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Round table on policies to address food price volatility

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I. Background

1. From the 1960s to the early 2000s, food prices generally declined in real terms, apart from a peak from 1973 to 1974, and then increased slowly from 2003 to 2006. However, the volatility in international food prices since 2006 has been unprecedented since the mid 1970s. Prices increased sharply from September 2006 to June 2008, when the FAO Food Price Index (FFPI) rose from 125 to 224 points. It then started to decline and reached 141 points in February 2009. In July 2010 it began to increase again, reaching 238 points in February 2011, its highest level since January 1990 in both nominal and real terms.

2. Since then, the FFPI has declined again – reflecting decreases in international prices of all the commodities included in the index – to an 11-month low of 216 points in October 2011, which was still 5 percent above its value a year earlier. In most countries in the Asia-Pacific region, domestic food prices have been volatile in recent years. Moreover, food price indices have risen faster than the consumer price indices. For example, during the first semester of 2011, most countries in the region experienced higher food inflation rates than overall inflation rates, except for the Philippines.

3. The OECD-FAO Agricultural Outlook 2011–2020 projects high agricultural commodity prices in real terms during the next decade, compared with the previous decade. High and volatile food prices are likely to continue in this decade if the rate of growth of food production does not keep pace with demand and if other factors, including high crude oil prices, remain unchanged.

A. Causes of food price volatility

4. There can be international and domestic causes of food price volatility. The main underlying reason for the observed volatility in international food prices is the tightening of the demand-supply balance, reflected in declining stock-to-utilization ratios for foodgrains globally during the last decade. While the demand for food is steadily growing because of an increase in population, income and biofuel production, the supply of food has been constrained by several factors.

5. The rate of productivity growth for major cereals (e.g. rice and wheat) has stagnated in the past decade. In the Asia-Pacific region, there has been hardly any expansion of arable land (some countries have even seen a decline), and soil quality and water resources are declining. These factors increasingly limit the growth in agricultural production. This situation, combined with rapid population growth, has led to a tightening demand-supply balance, market uncertainty, food price volatility and an upward trend in food prices.

6. Food price volatility also is increasingly influenced by stronger linkages between agricultural markets and energy markets, created by the diversion of maize and other commodities to biofuel production. Volatility in energy markets thus gets transmitted to food markets. In addition, attempts by countries to restrict food exports in order to safeguard domestic food security may lead to sharp increases in international prices, especially if the country is a major exporter of the commodity in question.

7. Food prices vary within a year according to the seasons, because the output of a particular product occurs only once or twice a year even though it is consumed throughout the year. Food prices also fluctuate from year to year because of variations in output and stock positions arising from domestic supply shocks related to weather, pests, diseases and natural disasters. This may be compounded by a monopolistic market structure; poor infrastructure; lack of credit, insurance and other support services; and changes in relative prices and price expectations.

B. Why food price volatility is a problem

8. When food prices increase in international markets, import-dependent, low-income, food-deficit countries are likely to face foreign exchange constraints and find it hard to maintain domestic food price stability because of fiscal constraints. Large spikes in domestic food prices pose a serious

threat to poor people in developing countries who spend up to three-fourths of their income on food. Over 70 percent of farmers in the Asia-Pacific region are smallholders and most of them are net food buyers. In most developing countries, which do not have effective safety nets because of their governments' limited financial and adminstrative capacity, a steep rise in food prices may force the poor to cut their food consumption, spend their precious savings and, if the situation is prolonged, sell their productive assets or skip educational and health care needs which could push them into poverty traps.

9. Producers, as well as consumers, take suboptimal decisions as a result of significant and unanticipated food price volatility. Producers find it difficult to plan production in an effective way because of uncertainty about future price movements. Higher commodity prices should provide a positive incentive to the agricultural sector, which has been experiencing price declines in real terms for three decades. However, supply response also depends on the relative cost of production inputs, and the incentives provided by higher international prices are not always passed on to producers because of high transaction costs or domestic policy interventions.

C. Policy options to address food price volatility

10. Public investment in agricultural research and extension, irrigation and other infrastructure and support services will increase farm productivity and cost efficiency. This may in turn improve the competitiveness of domestic production, increase farmers' profits and make food more affordable. Such public goods provided through investment by the public sector can play a catalytic role in attracting private investment in agriculture and creating a sustainable basis for agricultural growth. Increasing the productivity, sustainability and resilience of agriculture would reduce price volatility in the long term. This would have a strong positive impact on the incomes of the rural poor, who constitute most of the poor in this region and depend on agriculture for their livelihoods. Rural households would become less vulnerable to price fluctuations and poverty traps.

11. Addressing domestic price volatility in the short term requires effective trade and marketing policies. The choice of a particular policy instrument and its success depends on the country context. Furthermore, market-oriented measures need to be complemented with safety net measures to protect the poor during periods of price spikes. These measures have policy and fiscal implications. For example, reducing import tariffs may mean lower revenue for the government, while open market operations by the government may interfere with private sector operations and some taxes may be passed on to producers which would create disincentives for investment.

12. Therefore, domestic policy responses need to be based on careful analysis of their fiscal and political viability and of the potential consequences for producers and consumers, winners and losers – possibly drawing on country experiences and lessons from past policy responses. Policy-makers also need to consider whether: (1) price volatility can be effectively addressed at reasonable costs without distorting the market mechanisms, particularly in the short-run; (2) certain policies could create a win-win situation; (3) scope exists for cooperation between the government and the private sector in addressing the issue; and (4) opportunities exist for regional cooperation, and if so, in what areas.

II. Proposed round table approach

13. The round table aims to provide a forum to share country experiences, learn from each other's attempts in addressing food price volatility and identify possible policy options at the national and regional levels with the aim of reducing food price volatility and mitigating its adverse impacts on producers and consumers. Discussions will be facilitated by a moderator who will promote interaction on relevant issues, challenges and potential solutions in order to generate concrete recommendations. To ensure maximum interaction among participants, each country is encouraged to contribute one or two concerns or comments reflecting recent experiences with food price volatility and to articulate the key issues that need to be addressed collectively.

14. Relevant discussion topics on policy options to address food price volatility may include the following:

- What are the key policy and institutional adjustments and reforms required to increase public and private investment in agriculture and rural development in order to reduce the production risks faced by smallholder farmers and reduce price volatility?
- What measures are needed to enable small-scale farmers to reap the benefits of high food prices?
- What are the key features of safety net programmes and other measures that need to be implemented in order to protect poor people's food security in the face of high and volatile food prices?
- What measures need to be taken by countries to collect and disseminate timely and reliable information regarding food production, stocks, consumption and trade, in cooperation with the new international Agricultural Market Information System (AMIS) hosted by FAO? How can the region contribute to successful implementation of AMIS?
- What measures need to be taken to improve regional and international policy coordination with regard to policies on land use, trade, bioenergy production and speculation in food commodities?
- What options are available for providing assistance to low-income food-importing countries in meeting their food import bills in the face of volatile international food prices?
- What are the options for building foodgrain reserves at the national and regional levels to provide a defence against food price volatility?
- What priority areas of technical assistance can FAO provide to member countries to help them address high and volatile food prices?