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COMMITTEE ON COMMODITY PROBLEMS

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EXPERIENCES WITH DOMESTIC FOOD PRICES AND FOOD POLICY RESPONSES DURING 2007–2011

Executive Summary

During the periods of high and volatile prices in the world food markets since mid-2007, there have been reports of widespread price rises in the domestic markets also. This triggered many and varied policy responses aimed at containing the price rises and addressing longer-term food issues. In the mean time, the Secretariat stepped up its work on the compilation and review of domestic food prices and policy developments, and thus there is now a critical mass of information for many countries for a thorough review of these experiences during 2007-2011. The document CCP 12/5 presents these experiences, first on the domestic cereal prices and then on national policy responses. Some policy and analytical issues are summarized at the end of the document for the consideration of the Committee.

Suggested action by the CCP

The Committee may wish to:

- Recognize that increased policy coordination among countries and enhanced market transparency could contribute to stabilizing markets both domestically and globally.
- Underline the importance of urgent and successful conclusion of the Doha Round of trade negotiations.
- Recommend that FAO keep a close watch on food commodity price movements and policy responses, and conduct in-depth analyses and country case studies as required.
- Request FAO to continue and strengthen its assistance to member countries in both policy and programmatic actions to effectively address high and volatile food prices.

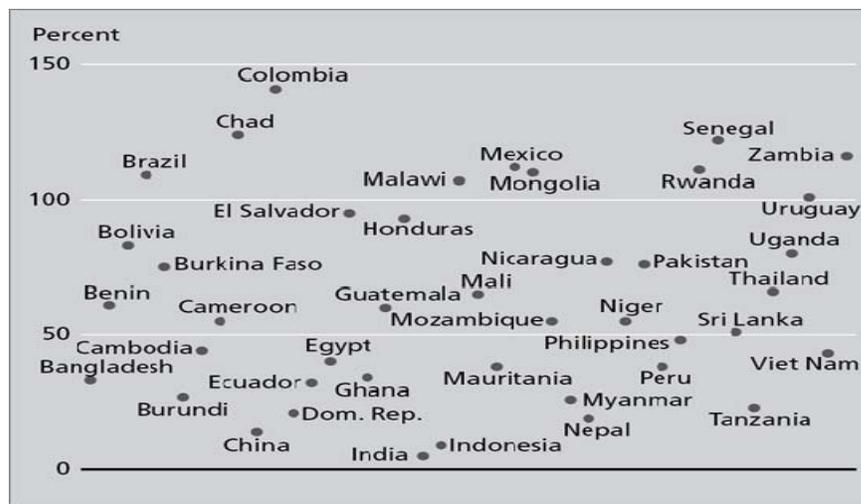
I. REVIEW OF THE DOMESTIC CEREAL PRICE RISES DURING 2007-2011

1. The review is based on 155 series of domestic cereal (rice, wheat and maize) prices from 52 countries. During 2007-2011, there were five instances of surges or spikes in cereal prices in the world markets, one for rice (2007/08) and two each for wheat and maize (in 2007/08 and 2010/11). The question asked in the review below is the following: how much did the domestic prices rise during the periods when the world prices spiked? The change in the domestic price relative to the change in the world price in a given period, is called “transmission rate”. This is a rough measure of transmission. It may be noted that while a change in the world price is a crucial determinant of the change in the domestic price, the degree of this relationship depends on other factors also, such as the level of self-sufficiency, barriers and policies that moderate the transmission, and structural constraints.

A. Rice

2. Rice prices spiked from October 2007 to May 2008 when the export price of Thai A1 variety rose by USD 475/tonne (or 160 percent). In this period, (adding two more months until July 2008 as prices were still rising strongly, reflecting lagged transmission) domestic prices rose on average for the 42 countries covered by USD 305/tonne (or by 50 percent), which gives a transmission rate of 64 percent. As Figure 1 shows, transmission exceeded 100 percent for 10 countries, i.e. domestic prices rose by more than the change in the world price, and by 50–100 percent in 15 other cases. Transmissions were below 50 percent for the remaining 17 countries. Price rises in local currency (LC) terms were lower than in the dollar terms for 23 of the 37 countries, by 10 percentage points or more in 15 cases, reflecting currency appreciation. On the other hand, LC prices rose more than the dollar price in 11 cases, but markedly so in only two cases, reflecting currency depreciation. By region, transmission rates were relatively lower for Asian countries (42 percent) than in Africa (70 percent) and Latin America (74 percent).

