

## COMMITTEE ON COMMODITY PROBLEMS

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## MANAGEMENT OF WIDE INTERNATIONAL COMMODITY PRICE MOVEMENTS – NATIONAL AND INTERNATIONAL EXPERIENCES AND POLICY RESPONSES

### I. Introduction

1. Between 2007 and 2008, world markets experienced a dramatic swing in commodity prices. Food prices increased substantially, reaching during the summer of 2008 their highest level in 30 years. Although food prices have declined since their peak, they remain at a level higher than that prevailing in 2005, underlying the need to implement policies to protect the poor and vulnerable in developing countries. This document focuses on the experiences of a number of developing countries during the 2008 price surge, focusing mostly on the Eastern and Southern Africa regions, as well as on countries in Asia. It provides a brief report of the impact of food price increases at the household level and discusses the policies that were implemented in terms of their effectiveness, drawing a number of lessons from this recent experience. The document also discusses a number of international policy options that aim to improve low income developing countries access to food imports during food price surges and to instill more confidence, predictability and assurance in global markets of basic food commodities.

### II. Evidence on the extent of the negative impact of international food price increases

2. Across developing countries, food price surges can have very diverse effects on households. Consumption patterns and the net position of households towards food markets, that is whether households are net sellers or net consumers of food, determine the impact of price increases on poverty and food security. Although the direction and magnitude of the price surge impact varies across countries, on average the available evidence suggests that increases in poverty occur more frequently than reductions. On the one hand, high food prices are estimated to have increased poverty in Madagascar, Nicaragua, Pakistan and Zambia, where most of the rural households are net food consumers. On the other hand, poverty in Peru and Viet Nam may have reduced to some extent due to a significant number of households which are net producers of

rice.<sup>1</sup> Additional analysis on the impact of the food price surge on a number of West and Central African countries suggested that a 50 percent increase in the price of selected food items may result in an increase of between 2.5 and 4.4 percent in the share of population in poverty. These countries import a large share of their food requirements and the negative impact on food consumers outweighs any positive effect on the net producers of locally produced goods.<sup>2</sup>

3. In Asia, the increase in rice prices can have a potentially important effect through labour markets. Higher rice prices, by stimulating the demand for unskilled labour in rural areas, can result in a long term increase in rural wages, thereby benefiting vulnerable social groups and the landless who supply their labour to the agricultural sector. Recent research implies that during price surges the labour market can channel significant benefits to the poor in Asia. For example, real wages in Bangladesh and the Philippines increased in the wake of substantial increases in real rice prices.<sup>3</sup> Therefore, depending on the proportion of net producing households in a country, food price increases can lead to an increase in the demand for farm labour and increased income for rural workers, with illiterate workers and disadvantaged groups being potentially the largest gainers.

4. Research carried out in FAO examined the impact of food price increases on consumption, food expenditure and food security in Eastern and Southern Africa.<sup>4</sup> In these regions, maize is the most important staple. For example, the annual per capita consumption of maize in Malawi amounts to about 130 to 160 kg, while that in Zambia ranges between 120 and 150 kg. The analysis suggested that an average household facing a 50 percent increase in the price of grains, would reduce maize consumption by 8.5 and 15.6 percent in Malawi and Zambia, respectively. Poor and food insecure households were found to reduce maize consumption to a lesser extent, as compared to this average, reflecting that the poor have limited possibilities for substitution.

5. The analysis also suggested that in spite of the contraction in maize consumption, household food expenditure increased as prices soared. On average, household expenditure in Malawi was found to increase by 9.7 percent, as the 8.5 percent decrease in maize consumption did not suffice in keeping total food expenditures low. For the poor households which allocate approximately 33 percent of total food expenditure to maize, food expenditure was estimated to increase by 16 percent. Poor female-headed households of which food expenditure is characterized by a high share of maize, approximately 43 percent, were found to experience significant increases in food costs. In Zambia, similar price increases were found to result in an increase of 8 percent in the average household food expenditure. Nevertheless, as poor households in Zambia allocate about 20 percent of their food budget to maize, a 50 percent increase in grain prices was found to result in an 8.6 percent increase in total food expenditure.

