


Why Are Agricultural Commodity and Food Prices Rising?




Christopher Delgado

Strategy and Policy Adviser

Agriculture and Rural Development

The World Bank



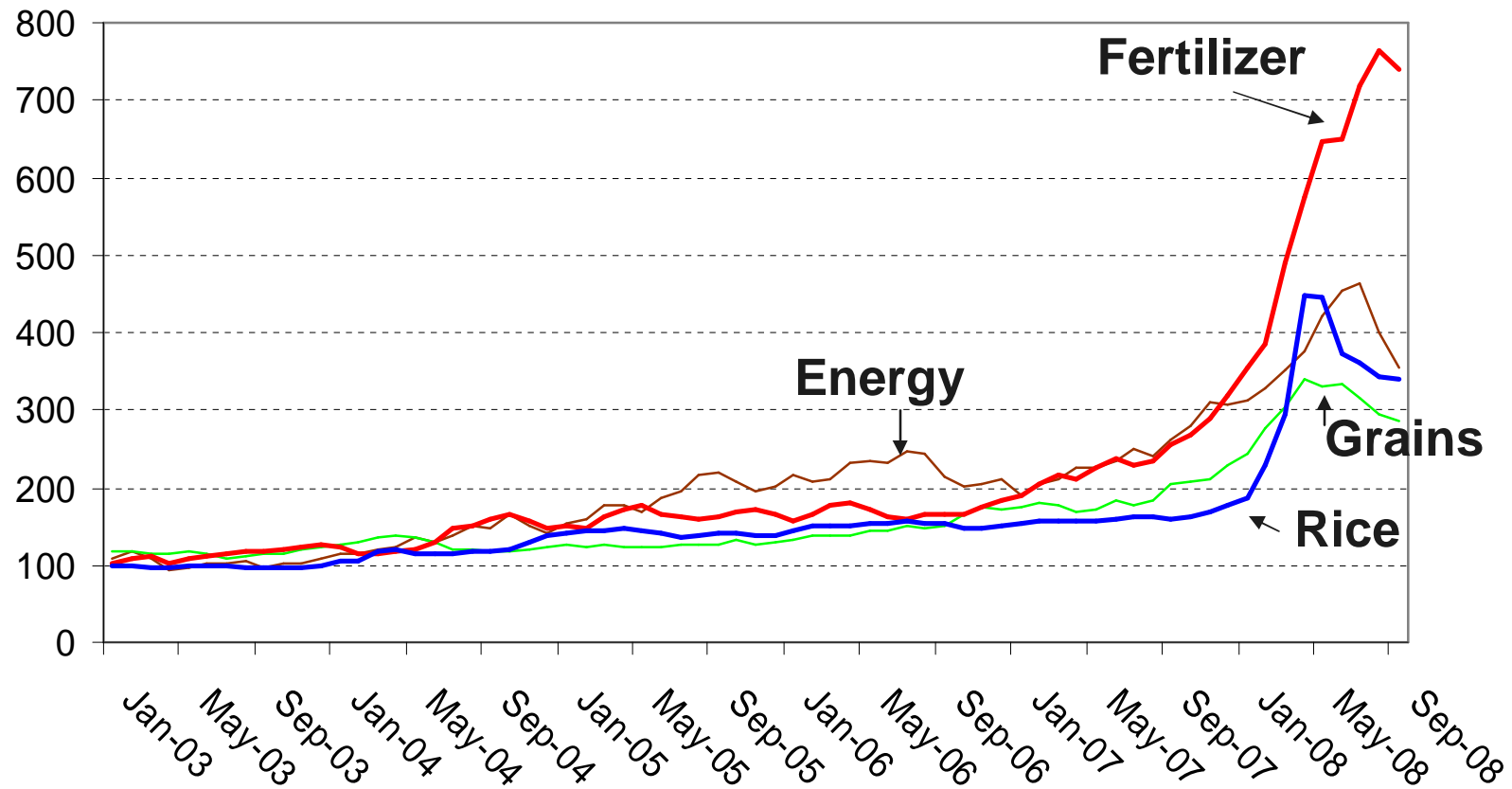