Figure 1 - Transmission of rice price spikes (October 2007–May 2008)



Note: The transmission measure is the ratio of the change in the domestic price to that in the world price during the spike.

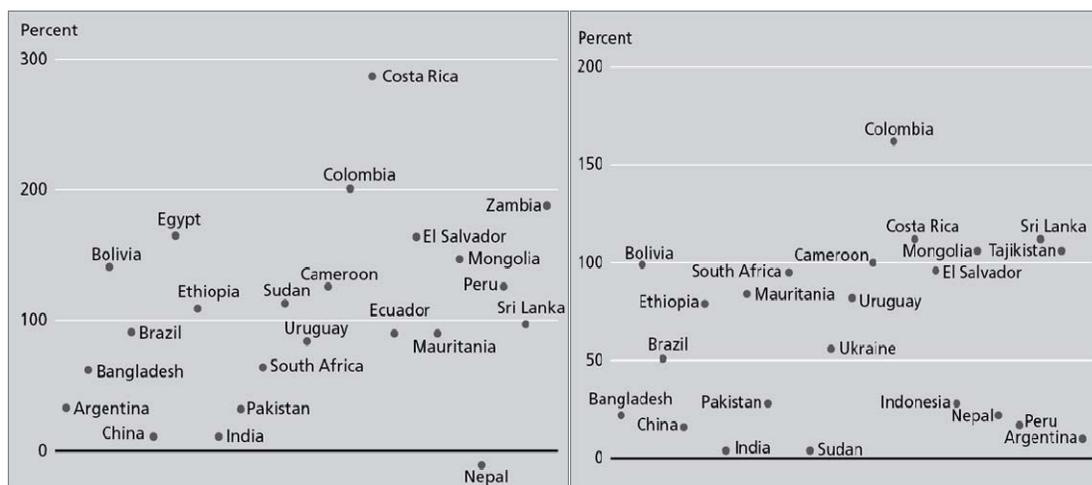
B. Wheat

3. There were two spikes for wheat prices: the first from May 2007 to March 2008 and the second from June 2010 to February 2011. This review is based on 56 price series from 26 countries - 27 series for the first spike and 29 for the second. For each period, 12 series are for wheat grain and the rest for wheat flour. Although the two products are not identical, the world price of grain is expected to strongly influence the flour price in the domestic market.

The first spike, May 2007–March 2008

4. In this period, the world price (US #2 Hard Red Winter) increased by USD 279/tonne (or 137 percent). The average change in the price of wheat grain for 12 countries was USD 221/tonne, or a transmission rate of 79 percent (USD 221/279). Transmission was lowest for both China and India (11 percent in each case, while it exceeded 100 percent for four countries (Bolivia, Egypt, Ethiopia and Sudan) (Figure 2). Price rises were lower in LC terms than in dollar terms, by 17 percentage points on average. As for wheat flour, the average price for 15 countries rose by USD 377/tonne, implying a transmission rate of 135 percent (from the grain to the flour market). Transmission exceeded 100 percent for 10 countries and was between 50 to 100 percent for three. Price changes in LC terms were lower than in dollar terms in most cases.

Figure 2 - Transmission of wheat price spikes
First spike (May 2007-March 2008)



Note: The transmission measure is the ratio of the change in the domestic price to that in the world price during the spike.

The second spike, June 2010-February 2011

5. In this period, the world price rose by USD 179/tonne (or 98 percent). For *wheat grain*, the average change in the domestic prices for the 12 countries with data (including two additional months as above) was USD 92/tonne - a transmission rate of 52 percent, lower than the 79 percent observed in the first spike. Transmission rate exceeded 50 percent for seven of the 12 countries but not over 100 percent in any case, and was below 20 percent for China, India and Sudan. Besides being markedly lower than in the first spike, domestic prices did not generally continue to rise strongly after the peak in the world price in February 2011. As for *wheat flour*, the price change for 17 countries averaged USD 133/tonne, a transmission rate of 74 percent, substantially lower than the 135 percent for flour in the first spike. There were seven cases of the transmission exceeding 100 percent and four cases between 50 percent and 100 percent (Figure 2). The price changes in LC terms were lower on average for the sample by about 10 percentage points than in dollar terms.

C. Maize

6. Similar to wheat, world prices of maize witnessed two periods of spikes: July 2007-June 2008 and June 2010-April 2011.