6. As high food prices and increased food expenditure imply decreases in purchasing power, more households fall into poverty and become food insecure. In Zambia, the analysis suggested that a 50 percent increase in grain prices could result in a 5.4 percent increase in the number of food insecure households. The corresponding increase in the number of food insecure in Malawi was found to be significantly larger being estimated at nearly 16 percent due to the higher share of maize in food consumption and expenditure. Staple diet diversification is important in

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<sup>1</sup> Ivanic, M. & Martin, W. 2008. Implications of higher global food prices for poverty in low-income countries. Policy Research Working Paper No. 4594, Washington, DC, The World Bank.

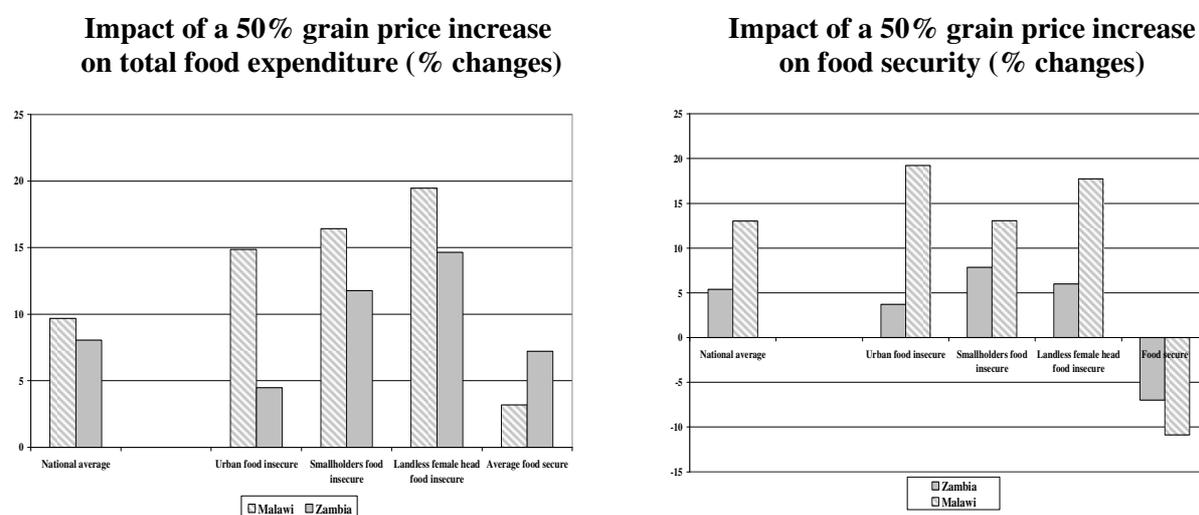
<sup>2</sup> Wodon, Q., Tsimpo, C., Backiny-Yetna, P., Joseph, G., Adoho, F. & Coulombe, H. 2008. Potential impact of higher food prices on poverty. Policy Research Working Paper No. 4745, Washington, DC, The World Bank.

<sup>3</sup> Hossain, M, and U.K. Deb. 2010. Volatility in Rice Prices and Policy Responses in Bangladesh. In Dawe, D. (ed) *The Rice Crisis*, FAO and Earthscan and Lasco, C.D., R.J. Myers and R.H. Bernstein. 2008. Dynamics of Rice Prices and Agricultural Wages in the Philippines. *Agricultural Economics*. 38: 339-348.

<sup>4</sup> Rapsomanikis, G. 2009. *The 2007-2008 Food Price Swing: Impact and Policies in Eastern and Southern Africa*. FAO Commodity and Trade Technical Paper No. 12. FAO Trade and Markets Division.

determining the impact of food price surges on households. In Uganda, maize consumption amounts to an average of 29 kg per capita, a quantity significantly lower than that consumed in other countries in the region. Ugandan households consume a variety of staple foods, such as rice, millet, matooke and cassava. Although the prices of rice and millet also rose, the prices of matooke and cassava, foods that are not internationally traded, exhibited weaker increases of about 35 and 20 percent respectively as compared to an increase of 75 percent in the price of maize.<sup>5</sup> Wide staple diet diversification and the large quantities of domestically produced staples consumed, significantly moderated the negative impact of the international price surge on Ugandan households. FAO analysis suggested that a 50 percent increase in the price of grains could result in an increase of 2.5 percent in the number of food insecure households, an impact significantly smaller to that experienced by other countries in the region.<sup>6</sup>

