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Do's and Don'ts of Managing the New Food Price Environment in Countries with Food Insecure Populations

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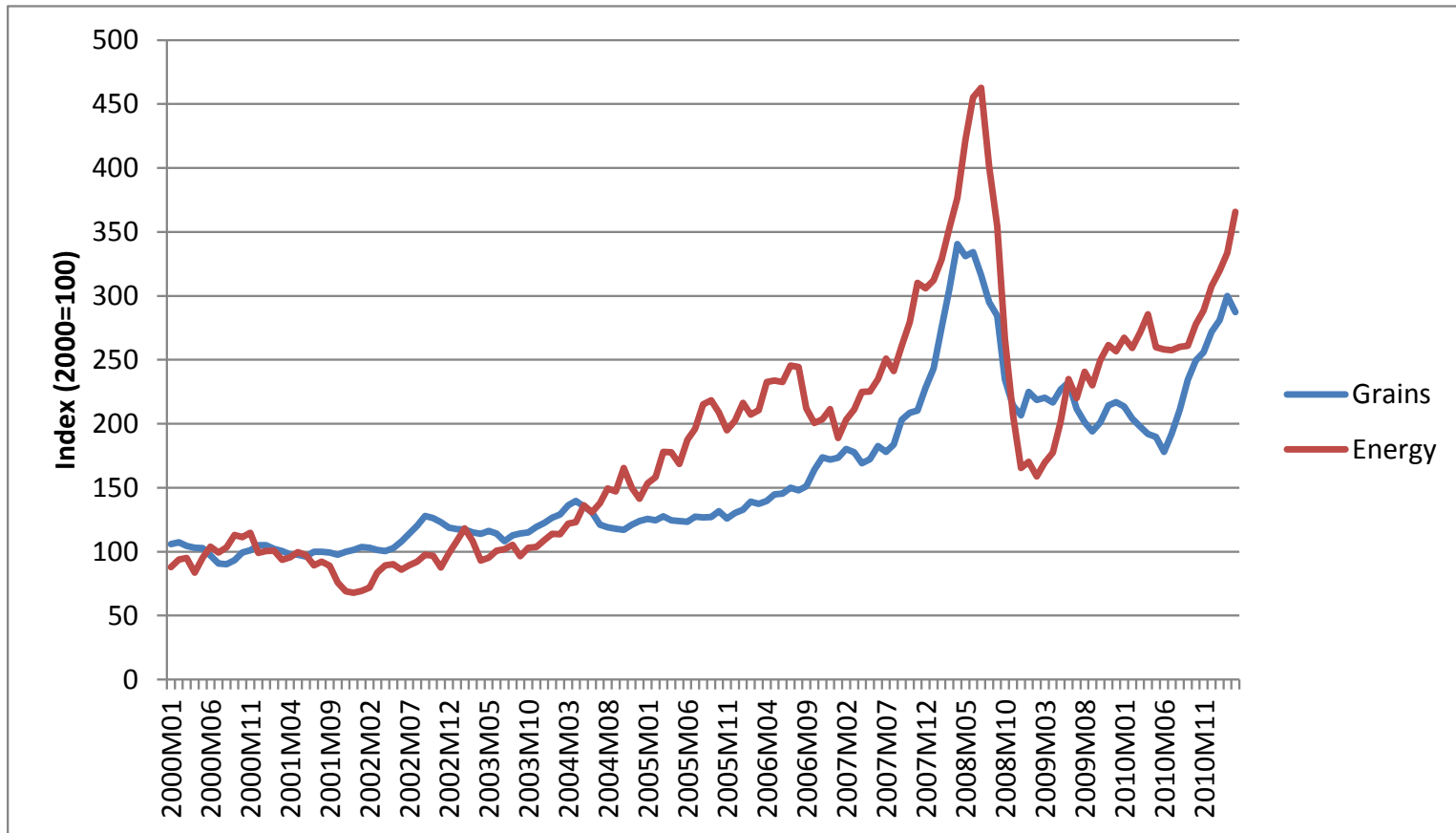
Presented at “Special Seminar on Poverty Reduction and Food Security Despite High Food Price Volatility”, sponsored by USAID Bureau for Food Security. May 20, 2011. Washington, D.C.

Outline

- Background on events since 2007
- Key observations on recent worldwide and domestic commodity price behavior
 - Short-term price transmission
 - Internal vs. external drivers of volatility
 - The issue is not just volatility, but the likelihood of higher price levels in the long-term
 - Concept of regime shifts
- Implications
- What to do and not do

Background – world prices

World Bank World Price Indices for Grains and Energy (Pink Sheet)
2000-2011



Background - causes

- Very broad phenomenon
 - Food, energy, metals/minerals
- Causes: still much debate
 - Increased demand from
 - Economic growth in Asia ... and SSA!
 - Biofuels, especially in US
 - Poor harvests in Australia, Russia
 - Speculation
 - The financialization of agricultural commodity markets

Background - responses

- Reflexive closing of borders in many countries
- Broad assertion of need for greater role for the state in cereals markets
- Upsurge in civil unrest in developing countries
- Renewed focus on agriculture among development agencies following 2007/08 crisis
- ... but limited follow-through due to worldwide financial crisis
- Are we in a fundamentally new environment? What does that environment look like? What to do?

Key Observation # 1

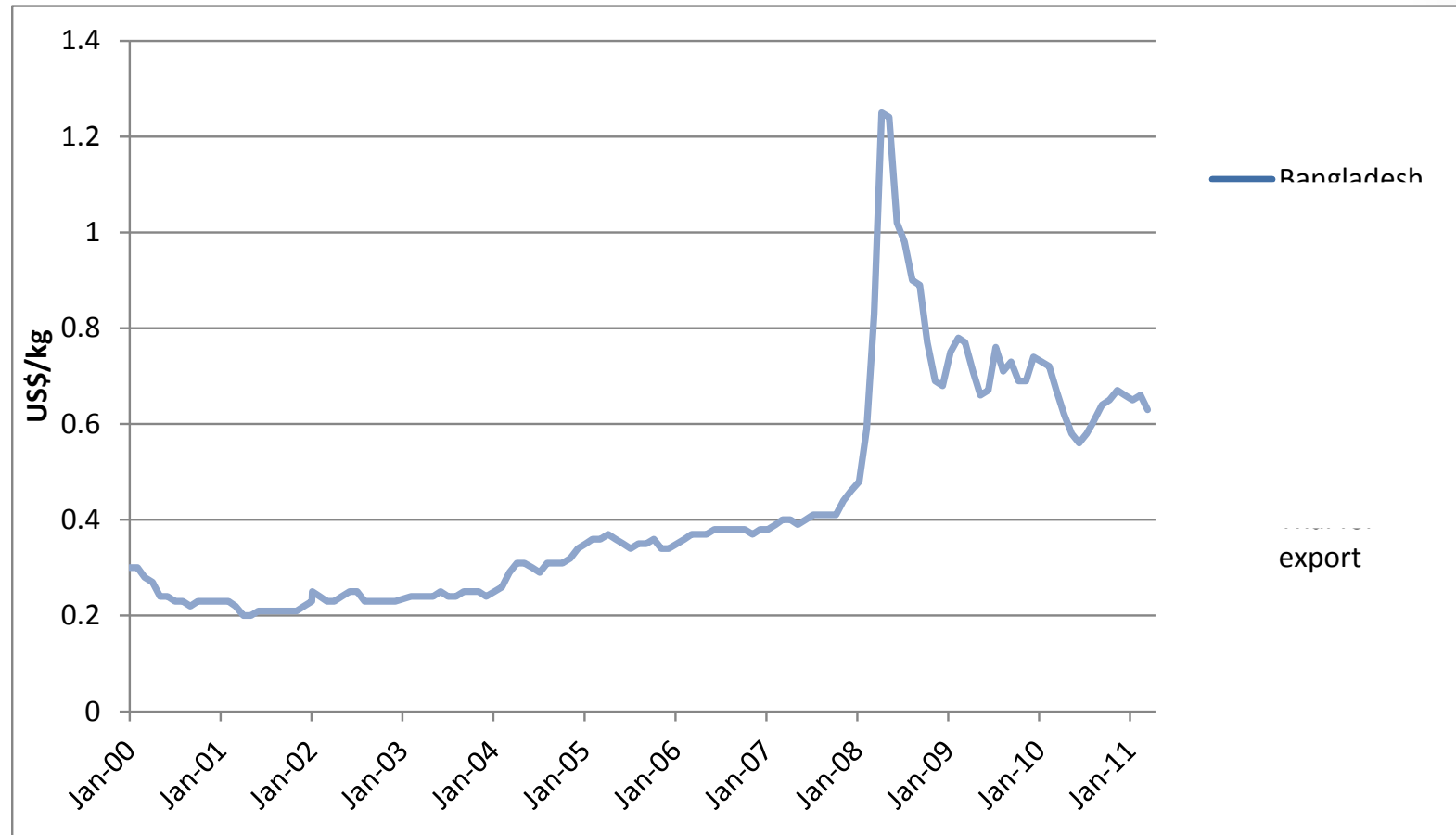
Short-term price transmission to local markets (2-3 months) has been:

(a) low on average and

(b) highly variable across countries

Demonstrate with rice in Asia ...

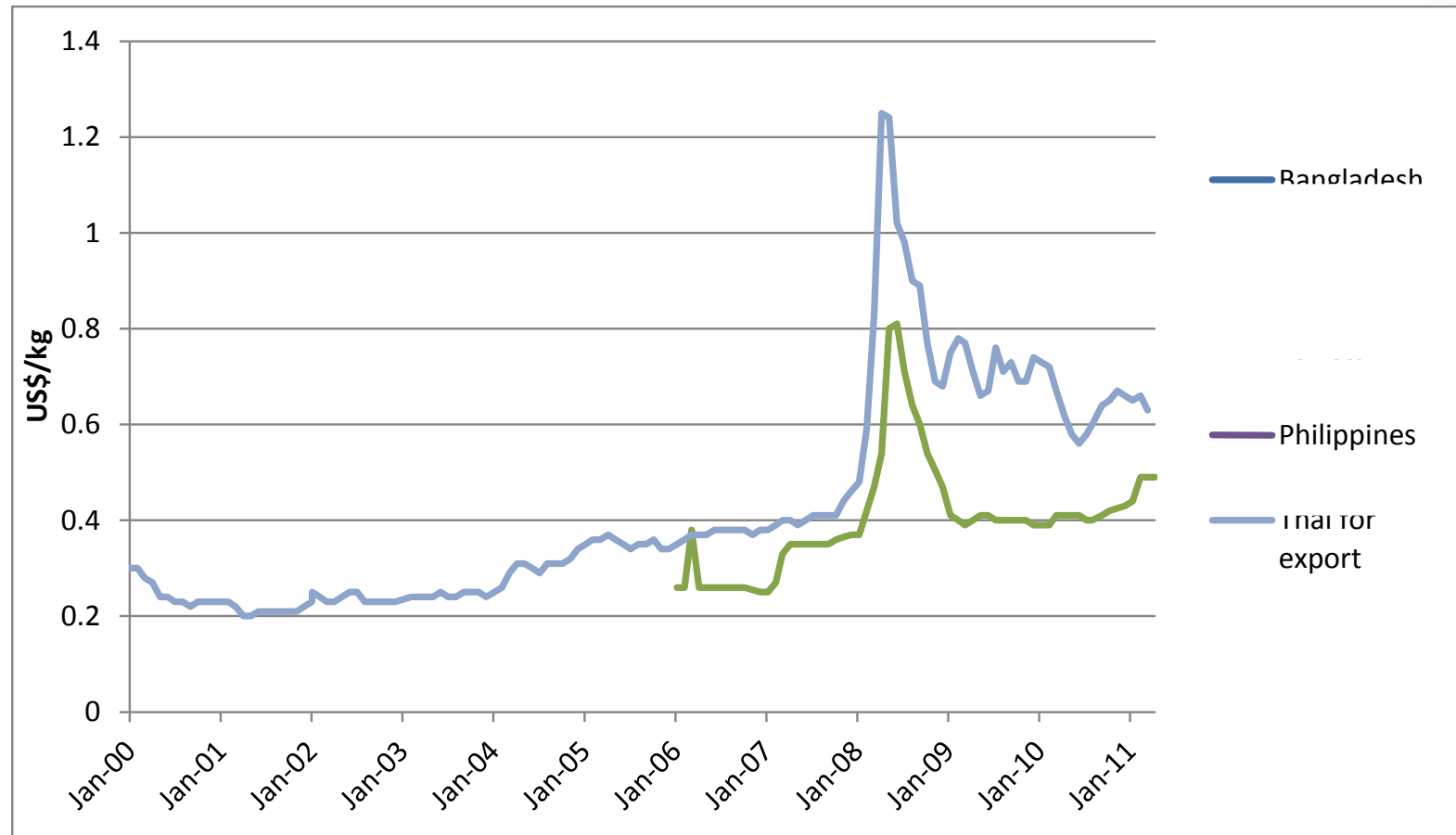
Rice price behavior



Source: FAO-GIEWS

> 3x from late 2007 to early 2008, + regime shift

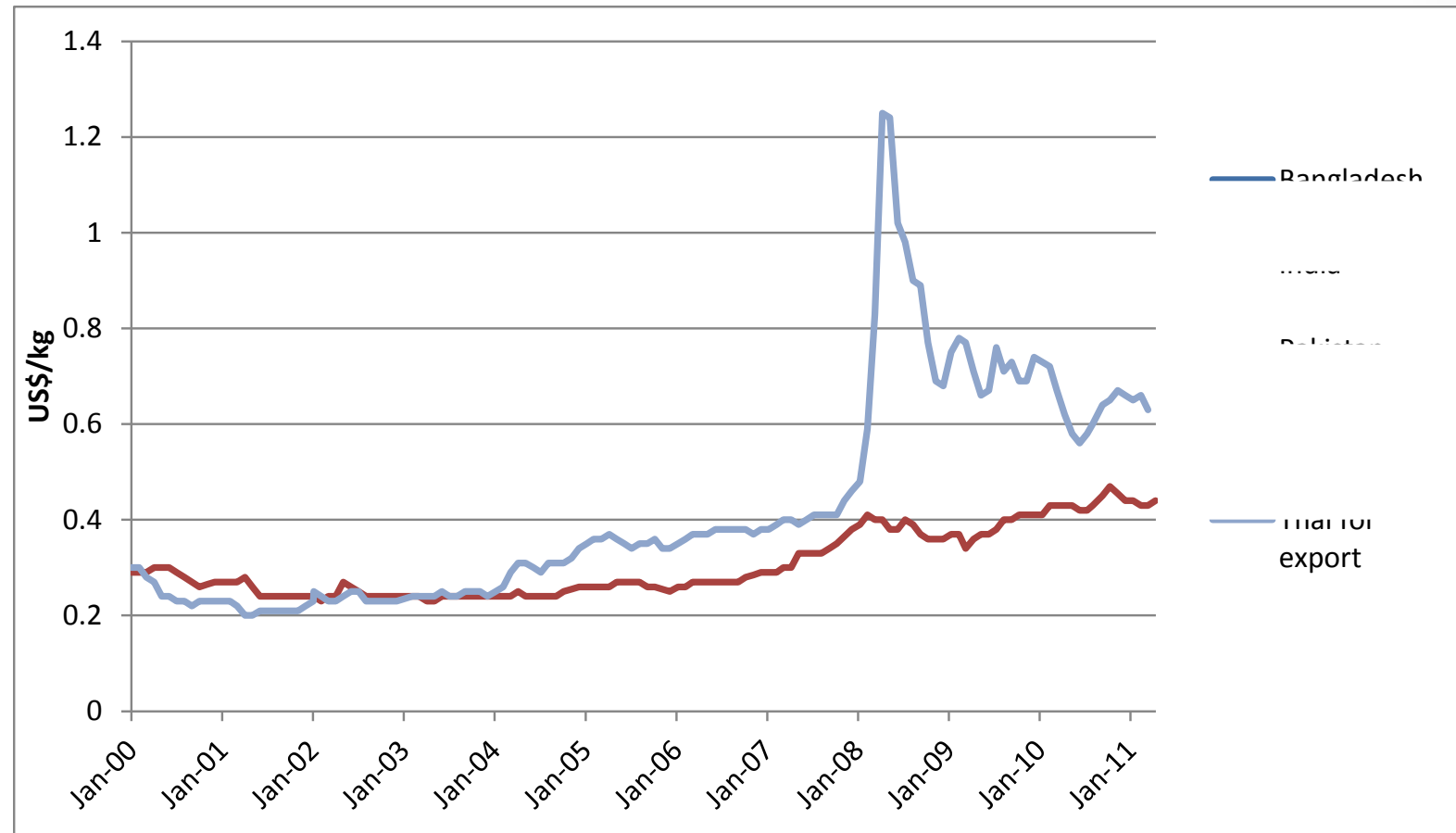
Rice price behavior (2)



