Meeting of the Council at Ministerial Level, 24-25 June 2009

COMMODITY PRICES AND FOOD SECURITY

JT03266581

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I. Introduction

1. The 2008 OECD Ministerial Council Meeting (MCM) was held at a time of very high food commodity price spikes and associated social unrest in a number of developing countries. A paper prepared for consideration by Ministers at that time focussed on the causes, consequences and policy responses, emphasising both the need for short term humanitarian assistance and for sustained medium term attention to address the underlying development problems that contribute to widespread hunger amongst almost one billion people around the world.

2. OECD was invited by the MCM to undertake further work, in particular to monitor developments in agricultural markets and to promote sound international policy responses to address the long term structural factors driving food prices. Since that time work has been on-going jointly between agriculture, trade and development communities of the OECD and in cooperation with other international organisations, in particular the FAO. OECD also continues to participate in the UN High Level Task Force on Global Food Security and in the G8 Experts Group on Global Food Security. The remainder of this note highlights recent developments and the current market outlook, and identifies lessons learned.

II. Recent developments and outlook

3. The sharp run-up in food commodity prices in 2007 and 2008 meant that tens of millions of people were added to the already more than 800 million people estimated to be going hungry, reawakening widespread concern about global food security. Food commodity prices subsequently fell even faster than they had risen on world markets, though in many developing countries local and regional markets remained isolated from these developments, in some cases because they remain poorly connected to global markets, in others because of government interventions. As the global economic crisis unfolded, still more people found they could no longer afford the costs of food needed to meet minimum dietary requirements.

4. This year’s OECD/FAO Medium Term Agricultural Outlook calls for commodity prices (in real terms) to resume their long term downward trend, but holding somewhat above averages observed earlier this decade. There is consensus that prices will be more volatile in the future – a belief that has persisted even as prices have fallen.

5. Looking forward, continuing low levels of stocks imply that any supply or demand shock would have greater impact than in the past. In thin markets (low volumes, few actors), policy decisions (such as export restrictions) can severely reduce global supplies and drive up prices on international markets. The effects of crude oil prices are clearly important, both because of the demand links through biofuels markets and the supply links through costs of petroleum based inputs into production (e.g. fertilizers), transportation and processing of agricultural goods.

6. The longer term outlook features both opportunities and challenges for food security. At the global level, FAO projections of world population and food production to 2050 show levels of food availability per capita growing at least as fast as during the last half century. At the country level this picture changes, however, and many regions of the world do not possess the agricultural or financial resources needed to feed their growing populations. More than ever, food insecurity is tightly linked to poverty and challenges for the future lie in affordability and accessibility, as well as availability of food.

7. A critical variable in the outlook, especially in Africa, is climate change. Rain-fed agriculture is the mainstay of rural peoples’ livelihoods, but agriculture on increasingly ecologically fragile lands is a high risk venture, not only from higher temperatures and lower rainfall, but also from increased climate variability. Developing country farmers increasingly need help to manage these risks and to incorporate
climate related advice into decision making concerning soil management, fertilizer use, crop variations and crop rotation.

III. Policy responses and conclusions

8. Developing countries and the international donor community responded strongly to the food crisis of 2007 and 2008. Some of those efforts have been sustained and expanded to deal with the consequences of the subsequent economic crisis, focusing increasingly on the longstanding problem of food insecurity (rather than the narrower problem of high food prices). Bilateral donors, multilateral agencies and development banks emphasise safety nets for emergency short term relief and investment in agriculture to assure adequate food supplies in the longer term. National governments focus on policy measures that in many instances seek more broadly to protect consumers from high international prices.

i) Safety nets

9. Emergency relief provided under a variety of safety net programs includes in-kind food assistance, cash transfers and direct income support. In-kind food assistance programs, usually implemented jointly with the World Food Program (WFP), were applauded for being timely and substantive compared to the past. The WFP managed to attract historic amounts of commitments - its emergency appeal for USD 755 million funding was oversubscribed to almost USD 1 billion (particularly due to significant donations from Gulf States, notably Saudi Arabia).