**Figure 1 – Impact of food price rises on household food expenditure and food security in Malawi and Zambia**



7. Evidence on the behaviour of rural households during the recent price surge is sparse. In Kenya, an examination of households' response suggested that approximately 38 percent of the households experienced a food deficit and resorted to various coping strategies. These included the sale of livestock, seeking farm and non-farm employment, a decrease in the purchase of agricultural inputs and disinvestment in human capital.<sup>7</sup> Although seeking employment opportunities has in the past been a usual response to food deficits in Kenya, in 2007-08 poor rains resulted in reduced agricultural activity, rendering the supply of labour ineffective as a strategy to hedge against the risk of food deficit. A number of households resorted to the consumption of a part of the seed that was stored for the next planting season, while high fertilizer prices prompted smallholders to purchase low quantities of fertilizer. These coping strategies affect future production and income streams. Delays in the payment of school fees and reduction

<sup>5</sup> Benson, T., Mugarura, S. & Wanda, K. 2008. Impacts in Uganda of rising global food prices: the role of diversified staples and limited price transmission. *Agricultural Economics*, 39: 513–524.

<sup>6</sup> Rapsomanikis, G. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Eastern and Southern Africa. FAO Commodity and Trade Technical Paper No. 12, FAO Trade and Market Division.

<sup>7</sup> Okello, J. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Kenya. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

in health care were also found to be common responses, suggesting that price upswings can result in disinvestment in human capital.

### **III. National policies implemented to manage international food price increases**

8. Many developing countries responded to the food price surge through a spectrum of policies at the market, as well at the household level. Several food importing countries reduced import tariffs, while many producing countries limited, or even banned, exports in order to avoid food shortages and further price increases. A number of countries chose to intervene directly in the market by managing food reserves in order to stabilize domestic prices. Trade policies and direct market intervention attempt to reduce the cost of food and increase its availability for all, both poor and non-poor. Countries also resorted to micro-level interventions through targeted consumer and producer subsidies and safety nets which aimed at supporting specific population groups who are vulnerable and most in need.

#### **A. TRADE POLICIES AND DIRECT MARKET INTERVENTION**

9. Import tariff and tax reductions were a common policy response by food importing countries. For example, in Kenya, the import tariff on wheat was reduced from 35 percent to 10 percent, while the tariff rate on maize imports was reduced to zero. The value added tax on wheat and maize flour, as well as on other foods, such as milk, was also reduced in order to rein in the food price surge.<sup>8</sup> Nevertheless, as in many other developing countries, these measures did not suffice in containing food price increases. The effectiveness of import tariff reductions was determined by the initial level of applied tariffs. Available tariff data suggests that the majority of developing countries do not generally apply high tariffs on basic foods, and so the scope for tariff reduction is limited. For example, for a sample of 60 low-income food-deficit countries surveyed in 2008, applied tariffs on cereals and key vegetable oils fell within the range of 8 and 14 percent, respectively. Tariffs were much lower than these averages for a majority of these countries, suggesting that these applied rates, when reduced to zero, were adequate for offsetting only a small part of the overall rise in the international food prices.<sup>9</sup>

10. Many developing countries implemented export restrictions in an attempt to lower domestic prices and ensure domestic food security. Completely banning food exports was a common reaction to the food price surge in Africa. Although, in general, export bans can lower domestic food prices and are seen as supporting consumers, their effectiveness is undermined due to informal trade which is common in the Eastern and Southern African regions.<sup>10</sup> There are also a number of negative consequences. First, export bans imply a tax on producers and lower the incentive to respond to the international price rise by increasing supply. In the long term, export restrictions may discourage investment in agriculture and thus can have negative implications for food security. Second, in the short term, export restrictions can harm traditional trading partners. For example, during the height of the food price surge in 2008, the National Cereals and Produce Board, the state marketing board of Kenya, was not able to import sufficient quantities of maize mainly due to export bans implemented by a number of countries in the region.

11. Concerted implementation of export restrictions by major exporters renders the international market unreliable as a source of food. Government control over exports and imports and food reserve management to defend pre-determined prices characterizes the rice sectors of

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<sup>8</sup> Okello, J. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Kenya. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

<sup>9</sup> Sharma, R. & Konandreas, P. 2008. WTO provisions in the context of responding to soaring food prices. Commodity and Trade Policy Research Working Paper No. 25. FAO Trade and Markets Division.

