



## Concept Note

### FAO event on “Food Price Volatility and the Role of Speculation” with the participation of His Excellency Leonel Fernández, President of the Dominican Republic

Sheikh Zayed Centre, FAO Headquarters, Friday, 6 July 2012

#### Food price volatility and its causes

For most of the past fifty years, real agricultural commodity prices followed a downward trend punctuated by short-lived peaks that were not matched by equally pronounced and short-lived price falls, but rather were separated by extended price troughs. Since 2000 it appears that prices have departed from their long-term downward trend and have become increasingly volatile. Prices increased between late-2006 and mid-2008 to their highest level in thirty years, fell sharply through 2009 then regained their 2008 peak in late-2010-early 2011. The resurgence of high food prices in 2010 prompted fears of a repeat of the 2007-8 food crisis threatening increasing food insecurity, rampant food price inflation and civil unrest. Fortunately, the worst fears did not materialize generally. The FAO – *OECD Agricultural Outlook* however, expects prices to remain above their historical trend levels and to continue to be volatile in the medium term. High and volatile agricultural commodity prices are likely to persist and continue to challenge the ability of consumers, producers and governments to cope with the consequences.

The secular downward trend in real prices reflected a tendency for technical improvements to increase yields and production faster than population and income growth increased demand. There has been, however, some slowing of the rate of yield growth in recent years while demand has continued to grow rapidly. Low levels of investment in agriculture and in research and development, whether international or national, public or private, have slowed production growth. High rates of economic growth in emerging economies have increased food demand especially for livestock products and hence feed grains. At the same time, there has been increasing demand for certain agricultural products as feed-stocks for biofuel production which has expanded significantly, sometimes as a result of subsidies and mandates. Biofuel production links agricultural prices and markets more closely to energy markets and in particular to volatile oil prices. High prices tend to be accompanied by heightened price volatility. Some degree of price volatility is typical of agricultural commodity markets as a result of their fundamental characteristics. Agricultural production is subject to natural shocks such as weather variations, pests and diseases. Since agricultural product demand and supply are inelastic in the short-run, wide price adjustments may be necessary to clear markets, especially where stocks are low. However, recent volatility has been exaggerated by the closer linkages between agricultural and energy markets and the “financialization” of agricultural commodity markets and the associated speculation which has forged closer links between the prices of agricultural commodities and those of financial assets. The impact of speculation on food prices is a highly controversial topic. Lack of

detailed data and information makes it particularly difficult to measure. While some information is available for the organized futures markets, little is known about over-the-counter trading or how the development of high-speed trading will change things. However, it has become widely accepted that speculation has contributed to recent price volatility, at least in exaggerating the magnitude and duration of price movements. As a result, there has been increasing pressure for the introduction of greater regulation to limit this impact. The US and the EU are already taking steps in this direction. However, more understanding is still needed of the relationships between agricultural and financial markets, the impact of speculation and what regulatory approach might be appropriate and effective.

### **The UN Resolution and the High Level Technical Debate**

A debate on the negative impacts of high and volatile food prices on the poor and vulnerable and the role of speculation in recent price swings was initiated in the United Nations by President Leonel Fernández of the Dominican Republic. FAO was pleased to support President Fernández' initiative. The resolution "Addressing Excessive Price Volatility in Food and Related Financial and Commodity Markets" was introduced in the United Nations by the Dominican Republic in December 2011 and was adopted by consensus. Recognizing the need for a comprehensive and coordinated response, the United Nations General Assembly invited all relevant UN agencies, in particular the Food and Agriculture Organization, to participate actively in discussing this matter and to continue to conduct research and analysis.

As mandated in the Resolution, the President of the General Assembly of the United Nations convened a High-Level Thematic Debate (HLTD) on this topic on 11 April 2012. This was intended to provide an opportunity for Heads of State and Government, Ministers and other High level officials and relevant International Organizations to discuss, at the political level, and seek consensus on the causes of excessive price volatility, how these affect countries' efforts to achieve food security, and policy options to address this issue.

### **FAO event on food price volatility and the role of speculation, 6 July 2012**

The HLTD was also intended to begin a process that would lead to more definitive, in depth examination and monitoring of the issue by the international community and in particular the question of speculation and its impact. FAO participated in the HLTD debate and the event to be held on 6 July 2012 is the first step in carrying it forward. The event provides for a further exchange of views on the extent to which speculative behaviour on commodity futures markets has contributed to food price volatility and on associated regulatory issues. The discussion will benefit from the expert opinions of invited panellists. It will contribute to building consensus on these controversial and complex issues and will help identify information needs and priorities for further analysis by FAO.