State of the Food Crisis





Food prices now declining, likely to remain high

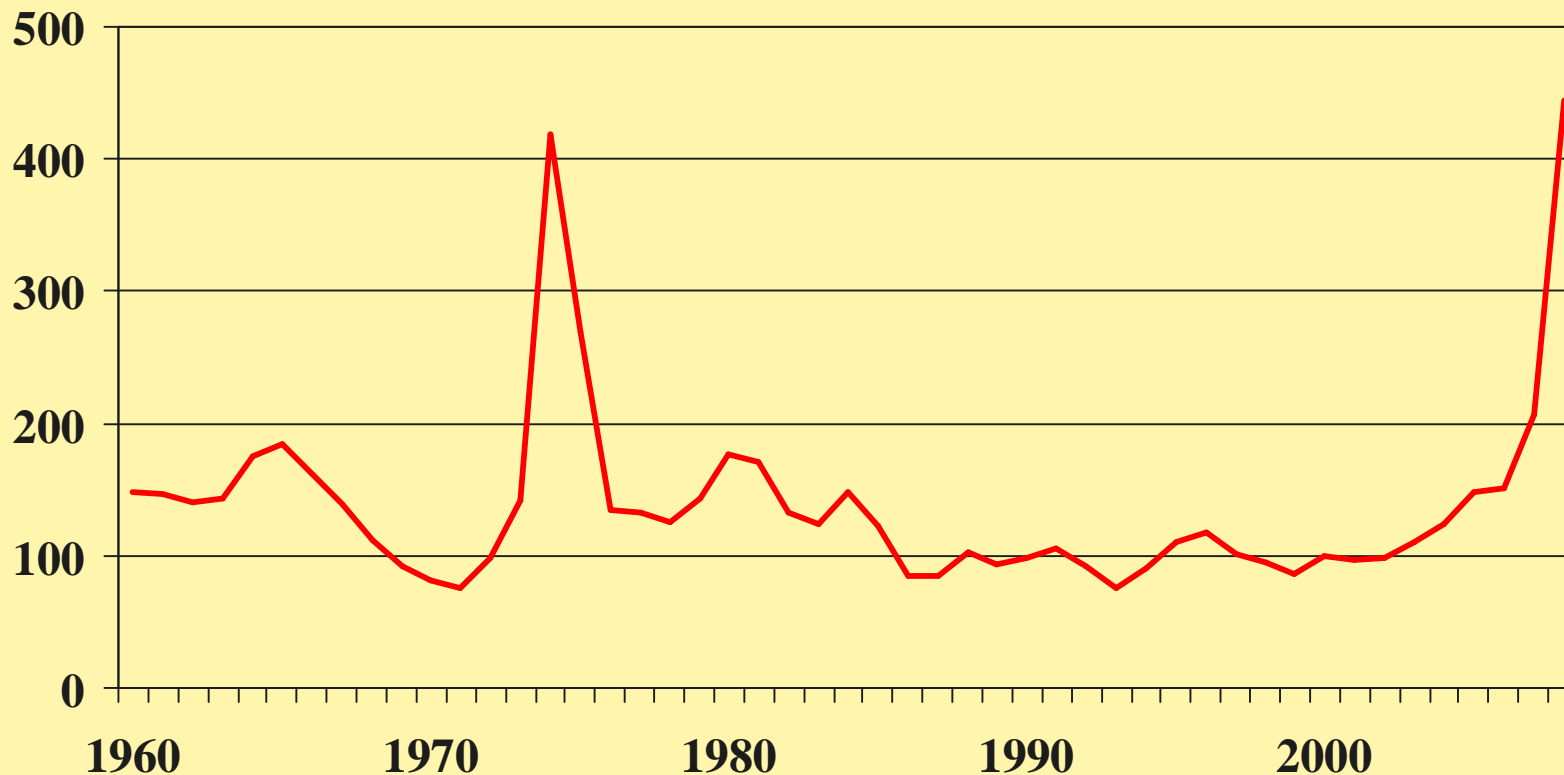
Commodity price index in current dollars (2000=100)