<sup>10</sup> Famine Early Warning System Network. 2008. Informal Cross Border trade in Southern Africa. Issue 42, May.

most Asian rice producing countries. Countries, such as China, India and Indonesia, used such a combination of trade and stock policies and managed to stabilize their domestic rice prices during the 2007-2008 rice price surge. However, in 2008, the decision of India and Viet Nam, the world's second and third largest rice exporters, to ban exports of rice resulted in a 43 percent increase in the price of rice between October and February of the same year. Although exports from both countries continued, to a limited extent, under Government-to-Government contracts, the export restrictions created substantial uncertainty in the market, especially because governments announced the export bans without clarifying their duration.<sup>11</sup> Strong buying behavior by some importers also contributed to the uncertainty in the markets. 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. More predictable and less discretionary policies would convey clearer information and render panic and hoarding less likely, resulting in less uncertainty.

12. Food importing countries in Eastern and Southern Africa also resorted to food reserve management in order to lower domestic food prices. Marketing boards attempted to contain maize price increases through a combination of import programmes and domestic food procurement and the subsequent release of food into the market in affordable prices. The cost of such operations is significant and may also escalate in line with increases in international prices. Their effectiveness depends on the board's capacity and budget to mobilize imports, or procure domestically produced food and proceed to food sales at predetermined price levels. In addition, success also depends on the expectations market participants, such as traders and producers, have for the behaviour of prices in the future. For example, attempts by the National Cereals and Produce Board in Kenya to domestically purchase additional quantities of maize, following the difficulties in implementing import programmes, were also unproductive. Due to the increased cost of fertilizers, producers found the price offered by the board unattractive and held on their stocks. With no other possibility for securing sufficient quantities of maize, the marketing board's operations had little effect on offsetting price increases.<sup>12</sup>

13. In a number of Eastern and Southern African countries, marketing boards are often the single most important player in the market and their power over maize prices affects other market participants. Often largely unexpected changes in marketing boards' policies result in a lack of trust between the public and private sectors. This can have negative consequences in times of crises. During the recent food price surge, attempts to initiate import programmes to meet food requirements in Zambia through the private sector and the national marketing board, the Food Reserve Agency, were not productive due to such a lack of trust between the public and private sectors. With the Government reserving the right to intervene and influence the market price in the event of further increases, private traders were unwilling to import grains. Due to the resulting maize shortages, domestic maize prices increased further towards import parity levels.<sup>13</sup> Marketing board operations can also have unintended negative effects on domestic markets. In some cases, competition between marketing boards and private traders in domestic food procurement may have resulted in further fuelling the trend in food prices.<sup>14</sup>

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<sup>11</sup> Dawe, D. and T. Slayton. 2010. The World Rice Market Crisis of 2007-2008. In Dawe, D. (ed) The Rice Crisis, FAO and Earthscan.

<sup>12</sup> Okello, J. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Kenya. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

<sup>13</sup> Govereh, J. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Zambia. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

<sup>14</sup> Chirwa, E. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Malawi. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

## B. CONSUMER AND PRODUCER SUBSIDIES AND SAFETY NETS

14. A number of countries responded to the price surge by subsidizing food. Universal food subsidies allow for a quicker response in improving access to food and in offsetting the first round impact of price increases. The release of food at predetermined prices by state marketing boards implies a food subsidy for all consumers, both poor and non poor. In general, such measures were not successful in stabilizing grain market prices either due to the lack of sufficient public food stocks or due to structural inflexibilities in the food marketing system.<sup>15</sup> In addition, these universal subsidy programmes proved to be costly without effectively targeting those who really need support. For example, in Zambia, a number of policy experts argued that consumer subsidies should target the poor only by placing them on “roller” maize meal, a relatively inferior product, as compared to “breakfast” maize meal that is preferred by well-off households.<sup>16</sup> Other countries implemented similar food release programmes to stabilize grain prices. Kenya attempted to target the vulnerable through a dual pricing strategy by which the poor would be entitled to purchase grain at lower prices than those determined by the market. A number of factors combined to reduce the effectiveness of this measure. First, poor consumers faced significant transaction costs as they had to travel to distant marketing board depots to purchase the subsidized maize. Second, the board also sold the subsidized maize in large bundles making it still unaffordable to the poorest who could only pay for smaller packages. Such experiences underline the difficulty of providing targeted assistance to vulnerable population groups in the absence of established social safety net programmes.

