FONDATION POUR LES ÉTUDES ET RECHERCHES SUR LE DÉVELOPPEMENT INTERNATIONAL

International responses to vulnerabilities of developing countries to food commodity price risks*

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The period since 2006 has witnessed unprecedented food commodity price developments. Between September 2006 and February 2008, world agricultural commodity prices rose by an average of 70 percent in nominal dollar terms, with prices in some products rising by much more than that. The strongest price rises were observed in wheat, maize, rice, and dairy products. Prices fell sharply in the second half of 2008, although in almost all cases they remained above the levels of the period just before the sharp increase in prices started.

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policy brief
89
March 2014
note brève

* Brève issue du colloque organisé par la Ferdi les 9 et 10 janvier 2014 :
Développement durable - développement vulnérable
Les 10 ans de la Ferdi : un anniversaire pour une nouvelle étape

In 2010 sharp price rises of food commodity prices were observed again, and by early 2011, the FAO food commodity price index was again at the level reached at the peak of the price spike of 2008. In 2011 and 2012 prices fell again and then rose again considerably in early 2013, only to fall in late 2013. In other words within the past six years many food commodity prices increased very sharply, subsequently declined equally sharply, and then again increased rapidly to reach the earlier peaks. During 2012-13 the FAO food commodity price index in real terms was at levels not seen since 1974-75. Such rather unprecedented volatility in world prices creates much uncertainty for all market participants, and makes both short and longer term planning very difficult. It has also created considerable international discussion and debate as to ways and policies to reduce the food commodity market volatility, and to assist developing countries to better cope with its adverse effects.

Previous episodes of sharp food commodity price rises such as those of 1973-75, early 1980s, and mid-1990s, also led to international discussions and policy suggestions, but very little, if anything, was adopted at the international level to assist low income food deficit countries to cope with the consequences. This time the food commodity crisis lasted a long time (about 6 years and possibly still going) and has seen a variety of international responses. The purpose of this brief is to discuss some of the international responses since 2006, and especially, more recently, towards dealing with food commodity market volatility.

Historical analysis has shown that commodity price volatility is larger than the volatility of manufacturing good prices, and that it has not increased over a long time, despite occasional peaks. Similarly international food commodity price volatility appears not to have increased significantly over the past 50 years. Nevertheless, what has changed considerably in recent decades, is the exposure and vulnerability of many developing countries (DCs) to international food shocks. There has been a shift of developing countries from the position of net agricultural exporters up to the early 1990's to that of net agricultural importers. Growing dependence on food commodity imports implies growing vulnerability to external food commodity shocks. Projections to 2030 and 2050 indicate a deepening of this trend, which is due to the projected decline in the exports of traditional agricultural products, such as tropical beverages and bananas, combined with a projected large and growing deficit of basic foods, such as cereals, meat, dairy products, and oil crops.

Since 1990, the food import bills of least developed countries (LDCs) have not only increased in size, but also in importance, as they constituted more than 50 percent of the total merchandise exports in all years. In contrast, the food import bills of other developing countries (ODCs) have been stable or declined as shares of their merchandise exports. These trends were reinforced during the 2007-8 food crisis. (Prakash, 2011). Furthermore, it appears that there is considerable volatility in both the barter terms of trade as well as the income terms of trade of DCs especially LDCs. It also appears that for LDCs the income terms of trade seem to have declined over the past several decades while they have stayed stable or increased for other DCs or developed economies. It thus appears that from the DC viewpoint a major issue in the context of high international food prices is the compensatory financing of food related shocks.

The international response to the recent global food crisis started in June 2008 at the high-level Conference on world food security convened by FAO in Rome. In the declaration of that conference, the high-level representatives of 181 governments resolved to make food security part of their permanent national policies, and decided to respond quickly to the short-term needs for assistance of affected countries, to support agricultural production and trade, to undertake initiatives to moderate unusual fluctuations in food grain prices, and enhance risk management for affected countries. The conference acknowledged the world's food system vulnerability to commodity shocks, and resolved to help make the system more resilient.