Fertilizer prices likely to stay high for a while

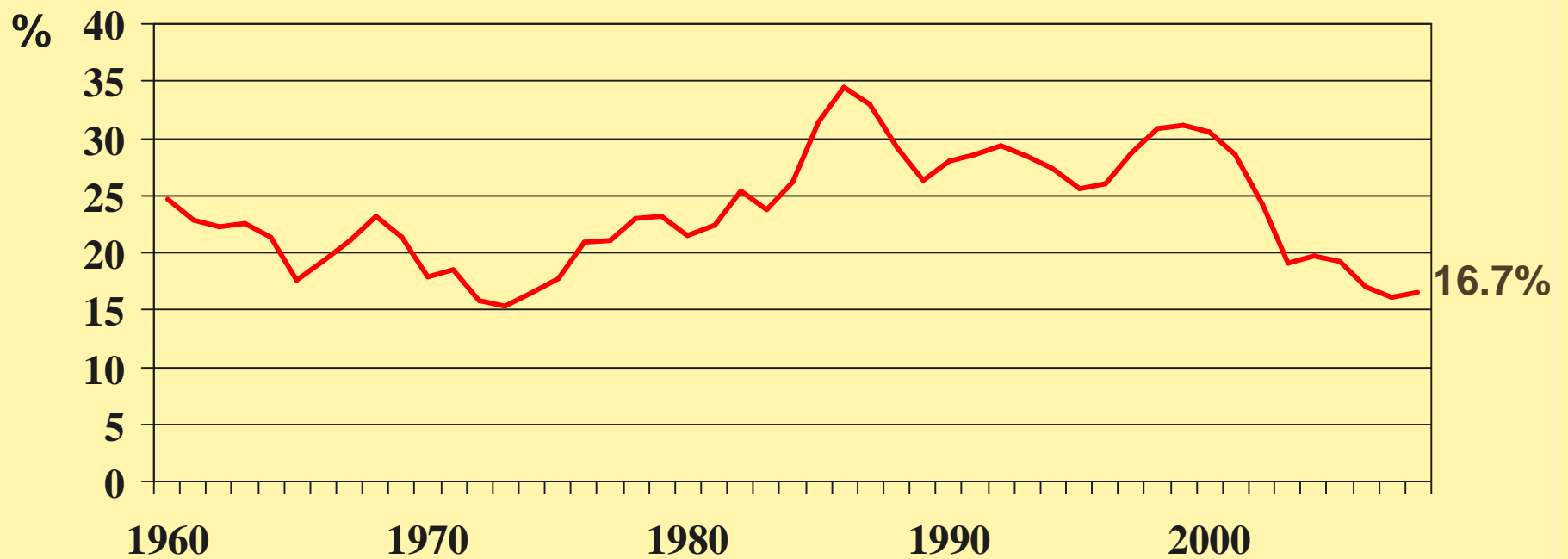
Real fertilizer prices, 1960-2008*
Index in constant 2000 \$s relative to MUV