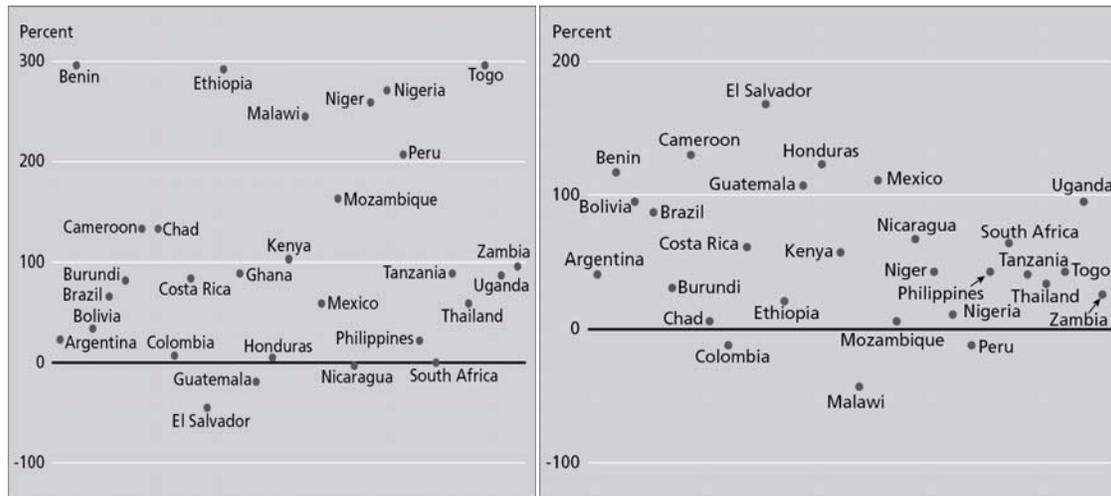
The first spike, July 2007 to June 2008

7. In this period, the world maize price (US #2 yellow) rose by USD 135/tonne (92 percent) while the average increase in domestic prices for 29 countries was USD 146/tonne, giving a transmission rate of 108 percent. The transmission rate exceeded 200 percent for seven countries (Benin, Ethiopia, Malawi, Niger, Nigeria, Peru and Togo,) (Figure 3) and was between 100 and 200 percent for the other four (Cameroon, Chad, Kenya and Mozambique). These are very high price

changes and require in-depth analyses of the underlying reasons, more so because many studies on market integration have noted weak price transmissions for maize in Africa due mainly to small volumes traded and indicating the dominant role played by domestic factors. Price changes in LC terms are mostly lower but not by that much. By region, transmission was 165 percent on average for 16 countries in Africa, but only 62 percent on average for the 11 countries from Latin America.

Figure 3 - Transmission of maize price
First spike (July 2007-June 2008)

Second spike (June 2010-April 2011)



Note: The measure is the ratio of the change in the domestic price to that in the world price during the spike.

The second spike, June 2010 to April 2011

8. The world maize price increased by USD 162/tonne, compared with USD 135/tonne in the first spike. The domestic prices in 28 countries rose on average by USD 90/tonne, giving a transmission rate of 56 percent. The transmission exceeded 100 percent for six of them (Benin, Cameroon, El Salvador, Guatemala, Honduras and Mexico), and was between 50 and 100 percent for the other seven. Price changes in LC terms were lower than in dollar terms in 21 cases.

Summary on domestic price changes

9. The review showed that domestic prices rose significantly during the periods corresponding to the spikes in the world markets. Taking together all 155 price series for both periods, domestic prices rose by more than the increases in the world markets (i.e. over 100 percent transmission) in 48 of the 155 series, while the transmission rate was between 50 and 100 percent in 50 cases and less than 50 percent in the remaining 57 cases. Transmission rates for wheat and maize were significantly lower during the second spike (2010/11). One crucial reason for this was increased cereal production in 2009, and most likely larger stocks moving into the 2010/11 season. Better preparedness following the experience of 2007/08 might also have led to lower transmissions. With so many instances of transmissions exceeding 100 percent, and even 200 percent in several cases, these episodes deserve more focussed research with a view to understanding the role of policy and non-policy (e.g. weather) factors in exacerbating the transmission, or in moderating the price rises. Econometric analysis of market integration and price transmission should be a priority in this direction.

II. National policy responses to cereal price spikes during 2007-2011

10. The high and volatile food prices, and specifically the price spikes, naturally triggered many and varied policy responses. A 2008 FAO survey based on information for 77 countries found that about half of the countries surveyed took measures to reduce food import taxes, 55 percent used price controls and consumer subsidies, 25 percent imposed some form of export restrictions, 25 percent took actions to increase supply drawing on cereal stocks and 16 percent showed no policy intervention

whatsoever. A similar picture emerges from more recent updates of policy responses by FAO and other agencies.