15. In a number of countries additional efforts to stabilize food prices were made, mainly through the expansion of existing safety net programmes. Scaling-up safety net operations was achieved by either increasing the benefit per person or by expanding the targeted population groups through the relaxation of the eligibility criteria. For example, in response to the food crisis in January 2008, the food or money transfers for public works in the Productive Safety Net Programme, an important safety net in Ethiopia, was increased by 33 percent. As prices continued to rise in August 2008, the safety net strained to provide sufficient support to the vulnerable, as demand for food transfers increased sharply.<sup>17</sup> In other countries in Africa, governments also increased the benefits delivered through existing safety nets. For instance, in Kenya, the Government increased more than twofold the budget of a cash transfer program targeting children in some 25 000 poor and food insecure households.<sup>18</sup> Similar increases in cash transfers to vulnerable population groups were implemented by scaling-up safety net programmes established by non-governmental organizations across the developing world. Nevertheless, such expansions presented significant difficulties. Most programmes lacked the administrative capacity to expand, while in many cases there was need for additional targeting mechanisms to include households that became vulnerable due to the food price surge. In addition, high budget requirements presented significant problems, as when food prices surged, most low-income developing countries faced increased food bills and decreases in government revenue. In general, the experience of many countries in attempting to provide assistance suggests that if safety nets are small and fragmented or non-existent, as in many developing countries, the number of policy options to protect the vulnerable is limited.

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<sup>15</sup> See for example Govereh, J. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Zambia. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

<sup>16</sup> See Chapoto, A, Haggblade, S. Shawa, J. Jayne T. & Weber M. 2008. Marketing policy options for consumer price mitigation action in the 2008/09 maize marketing season in Zambia. Food Security Research Project – Zambia , Brief No. 31, September.

<sup>17</sup> Demeke, M., Pangrazio, G. & Maetz, M. 2009. Country responses to the food security crisis: Nature and preliminary implications of the policies pursued. FAO Agricultural Policy Support Service.

<sup>18</sup> Okello, J. 2009. The 2007-2008 Food Price Swing: Impact and Policies in Kenya. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

16. In the context of the recent high food price episode, input support programmes became more relevant due to the significant and rapid increases in the international price of fertilizers relative to those of food prices. As the increase in food prices lagged behind the increase in fertilizer prices, expectations for lower profitability resulted in a significant reduction in the use of fertilizers, affecting the livelihood of smallholders and hindering supply response. Targeted fertilizer and other input subsidy programmes are an important policy instrument in many African countries, such as Kenya, Malawi, Tanzania and Zambia. Such targeted subsidies lower input costs and increase the profitability of agricultural production for the poor, especially when input costs rise faster than food prices. In this manner, they enhance the ability of smallholders to respond to the increase in food prices, assisting in assuring national and household food security. Increases in the production of food can result in price surges in the domestic market becoming shorter in terms of time and less pronounced in terms of magnitude, thus benefiting consumers.

17. Although targeted input subsidies have the potential to succeed in offsetting the negative effect of price upswings, they represent a large fiscal burden and their effectiveness should be assessed against their costs. For example, the Agricultural Input Subsidy Programme in Malawi represented approximately 43 percent of the Ministry of Agriculture total budget in 2006–2007.<sup>19</sup> With the international prices for urea rising more than twofold in 2008–2009 and the need to increase the amount of the transfer and to include more farmers, such programmes' costs also increased. For instance, in Zambia, the scaling-up of the Fertilizer Subsidy Programme in 2008–2009 by increasing the number of beneficiaries, as well as by providing a transfer equal to 80 percent of the commercial price of fertilizer resulted in an increase in the budget amounting to US\$137 million as compared with US\$56 million in the previous year.<sup>20</sup> Such a fiscal burden highlights the difficulties in scaling-up input subsidy programmes during commodity price surges. The extent to which a developing country can expand input subsidies may be limited and may depend on the government's budget constraints and foreign exchange reserves. For example, in Ethiopia the fertilizer price hike exacerbated foreign exchange difficulties which were addressed by a grant and credit to provide foreign exchange for importation of fertilizers.<sup>21</sup>

#### **IV. International policy considerations**

18. Commodity price surges such as that of 2007–2008, as well as the one in 1973–1974 are likely to be repeated, while little is known on their frequency, magnitude and persistence. Both price spikes took place during periods of rapidly accelerating economic activity, driven by growth and macroeconomic policies, such as increases in money supply. Both price booms ended with economic recession. However, fast economic growth on its own does not always lead to price surges. Many conditions should also prevail in order for a price spike to take shape. Market fundamentals play an important role. For example, crop failures in the years before 1974, intensified the impact on food prices. In 2008, stagnant productivity and tight food markets, low global inventories and strong demand for crops from the biofuel sector in an environment of rapidly increasing oil prices, all affected the movements of prices.