According to the conceptual framework proposed by Hiemenz (2012), the international response to food price volatility "is an example of what modern political science calls the "new sovereignty". National governments give up part of their national sovereignty and cooperate with each other to accomplish objectives which they cannot accomplish acting alone in their jurisdictions. They form trans-governmental regimes and networks such as the G8 or the G20, the EU, the World Trade Organization, or, most comprehensively, the UN to tackle regional or global problems which require coordinated intervention towards a common objective (such as human rights, global security, climate change, etc.)." These networks help build trust among participants but also create frictions as unequal access to information as well as difference in political and economic power can influence the agenda and outcomes. Countries that are not satisfied can ignore decisions that require political action or can just not participate in any agreement or institution that is created. Any intergovernmental agreement requires a set of institutions capable of implementing or enforcing a decision. Such institutions can be national (such as development agencies or regulatory bodies or central banks) or international organizations such as the World Bank, the IMF, the UN, the WTO etc. Concerning responses to food price volatility, the relevant questions to pose in viewing the international responses include the self-interest of participating countries, their ability to influence the agenda, the capacity of governments to translate supranational decisions into national legislation, and the capacity of international organizations to play a role.

In 2009, under the weight of the 2007-8 financial crisis, and estimates that because of the high food prices at least 100 million more people in DCs were thrown into extreme poverty and hunger, the Heads of the G8 states decided to launch the L'Acquila Food Security Initiative (AFSI), determining to "act with the scale and urgency needed to achieve sustainable global food security". The Initiative aimed at achieving sustainable global food security by promoting agricultural production and productivity growth, agricultural investments, emergency relief strategies, rural and economy-wide growth, as well as external factors conducive to improving food security such as open international commodity markets. In addition, G8 countries and 19 other participating developed and developing countries made commitments towards mobilizing US$ 22.2 billion over a three year period. As of the end 2012 more than 67 percent of these pledges had been disbursed.

The L'Aquila Initiative was unique in that it acknowledged food security as a global governance problem requiring coordinated action by the international community; made the link between food security and the macro-economic and financial environment; and solicited the cooperation of international and regional organizations in promoting food security. Concerning food price volatility related issues, the AFSI supported cash based social protection systems and targeted nutrition interventions and called for removal of export restrictions and consultations in advance of such restrictions. It also asked for a system of stockholding to deal with humanitarian crises. Finally it called for expansion of risk management instruments.

In 2010 the G-20 in Seoul discussed the AFSI. Despite the fact that the Seoul meeting focused mostly on financial issues, given the global financial crisis, the final declaration called for more work towards better regulation of financial derivative markets and futures markets. It called for support of trade finance, and invited relevant international organizations to develop, for the 2011 Summit in France, proposals to better manage and mitigate risks of food price volatility without distorting market behavior.

In preparation for the 2011 G20 summit in Cannes, there was a report prepared by 10 international agencies (FAO, et. al, 2011), which presented 10 major recommendations to deal with food price volatility. These included policies for increased agricultural productivity, the establishment of an agricultural market information system (AMIS), the increased transparency and efficiency of agricultural futures markets, improving market access and reducing trade distorting supports within the WTO, as well as defining critical food shortages as a precondition for allowing export restrictions, to strengthen the commitments made in L'Aquila to allow humanitarian food purchase to be exempted from food export restrictions, to remove subsidies on biofuels, to support food emergency reserves, to support developing countries with contingent financing from international financial institutions, to support targeted safety nets, to make available to vulnerable households market based risk management instruments and provide relevant services, and strengthen policy coordination in relation to food price volatility.