11. What follows summarizes these policy responses. In order to better highlight the shorter-term and longer-term responses, as well as emerging issues and debates on policies, the presentation is made under the following six headings: a) trade policy; b) increasing emphasis on food production and self-sufficiency; c) international investment in agricultural land; d) increased outlays on farm support and innovative schemes; e) increased public sector involvement in food markets; and f) varied ad hoc responses to contain the retail price rises of basic foods.

A. Trade policy as a measure to control local food inflation

12. Many countries resorted to trade measures in an attempt to control domestic food prices, mainly because they are quick and cheap to apply. Many food importing countries reduced their tariffs, sometimes to zero, with varying effects. The impact on lowering prices depended on the tariff level and the size of the reduction. For instance, Morocco slashed its tariffs on imported wheat from 130 to 2.5 percent and Nigeria cut its duties on rice imports from 100 to 2.7 percent. On both cases the effect on prices would appear to be significant. Smaller impacts would be expected in the case of Peru who suspended tariffs on the imports of wheat, maize and all flours that ranged from 17 to 25 percent and of Indonesia who removed duties on imported wheat that were just 5 percent.

13. The other trade measure that was used by several countries was export restrictions, which came in various forms: ordinary tax (ad valorem and specific), variable tax, differential taxes based on the stage of processing, Minimum Export Prices (MEPs), quotas and export bans. In several cases, instruments were used in combination, both sequentially and concurrently, as policy-makers reacted to rapid changes in food prices at home and abroad. Export restrictions were generally relaxed or lifted following the end of the first spikes in 2008, but some countries continued using them until after the second spike in 2011. Restrictions were again imposed by many during the second spike in 2011. Beginning in July 2011, restrictions were lifted by all major cereal exporters such as Argentina, India, the Russian Federation and Ukraine, in some cases regulated by export tax or quotas. Rice exports from Viet Nam continue to be subject to MEPs that are adjusted frequently.

14. Restrictions on food exports attracted a great deal of debate in this period, not only within countries but also at various global fora on trade and food security as well as at the WTO Committee on Agriculture. The debates addressed several issues related to impact and effectiveness: impact on world market price and volatility; effectiveness within countries in stabilizing consumer prices; impact on producers; impact on longer-term production and market development; impact on private trade; and appropriateness of alternative restrictive instruments. These discussions occurred among stakeholders such as industry groups (farmers, processors and traders), consumer groups and the government, and at times even among different ministries.

15. As of February 2012, most restrictive measures such as bans and quotas have been lifted. Yet, it was quite common to find national media and market analysts pointing to the possibility of the governments restricting exports again, depending on developments in such triggers as food inflation and the pace of current exports. Export taxes and restrictions are WTO-compatible, subject to the reporting requirements called for in Article 12 of the WTO agriculture agreement. This legal provision aside, the experience of 2007–11 shows that there is much scope to fine-tune this trade policy instrument so that it is more effective and less negative on farmers and private trade. Restoring the confidence of the importers in the global food market is also an issue to be addressed.

B. Increasing emphasis on food production and self-sufficiency

16. The global food crisis of 2007–08 prompted many countries to accord greater weight to food production and set higher targets for self-sufficiency, as part of the new or renewed national food security strategies. While increased domestic prices, in turn due to higher prices in the world markets, naturally shift production possibility curves upwards, these policy responses reflect a desire for raising and maintaining food production at higher levels. Such responses are also due to a growing feeling that the world food markets have become less reliable. In some cases, these policy positions were

articulated earlier but were renewed as a response to the crisis. For example, China had for some years a policy of “grain security”, with a target of 95 percent self-sufficiency; this was reiterated in an important policy document in November 2009. In the mean time, support to grain production has been stepped up markedly during the past four years. The Russian Federation announced in January 2010 the *Food Security Doctrine* with, *inter alia*, quantitative goals for minimum self-sufficiency, which is 95 percent for grains. In Angola, the *National Strategy on Food Security and Action Plan* was approved in 2009. In West Africa, many governments launched new campaigns for food production, rice in particular, also setting higher targets for self-sufficiency, for example in Benin, Burkina Faso, Côte d’Ivoire, Mali, Nigeria and Senegal. Self-sufficiency targets for wheat were also raised in Algeria and Egypt. Elsewhere, Bangladesh, Indonesia, Malaysia and the Philippines reiterated or announced higher or full self-sufficiency goals for rice.

