1. Managing Food Price Volatility : Workshop Minutes

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*The aim of this workshop was to present the study "**Managing Food Price Volatility for Food Security and Development**", produced by GREMA with the support of the Ministry of Foreign and European Affairs, the Ministry of Food, Agriculture and Fishing, the Ministry of the Economy, Industry and Employment, and the Agence Française de Développement, and to discuss this report with experts from different backgrounds (researchers, international organizations, farmers' organizations, etc.). The workshop was attended by approximately one hundred participants.*

Morning Session

Opening: In his speech, Mr. Thiébaud from the MAEE reminded the audience that this study was produced in the context of the French presidency of the G20, and that fighting price volatility was one of the priorities of the French presidency.

- **Presentation of the Study, by Françoise Gérard, CIRAD**

The presentation of the study made it possible to go over its context, objectives and main conclusions. With the 2008 crisis, operators were suddenly reminded of price instability, which is inherent in agricultural product markets; and current market tensions have sharpened the feeling that instability will only increase in the years to come. Experts now agree that there is a conjunction between two types of instability in agricultural markets, and that these instabilities are of different natures and, accordingly, respond to different remedies:

- Some price instability is caused by the dependency of yields on natural conditions, a characteristic of agricultural production. These fluctuations are attenuated in a global market that is self-regulated by trade, particularly when transfer costs between markets are low. This reasoning is the basis for the negotiations on trade liberalization (WTO).

- However, a second source of price volatility is also at work. It is linked to projection errors by farmers, traders and speculators, which are much more frequent than for any other type of production precisely because of the multiple hazards affecting production levels and giving considerable importance to information enabling projections in price formation. Habitually, a price rise indicates increased demand and is a signal to producers, who have every interest in investing. However, in the case of agricultural products, a price rise can come solely from a poor harvest. In this case, the increase in production by farmers causes prices to drop, destabilizing the market. The phenomenon is the same with traders and speculators who manage the transfer of goods in time and space. It is found on markets at all levels (local, national, regional, international), and is a characteristic shared with financial and commodities markets. Unlike the first type of fluctuations, they are not attenuated by the size of the market: because of the statistical characteristics of this series (scale invariance), shocks are not diluted, they are cumulative and synchronize themselves!

This second type of instability, generated by projection errors, is responsible for a large proportion of price instability. It is a market failure because the market is no longer able to coordinate individual decisions based on the transmission of an adequate price signal to agents. It justifies direct market intervention. Intervention is, however, not issue-free, and it is important to remember that the liberalization undertaken for a quarter century has been justified by the avoidance of the costs and unwanted effects of public intervention, after a quarter century of intervention with mixed results despite considerable resources.

This is why, beyond theoretical analysis, this study emphasized a precise study of experiments undertaken in different contexts (historical, economic, geographic, institutional) and on different scales (local, national, regional, international) so as to determine the invariances necessary for effective recommendations.

The following principles can be deduced from the study: a combination of instruments must be set up; and the policy followed must be legitimate (and therefore negotiated) and credible (which implies access to considerable expertise and financial resources as well as to institutional capabilities that make it possible to ensure contracts are followed, avoid harmful rent-seeking behaviors, and fight corruption). It is necessary to ensure that each type of actor has the capacity to defend their interests and represent themselves in each consultation body. Undeniably, the process is costly in the short-term, but price stabilization—when it is well done and avoids in particular the rut related to over-production—allows for remarkable progress in the area of food security and poverty alleviation. This progress is, however, progressive and cannot be clearly felt in the short term, which intensifies the difficulties associated with these policies.

When it comes to international bodies, the most important thing is to encourage the poorest countries to set up ambitious agricultural policies that target poverty alleviation. Historical analysis can clarify the decisive role played by large international organizations' public positions in the local definition of economic policy. A shift in discourse that draws the lessons from the past is necessary. This shift must be accompanied by resources and innovative financing methods.

- **Presentation of the Outcome of the November 29-30 Workshop, by Peter Timmer, Harvard**

The speaker, a professor emeritus from Harvard, is probably one of the best-known experts in the world on this subject. He first emphasized the quality of the analysis by the team and the summary paper, as well as the richness of the discussions during the workshop.

He then underscored the destructive nature of price instability for food security. Price hikes are particularly disadvantageous for consumers while price drops affect producers, making price instability a true hindrance for investment and thus modernization. Above all, it is a major roadblock on the path to growth and poverty alleviation.

To fight price instability, it is important to determine which level of instability is the problem and what type of actors are concerned by it. Another key point is the type of product concerned, its role in consumption, the country's position as importer or exporter, and its unique characteristics. Border instruments, buffer stocks and the regulation of international financial markets are the primary tools available to countries to manage the problem. Setting up these policies is complex and costly in the short term, whereas the benefits appear only over the long term; they must be based on exemplary technical analysis that is continuously updated to reflect changes in the context. On the international level, all negotiations that make it possible to improve market operation and information are useful.