Grain stocks remain at record lows

World Grain Stocks-to-Use



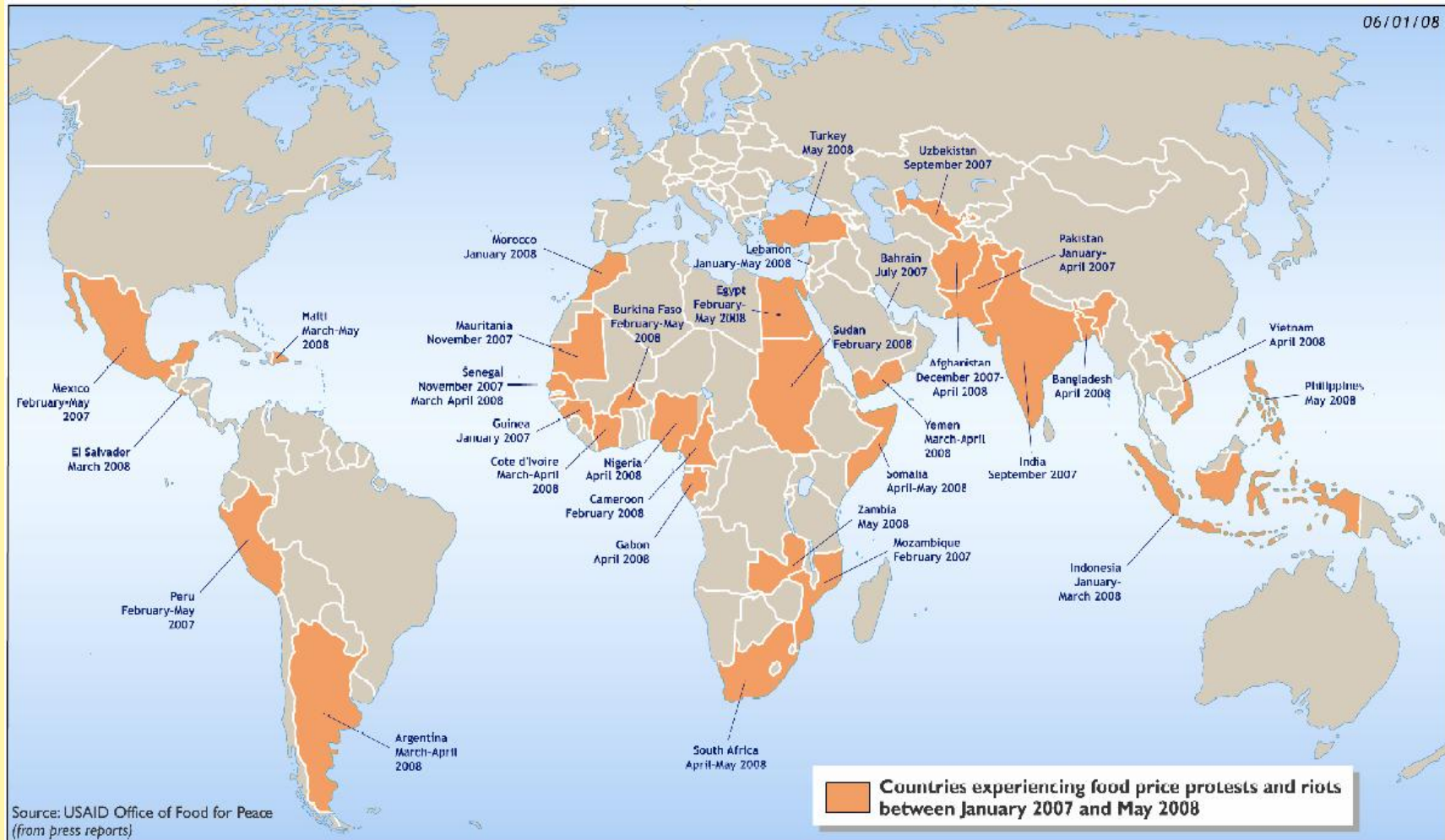


Global food prices: recent changes

- **International food prices are declining, but likely to remain high** relative to 2005 levels
- **Weakening import demand and improved supply** have lowered global prices somewhat
- **Domestic prices have not declined to the same extent** as international prices in many countries
 - Food price inflation remains very high (92% in Ethiopia, 22.5% in Liberia, 23.7% in Togo, 76.4% in Afghanistan)
- **Fertilizer prices continue to remain high**, despite recent declines in energy and natural gas prices