Source: FAO-GIEWS

Exporter that continued to export

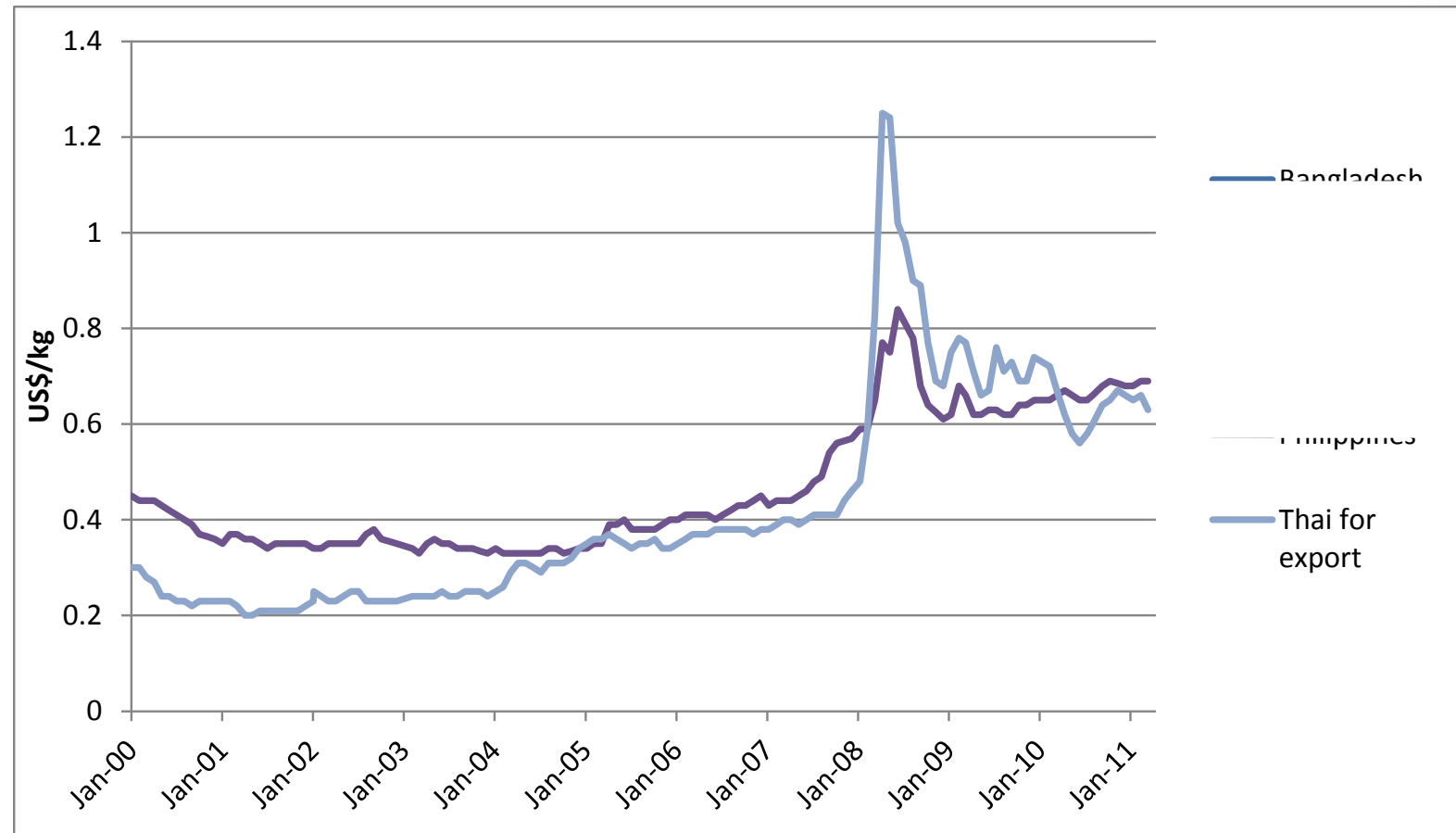
Rice price behavior (2)



Source: FAO-GIEWS

Exporter that closed its borders

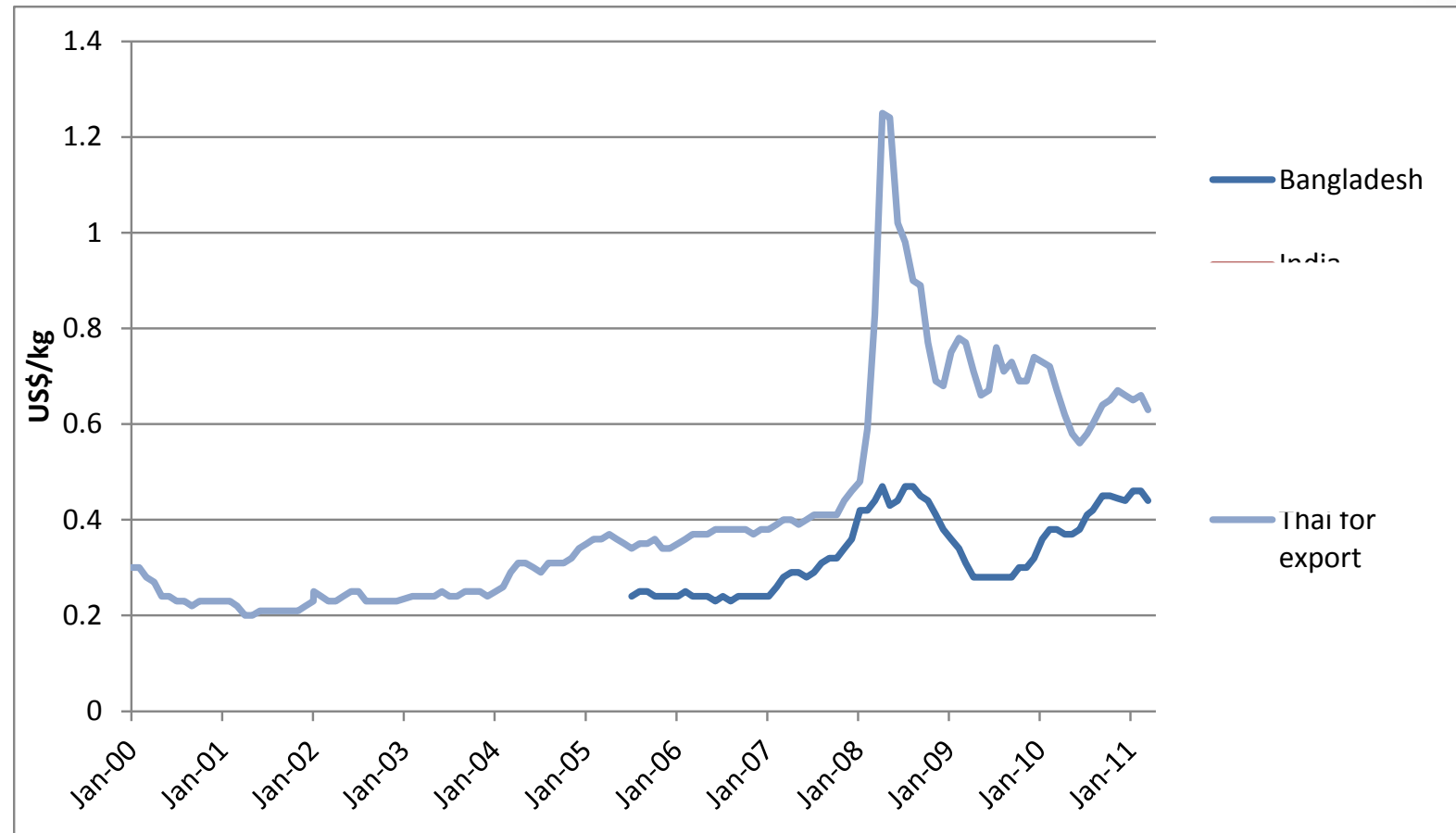
Rice price behavior (3)



Source: FAO-GIEWS

*Major importer that partially controlled imports
and sales prices*

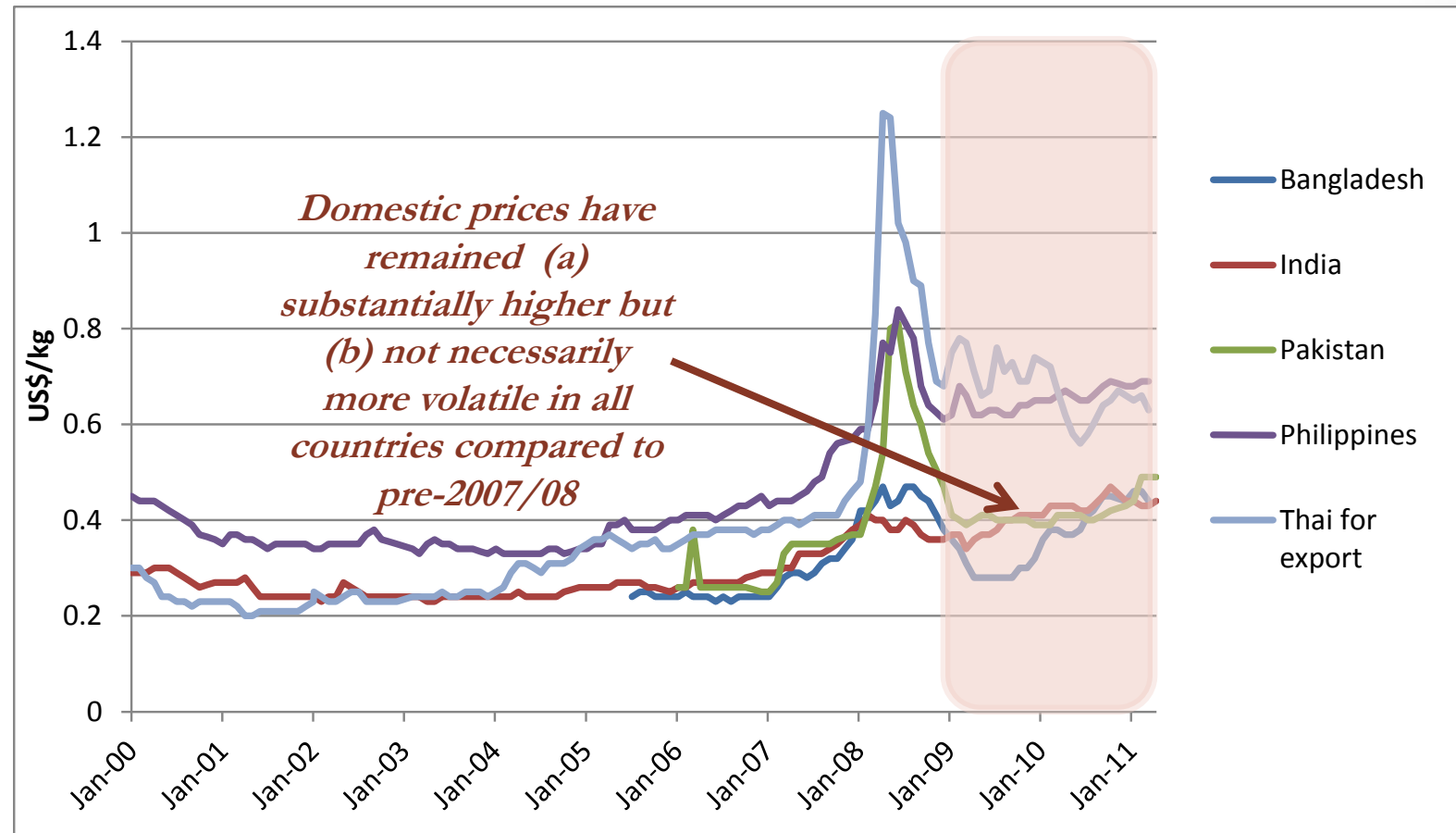
Rice price behavior (4)



Source: FAO-GIEWS

Importer (5% of consumption) that (presumably) subsidized sales prices

Rice price behavior (6)



Source: FAO-GIEWS

Key observation # 2

Historically, drivers of domestic volatility have been more internal than external

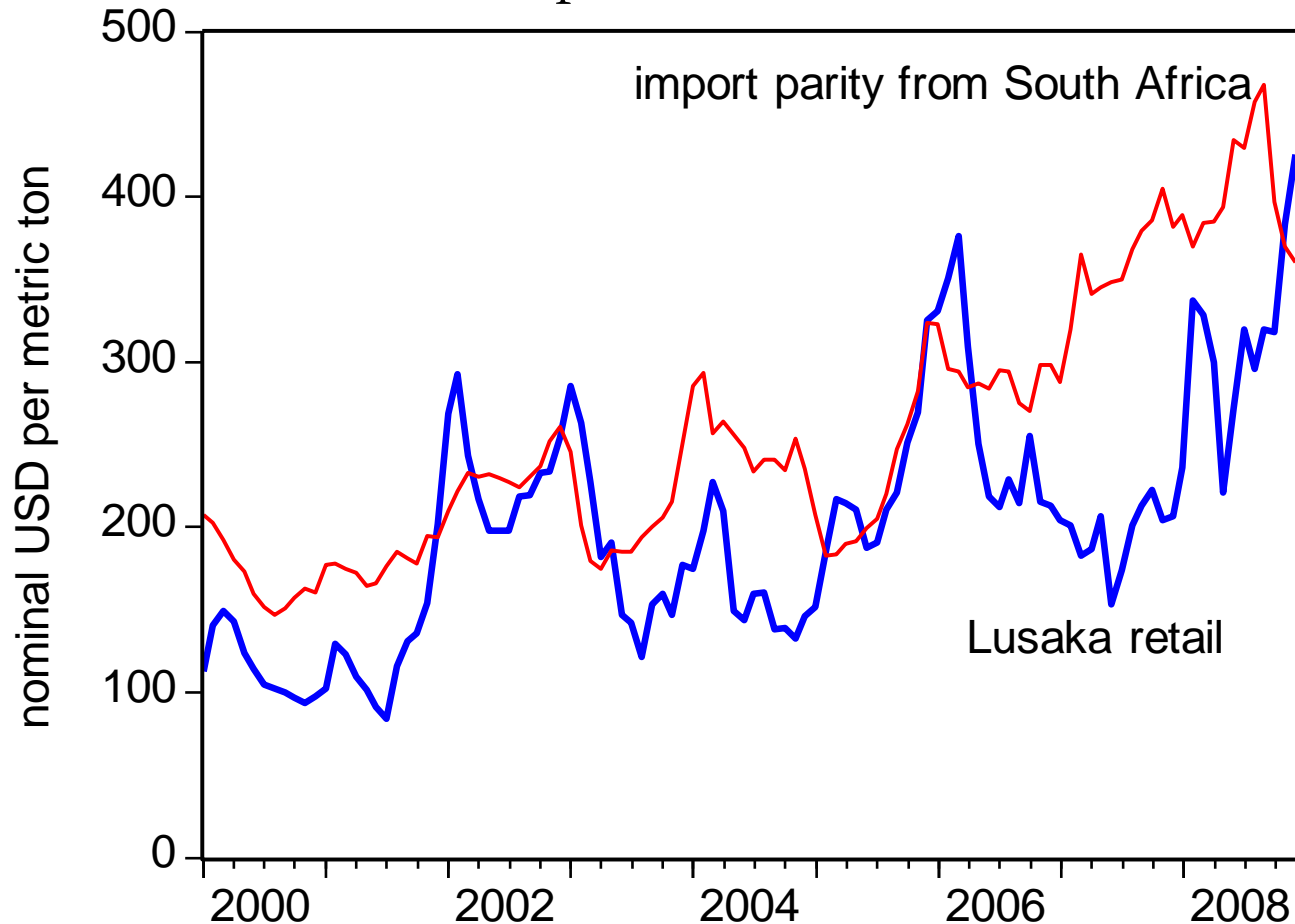
Internal drivers

- High costs of storage and trade
 - A wider range within which prices can fluctuate, even if trade were fully liberalized
- Rainfed production
 - Greater year-to-year variability in production
- Unpredictable policy
 - Sidelines the private sector, leads to greater price spikes
- Poor management of public stocks

Demonstrate with maize in southern Africa ...

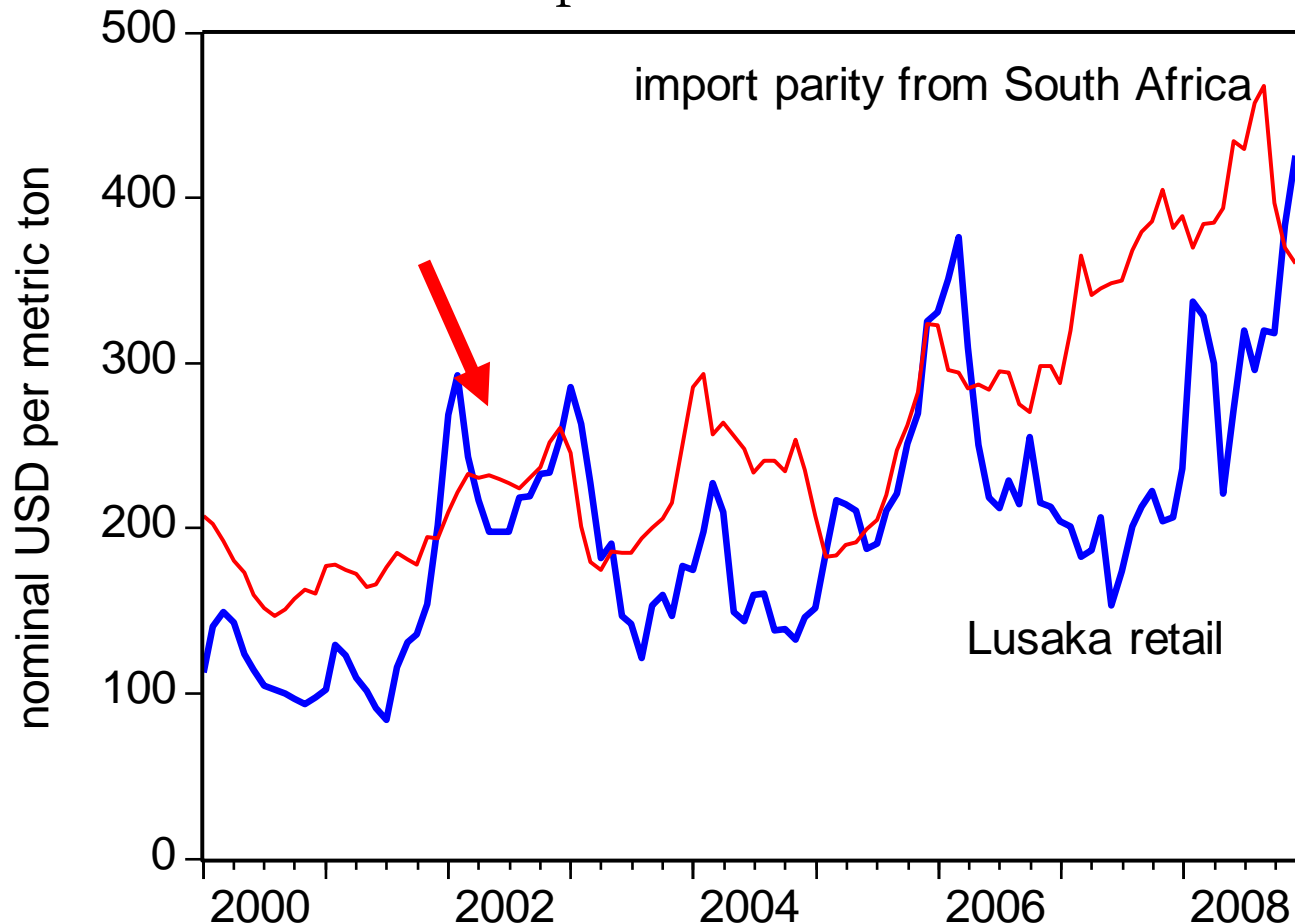
Internal drivers (1)

