as a contingent liability with fiscal implications. Experience has shown that engaging developing and emerging countries on risk management takes a sustained effort to build capacity to the point where decision-makers are comfortable with the use of risk management tools and have established appropriate institutional frameworks (including careful budgeting of costs and targeting of benefits). Globally there is a need to learn lessons from countries such as Mexico that have become sophisticated in developing a framework for analyzing fiscal risks and taking innovative steps to manage those risks.