17. Some regional economic groups have responded similarly. In West Africa, the food crisis prompted a reformulation of the regional agricultural programme. In June 2008, Heads of State of the Economic Community of West African States (ECOWAS) Members held a summit in response to the food crisis and announced a programme of promoting regional food value chains (rice, maize and tubers) for attaining food sovereignty. The East African Community (EAC) is also moving in that direction under its regional food security strategy.

C. International investment in agricultural land to secure food supplies

18. One interesting response to high food prices and perceived weakness of the global food markets has been to invest by rich food-deficit countries in primary food production in countries where land is perceived to be abundant and under-utilized. This generated considerable debate. On the one hand, such investment was welcomed as this would bring much-needed investment in developing countries to modernize agriculture, transfer technology, create employment and generate upstream and downstream linkages. On the other, concerns were raised that large-scale investment in land entails risks for the host country and local communities in the absence of appropriate policies, laws and institutions, as also shown by some case studies.

19. In response, there have been calls for international guidance to regulate such investment. FAO has facilitated the international negotiation of the *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests* in the context of National Food Security (VGGT). Once approved by the Committee on World Food Security in May 2012, the guidelines will serve as a reference and provide guidance to improve the governance of tenure of land, fisheries and forests with the overarching goal of achieving food security for all in a sustainable way. In addition, FAO, IFAD, UNCTAD and the World Bank have jointly developed voluntary *Principles for responsible agricultural investment that respect rights, livelihoods and resources*. These instruments will, *inter alia*, serve as inputs to the CFS-led consultations for the development and the broader ownership of principles for responsible agricultural investment that enhance food security and nutrition.

D. Increased outlays on farm support and innovative schemes

20. Consistent with this shift in strategy, many governments around the world have announced new pledges and/or raised outlays on food production programmes. One notable and immediate response to the food crisis was fuel and fertilizer subsidies, as well as those on seeds and farm credit. Innovative schemes, such as “smart subsidies” for fertilizers and public-private partnerships, are also being pursued. These responses were conspicuous in many countries in Africa, as well as elsewhere such as Azerbaijan, Bangladesh, Costa Rica and Indonesia. In China, outlays on grain production support programme – direct income support as well as subsidies on seeds, machinery, fuel and fertilizers – increased by over four times between 2006 and 2010. In Angola, the government announced in 2009 an investment of USD2 billion in agriculture to significantly boost cereal production. In Kenya, budgetary support to agriculture was raised substantially, by 66 percent, in 2009 and sustained. As a result, it was reported in 2011 that this share has increased to about 9 percent from 4 percent some years back. Encouraging food production through price support schemes, defended by

public procurement, has also been a popular response. Where these schemes existed already, such as in China and India, support prices were raised markedly. Elsewhere, new schemes were announced, e.g. in Algeria, Angola and Nigeria.

21. The national commitments have been complemented by increased pledges of external assistance to agriculture at high-level international summits and conferences, all in response to the food crisis. Overall, the price spikes and projections of high and volatile food prices have had considerable influence on both the thinking and action. There is thus a change in perception with the realization that food production was underfunded in the past and that countries ought to be making much more effort for developing this subsector.

E. Increased public sector involvement in food markets

22. While many countries do not have sizable programmes on public procurement of foodgrains as part of the scheme to support farm price and maintain public reserves, new announcements of intention, decisions and policy discussions point towards increased role for the state in food markets. In India, public procurement of cereals during the past four seasons has been historically high, averaging about 30 percent of the total output of rice and wheat, and markedly higher than the public reserve norms. India's projected needs amount to some 60–70 million tonnes of cereals to implement the new National Food Security Act. In China too, wheat procurement has increased and averaged about 35 percent of the total output in the past three years. In the Russian Federation and Ukraine, which are major exporters, public procurement as a share of total output remains historically low but some recent decisions and policy discussions may result in increased procurement in the coming years. Market prices of bread and meat are likely to be important factors influencing the scale of the interventions. In the Russian Federation, new schemes such as grain collaterals and regional food funds for procurement are also being discussed.

23. Thailand's return in 2011 to its earlier Paddy Pledging Programme (PPP) is expected to increase the government's role in the rice market, especially if the rice pledging price is set at a higher level. The PPP replaced the Price Insurance Scheme (PIS) which was based on direct payments and involved very little public procurement. In Africa, where there are far fewer schemes, the main debate has been on the role and size of the grain reserves, i.e. how large these reserves should be and whether these would also be used to stabilize market prices. For example, under its *Food Security Action Plan 2010-2015*, the EAC has proposed that its member countries increase their reserves considerably. These policy discussions have triggered some debates on the role of stocks versus trade in ensuring price stability and food security, an issue that had attracted considerable attention in the 1970s and 1980s.