- Nominal USD maize prices in **Zambia**



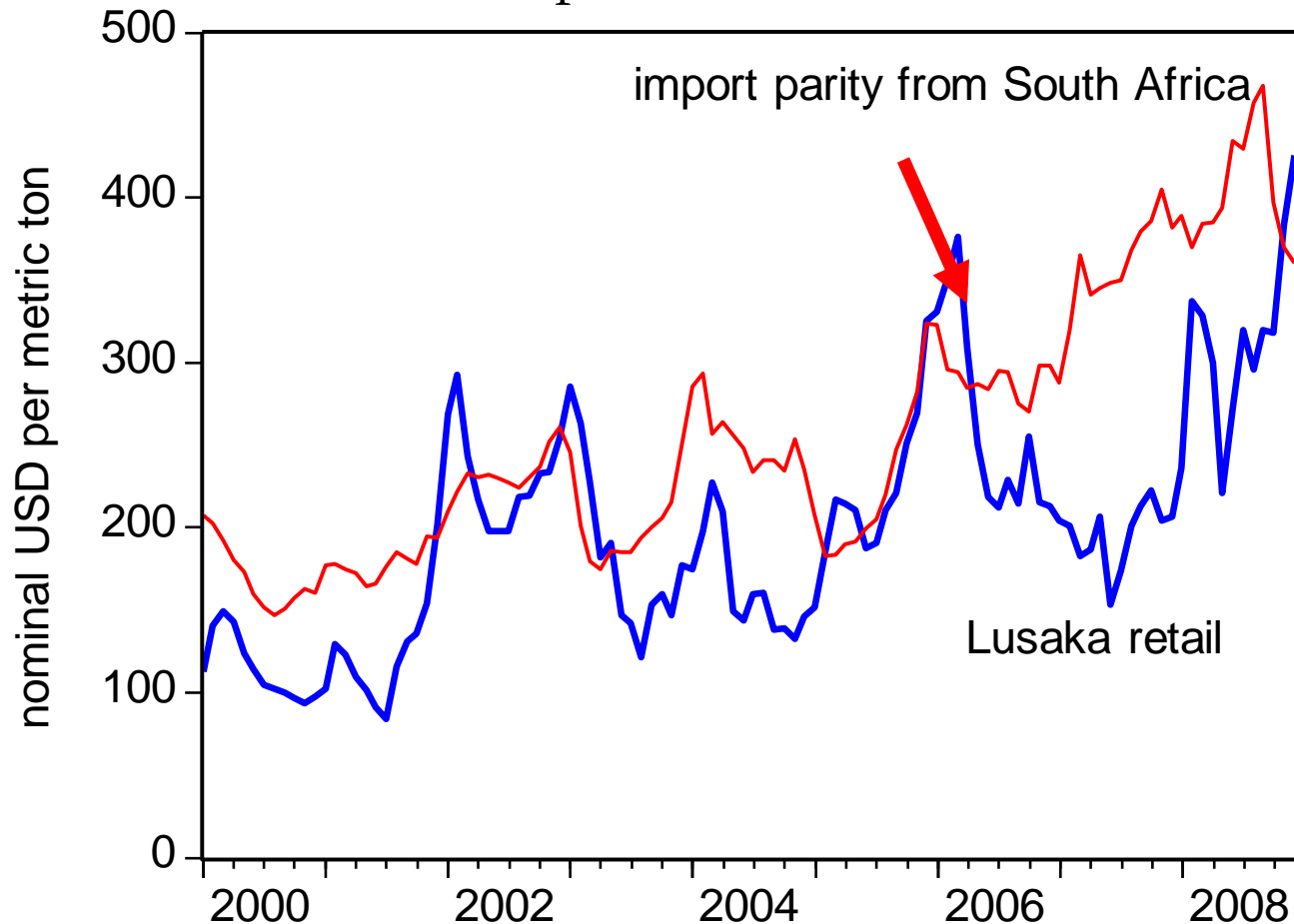
Internal drivers (2)

- Nominal USD maize prices in **Zambia**



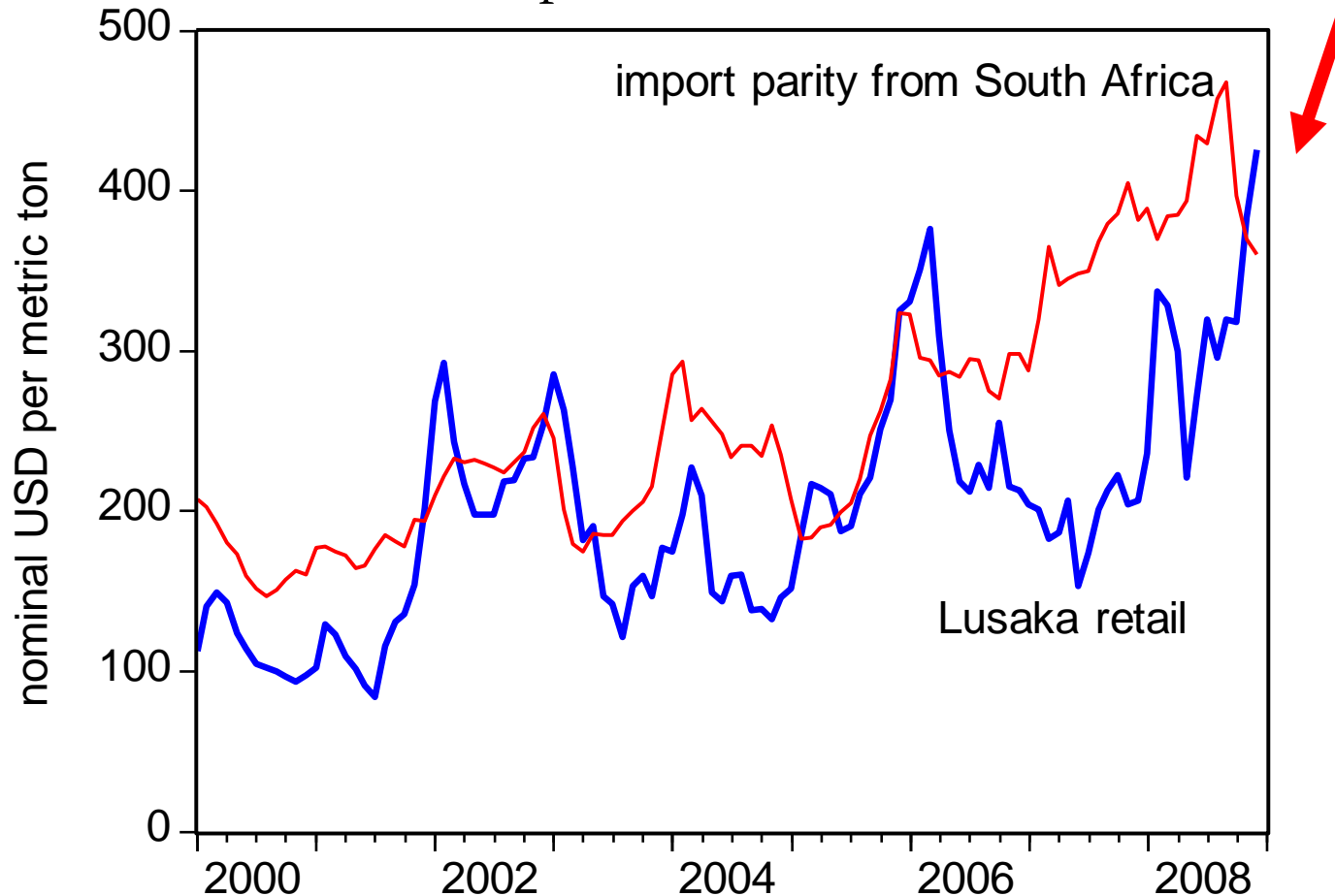
Internal drivers (3)

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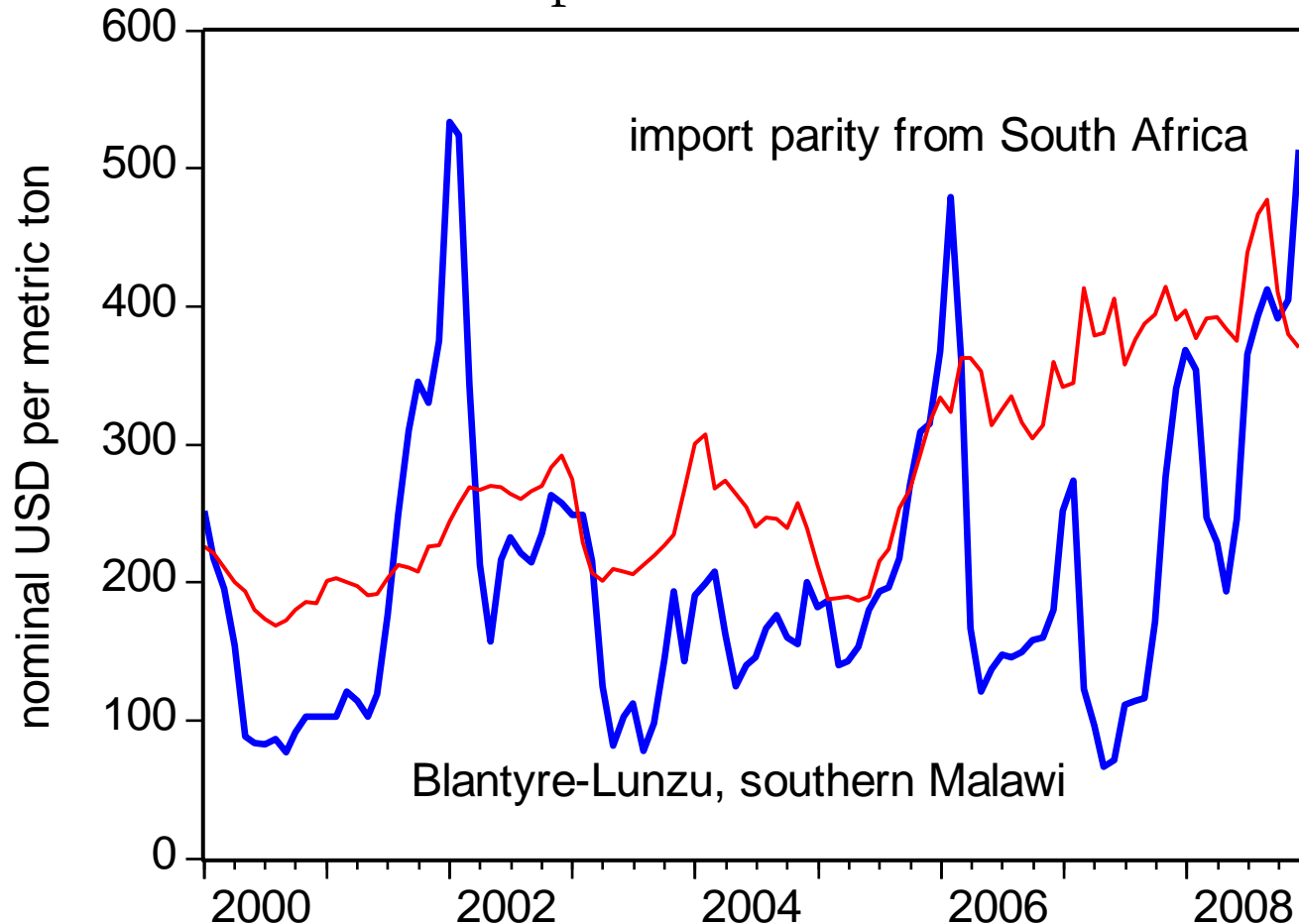
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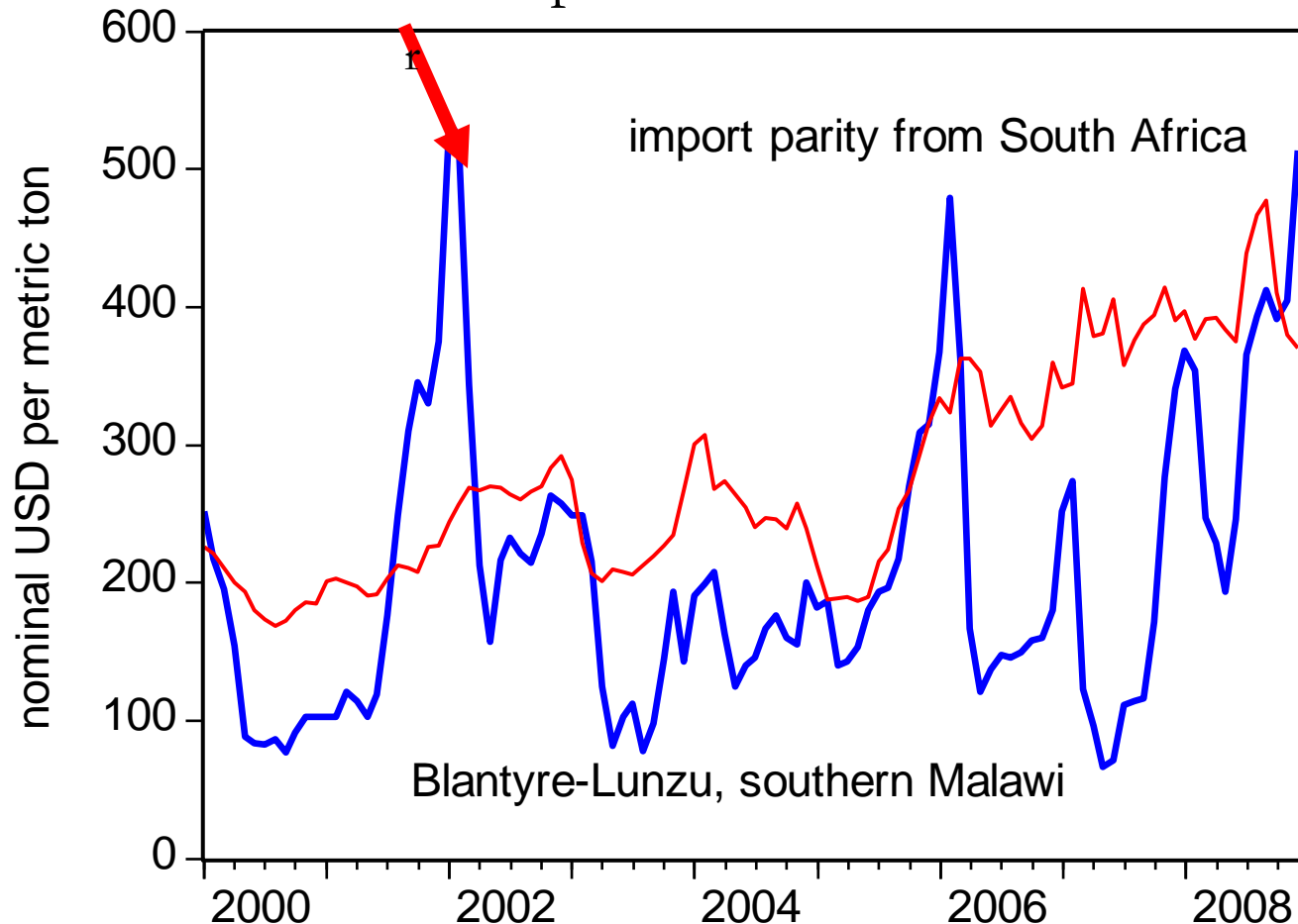
Internal drivers (5)

- Nominal USD maize prices in **Malawi**



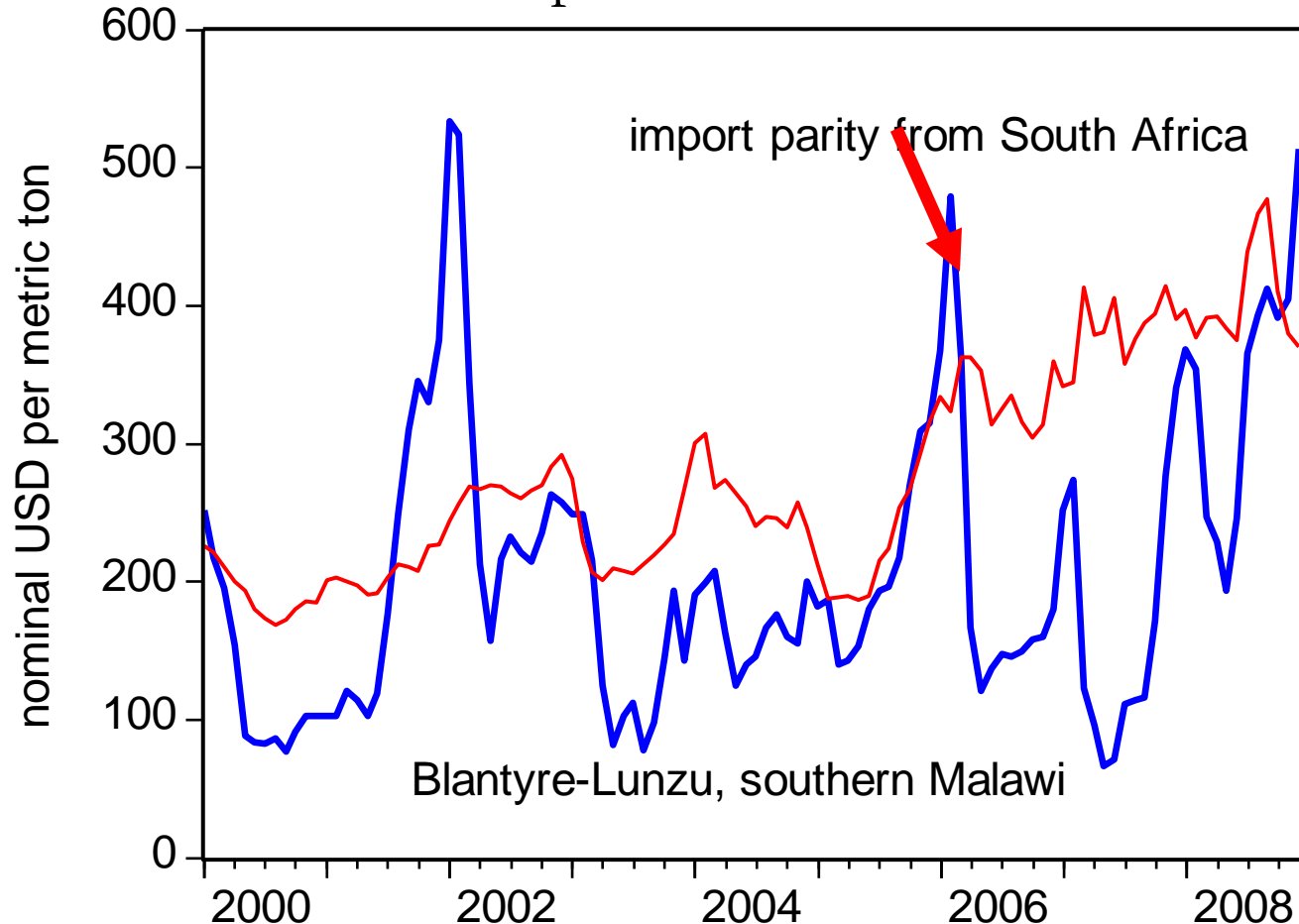
Internal drivers (6)