In short, fighting instability requires different forms of action in function of the context, and is a difficult task but **countries must be encouraged to fight instability rather than discouraged from doing so.** It is also useful to distinguish between the general goal of price stabilization and combating emergency situations. The ultimate goal of the first is to minimize the occurrence of the second and lessen the cost of such situations.

Panel of Four Experts from the Academic Sphere:

What are the main sources of price instability? What are the primary reasons for the success or failure of public interventions? What can be done on the international level?

- Philip Abbott is a Professor at Purdue University (USA); he has recently written a comprehensive report on volatility and national stabilization initiatives for the OECD.

During his speech,

- he addressed the causes and consequences of the sharp rise in international commodity prices, notably specifying that the current peak period was longer than peaks had been in the past, and that it may have been generated by new as well as old factors. He emphasized the importance of stocks in price changes, observing that perisitent biofules demand means that expected carry-out stocks remain low even after several excellent years of agricultural production, leaving markets vulnerable as current weather events occur. If there is a role for speculation it is that positions taken reflect inflationary expectations, for which public market intervention in grain markets are not very relevant; and

- he insisted that national price stabilization initiatives generate instability on the international level, which calls for caution when intervening. Reliance on international trade to stabilize domestic markets, even partially, will require that major exporters as well as large but self-sufficient markets (e.g. China and India) do not close their borders. The isoaltionist policies not only of exporters but also of importers were an important underlying cause of the price spikes realized in 2008, and are likley to be reinstituted now.

- Andrew Dorward is a Professor at The School of Oriental and African Studies, (University of London) and a specialist on these issues. He addressed several points:

  - The causes and consequences of price instability and the question of the magnitude of the 2008 crisis compared to the 1974 crisis, which depends heavily on the deflators used and the markets examined (period/country/products).

  - The issue of the problems raised by price instability must be placed in a wider context that makes it possible to take into account the current challenges in the area of natural and fossil resource management in response to population growth. Demand-side actions must not be neglected: reducing waste, changes in food habits in regard to meat consumption.

  - The emphasis is too frequently placed on managing the effects of instability but not enough on preventing this instability. To manage the problem, it is necessary to view it as a whole, and to focus more on promoting long-term processes increasing both volumes and stability of supplies and stocks in order to reduce the need for generally more problematic management of price stability.

  - It is important to take into account the specific situations of different types of farmers, and in particular the differentiated effects of policies on net buyers. The institutional dimension and the way that policies are implemented are of crucial importance.

  - Stable, low food prices are important for food security and social peace. Today, however, with the growth of the population and incomes, natural resources are becoming restrained, which implies high prices, in particular for energy and perhaps for food. This must be taken into account when defining economic policy.

- Maximo Torero (IFPRI) is the author of a proposal on managing price volatility when it is excessive. He presented the online platform set up by the IFPRI on this subject, which provides public information that can be used in making decisions.

    - He discussed the existing consensus on the negative impacts of "excessive volatility" for farmers and consumers. That said, the challenge is to define what is meant by excessive volatility.

    - He insisted on the fact that his analysis was international in scope, and that other approaches were necessary on the national level.

    - Stabilization at the national level must nevertheless take into account the dependency between markets and avoid exporting domestic instability to foreign markets.

    - The importance of the non-distorsive nature of the instruments used. The costs involved with the use of each instrument must be carefully assessed along with their impact on excessive volatility. In regard to physical stocks, for example, the definition of the optimal stock size and the need for a transparent trigger mechanism are key points. It is necessary to clearly distinguish between regulatory stocks and strategic emergency reserves.

    - The importance of information on stock levels. This is a major challenge, even on the national level, but it is crucial that this challenge be overcome.

- Kako Nubukpo is a Professor at the University of Togo, and Division Chief at the Office of the Presidency of WAEMU. He had decided to address the subject of price instability and public intervention from the standpoint of cotton, on which he is an acknowledged specialist. In particular, he discussed:

    - The (very high) volatility of cotton prices, which justifies applying price stabilization measures, and its causes (production cost variations cannot explain the high level of volatility), the role of developing countries' subsidies in price formation, and the links between cotton cropping and cotton growers' food security.

    - The importance of exchange rates in international competitiveness and the over-valuation of the CFA franc that constitutes a major handicap for agriculture; American subsidies are therefore the only issue behind the problem of African cotton's competitiveness.

    - The importance of the budget constraints associated with HIPC initiatives, which prevents any ambitious agricultural policies.

Points Raised During the Discussion with the Audience:

- The importance of tackling unregulated markets to limit the impact of the financialization of markets on price volatility, while also avoiding "over-regulation."

- The issue of exporting instability when one country stabilizes its own market.

- The current lack of successful experiments in the area of insurance in the framework of the World Bank program on price risk management.

- The interesting case of the rice market, for which there is no futures market and that has not been financialized. This forces one to look at other determining factors in the recent price spike and volatility.