Countries with food price protests and riots 1/07- 5/08

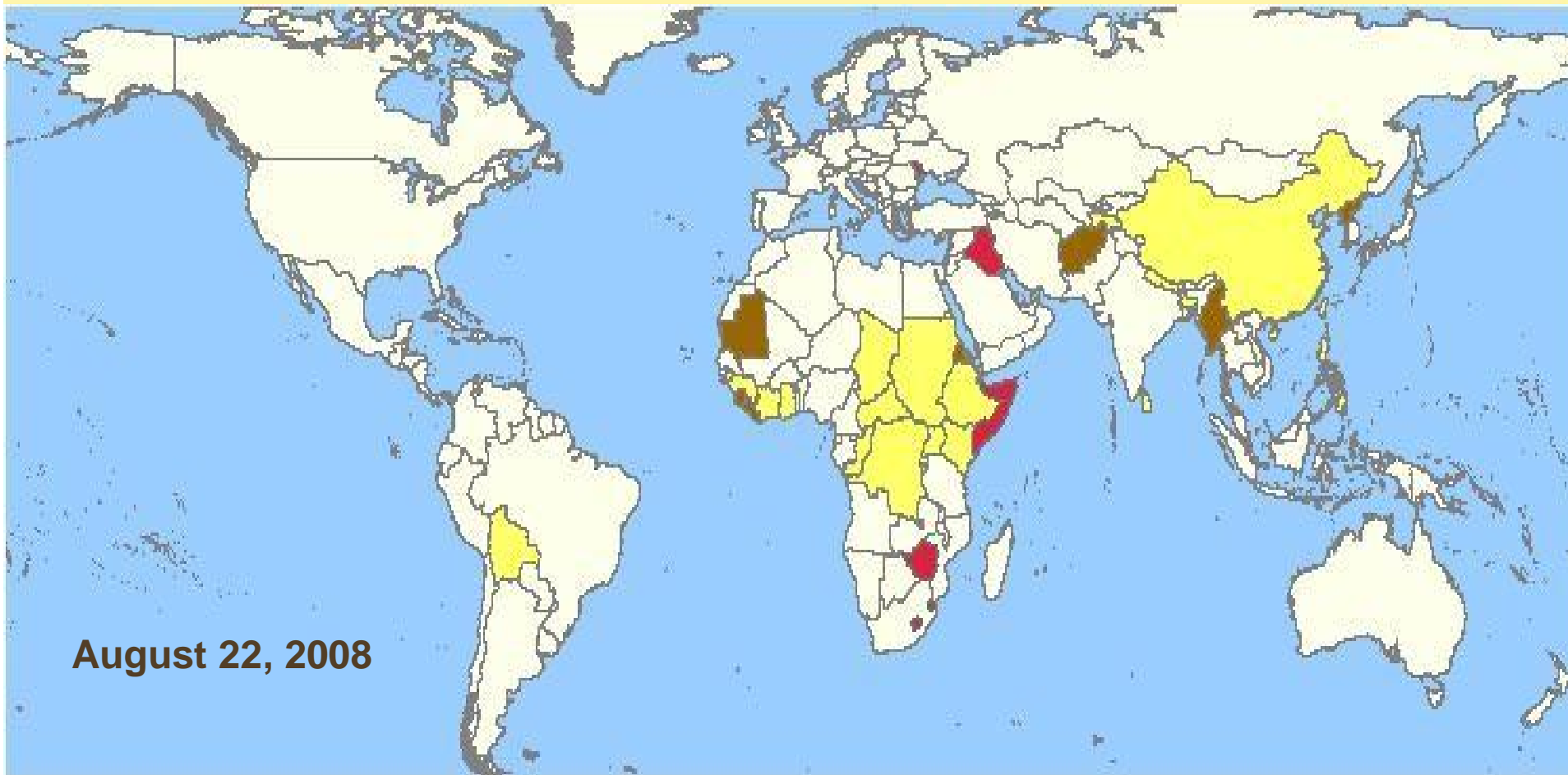


Source: USAID Office of Food for Peace



Global Information on Crisis and Early Warning: 33 Countries

- Shortfall in aggregate food production/supplies
- Widespread lack of access
- Severe localized food insecurity



Source: http://www.fao.org/giews/english/hotspots/map_m.htm



Analysis of Impacts



Food prices and wage rates

- **Average HH budget share to food staples of 50%** not uncommon in poor countries, and marginal budget shares $> 25\%$
- In poorest countries, **many bulky basic staples behave like non-tradables** (cassava, grain in landlocked areas without transport, etc.)
- **High observed correlation** between food staples and urban wage rates in developing countries with some lag
- “High” food prices eventually mean **less competitive labor-intensive industries**, *cet. par.*



Food prices and non-farm rural income

- **1/3 – 1/2 of farm HH income is typically from non-farm sources** in developing countries
- **Most small farmers in Asia and Africa get only a small share of cash income from grain sales**
- **Most agricultural cash income in developing countries is from cash crops, high value crops and animal products**, with much higher returns to scarce factors than grain, even under today's prices



Bottom line

- Empirically the large **majority of rural people worse off in developing countries under food price spike** (Ivanic and Martin 2008)
- **Unless high grain prices** engender productivity growth in developing countries, they tend to raise costs more than overall HH income
- **Volatile grain prices** tend to discourage investment in increasing productivity that would help solve long-term problem



Impacts on poverty

- **Increase in the number of global poor** due to rising food prices estimated to **exceed 100 million**
- **The number of chronically hungry people increased by over 40 million in 2008 alone** to reach 970 million
- Already poor households suffer **further detrimental effects beyond increase in poverty headcount (decreased access to educ./health)**
- **Rising inequality** from recent rise in food prices
 - Gini index of inequality raised by 5% in Bangladesh
 - Rich-poor gaps widening in Latin America



Negative impacts likely to continue

- **Increased volatility in food prices** anticipated
- **Increased input prices a major concern, discouraging smallholders** in particular
- **Countries are in the process of reverting to the food policies of the 1970s** (food self-sufficiency at any cost, costly strategic grain reserves, reversal of diversification policies, etc) which would eventually be harmful to both poverty alleviation and food security



Drivers: Demand and Supply



Why have food prices risen? —food and feed demand

- **Sustained food demand from emerging markets** (of the 73 million net additional persons in the global population each year, 97.5% are in developing countries)
- **Diet changes**, from grain to more diversified diet, meats and dairy with higher derived demand for grains and oilseeds
 - Developing countries accounted for 4/5 of the human population and 1/3 of global meat consumption in early 1980s
 - Now they consume more than 2/3 of a much larger supply of global meat; 3/4 of the increase came from grain-consuming poultry and swine
 - 5 Asian countries growing in aggregate at more than 7% annually still have 1.8 billion people earning below \$2/day, the benchmark where dietary diversification occurs