- Nominal USD maize prices in **Malawi**



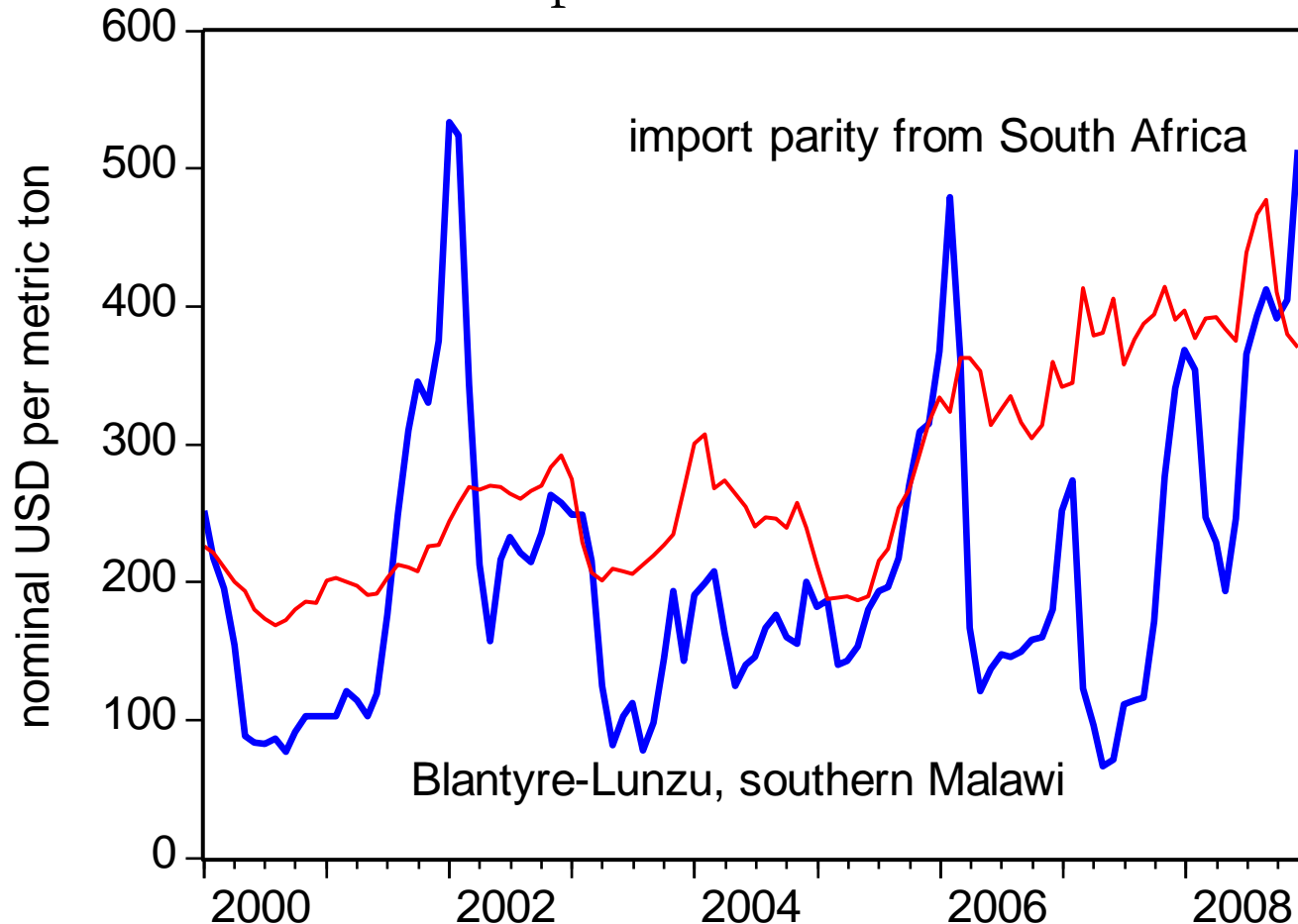
Internal drivers (7)

- Nominal USD maize prices in **Malawi**



Internal drivers (8)

- Nominal USD maize prices in **Malawi**



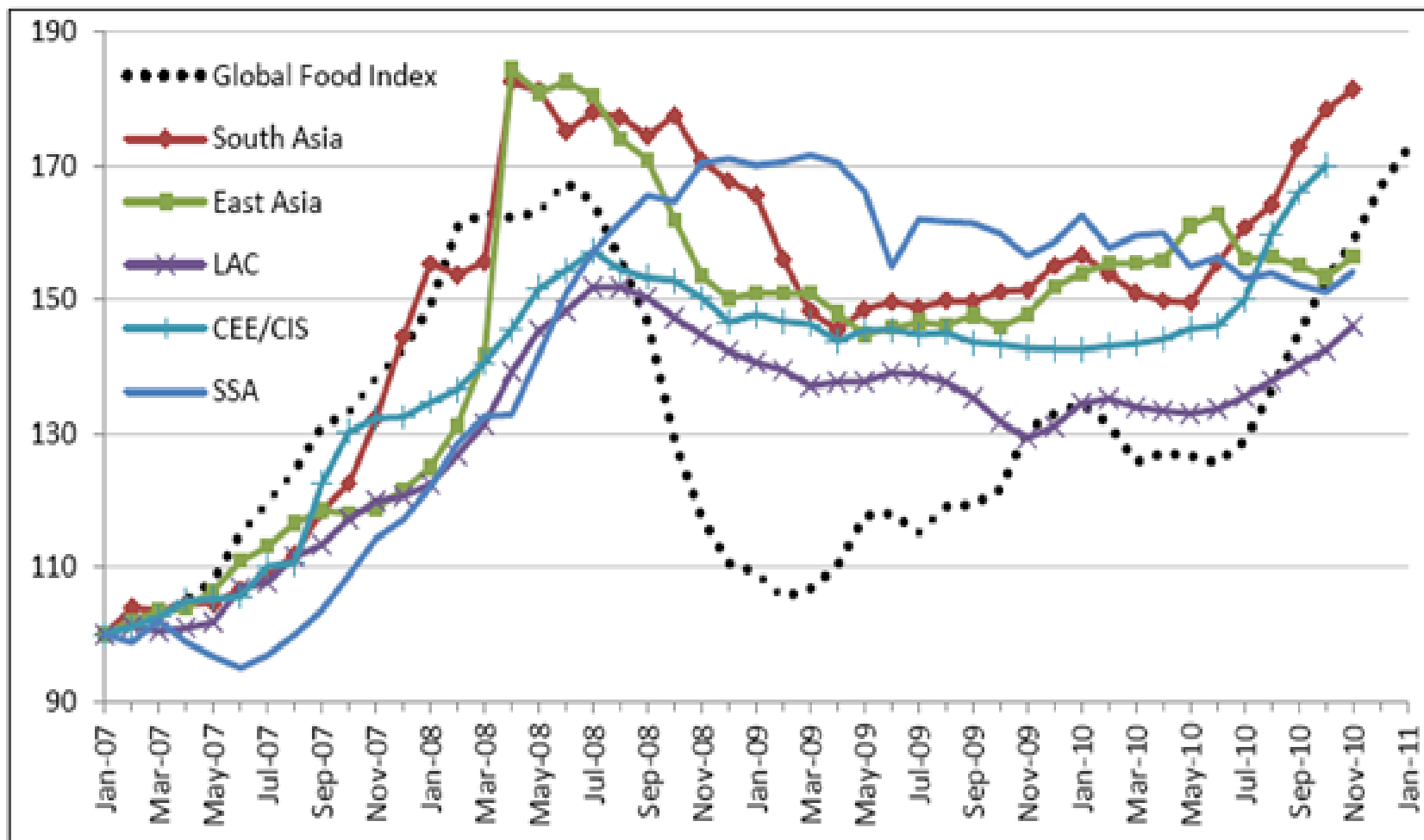
Key observation # 3

But the issue in developing countries is not just price volatility ...

price levels have shifted

(and are not necessarily more volatile)

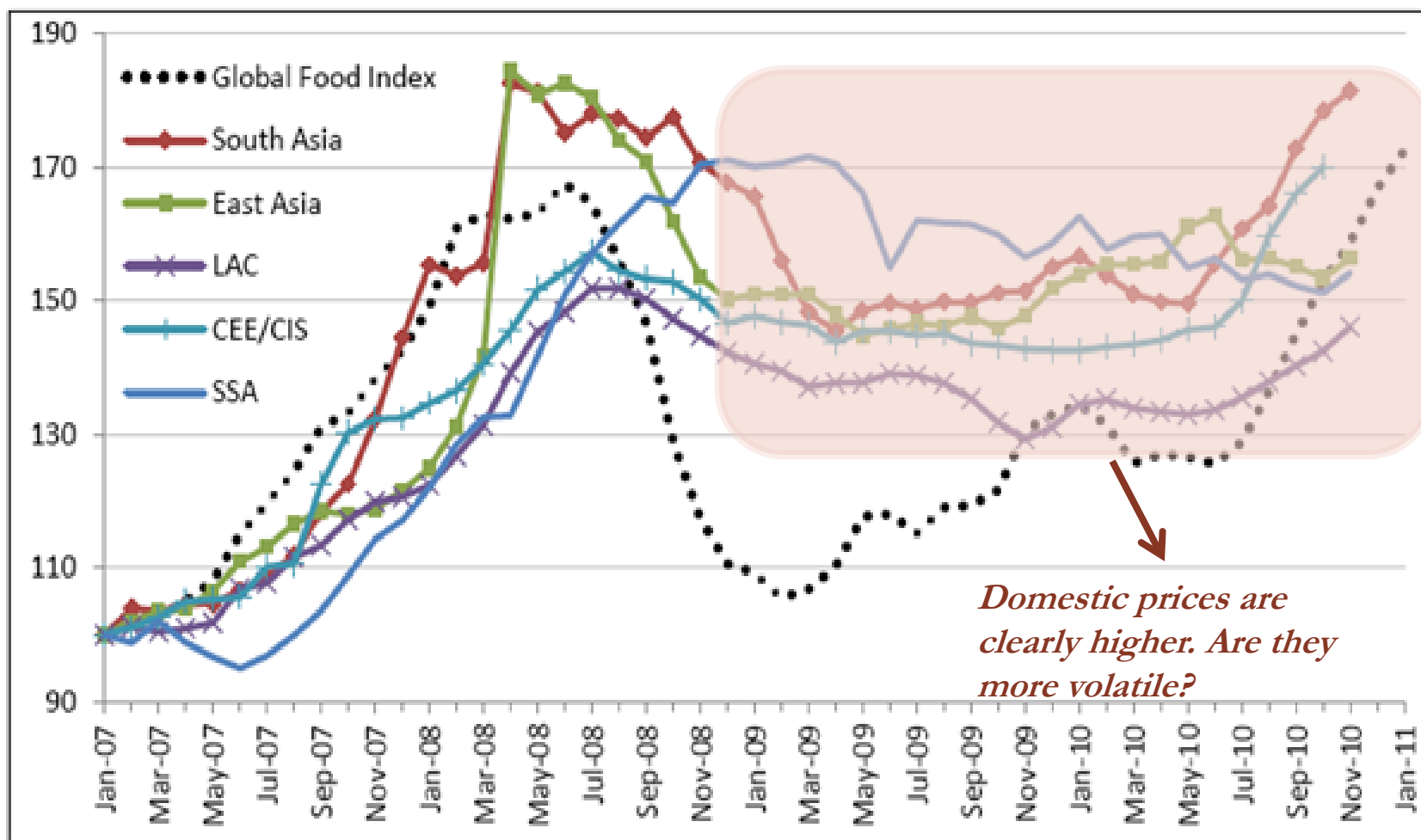
Food price indices, world and regions



Source: Figure extracted from Ortiz and al., (2011) in Escalating Food Prices, UNICEF, Page 8.

FAO (2010f) and authors' calculations. Note: Sample includes 5 countries from South Asia, 5 from East Asia, 16 from LAC, 7 from CEE/CIS and 24 from SSA

Food price indices, world and regions

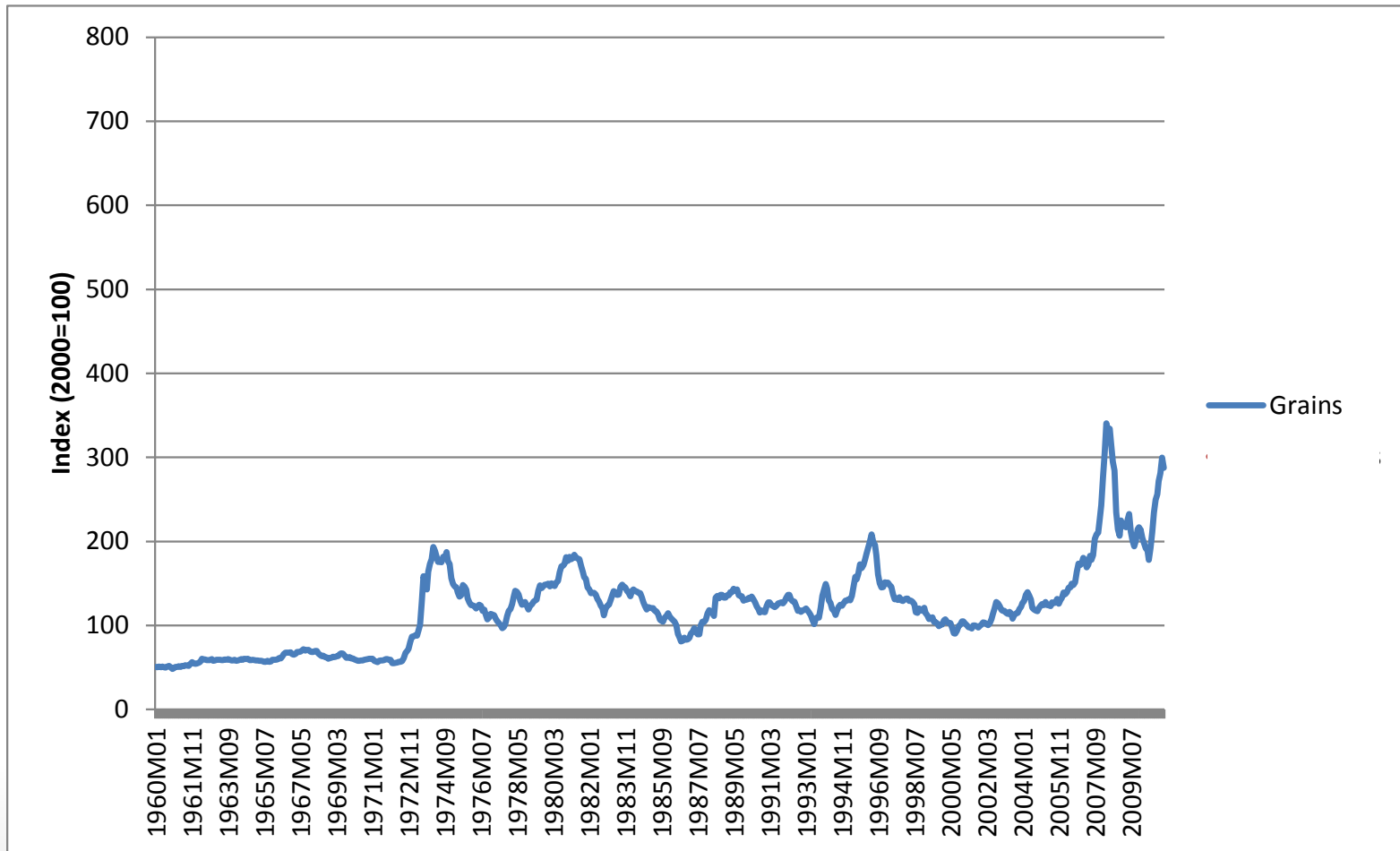


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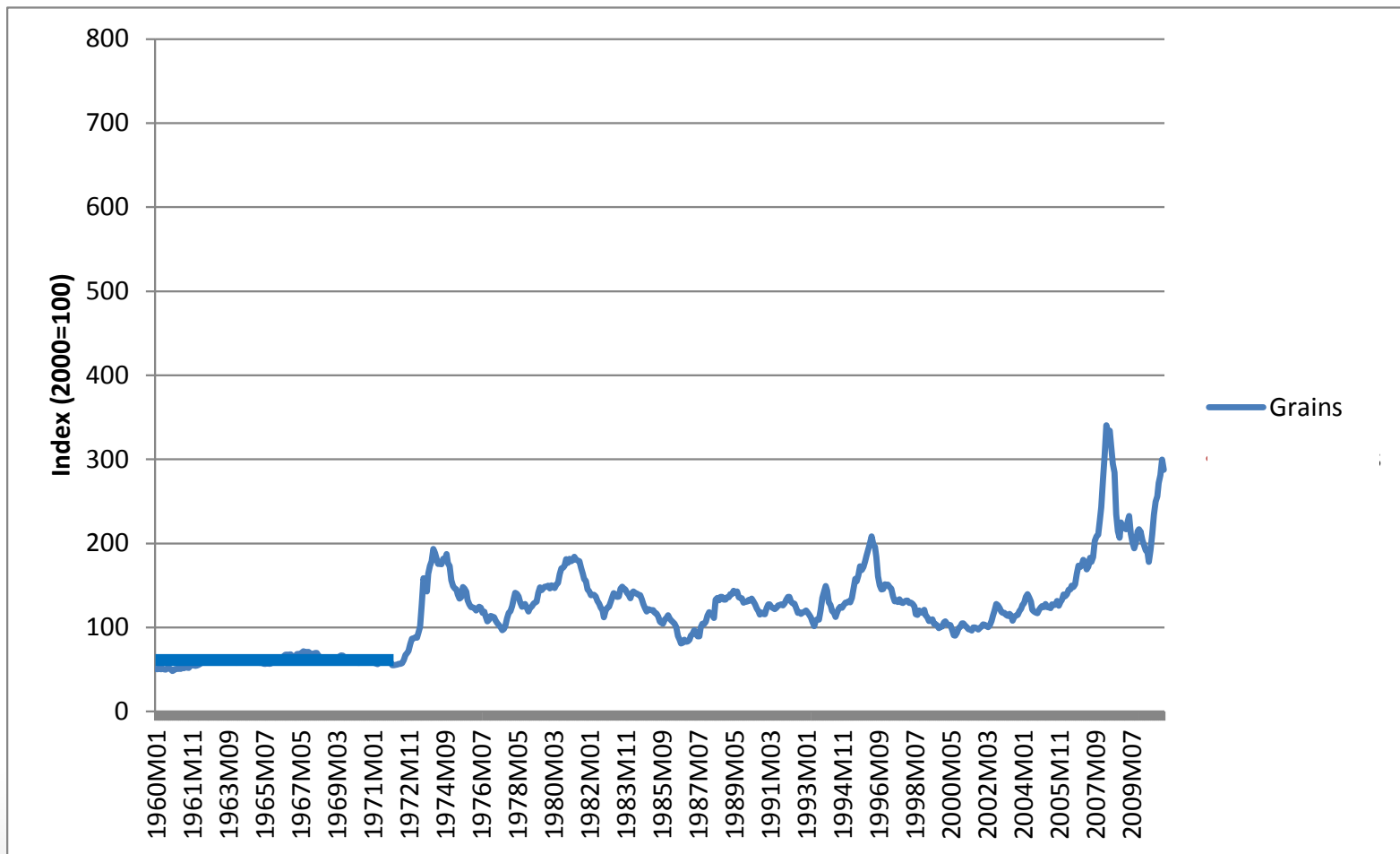
Higher price levels – the long view