19. Although researchers have reached a common understanding on what triggered the behaviour in food prices in 2008, the relative importance of these drivers is not yet clear. There is also little to advise on the future frequency, magnitude and persistence of price surges, as the above observations suggest that many conditions have to concur for such an event to take place. It is certain that price surges will take place periodically, and given that the main driving forces are

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<sup>19</sup> Doward, A. 2009. Rethinking agricultural input subsidy programs in a changing world. FAO Commodity and Trade Technical Paper forthcoming, FAO Trade and Market Division.

<sup>20</sup> Govereh, J. 2009. The 2007–2008 Food Price Swing: Impact and Policies in Zambia. Discussion paper, Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

<sup>21</sup> World Bank. 2008. Report No. 46658-ET in Emergency program paper for proposed additional financing IDA grant and credit for a fertilizer support project.

macroeconomic in nature, little can be done to prevent them. However, there may be ways to reduce substantially the probability of them occurring again. A major aspect of any commodity price spike is a fast and sudden erosion of confidence in the workings of the market, both national and international, with the result that uncoordinated operations, by private and public agents alike, for individual protection leaves all worse off. In this context, the most efficient way to reduce the probability of future surges in global food markets is to promote market information, transparency and competition and at the same time to create or enhance institutions to ensure confidence in the markets.

20. At the international level, policy options to stabilize prices are limited. The complex mechanisms by which world market price surges arise and the individual country reactions render international interventions difficult. International stock management schemes, such as those characterizing the International Commodity Agreements, require continuing commitment and are vulnerable to changing market conditions. Indeed, the experience of international food reserves has not been promising. As one example, the ASEAN Food Security Reserve, established in 1980 with an initial stock of 50 000 tonnes of rice, has been used infrequently, if at all. Moreover, the quantities in the Reserve are very small and would only be sufficient to deal with localized shocks. In general, collective action problems have prevented this Reserve from becoming an important component of food security systems in the region. Establishment of a larger scheme, by extending to more countries or holding higher levels of stocks would likely encounter even larger collective action problems.<sup>22</sup>

21. In general market regulation policies at national and international levels, based on global or regional buffer stocks, cannot prevent price spikes, as speculators can normally counteract the actions of all but the most well financed intervention activities. The experience with public buffer stocks suggests that, often, such interventions have been disruptive, rather than stabilizing. Given the current state of knowledge about markets and previous experiences with collective action problems, it is not likely that such initiatives present practical solutions on a multilateral basis. The same logic holds for what has been termed “virtual stocks” which are designed to alter the fundamentals of the futures rather than the cash markets.<sup>23</sup> Any attempt to publicly influence the prices in futures markets would not only quickly become extremely expensive, but would also most likely lead to withdrawal of the agents who use the futures markets for hedging purposes, thus rendering futures market purely speculative.

22. One of the major international responses to commodity market volatility in the past has been compensatory financing, such as what was 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.<sup>24</sup> During the recent 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 provides for liquidity to mitigate the negative impact of

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<sup>22</sup> The purpose of the ASEAN Food Security Reserve, as stated in the original Agreement, is to provide for a supply of rice in emergency situations when a member country, having suffered a natural or man-induced calamity, is unable to cope with such state or condition through either its national reserve stocks or normal international trade. See also Dawe, D. 2005. *The Role of Food Reserves in Achieving Food Security*, presented at the East Asia Emergency Rice Reserve (EAERR) Pilot Project Workshop on Rice Reserve System, March.

<sup>23</sup> Proposals for intervention in the futures markets can be found in von Braun, J. and Torero, M. 2009. *Implementing Physical and Virtual Food Reserves to Protect the Poor and Prevent Market Failure.*, IFPRI Policy Brief 10, February.