F. Varied ad hoc responses to contain the retail price rises of basic foods

24. Containing food prices rises at the consumer or retail level, in contrast to the wholesale level, was also a prominent challenge faced by many governments. This was more so where the consumer good was a processed product, such as bread and pasta, as well as meat whose price depended on the price of grains. Thus, some governments that restricted cereal exports found that while grain prices were contained, this was much less so for the processed products. This prompted several responses towards directly regulating the retail prices such as setting price caps and government-mediated negotiations among traders for fixing maximum prices and margins. Middlemen and processors were often blamed for being hoarders and speculators. These experiences raised, once again, questions on the proper functioning of the food markets as well as the role of the government in food trade.

25. To illustrate some cases, in the Russian Federation, the correlation between the price of grains and bread was noted to be relatively low, to the extent that when wheat prices started to decline from March 2011 bread prices continued rising. As a result, some actions were taken – e.g. setting prices for some period through negotiations among grain producers, millers and bakers – and new ideas floated such as establishing a list of socially significant products whose mark-ups between the wholesale and retail prices would be capped at some reasonable level. In Ukraine, a list of “socially sensitive products” was drawn, which included all grains and some edible oils, for the purpose of controlling

retail prices and/or margins when necessary. Some administrative measures were also taken in China and India to prevent hoarding and speculation, including limiting participation in auctions and futures markets. In Sri Lanka, the Government fixed maximum retail prices for a number of products such as rice, wheat flour, poultry and sugar. For some of these products, farm prices were also administered, which made the process of fine-tuning policies (e.g. tariff rate) more complex. The capping of the retail prices or price margins was also a common response in several countries in Africa, e.g. Algeria, Cameroon and Ethiopia.

III. SUMMARY – SOME POLICY AND ANALYTICAL ISSUES

26. First, there is much to learn on the process of price transmission from the world to domestic markets. Aside from the ten or so cases of large exporters that avoided high price transmission, there are other sub-groups of importers with varied experiences, some managing to prevent high transmission and others failing to do so. What policy and non-policy factors might have played a role in the process, and what can be learnt and shared as best practices?

27. Second, that the food price crisis prompted governments to prioritize food production and food security is a welcome development. Two issues among others may be noted here. One is to ensure that this prioritization is sustained even if food prices subside in the world markets. This will require, *inter alia*, securely mainstreaming appropriate food policies, programmes and support measures in national development plans such as in the Country Programming Framework (CPF) and Poverty Reduction Strategy Papers (PRSPs). Two, it is also important that high self-sufficiency targets are set with utmost care based on sound economic and social reasoning to avoid or minimize resource and environmental costs and economic inefficiency that might result from such policies.

28. Third, the food price crisis has also been blamed for an erosion of trust among food importers in the global food markets. This undermines years of efforts in economic policy making, notably through the WTO process, to make trade one key building block of national food security.

29. Lastly, opinions differ as regards whether increased public sector involvement in food markets is a positive or negative development. Over the years, the trend has been towards a reduced role of the state and greater involvement of the private sector. While this model seemed to work in normal times, the food crisis revealed weaknesses in the functioning of the domestic food markets as many governments had to resort to varied forms of ad hoc and unilateral measures to contain price increases, including limiting the role of the private sector. This experience calls for in-depth analysis and policy discussion, involving all stakeholders, with a view to making food markets effective in periods of high and volatile prices as well.

IV. SUGGESTED ACTION BY THE COMMITTEE

30. The Committee may wish to:

- i) Recognize that increased policy coordination among countries and enhanced market transparency could contribute to stabilizing markets both domestically and globally. Countries should be urged to widen and reinforce policy dialogue and consultation and avoid the use of ad hoc policies that may exacerbate the situation.
- ii) Underline the importance of urgent and successful conclusion of the Doha Round of trade negotiations to ensure a rules-based international agricultural trading system that is open, fair, non-distorted and non-discriminatory.
- iii) Recommend that FAO keep a close watch on food commodity price movements and policy responses, and conduct in-depth analyses and country case studies as required.
- iv) Request FAO to continue and strengthen its assistance to member countries in both policy and programmatic actions to effectively address high and volatile food prices, namely in the areas of market information and analysis, policy advice and capacity building.