**World Bank World Price Indices for Grains and Fertilizer (Pink Sheet)
1960-2011**



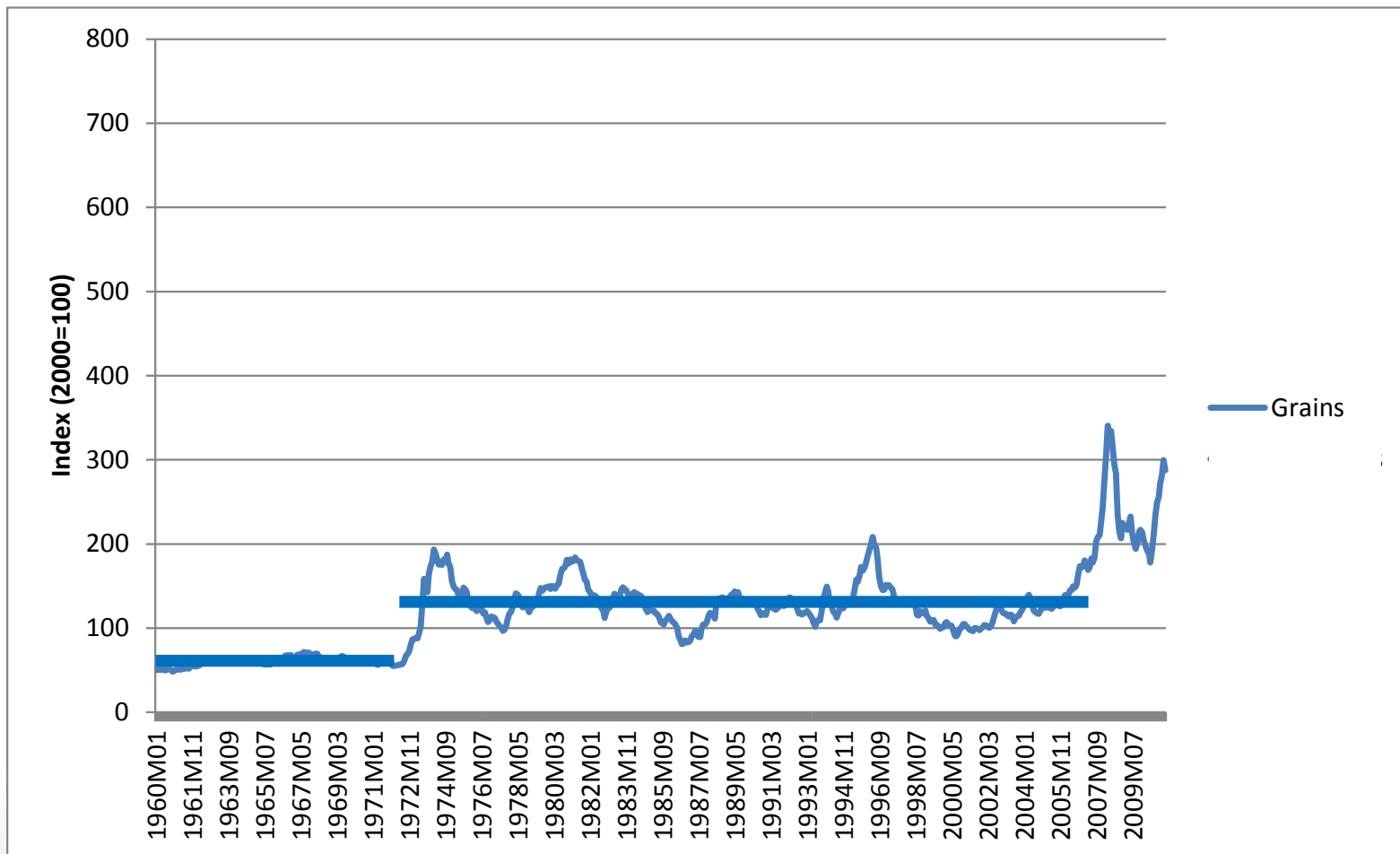
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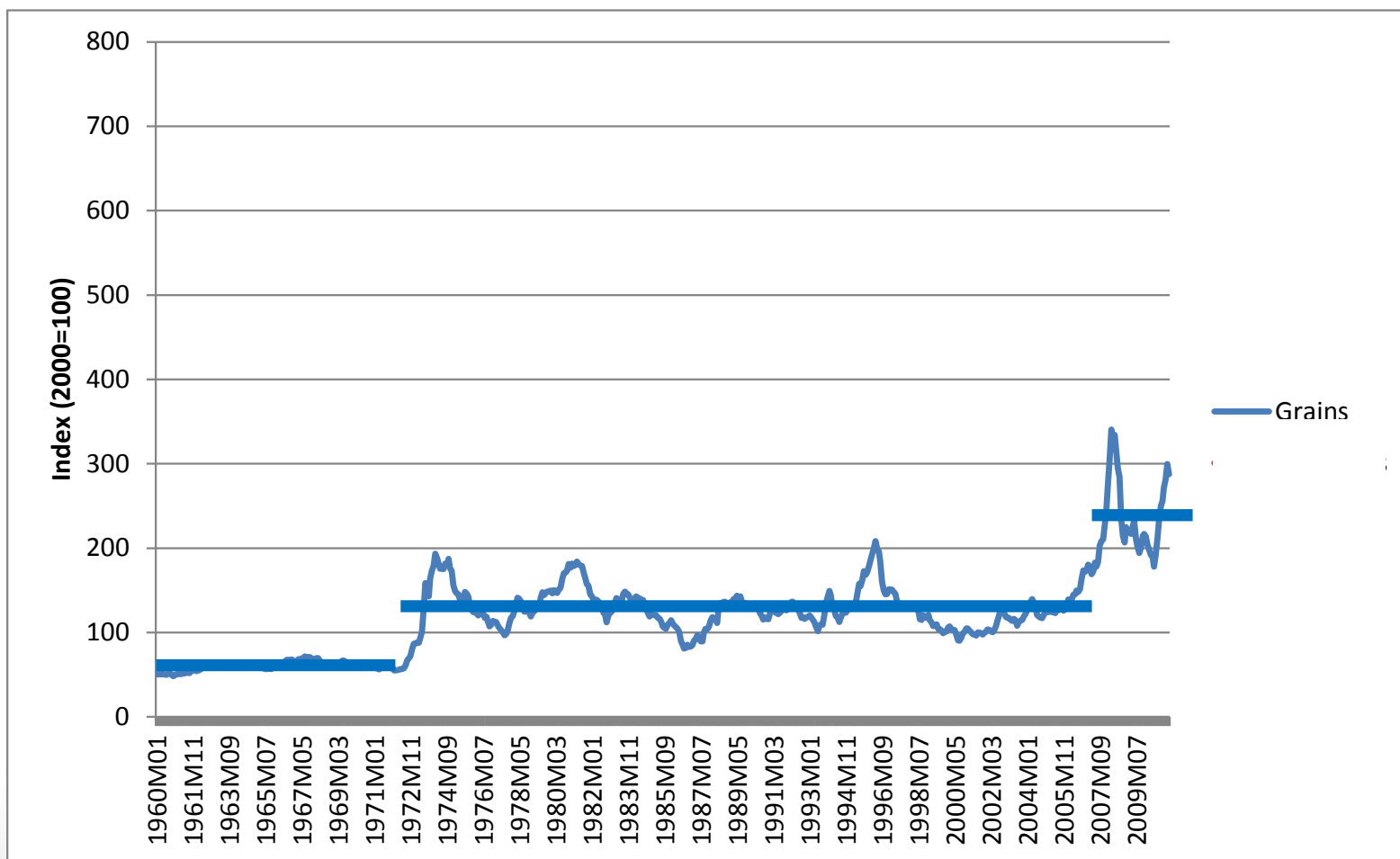
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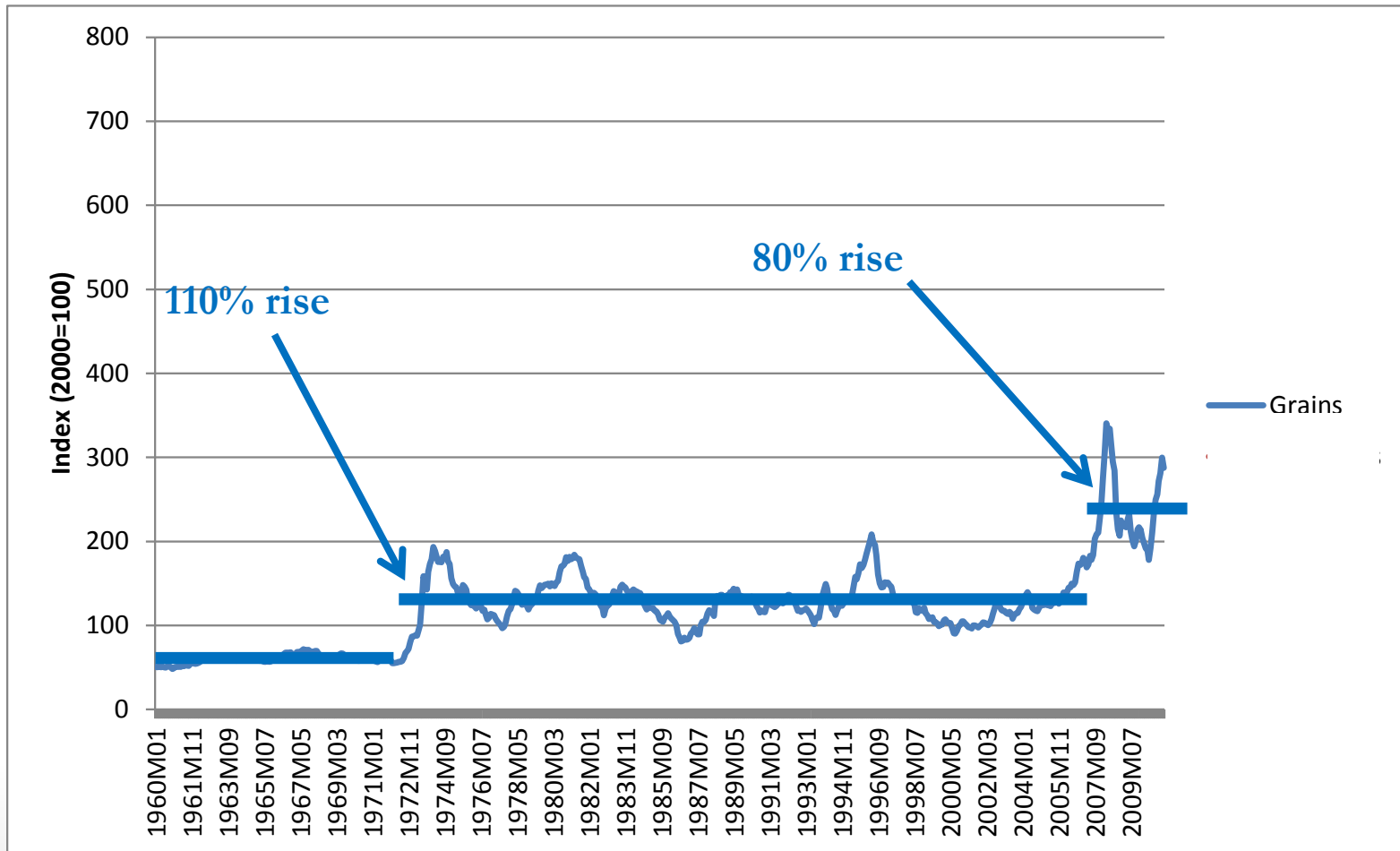
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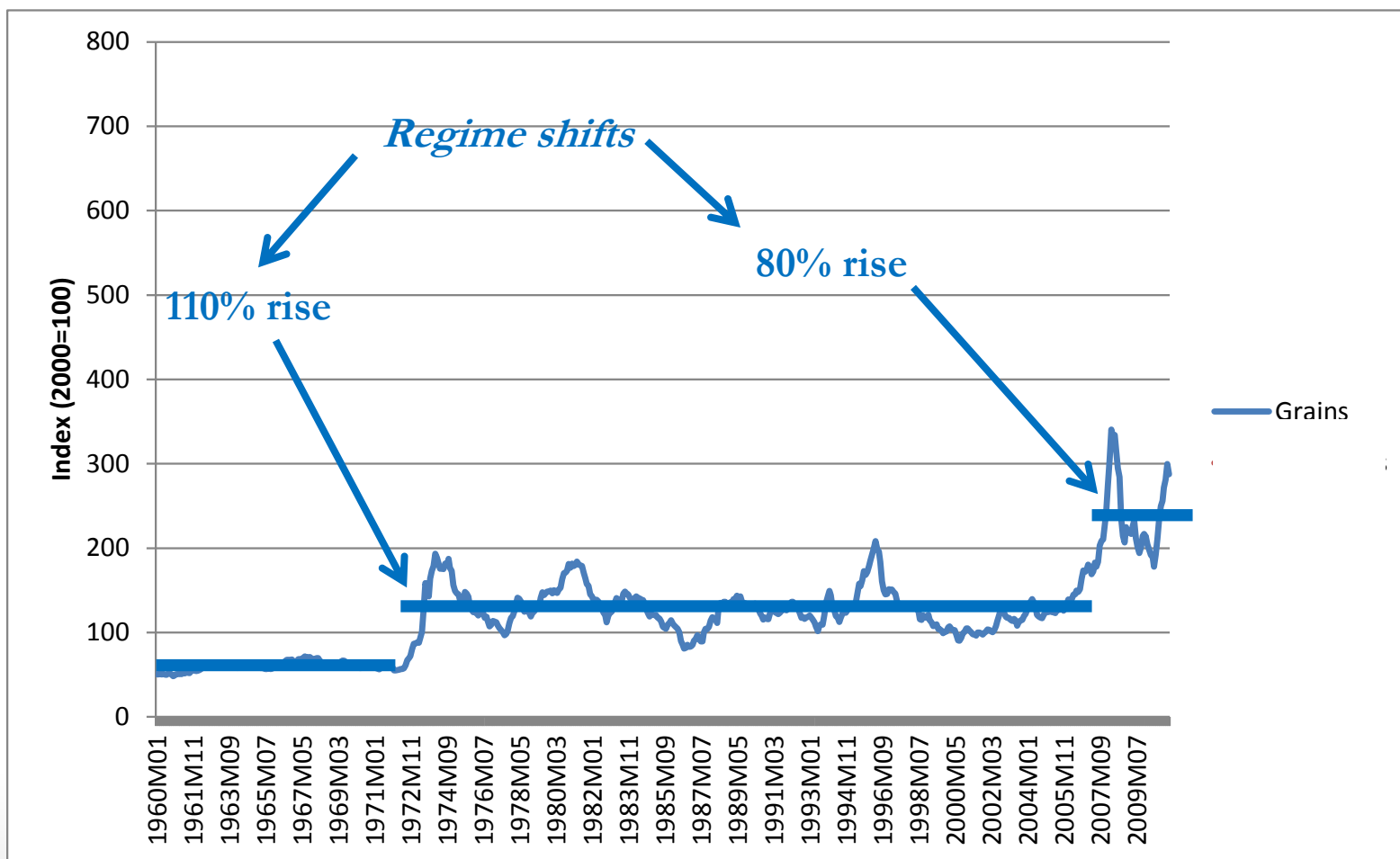