10. WFP purchases of food commodities locally proved to be cost-effective and complementary to agricultural development strategies, although local procurement efforts were hampered where exporting countries imposed restrictions and bans precisely when needs were the greatest.

11. There has been success in recent years in establishing cash transfer programs and moving safety nets in developing countries toward more desirable policy configurations, especially in Latin America. Evidence of that success showed up in the frequent use of cash transfer programs in response to high food prices in 2007 and 2008 in Latin America and in some countries in Asia. Elsewhere, less well targeted programs to increase disposable income of workers, and often the salaries of civil servants – alternatives resorted to more so in Africa where social protection systems are less well developed.

What lessons can be learned?

12. While countries responded very well to the latest WFP appeal, averting a severe budget shortfall, this also revealed the need for a longer term financing solution to maintain the activities of the WFP on a more predictable and planned basis. In general, local purchases are preferred to in-kind assistance and should be encouraged, but their impacts on local markets need to be closely monitored; cash transfer programs can be even more effective, allowing consumers to make their own choices as to how to best to allocate scarce resources.

13. But there is no single solution that fits all situations. For governments and international agencies, a key policy issue is the selection of target groups for emergency assistance. For example, from a safety net perspective, the target group would obviously be the most vulnerable and disadvantaged, for whom finding sufficient food to survive is a daily challenge. From another perspective, the target group might be slightly higher income groups, such as the emerging middle class. Governments have a range of delivery mechanisms at their disposal, including programs of emergency food distribution, subsidised food, food-for-work schemes and cash transfers. These allow differentiated responses geared to the particular vulnerabilities of different groups in society and the capacities of administrations to effectively respond. Finding ways to improve targeting mechanisms remains a high priority area for further research.
14. Crisis responses satisfy the immediate imperative to act. But, by themselves, they are insufficient and, in some cases, can even act as disincentives to bolstering the responsiveness of agriculture in the long term. While critical in the immediate term, crisis responses must not dilute policy attention from the long term imperatives of agriculture development and poverty reduction. Linking relief, rehabilitation and development is important in the early response to a crisis.

**ii) Market interventions**

15. In response to rising food commodity prices during 2007 and 2008, many emerging and developing countries intervened at the border to limit impacts on their domestic consumers using tariff reductions and export restrictions. They simultaneously made domestic policy adjustments, including the introduction of administrated prices, tax cuts and consumer subsidies. Several countries also increased direct financial support to encourage farmers to maintain or increase production. These included output, input, and credit subsidies, with special emphasis on fertilizer and seed programs.

16. While they may dampen the perceived risks of food shortages for domestic populations in the short run, many of these interventions reduce domestic food availability for importing countries and worsen instability on international markets. Such measures are also untargeted and benefit the better-off, who can afford to pay higher prices, as well as the poor. Isolationist trade policies also impact domestic producers. By muting price signals, they limit their participation in the supply response. Negative impacts are thus multiple -- at the domestic level, producers do not fully profit from opportunities; at the international level, price instability increases and necessary adjustments are delayed. These effects also run counter to longer term strategies for investments in the agricultural sector -- a necessary step for agriculture to better contribute to income generation, poverty reduction and national economic growth objectives. At the same time, it is important to recall that agricultural markets may not always quickly or fully self regulate – a longstanding concern attracting further attention with the crisis.

**What lessons can be learned?**

17. Many of the interventions in agricultural markets made by governments in response to high food commodity prices have since been abandoned. However, provision or subsidy of basic inputs for agricultural production, particularly seeds and fertilizers, still features prominently in proposals for donor financing, despite the fact that market distribution systems often work poorly. While potentially cost-effective as part of a package of emergency responses, their benefits may be greatly outweighed by their costs over the medium term. This issue requires closer attention. Moreover, there must be an increased focus on improving the functioning of input (and output) markets so that emergency measures are not needed at this level.