Based on this report the 2011 meeting of the G20 agriculture ministers adopted a draft "Action plan on food price volatility and agriculture" (Action Plan) in June 2011, that was to form the basis for the Cannes summit decisions. While the action plan endorsed several of the recommendations of the interagency report, it did not mention anything concerning agricultural financial markets and the control of excessive speculation. The Cannes G20 Summit declaration had a whole section devoted to Food price volatility and increasing agricultural production. It endorsed the Action Plan and decided to act on the five objectives of that Plan, namely (i) improving agricultural production and productivity, (ii) increasing market information and transparency, (iii) reducing the effects of price volatility on the most vulnerable, (iv) strengthening international policy coordination, and (v) improving the functioning of agricultural derivatives markets. It launched AMIS, and the "Global Agricultural Geo-monitoring initiative" to coordinate satellite monitoring observation systems around the world to enhance crop production projections. It endorsed recommendations by the International Organization of Securities Commissions (IOSCO), and launched a rapid response forum, based in Rome, to improve international policy coordination and common responses in times of market crises. Concerning protection for the most vulnerable, it supported the provision of and advice for modern risk management instruments, such as weather index insurance, contingent financing tools, and commodity hedging instruments to low income countries. Clearly none of these instruments and approaches tackles the compensatory financing needs of low income countries affected by high food prices, and there was no mention of any resources that were to be made available towards the objectives of the declaration. Similarly no mention was made of the humanitarian emergency reserve, as it would require resources that were not forthcoming.

Following the Cannes summit, an early warning system was established with AMIS as well as the rapid response forum, but there were no financial resources made available. In terms of commodity market regulations, both the US as well as the EU drafted new financial market regulations. As the agricultural commodity market regulation issues were bundled with other commodity market issues, in particular those of energy markets, the specificity of agricultural markets, such as seasonality issues, was lost.

In May 2012 at the camp David G8 meeting, the New Alliance for Food Security and Nuitrition was launched, the innovation of which was that it welcomed the participation of the private sector in increasing capital flow towards agricultural development. The G8 declaration also mentioned the management of risk as one of the ways to lift 50 million people out of poverty in ten years. Nevertheless, it offered no specifics.

In preparation for the Los Cabos Mexico G20 summit, G20 agricultural vice ministers took stock of the progress after Cannes, and the Action Plan. They noted and welcomed the meager developments since the Cannes Summit, such as AMIS, the Rapid Response Forum, the GEO Global Agricultural Monitoring Systems (GEO-GLAM) and the commitment in ECOWAS to establish a pilot regional emergency humanitarian reserve, the efforts by several international institutions to provide services and instruments of market based risk management in agriculture, and re-endorsed the Action Plan but made no new commitments, financial or otherwise towards mitigating the effects of price volatility.

The Los Cabos G20 June 2012 Summit declaration, which took place in the middle of continuing high food commodity prices, had a whole chapter devoted to "enhancing food security and addressing commodity price volatility". It first supported the agriculture vice-ministers report, especially on progress made on increasing agricultural productivity. Then it reaffirmed support for efforts such as AMIS, GEO-GLAM, the Rapid Response Forum, and the provision of risk management instruments. The declaration stressed the importance of well-functioning and transparent physical and financial commodity markets, and reduced excessive price volatility to achieve food security and inclusive growth. While recognizing that "mitigating the negative effects of commodity price volatility on the most vulnerable is an important component of reducing poverty, and boosting economic growth", they only resolved to ask G20 finance ministers to report on how G20 has contributed to better functioning of these markets. Thus no concrete measures were proposed.

Following the Los Cabos G20 summit, president Hollande of France launched in September 2012 a global campaign to win support for creating strategic stockpiles of agricultural commodities. Amid fears that the world could be on the brink of a third food price panic in four years after dire droughts in the U.S. Midwest and the Black Sea area, Mr. Hollande's comments once again put France in the forefront of efforts to give major producers and consumers greater power to prevent price spikes. He stressed the importance of market and crisis management policies through strategic food stocks.

France had first raised the issue of food reserves in 2011 as it chaired the Group G20. But the final declaration limited promises to institute food aid stocks in countries that could most need them, a measure that is yet to be implemented. His call met resistance from several key countries including the US, which had considerable experience with food commodity stocks, only to find out that they were not only costly, but also did not help prevent price spikes. In addition analysts have long known that such stocks are very difficult to manage both technically, as well as geographically. While food commodity stocks may produce desirable market outcomes in specific countries, as rice stocks have done in several Asian countries, international coordination is quite difficult. The French initiative does not seem to have found international support, as there is no mention of it in any subsequent high level meetings, or the WTO decisions in Bali in December 2013.

In June 2013, the G8 leaders in Lough Erne highlighted global food security in their declaration, but apart from promises to advance action in the areas of leadership, accountability, participation, and ensuring that there is impact on smallholders and women, there was no mention of agricultural market volatility or any commitments to act in any relevant areas.