<sup>24</sup> The IMF Compensatory Financing Facility has not been used since 2000 due to very tight conditionalities. See IMF. 2004. *Review of the Compensatory Financing Facility*, IMF Policy Development and Review Department, February.

exogenous shocks on developing countries' balance of payments, international reserves position and inflation.<sup>25</sup>

23. Although compensatory financing mechanisms can be used to stabilize the economies of developing countries during price surges, they may be not appropriate for addressing short-term food financing difficulties. The need for such food financing facility to assist low income net food importing developing countries was foreseen by the Marakkesh Decision and the World Trade Organization (WTO) Ministerial Conference at Doha.<sup>26</sup> On the basis of analysis by FAO, it was proposed to create a Food Financing Import 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. FIFF was designed to enable a country to finance food imports when there was a need, rather than to compensate balance of payment losses after the fact. The design was based on existing practices of international trade and of international finance, involving the international community as provider of conditional guarantees, rather than finance.<sup>27</sup> Very little has been pursued in the WTO since then on FIFF or similar alternatives, perhaps due to the low food price period that ensued. However, in retrospect, a functional international food import financing programme would have provided some relief to the affected countries during the recent period of soaring food prices, had it been in place. The rationale for this proposal remains valid.

24. In addition to an **enhanced system of food import financing aimed at low income countries**, such as the proposed FFIF, a number of institutions or arrangements could ensure more confidence in global markets, and assure smoother flows of food supplies:

**An enhanced system of global market information.** Many market policies are not well formulated due to lack of adequate information. An important element of market information is stockholdings and much can be accomplished to avoid price spikes by more accurate and timely information on national stocks of commodities.

**Enhanced transparency of trade policies.** The current Agreement on Agriculture in the WTO does not prevent governments from reducing or banning exports. Often such temporary trade policy changes can become permanent, leading to further trade distortions. A system of timely advance notice of agricultural trade policy measures affecting the supply of agricultural exports and the demand for imports, and even disciplines on some such measures that may be detrimental to markets could be made a part of the Doha Round agreement.

**Multilateral or regional agreements** among major exporters and major importers to assure export supplies in key commodities. Such agreements could be backed by national food stocks, but the way in which such agreements and commitments would be ensured should be left to individual countries.

**A system of global assurances of smooth supplies to the most vulnerable countries.** The major problem of global food price surges is that it affects disproportionately many low income food deficit countries. A reliable system of assurance of supplies is needed for such countries, on both bilateral, but possible multilateral basis. Such a system can be built by reference to agreed "protocols for collaboration" which could also be enhanced by guarantees of trade finance to ensure that trade is not restricted by the exposure limits of trade finance institutions.

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<sup>25</sup> Countries which made use of the Exogenous Shock Facility to mitigate the impact of the food and oil price surge include: Ethiopia, Kenya, the Kyrgyz Republic, Malawi, Mozambique and Senegal. Other countries resorted to the Facility due to the impact of the global economic downturn.

<sup>26</sup> Report of the Inter-Agency Panel on Short-Term Difficulties in Financing Normal Levels of Commercial Imports of Basic Foodstuffs, Document G/AG/13, WTO Committee on Agriculture, 28 June 2002.

<sup>27</sup> FAO. 2003. Financing Normal Levels of Commercial Imports of Basic Foodstuffs in the context of the Marrakesh Decision on Least-Developed and Net Food Importing Developing Countries. FAO Trade and Markets Division. See also Konandreas, P. 2009. Trade policy measures during food price swings: WTO-compatible instruments to respond to world price instability. Project on Policies for Good Economic Management of Food Price Swings in Africa. FAO Trade and Markets Division.

**Market based insurance system for imports of the most vulnerable countries.** Even if physical supplies could be guaranteed in times of food crises, it is not clear that some poor and vulnerable countries could afford the extra cost of necessary food imports in times of food price increases. A market based system of insurance of excessive country import costs could provide fast disbursing funds in such cases.

**A system of linking existing or prospective organized commodity exchanges.** Every organized exchange is supported by a sophisticated clearing house, to ensure that all transactions are executed. An organized and stronger link between such exchanges across different countries, may make the execution of international food commodity contracts more reliable and avoid many of the problems of counterparty risk that have plagued many food importing countries during the recent crisis.

## V. Committee guidance

25. Food price surges place significant demands on the economic management skills of governments. Policy responses to the food price increases were prompt in many developing countries through trade measures, food reserve management and producer and consumer safety nets. The 2008 food price surge also highlighted the need to further consider international mechanisms to improve the access of low income developing countries to food imports during periods of high prices. The Committee is invited to comment on the specific international policy proposals identified in section IV. The Committee may wish to call on FAO to:

- give increased priority to assessing specific national or international policy solutions;
- providing support to FAO Members through policy making capacity building; and,
- report back to the Committee on progress made and outcomes of the policy assessment and capacity building process.