18. It is striking that so many governments acted to restrict markets as prices increased, thereby discouraging their producers from increasing output in response to higher world prices. History has repeatedly shown that farm households respond quickly and effectively to economic incentives; global food security will more quickly be improved if agricultural markets are more open, so that competitive suppliers around the world are able to receive global price signals and to respond to growing global demand for food, feed, and non-food uses. But open markets alone are often insufficient. In this respect, the WTO Aid for Trade initiative, as an element of Official Development Assistance, can contribute much to boost supply-side capacity and trade-related infrastructure. Greater attention can also be given to ensuring effective safety nets and adjustment supports are in place for the most vulnerable members of society.

19. The past year has also seen renewed discussions of international reserves, stock schemes and commodity agreements based on stockpiling. But these alternatives have not always delivered the desired
results in the past, and have often accumulated spectacular losses. More recent ideas for international reserves (e.g. from the World Bank and IFPRI) need to learn from these lessons of experience. For those countries most vulnerable to production shortfalls and high international prices, a strategy that combines public investments for agriculture and trade openness to address medium term food security with maintenance of local strategic reserves of food commodities to enable emergency response might usefully be considered. There is as well a continuing need to monitor the impacts of agricultural trade policies in OECD Members to assess the extent to which they compromise progress in developing country agriculture.

20. Finally, the largely policy driven increase in demand for biofuels continues to warrant review, notably of the extent to which they displace production of food commodities such as wheat or corn in OECD and developing countries. OECD/IEA analysis suggests that the energy security, environmental, and economic benefits of biofuels production based on (first generation) agricultural commodity feed stocks are modest and are unlikely to be delivered by current policies. Alternative approaches (for example, that encourage reduced energy demand and GHG emissions, that promote freer trade in biofuels, and that accelerate introduction of ‘second generation’ production technologies) offer potentially greater benefits without the unintended impact on food prices.

iii) Agricultural development and poverty reduction

21. For many developing countries a growing agricultural economy can contribute to growth and to poverty reduction, and thus provide the supply of food and incomes needed to make food more affordable and secure. This has been widely recognised for some time. Poverty reduction and hunger were emphasised in the Millennium Development Goals and in the strategies of the World Bank and IMF since the beginning of this century. The OECD’s Development Assistance Committee had developed a strategy for pro-poor growth in agriculture. The Alliance for a Green Revolution in Africa and the UN Millennium project are ongoing initiatives to foster more rapid growth in agricultural productivity in Africa, based on a broad interpretation of the green revolution model.

22. While high food prices and the economic crisis have brought some increased attention from donors to these initiatives, thus far there has been relatively little concrete action of a medium to long term nature to promote development, both within and outside agriculture. Before prices increased recently, hundreds of millions of people simply did not earn enough income to buy food that was otherwise available; nor did they have the means to feed themselves. And even after the current economic crisis is past, many hundreds of millions of people will remain hungry unless action is taken.

What lessons can be learned?

23. The question of food security must stay high on the agenda of governments and international organisations. There are important actions to be taken immediately, as outlined above, but effort must be maintained over the medium and long term if a sustainable improvement in global food security is to be realised. Investment in agriculture is necessary to improve the food security situation, but it is also insufficient without progress on the wider political, social, and economic framework that would stimulate overall development and associated income and employment opportunities. Poverty is the dominant cause of food insecurity. Policies to improve the purchasing power of poor households through broad based economic development are essential. Solutions require, first and foremost, effective and committed national governments.