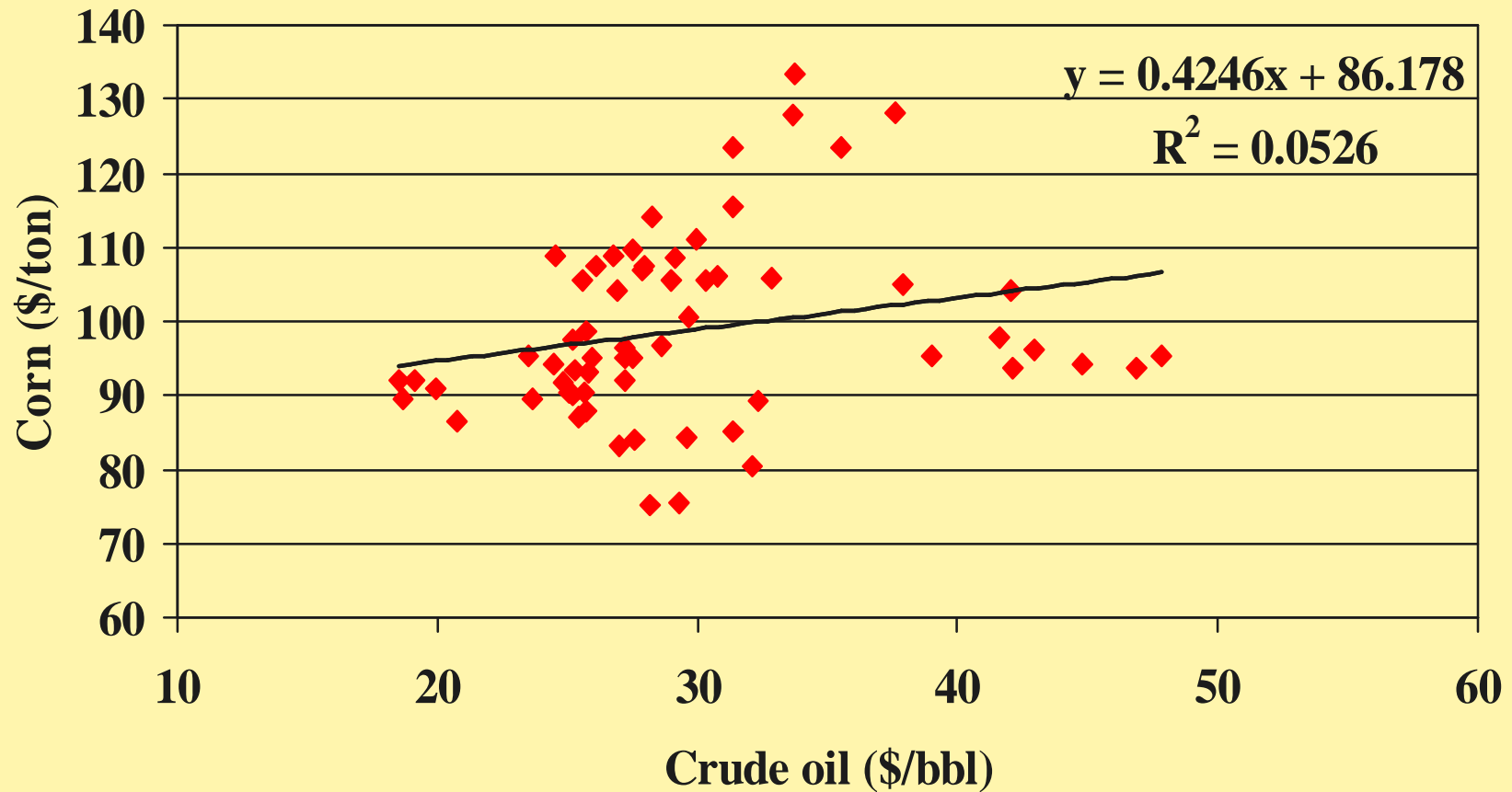


Why have food prices risen? —asset and fuel demand

- **Financialization of commodities since early 2007** (commodity index funds rose for a while as a response to shifts out of other forms of assets)
- **Biofuel policies** => demand shift, particularly in the United States (corn-based ethanol), and Europe (rapeseed for biodiesel), Argentina (soybeans for biodiesel)
- **70% of global increase in grain production 2004-2007 equivalent to use of corn for ethanol in US** in same period