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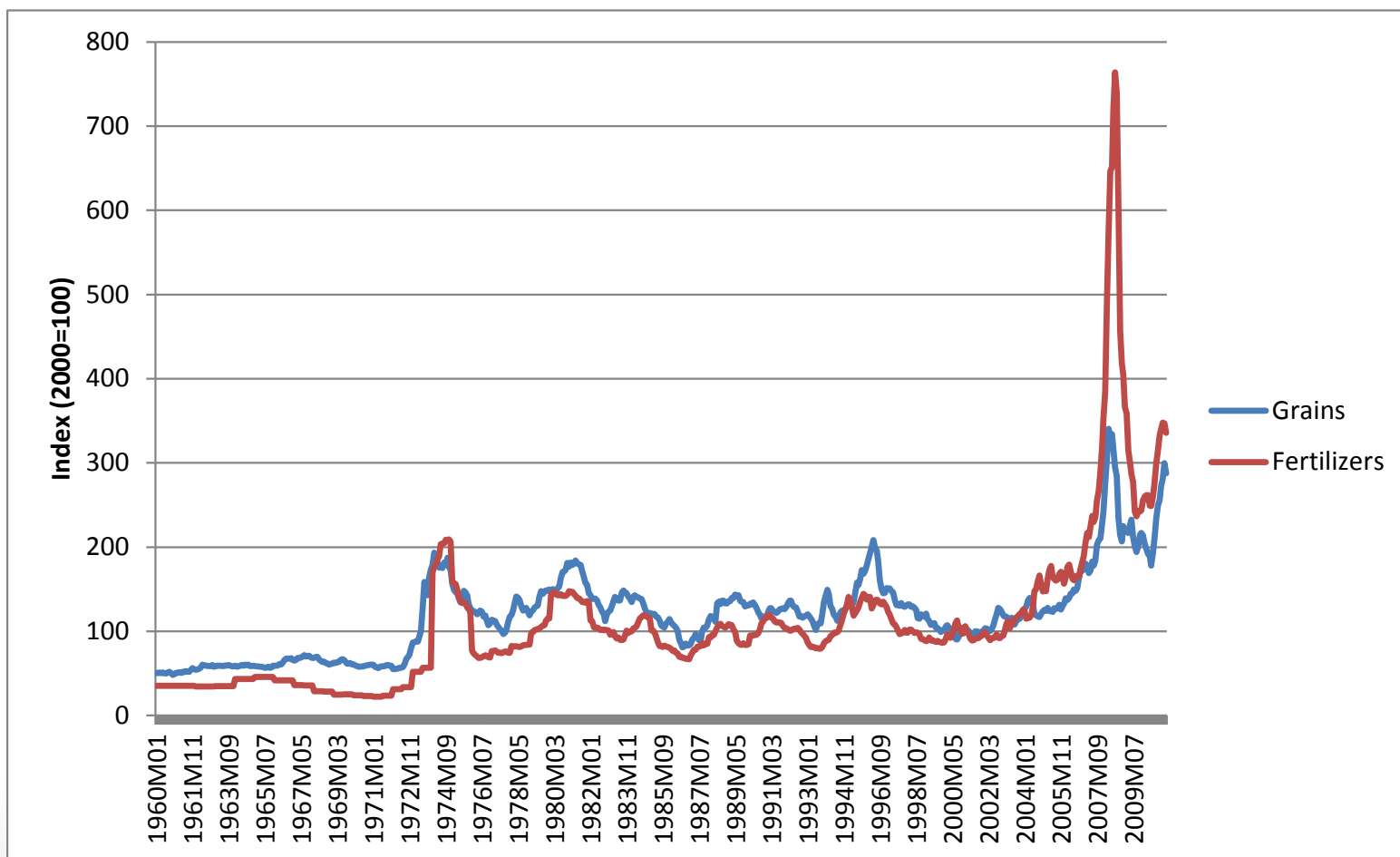
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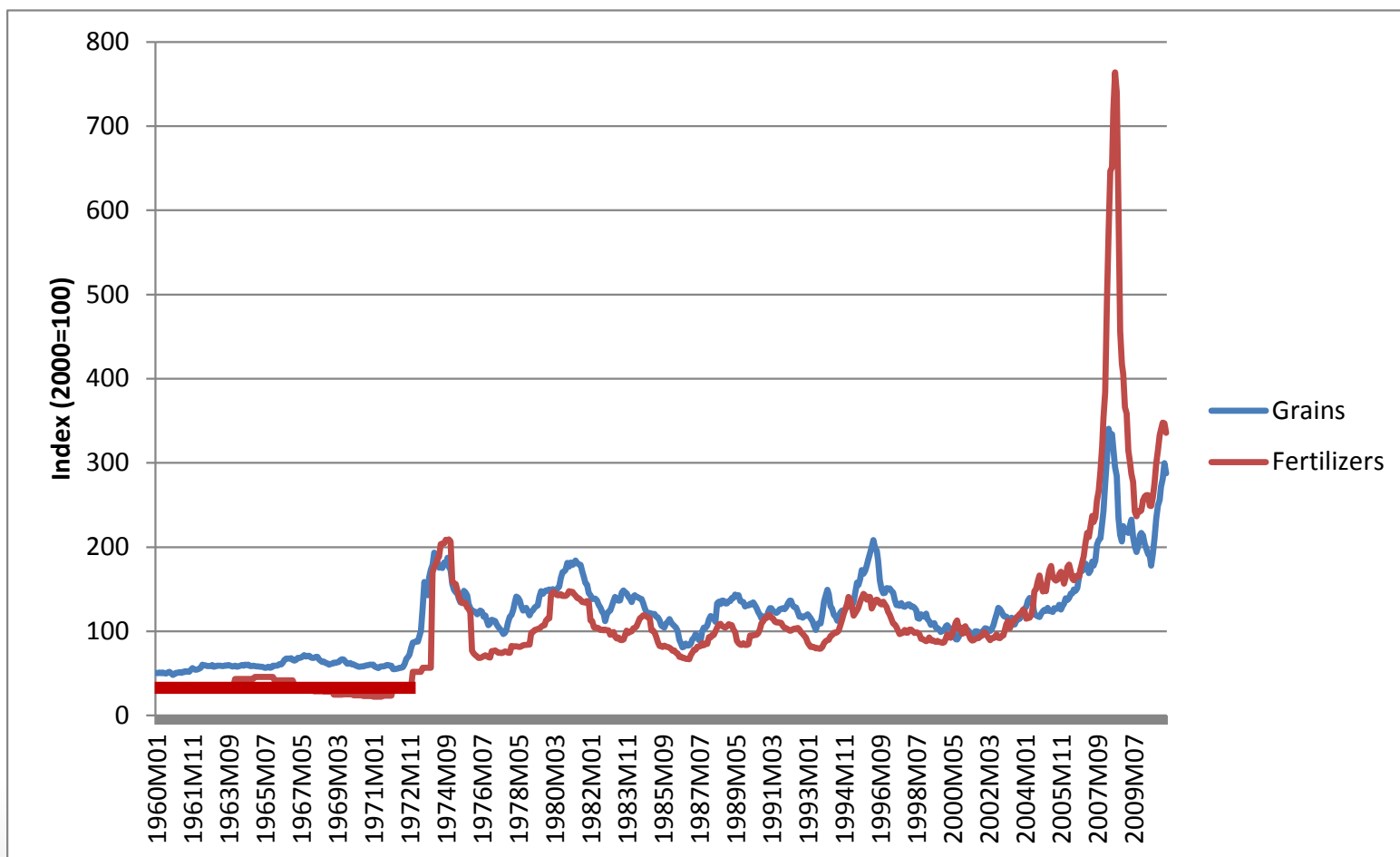
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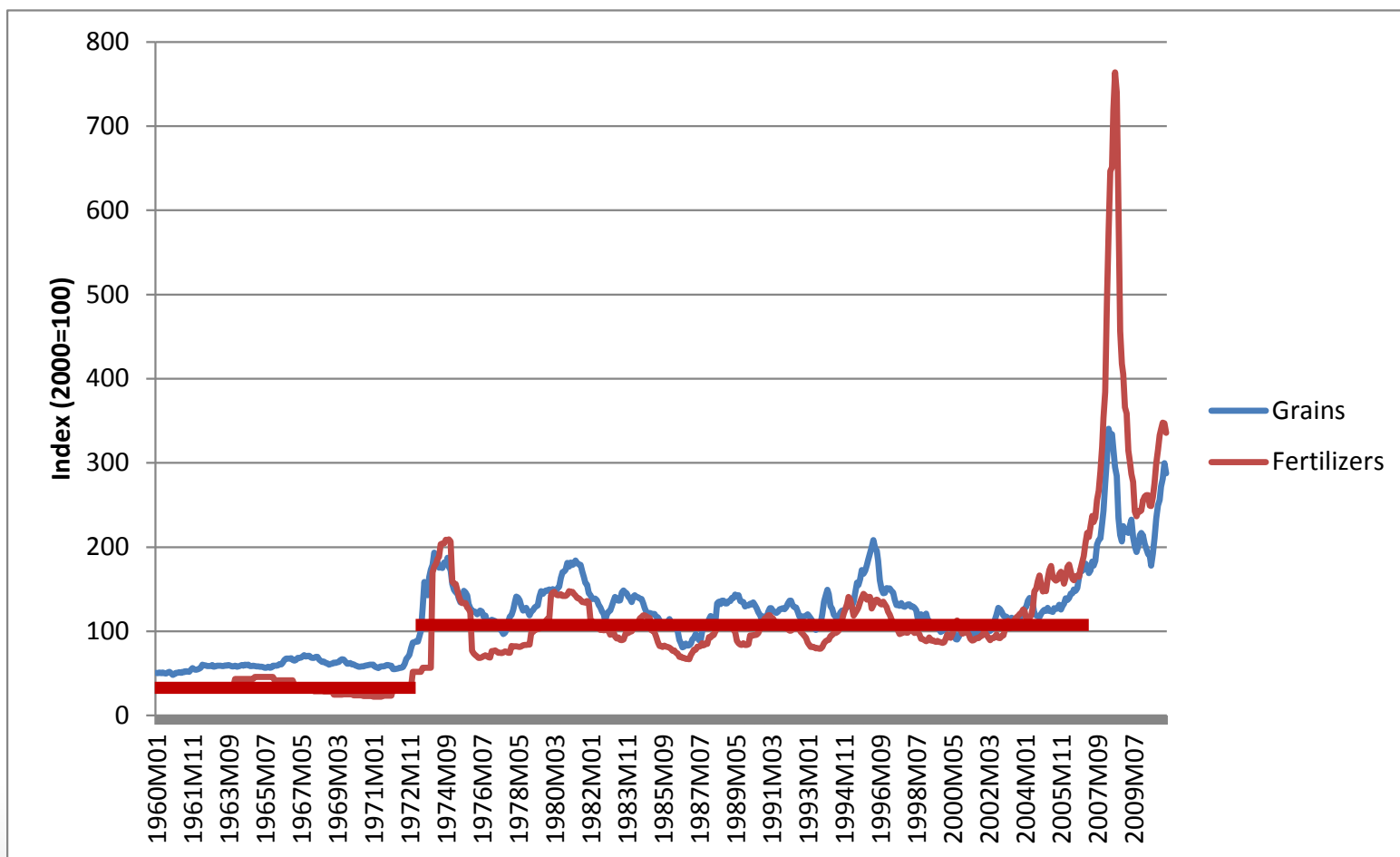
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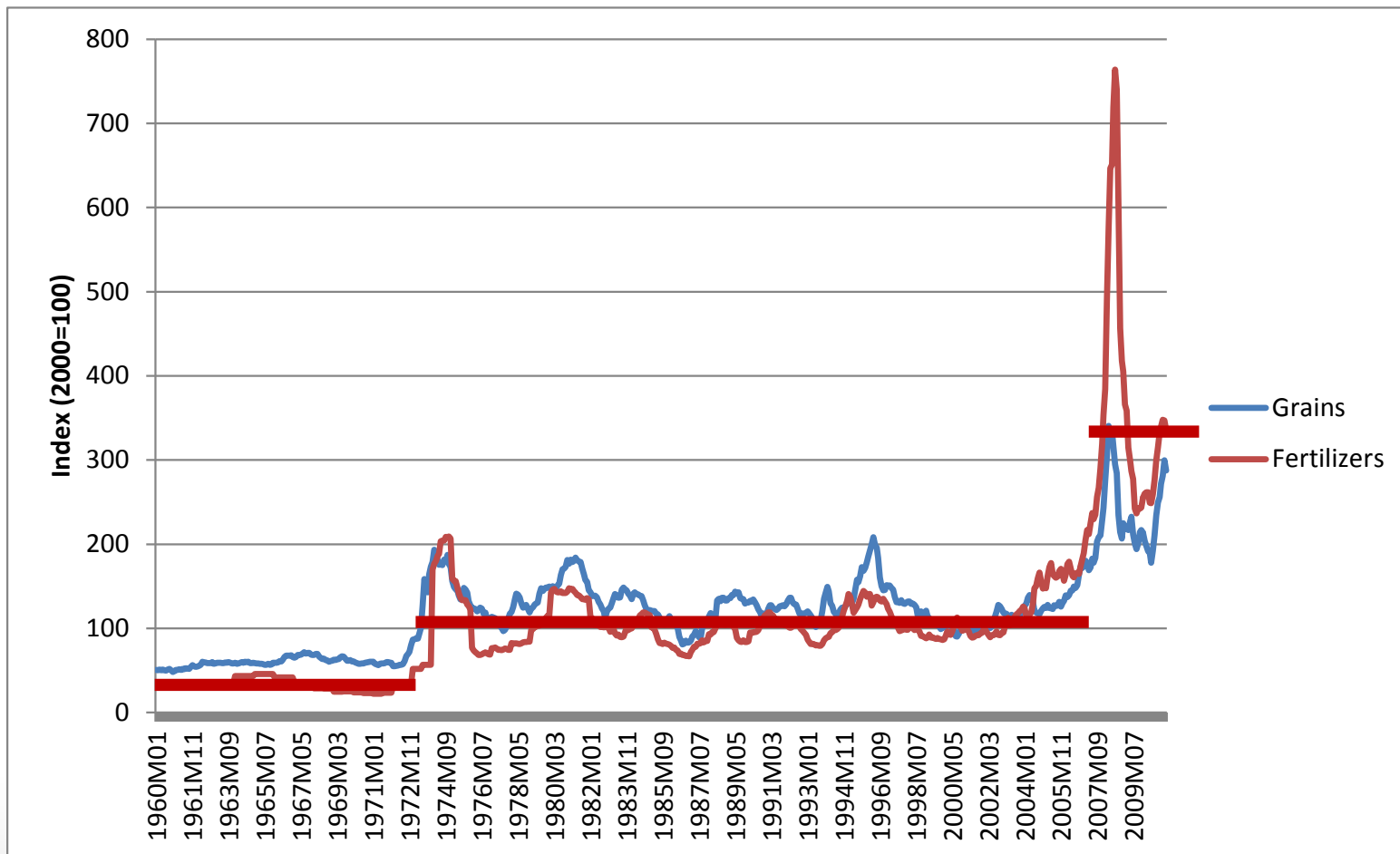
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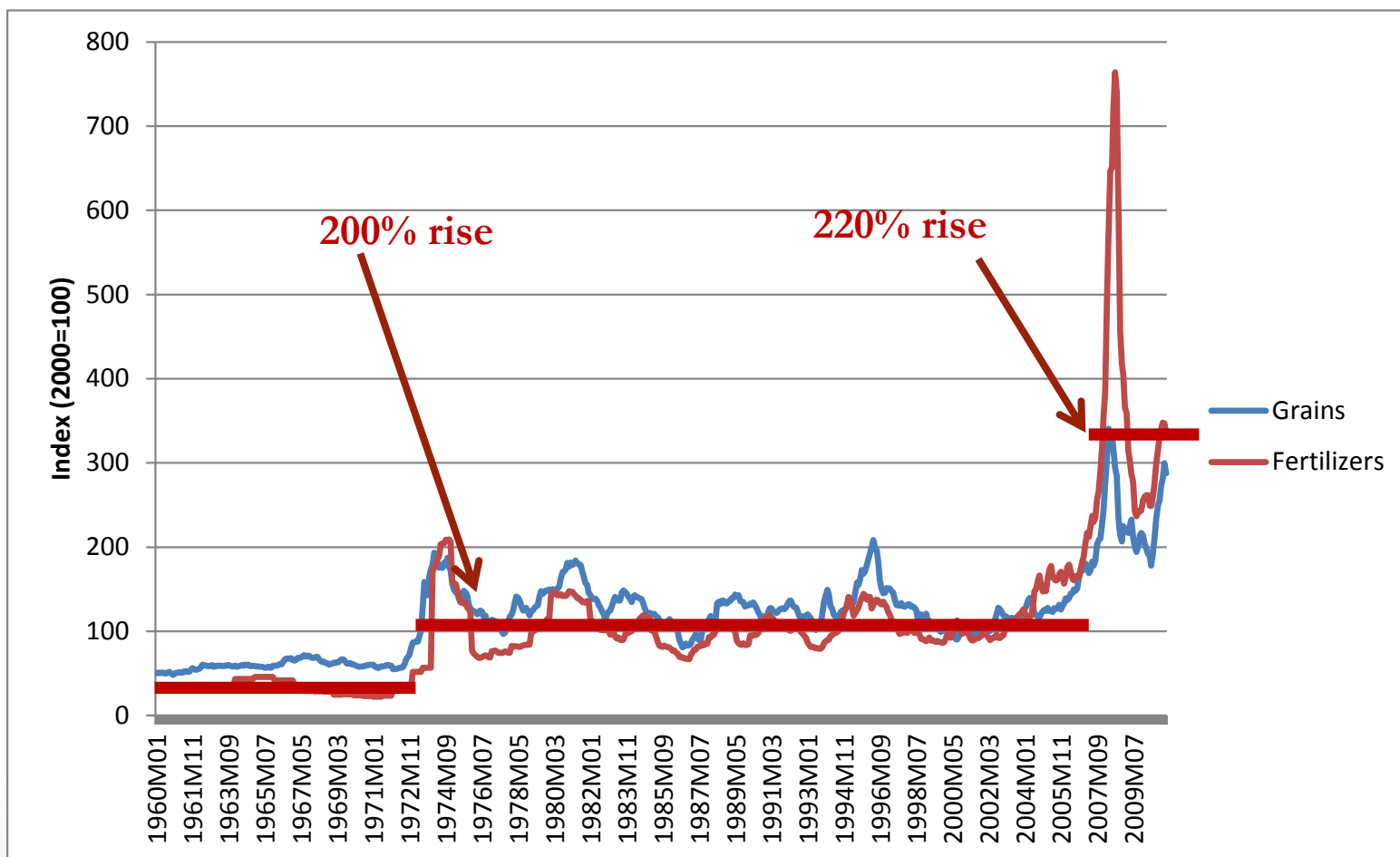