Afternoon Session

Producers' Point of View: Case study on the Union des Groupements pour la Commercialisation des Produits Agricoles de la Boucle du Mouhoun (UGCPA, Burkina Faso)

Mr. Dioma **Soumabéré** (UGCPA, Burkina Faso) discussed the importance of price stability for small farmers and shared the results of a local initiative in which organizing farmers and involving them in marketing is making it possible to obtain much more stable and higher prices. Indeed, farmers' organizations have often had to fill in for the State in setting up market regulation instruments. He raised the issue of the balance between the State and private actors in this regulation (some functions remain the sole responsibility of the State, such as all regulatory matters). He specified that the UGCPA is currently participating in the constitution of the country's food security stock and its intervention stock.

Round Table: The Viewpoint of the Political World

Is it necessary to act on agricultural price volatility? Why? How? On what level (national, regional, international)?

- Mr. Jonathan Brooks (OECD) stated that price instability requires both instruments acting on the long term and poverty and measures aiming to avoid the most harmful short-term impacts of sharp price hikes. However, price stabilization is not an objective in its own right (the goal is, rather, to protect vulnerable populations' purchasing power), and we know that it is associated with multiple problems—costs, inefficiency, government failures. Despite these difficulties, market stabilization has a role to play because of the existence of market failures and poorly developed safety nets. Direct intervention is thus necessary to correct market failures, for example by improving information, actors' capacity to manage risks and safety nets. The international level has a key role in the transmission of imbalances on national markets and its impact on national policies, in function of whether or not international markets are able to manage local hazards. In the rare—but nevertheless plausible—case that international markets experience a rapid price hike, it is necessary to finance poor countries so they can withstand this growth in their food bill.

- Mr. Hafez Ghanem (FAO) discussed the problems involved in measuring price volatility (according to him, the right measurement is the difference between real and expected prices). Volatility must be expected to rise in the coming years for several reasons: growing market integration, rising cereal exports from ex-USSR countries (with much more variable productivity than elsewhere), the increasingly close link between oil markets and maize, the financial deregulation in the mid-1990s, and changes in storage policies (smaller emergency stocks). Among his recommendations, he identified various areas for potential action: the constitution of minimum emergency stocks (as experiments in regulation stocks have been negative overall), market transparency, the definition of a regulatory framework for futures markets (without falling into the trap of over-regulation because they are important for cash flows and risk coverage), the development of insurance systems (with the support of investment banks), the establishment of safety nets for the most vulnerable populations, and the definition of new global governance, notably to prevent the (legitimate) decisions of some countries to restrict exports from being costly for the rest of the world.

- Mr. Ousmane Djibo (NEPAD) insisted on the importance of the regional level when setting up economic policy measures. He presented the African Union's agricultural program, which aims to improve food security through increased investment in the agricultural sector and the associated gains in productivity.

- Mr. Moses Shaha (ESAFF, Kenya) discussed the harmful nature of price instability for small farmers in Kenya and the difficulties associated with State intervention and how this intervention can increase uncertainty if it is not properly conducted. The experiment conducted by the ESAFF, based on farmers' groups, shows that success is possible on the local scale.

- Mrs. Lourdes Adriano (ADB) discussed the dramatic impacts of the 2008 price hike in the Asia-Pacific region, and insisted on the urgency of setting up measures aiming to lessen the negative short-term impacts on poor consumers without neglecting the medium and long term. New solutions on the international, regional and national level must be found based on renewed forms of public-private partnerships. Buffer stocks or reserves, managed in a transparent and predictable manner, must be set up on the national and regional levels, trade agreements must discourage protectionism, safety nets must be improved, and investments must be made in commodity chains. Market operations (information), agricultural research, and north-south and south-south cooperation are also necessary.

Conclusion: The Day's Lessons by Mr Frédéric Bontems, Director of strategic management and prospective, Agence Française de Développement

The devastating impacts of the volatility of agricultural product prices on producers and consumers, particularly the poorest, have placed this issue at the heart of the G20's concerns. The goal of the day was to contribute to reflections on the possibilities and techniques for public intervention in this area. Three essential points must be drawn from the study:

- the policy dimension—price volatility has direct consequences on countries' social peace;
- the multi-scale nature of the phenomenon—price instability is present in international markets as it is in local markets, and there are complex relationships between these scales; and
- the presence of two sources of instability, one linked to natural conditions (exogenous) and the other linked to projection errors (endogenous).

Seven lessons can be learned from the day:

- One must be precise and attentive to the words used; regulation must be defined as all mechanisms in which private actors and public authorities interact to ensure that foodstuffs markets operate efficiently and benefit food security.
- Regulations are needed on the national/regional level as well as on the international level to stabilize food prices.
- Lowering volatility is a necessary factor in agricultural development, but it is not sufficient.
- A panoply of instruments must be used, depending on the context (country/products) and whether it is an emergency situation or not.
- The transparency and predictability of national and regional public policies are crucial for success.
- On the international level, market regulation must make it possible to avoid bubbles and protect the poorest countries in the case of sharp food price increases.
- In this way, one can say that price stabilization is desirable, but that its feasibility relies on tricky conditions, depends on the context, and must continuously be adapted to the context. Furthermore, it is necessary to differentiate between short-term effects and long-term effects, and take into account these different timelines when defining policies.