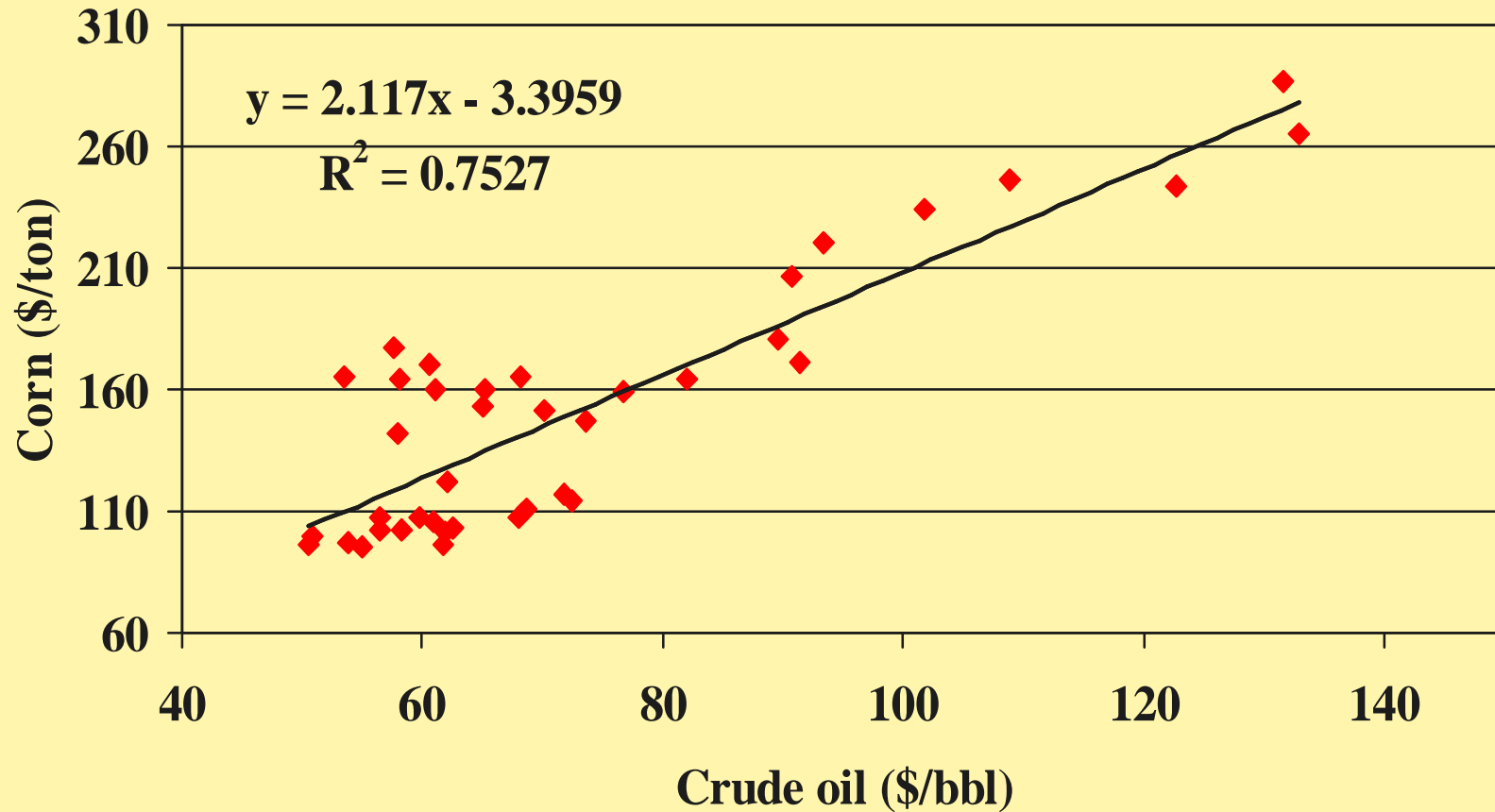
Linkages: corn and crude oil (<\$50/bbl)



Source: Don Mitchell, World Bank DEC-PG



Linkages: corn and crude oil (>\$50)



Source: Don Mitchell, World Bank DEC-PG



Why have food prices risen?—supply side

- **Increasing production costs**, sharply increasing costs of energy, transport, and fertilizer, and competition for land and water for biofuel crops, esp. in OECD
- **Fertilizer costs will only come down slowly** due to lag times and capital intensity for increasing capacity (3-7 years and \$ billions) and fact that key inputs such as sulphur (for DAP) sold forward for multiple years
- **Drought, flooding, pests and disease in key grain regions**, these shocks are hard to deal with when stocks are low