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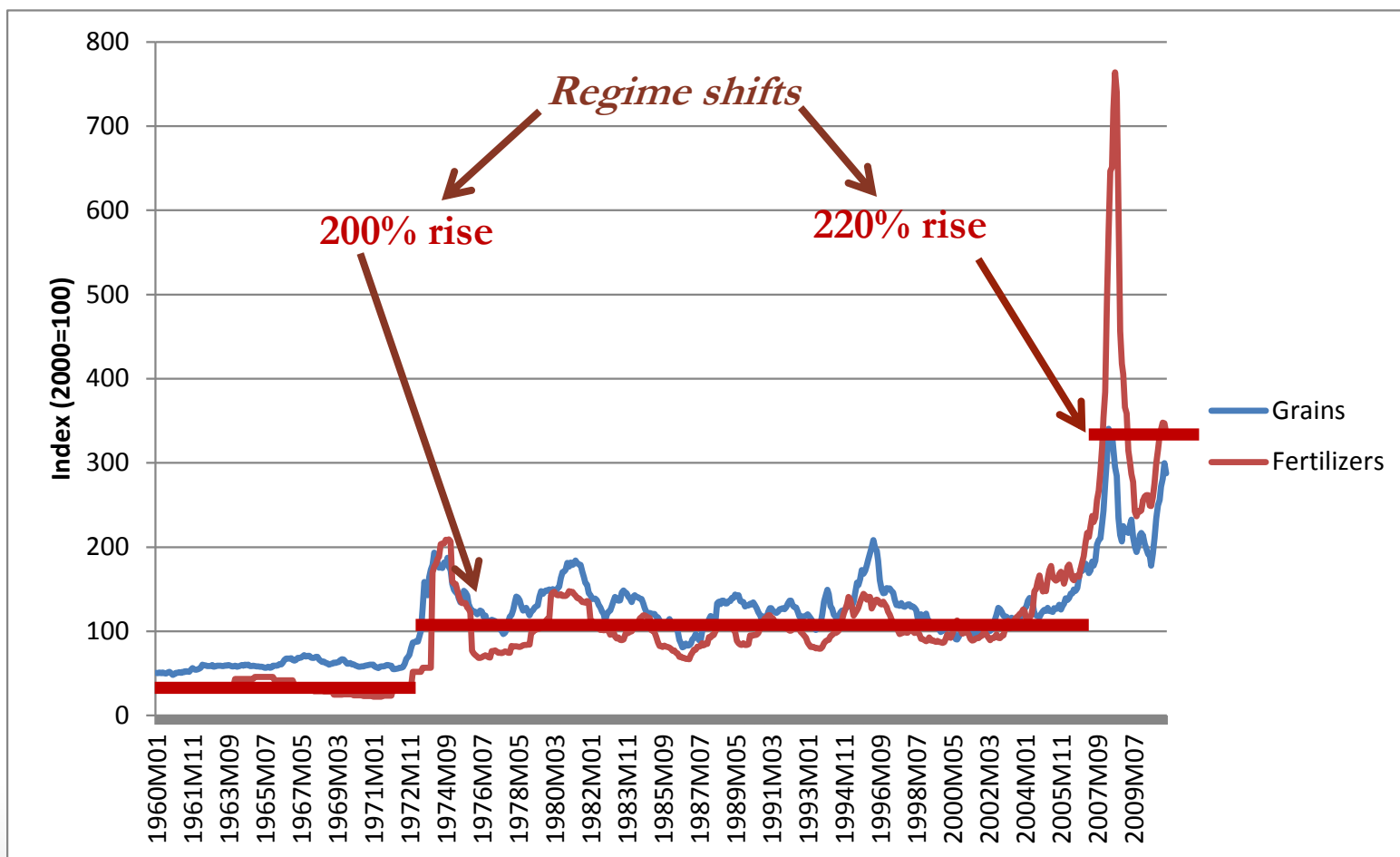
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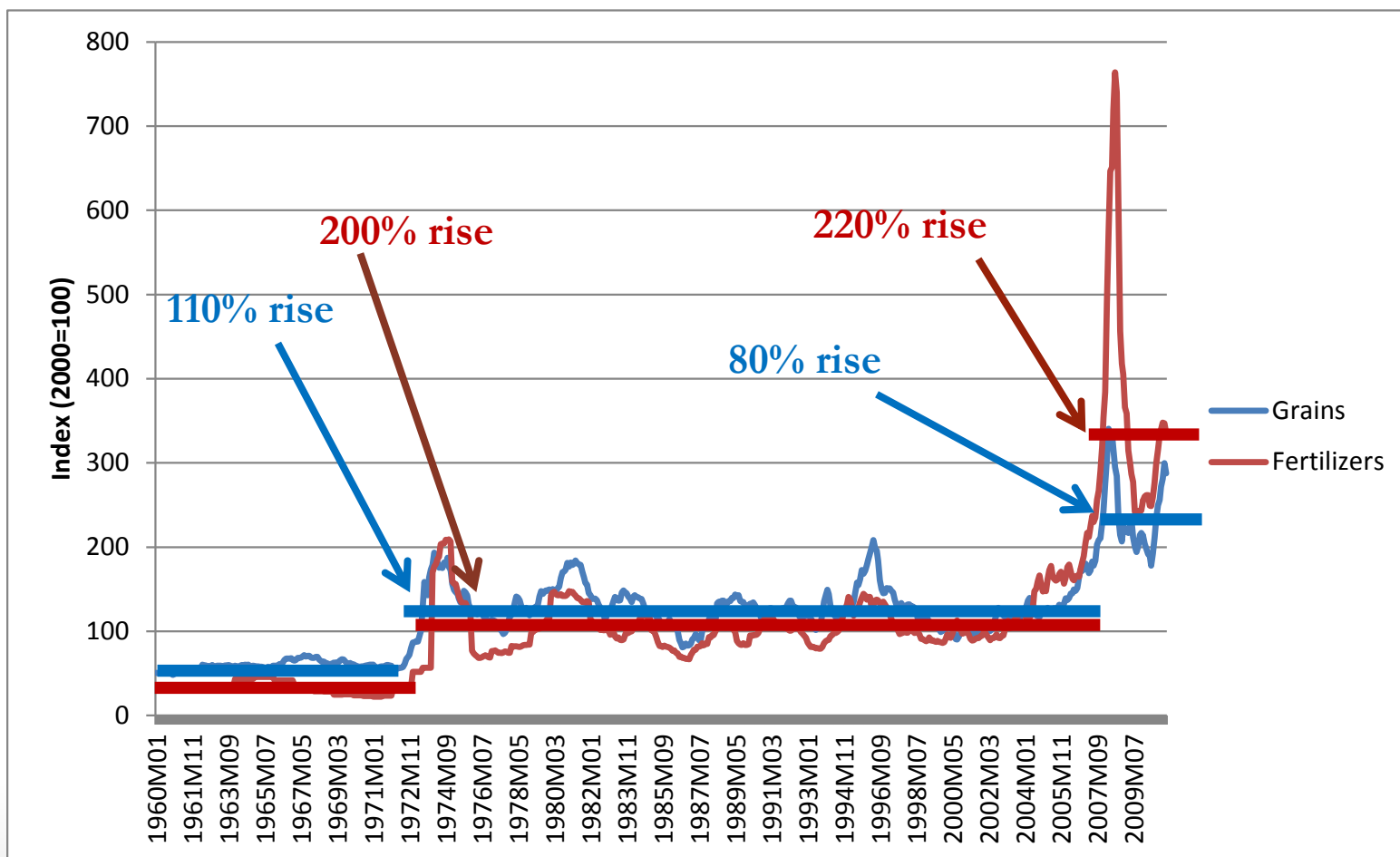
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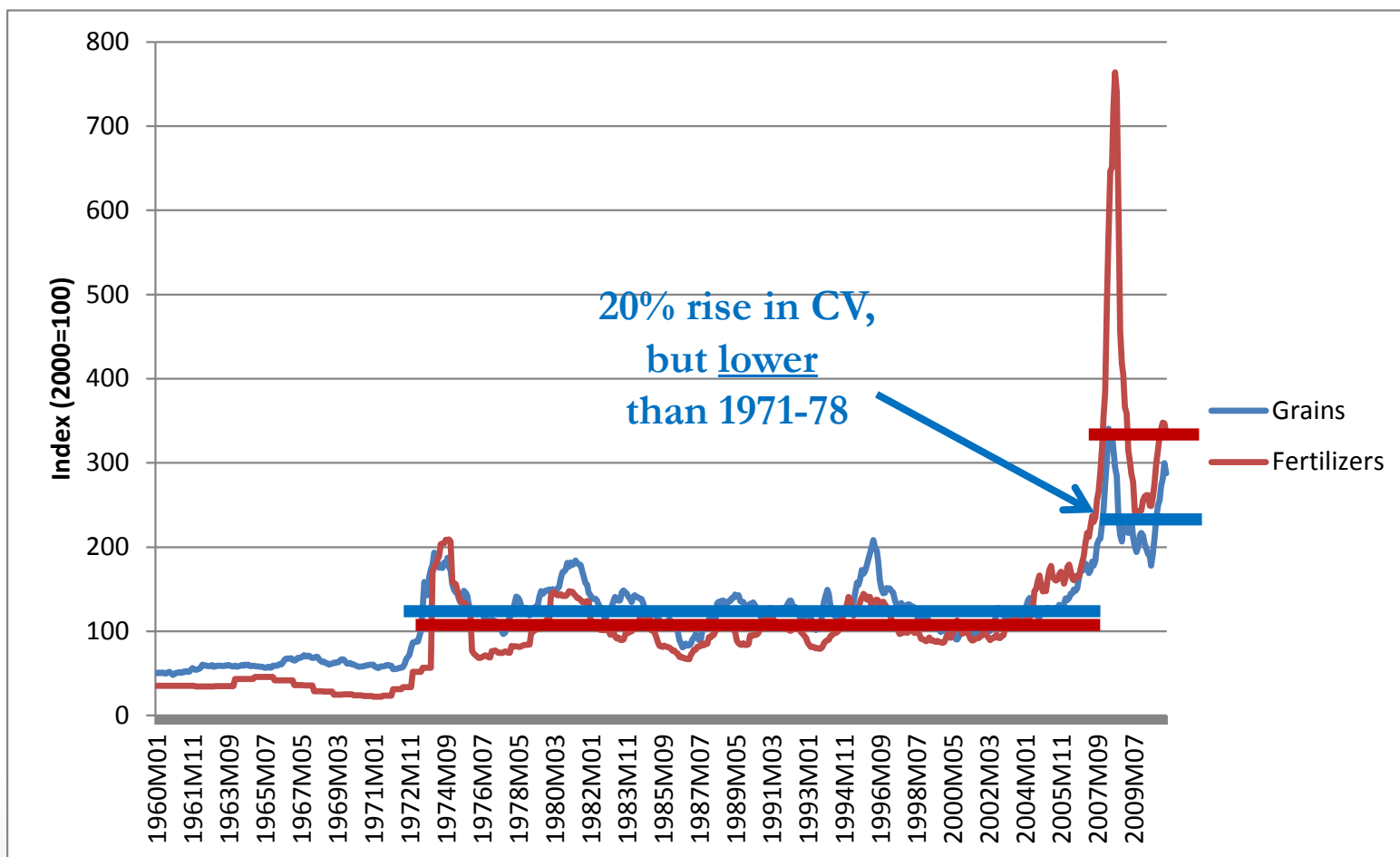
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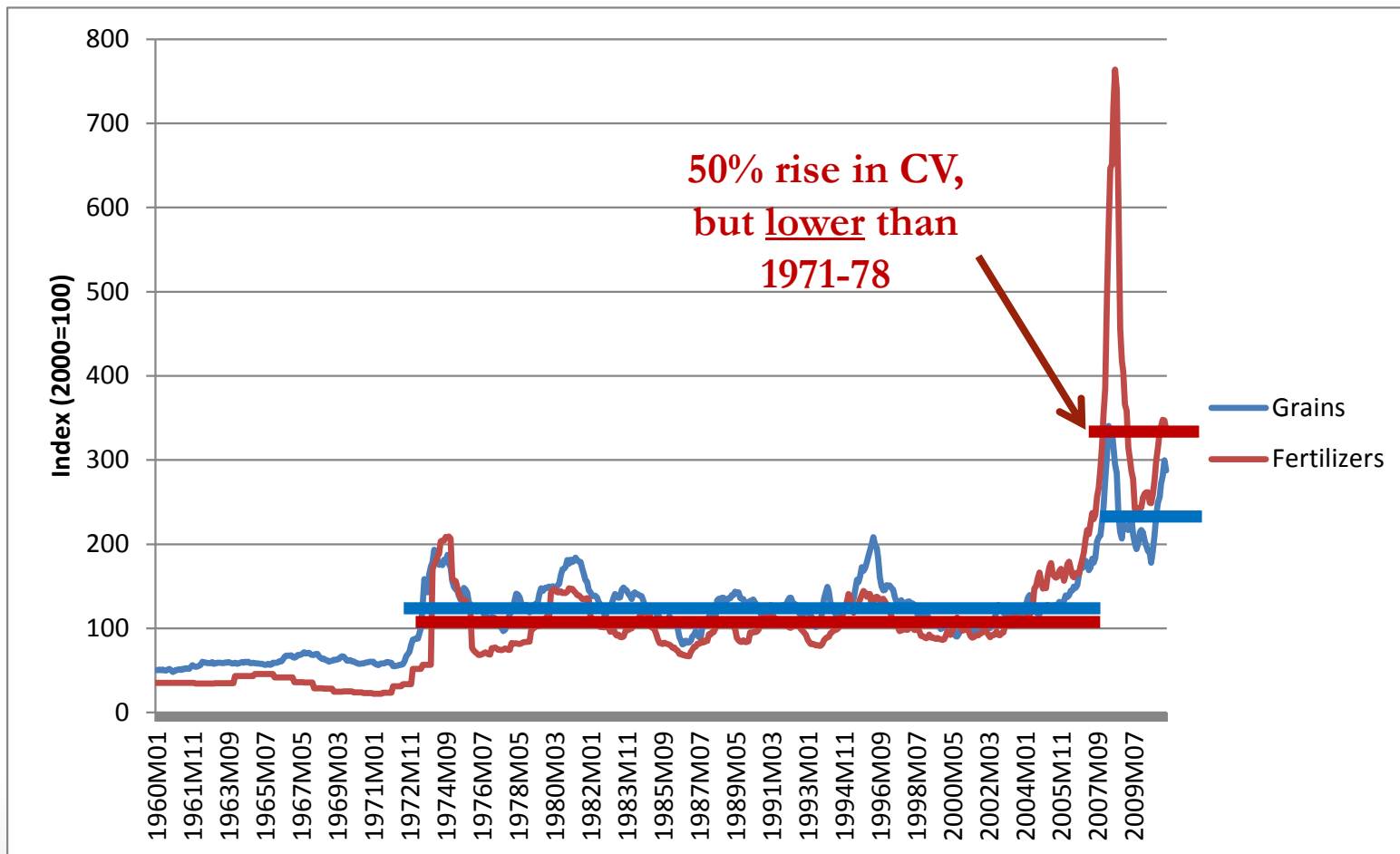
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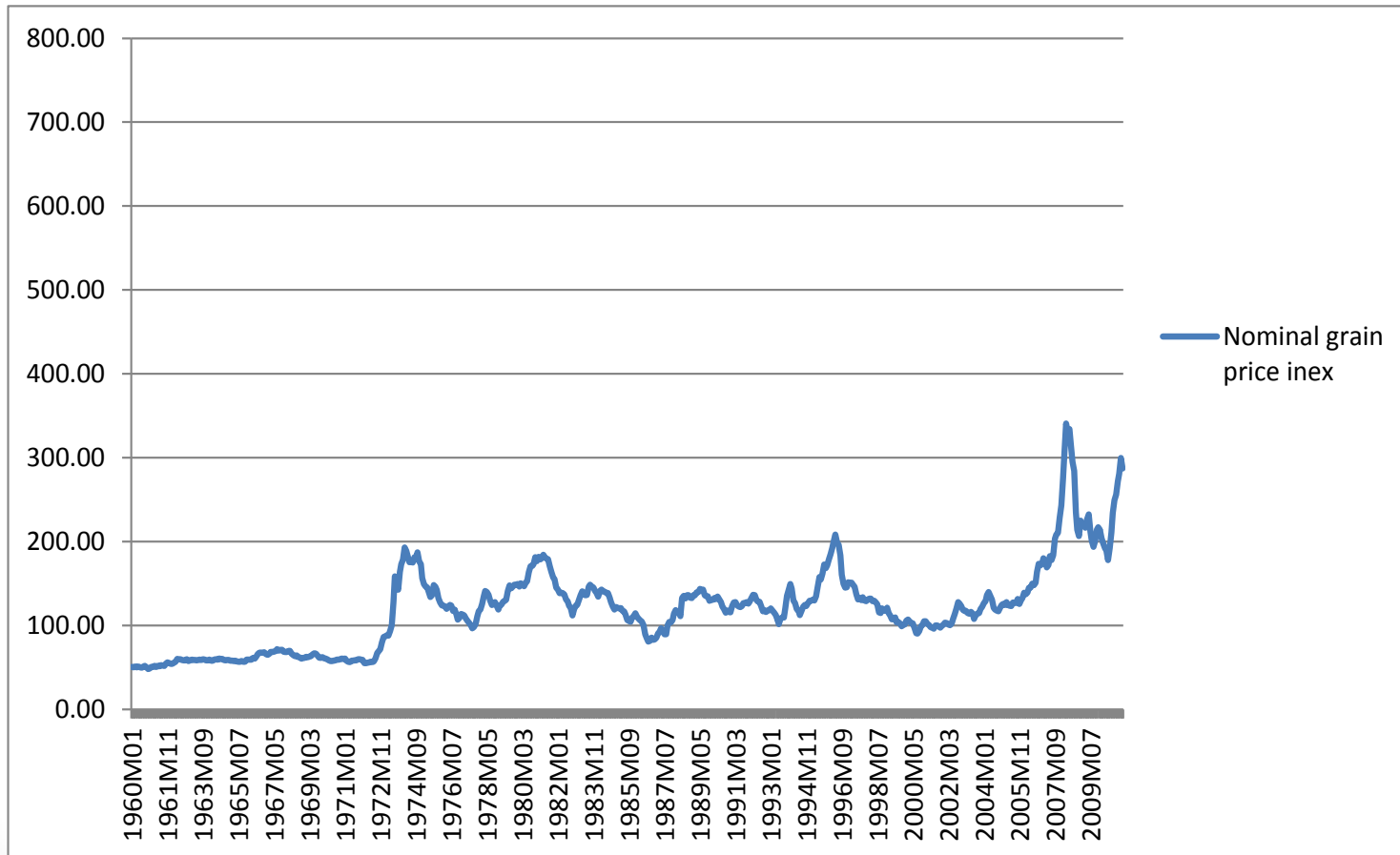