In September 2013, the declaration of the leaders of the G20 in St Petersburg, reaffirmed the commitment to food security and nutrition, encouraged ongoing effort in the agricultural sector to reduce hunger, under-nutrition and malnutrition, endorsed actions to increase production and productivity, endorsed targeted and market non-distorting support for vulnerable population, and reaffirmed commitments to implement previous G20 commitments including those stated in the Action Plan which was adopted in 2011. All other mention of commodity action was concentrated in the energy sector. No mention of any further financial support or institutional action or innovation relating to food market volatility was made.

The most recent international action relevant to food market volatility and food security took place at the WTO ministerial meeting in Bali Indonesia in December 2013. The major decision concerning food market functioning and rules was the decision on food stockholding. The discussion was motivated by a G33 proposal, which focused on allowing developing countries to not include domestic food purchases from small holder farmers to be held as stocks in the country's Aggregate Measure of Support (AMS) allowances. The proposal was strongly supported by India, in light of it large purchases of rice and wheat for it Public Distribution System (PDS), but was resisted by several other countries both developed as well as some developing, as such practices may distort international markets. The compromise reached in Bali allowed WTO Members to use an interim mechanism, and postponed final decision to the 2017 WTO ministerial conference.

Concerning compensatory finance for countries vulnerable to food shocks, the only facility that currently exists is the IMF's Exogenous Shocks Facility (ESF), which was established in 2008, and includes a High Access Component (HAC) that provides concessional financing for countries eligible under the Poverty Reduction and Growth Trust (PRGT), facing balance of payments difficulties caused by sudden and exogenous shocks. This has been superseded as of 2013 by the Standby Credit Facility (SCF), which provides financial assistance to Low Income Countries (LICs) with short term balance of payments problems in times of shocks or crises. Funds available under this facility are loans that carry low interest rates (0.25 percent), have a grace period of 4 years, and are subject to the IMF's conditionalities that aim to correct the causes, if any, of the situation that brought about the shock or crisis. The IMF also has other relevant short term financing instruments such as the Rapid Credit Facility. While several countries received support under the ESF since 2008, and it remains the IMF's main compensatory financing mechanism, complaints remain that it is too cumbersome and subject to conditionalities.

The only other compensatory finance mechanism available is the EU's FLEX facility. Reviews of its performance have shown that this facility has suffered from inadequate finance and delays in the financing procedures. The EU's V-FLEX mechanism that was approved in 2010 is a short term instrument designed to support vulnerable ACP countries subject to external shocks, and has received support of 500 million Euro but for only two years. This is in addition to the 1 billion Euro Food Facility approved by the EU on March 2009 and the allocation of 200 million Euro under the 2008 EDF to help developing countries to cope with higher food prices. The funds available from these programs are grants, compared to the IMF funds that are loans. 26 ACP countries were targeted for these funds in 2009-10.

Another initiative that dates back to the Uruguay Round is the idea of a Food Import Financing Facility (FIFF). The idea of that facility is to facilitate food import finance in times of high prices, and when the financing for food imports for poor food dependent economies reaches limits imposed by international private banks that finance food trade. While the idea received some discussion in the WTO, it did not advance, and while it resurfaced in the recent food crisis (Sarrris, 2013) nothing was done to advance it.

From the above it can be seen that the issue of supporting food dependent low income developing countries to deal with unexpected food shocks, especially those that are not of their own making, has been relatively high on the agendas of high level meetings, since 2006. However, not much has been accomplished in terms of additional resources to support new institutions designed to deal with such unusual events. The reason maybe that the most vulnerable of these countries do not have a voice in setting the agendas of the G8 or G20 meetings, albeit some of the members of these high level groups are concerned about political unrest in their own economies from high food prices. With declining world food prices, the risk is that the item may disappear from the priorities of major donors, as it did after the past world food crises. Nevertheless, the continuing high global food prices have helped preserve donor interest in the issue, and has generated or redirected some extra development aid resources towards projects or institutions that deal with food commodity market volatility. The hope is that the world will be better prepared, and vulnerable countries will have more options to deal with future food commodity crises.

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