Why have food prices risen?—supply side

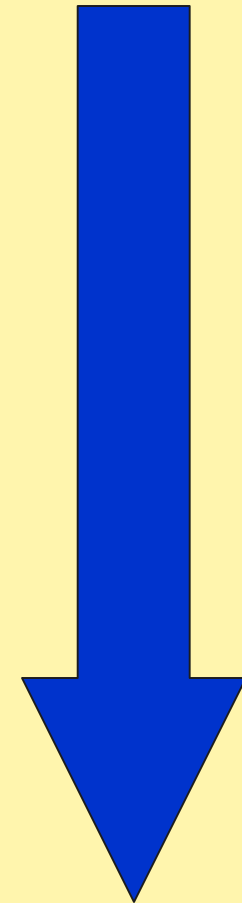
- **Disappearance due to policy reforms of stabilizing sales from large intervention stocks** in USA and EU that had been built up to support producer prices
- Did we reach a **tipping point** where defensive market behavior started?
- **Rice markets for example are very thin** (6 to 8% of world production is traded depending on year); price spike started day after major exporter banned exports, others followed, and then major importer announced plans to import large amounts even as price was surging)



Policy responses that further affect food prices...

Better policy choices

- Reduce Food Grain Taxes/Tariffs
- School Feeding Programs
- Conditional Cash Transfers to the Poor
- Targeted Food Subsidies
- Cash for Work
- Food for Work and Food Aid
- Build-up Government Buffer Stocks for Distribution
- Food Rationing
- Price Controls
- Export Restrictions/Taxes
- Export Bans



Worse policy choices



Differences in rice price passthrough b/c of policy

(April-June 2008)	Domestic rice price as % of World price
Cambodia	81
Thailand	78
Vietnam	54
Philippines	44
China	4
Indonesia	-3

(Due to different degrees of trade taxes/restrictions, and/or subsidies)



A Way Forward



International consensus on immediate needs

- **Work with the UN** and other stakeholders under High-Level Task Force and Comprehensive Framework for Action
- Priority to **support fundraising by WFP for humanitarian assistance**
- **Need for rapid financing to countries to support policy changes**
- **Social protection**
- **Risk mitigation** using financial tools as well as physical hedging
- Maintain productive capacity and **transit to longer term food production** viability



The Bank's Global Food Crisis Response Program

- Approved May 29
- **Umbrella** for providing rapid Bank support for a comprehensive response to the crisis
- **Provides balance** between short run food stabilization and measures to ensure countries able to cope better in medium term, including longer term action and lending to enhance **agricultural productivity**
- **Fast-tracking of up to \$1.2 billion of Bank resources:** existing country envelopes, re-programmed funds, regional IDA funds where appropriate, a new \$200 million trust fund from IBRD surplus (Food Price Crisis Response Trust Fund)
- Greatly expedites procedures for rapid response



Menu of GFRP Components

- **Component 1: Food price policy and market stabilization**
 - Examples: Support for grain stock management, improved use of market-based instruments to manage food prices, tax and trade policies
- **Component 2: Social protection** actions to ensure food access and minimize the nutritional impact of the crisis on the poor and vulnerable
 - Examples: Cash transfer program (CCTs, food stamps), school feeding, targeted food supplements and micronutrients
- **Component 3: Enhancing domestic food production & marketing response**
 - Examples: Seed and fertilizer supply and market development, Rehabilitation of small-scale irrigation, Strengthening access to finance and risk management tools
- **Component 4: Implementation support, communications and monitoring and evaluation**



Overview of World Bank funding response

- **Global Food Crisis Response Program (GFRP): \$883 million approved and firm pipeline since May 29 (147 days ago)**
 - Food Price Crisis Response (FPCR) Trust Fund: \$200 million committed
 - IDA/IBRD (including reallocations): \$683 million
 - Multi-donor Trust Fund established, first contribution of A\$50 million rec'd Oct. 10 from Australia
- **Additional \$400 million non-GFRP food crisis response approved and pipeline**



World Bank Group food & ag overall program FY09

- **IDA/IBRD agricultural lending to Africa FY 06-08** average was \$504 million/year
- **Same figure for FY09 in Africa** (already approved and firm pipeline) is \$1.2 Billion
- **Total World Bank Group lending to agriculture, agribusiness, plus food crisis-related social protection/nutrition** FY09 is projected to be \$4.7 Billion



Food priorities going forward

- **Shift in focus from immediate short-term needs to more medium-term responses**
 - Increasing smallholder agricultural productivity
 - Ensuring adequate safety net systems are in place to cope with greater volatility in the future
 - More attention to better nutrition
- **Continuing to increase regular new annual funding to agricultural public goods and safety net capacity**
- **A sharper focus on achieving nutritional outcomes**
- **Collaboration with other agencies and private sector of possible new international modalities for managing grain market risks for poor countries and humanitarian agencies, rebuilding confidence**