Higher price levels – the long view

- Regime shifts driven by rising energy prices
- Fertilizer prices (and energy prices even more so) rising more rapidly than grain prices
 - Rising average worldwide productivity
- Coefficients of variation ***not*** higher now
- Yet prices continue to *fall* relative to average purchasing power (per capita GDP)

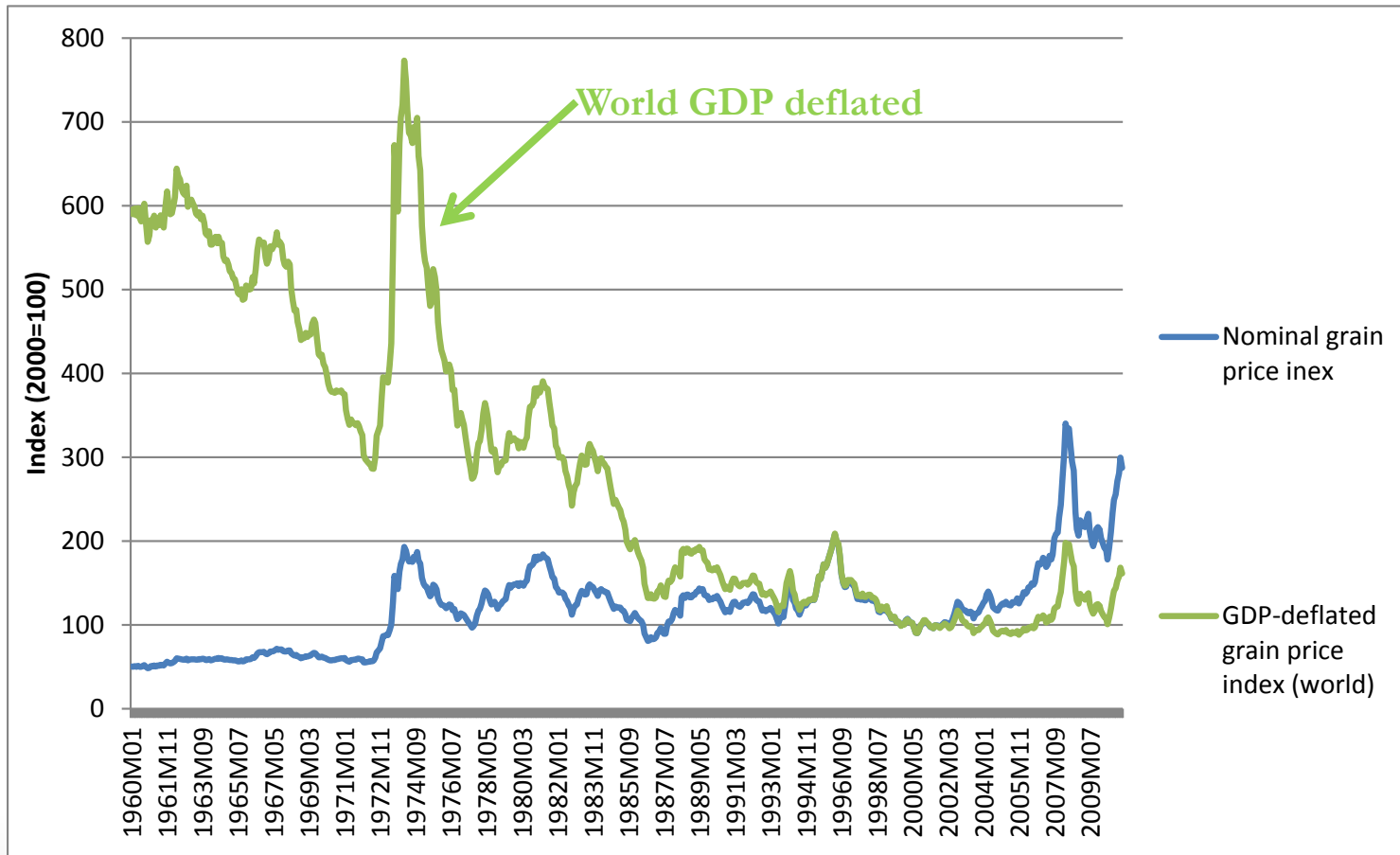
Higher price levels?

World Bank World Price Indices for Grains: Nominal and deflated with SSA and World per capita GDP (1960-2011)



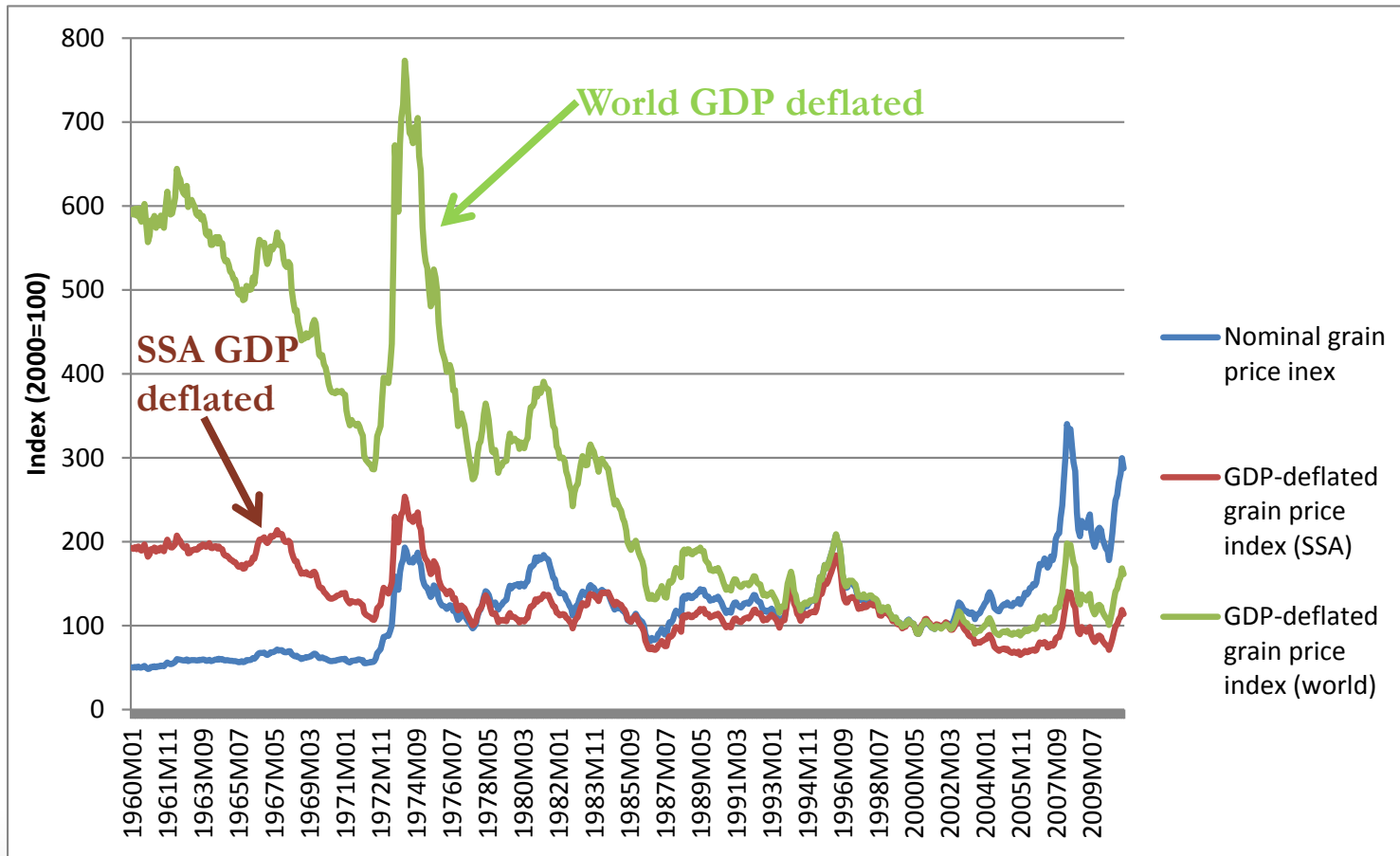
Higher price levels? (2)

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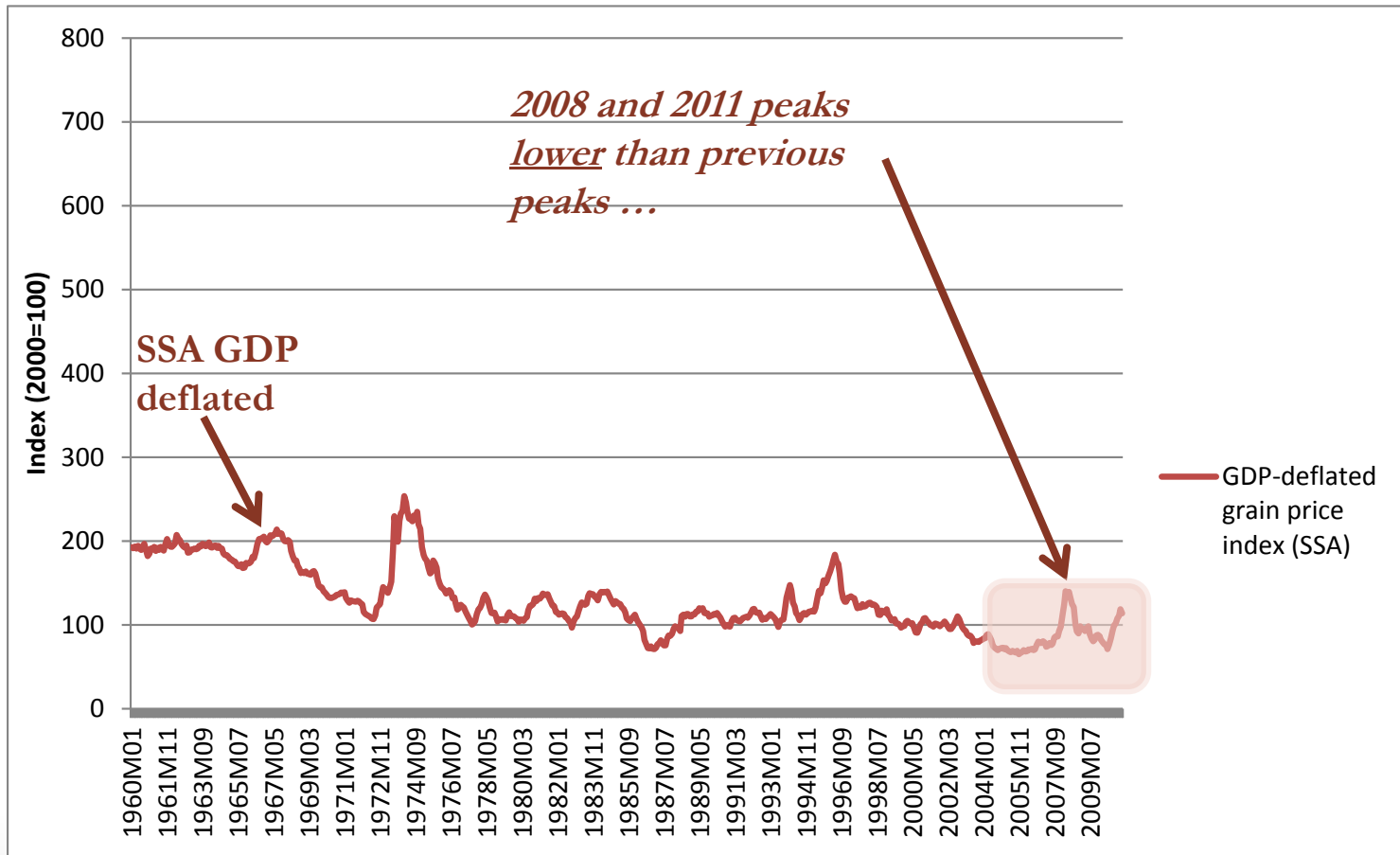
Higher price levels? (3)

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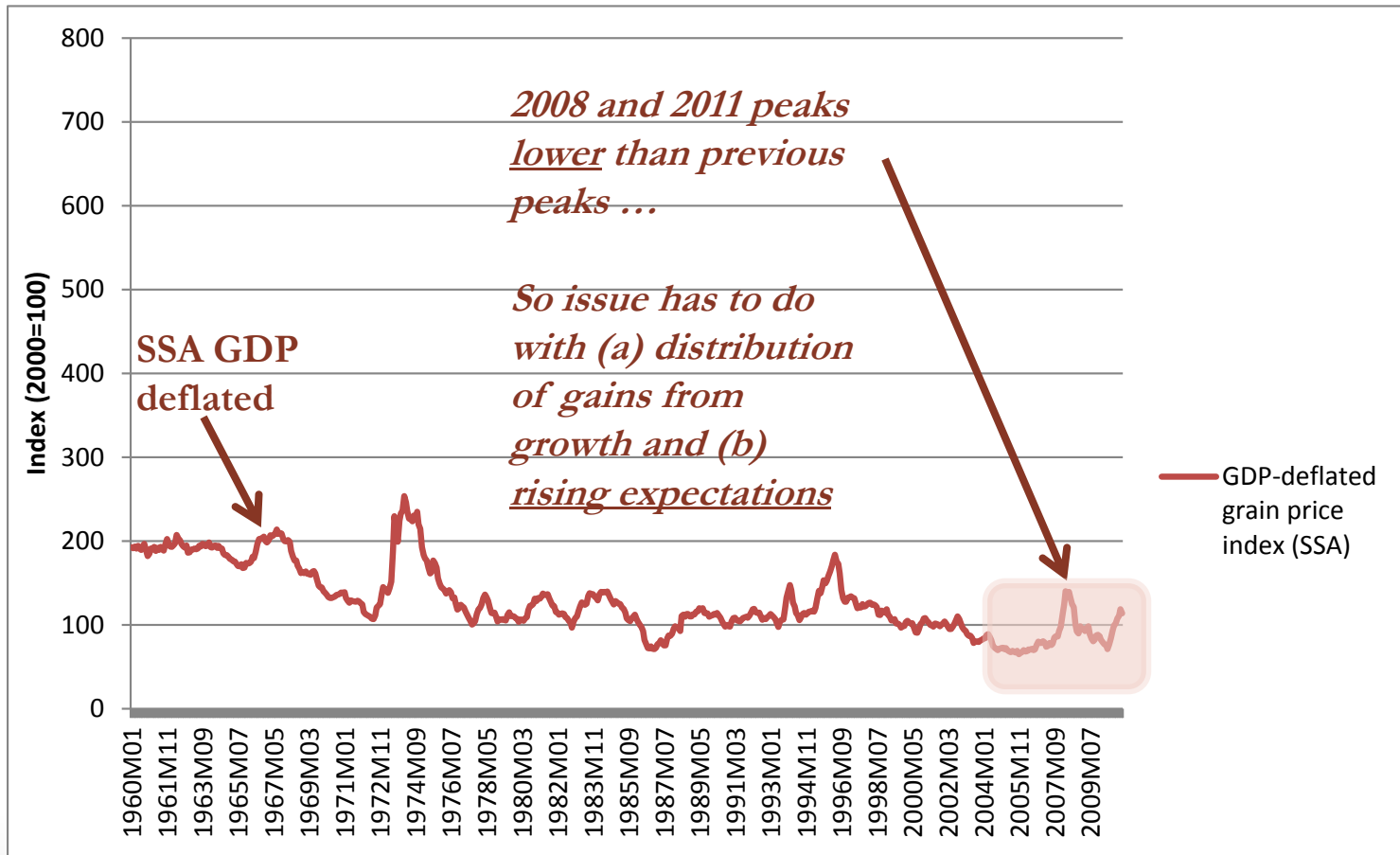
Higher price levels? (4)

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Higher price levels? (5)

World Bank World Price Indices for Grains: Nominal and deflated with SSA and World per capita GDP (1960-2011)



Key observation # 4

Price policy is a political issue

Food is political

- *“Citizens would willingly go to the market to buy food price stability, but such a market does not exist. Food price stability is a public good, not a market good. Understandably then, citizens turn to the political market instead.”*
 - Peter Timmer
- Competing culture, values, world views, pecuniary interests ... all drive the debate
- A multi-dimensional approach is needed

Summary of key observations

- #1: Short-term price transmission from world to developing country markets has been low and variable
- #2: Drivers of volatility in developing country markets have been more internal than external
- #3: But price levels – and the distribution of gains from growth -- not volatility *per se*, may be the real issue
- #4: The food price problem is a political problem

Some implications

- Volatility *per se* primarily hurts commercially oriented (market oriented) smallholder farmers
 - Most direct harm concentrated among 5%-10% of (better-off) smallholder farmers
 - But it also makes it harder for other smallholders to become more commercially oriented
 - A broader, longer-term problem
- High price levels help commercially oriented farmers, but hurt consumers
 - Urban consumers: Especially the poor, whose incomes have not risen as rapidly as those at the top
 - Rural net buyers: Though the level of purchases by these hhs is generally very low, reducing the impact on them

Some implications (2)

- The distribution of gains from growth is a major issue
 - Prices continue to fall relative to average purchasing power
 - Especially in Africa!
 - Per capita GDP growth in Africa has exceeded worldwide averages since 2000
 - But many of the poor have been left behind
 - ... and rising expectations among urban poor fuel discontent

What to do?

*Fundamental need to reconcile
urgent short-term needs with
long-term imperatives ...*

*Reconciling politics with
economics*

What to do? Long-term

- Exploit the opportunity to drive farm level productivity growth
 - The marginal value product of all inputs has risen dramatically!
 - Learn lessons about how sustainably to increase access to inputs
 - While building private input markets
 - Invest in varietal research
 - Invest in water control

What to do? Long-term(2)

- Drive broad-based economic growth
 - Education
 - Health care
 - Water & sanitation
 - Communications infrastructure
 - Road infrastructure

What to do? Long-term (3)

- Drive costs down in the marketing system
 - Reduce uncertainty with more rules-based government policies
 - Promote regional trade
 - (Invest in road infrastructure)
 - Improve marketing information
 - Promote competitive private trading systems
 - Financial systems
 - Clear rules of the game

What to do? Long-term (4)

- Pursue regional dialogue to try to keep borders open
- Engage civil society in all these discussions
 - Evidence-based policy dialogue
 - Messy, but no other option
- Build capacity to generate solid empirical information and inject it into broad societal dialogue

What to do? Short-term

- Safety nets
 - *‘It may be that finding a way to ... deliver effective and efficient safety nets will be the key to allowing markets to deliver their long-run promise. If so, designing and implementing them becomes the essence of effective policymaking’* (Timmer, 2010)
 - Related to political nature of food price policy, which has real economic consequences
 - Also related to inequitable distribution of growth

What to do? Short-term (2)

- Distinguish between emergency reserves and buffer stocks
 - The former are smaller, meant to cover gap until imports can arrive
 - The latter are explicitly meant to stabilize prices and so need to be large
 - Very poor record in Africa: High cost, opaque management lead to market disruption
 - Regional buffer stocks would face even greater problems

What to do? Short-term (3)

- Combine relatively small emergency reserves with robust safety nets
 - Reserves = 2-3 mths consumption max
 - Layered safety nets
 - School feeding
 - Conditional cash transfers
 - Temporary food aid
- Remember that consumers can substitute in consumption
 - Cassava, sweet potato, sorghum, millet
 - Rice this time!

What *not* to do

- Trade bans
 - India helped its consumers
 - But farmers lost and world prices were more destabilized
- Large-scale government procurement
 - Zambia lost nearly \$300m on its maize operations last year
 - Opportunity cost!
 - Who wins and loses?
- Generalized input subsidies
 - Poor targeting
 - Opportunity cost of the funds
 - Unsustainable

Thank you