24. Stimulating agricultural productivity and increasing output, in particular in developing countries, are clearly desirable. Increased investment in agricultural research, extension, market information, infrastructure and institution building are all required. There is considerable evidence that investment in agricultural research, development and extension has an especially high social payoff in respect of pro-
poor growth – a pace and pattern of growth that contribute significantly to poverty reduction. Two things are important in this context: first, the recognition that research findings need to be implemented in quite diverse situations, and second, that the connection between international agricultural research centres and national agricultural research institutions needs improving. Furthermore, an inclusive stakeholder approach, including with civil society and farmers organisations has to be established and the links to farmer education and commercial product and market development greatly strengthened. This implies major long-term development partnerships and the engagement of the private sector.

25. There is a continuing need to address market failures through the development of input and output markets, building and re-building institutions to assure quality control, legal frameworks, value chains and marketing systems including financial services. Many of these services had been provided by parastatals which were largely dismantled under the structural adjustment programs of the 1980’s and 1990’s. These were not, as had been hoped, replaced by private sector initiatives.

26. It is particularly important to keep focused on how best to pursue the outcomes that agricultural development strategies should seek to achieve – a more productive and environmentally sustainable agriculture and a growing economy that reduces poverty. In most developing countries the majority of poor people are small-holder farmers; this implies that they are the group that needs to be targeted but their pathways to development are diverse: some will remain small and primarily subsistence farms, others will expand and become competitive food suppliers on local or international markets, while others will find better income opportunities outside of agriculture. Development strategies must recognise and support these options. Development strategies also need to be tailored to the diversity of situations in developing countries, ranging from subsistence producers to globally competitive agriculture enterprises and from rural/agriculture-based to urban/transformation-based economies. Importantly, development strategies for achieving agriculture and food security must acknowledge the implications of climate change.

27. The international community needs to continue its search to find ways to better interact with national governments. In this regard, the implementation of the Global Partnership for Agriculture and Food Security constitutes an opportunity to enhance international cooperation in achieving global food security and promote better coordination at the country level. The Paris Declaration on Aid Effectiveness puts national ownership foremost in seeking a more effective aid strategy. But for new initiatives to succeed, donors and national governments must share a common priority. Requirements for coordination and for an overall vision of development put heavy demands on the limited capacity of many national governments, even when commitment to shared objectives is there. Regional initiatives such as the African Union’s Comprehensive African Agriculture Development Programme (CAADP) help to show the way forward, but require effective national government and regional co-operation on trade, infrastructure, research and education. Strategies to increase the capacity of developing country governments are key components of any new emphasis on agriculture, food security and poverty reduction.

IV. Conclusion

28. OECD will continue to participate in the UN High Level Task Force and the G8 Expert Group on Global Food Security. Likewise we will expand our ongoing collaborations with the FAO and other international organisations to work on the broad issues of global food security, drawing in particular on unique competencies in the areas of agriculture policy, development assistance, science policy and innovation systems. OECD is particularly well placed to offer policy advice incorporating economic, environmental and social considerations, based on the experiences of its 30 Member countries and a growing number of non-Members.

29. Particular attention will focus on clarifying which policies are most suitable for countries at various stages of development, elaborating the role of agriculture in wider economic development and
poverty reduction, and strengthening trade capacity in developing countries via analytical support to the WTO Aid for Trade initiative. The DAC will provide the advocacy and evidence needed to get donors interested again in the contribution of agriculture to food security, poverty reduction and pro-poor growth, where key issues are not so much the amount of aid for agriculture as fostering a better policy dialogue and helping build administrative capacities to promote that contribution.

30. International interest in dealing with humanitarian emergencies on a more proactive, preventative basis is strong. The OECD, together with the FAO, WFP, IFAD, and others, is well-placed to undertake analysis of the full range of policy measures (safety nets, trade policy, domestic stockholding, etc.) that can be deployed to dampen and mitigate the negative effects of episodic food security crises. Improving world food security requires confidence in trade regimes and the existence of a co-operative world economy. The OECD Ministerial Council Meetings can continue to play an essential leadership role in bringing all the relevant policy communities together in a coherent overall effort.