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Agricultural Price Volatility and Food Security: Rehabilitating the Role of the State

The world population will grow by at least two billion people between now and 2050, while one in seven people are already going hungry. In this context, the international consensus is that it is vitally important to increase agricultural production to ensure food security for humankind.

To do so, the issue of agricultural prices is decisive: developing agriculture requires remunerative average prices at relatively stable levels so as to allow farmers to cover their production costs, earn adequate incomes and invest to increase productivity.

Market liberalization does not generate these conditions because of competition between agricultural systems with vastly different productivity conditions and because of how agricultural markets operate. The recent soaring world food prices have helped revive the international community's interest in agricultural issues.

Yet, when it comes to combating price volatility, its responses have not been up to the task, notably in regard to smallholder farming which has a central role to play in food security, employment and ecosystem protection (Alpha, Castellanet, 2007).

The International Community's Inadequate Responses

In June 2011, the G20 established an action plan that was submitted to the G20 at its November 2011 meeting; this plan was the outcome of recent changes in the international community's attitude to agricultural and food price volatility. The announced measures claimed, however, to respond above all to the impact of sudden rises in food prices for the most vulnerable consumers. The problem of the prices paid to producers was clearly secondary.

Regional and national agricultural market regulation policies were excluded from the outset, even though they would aim only to limit price volatility, but not to ensure average prices for producers. On the contrary, the G20 called for national markets to open even further to the international market. However, price volatility is in large part due to the characteristics of production and agricultural markets (poor demand elasticity, large gap between producers' decisions and the arrival of products on the market, etc.), and expanding markets does not necessarily lower volatility (Gérard *et al.*, 2011).

Furthermore, integrating national agricultural markets in the world market is not simply a change of scale: in general, it also involves a shift from a regulated to an unregulated market. In these conditions, liberalization is, for producers, equivalent to increased volatility.

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It supports sustainable development processes in urban and rural areas by building on social equity, economic promotion and respect for the environment.

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The issue of average agricultural prices in different regions of the world is not addressed, whereas in areas where productivity conditions are the worst, agricultural price support is often critical to ensuring that farm incomes are sufficient. Many countries and regions (Europe, the United States, China, India, Japan, etc.) have had interventionist price policies that enabled their agricultural systems to develop strongly.

No international agricultural market regulation mechanisms are being considered, and the question of buffer stocks in particular is being ignored. Emergency stocks are, of course, envisaged provided they are compatible with World Trade Organization (WTO) rules—that is, provided they are merely humanitarian stocks with no market regulation functions.

The agricultural market information system planned by the G20 may have a limited impact: stocks are largely under the control of multinational companies that derive their profits from the information asymmetry in regard to the real state of the market (information that is not shared can earn them millions of dollars). It seems quite naive to count on their cooperation for greater transparency. Even assuming that information and transparency were perfect, they can not correct objective imbalances between global or regional supply and demand—imbalances that buffer stocks could offset in the short-term.

Finally, the G20 strongly advocates for the use of private risk management tools, but one can anticipate high costs for and limited results from these tools.

Private Mechanisms: Expensive and Little Accessible for Smallholder Farmers

★ Private Insurance

The Agricultural G20 and international community are pushing recourse to private insurance to safeguard against weather risks as private insurance is assumed to help lower risks for incomes and facilitate access to credit without addressing the issue of prices.

These weather insurance mechanisms have their limits. They apply mainly to developed countries, accounting for only 2% of amounts in Latin America and 1% in Africa. In a 2010 study, GRET and the AFD analyzed experiments with index-based insurance—insurance in which compensation is triggered by an objective external index or set of objective external indexes—which has the advan-

tage over classic crop insurance of considerably lowering management costs and adverse effects (fraud) (Chetaille *et al.*, 2011).

Nevertheless:

- Developing such mechanisms for the majority of small farmers is an illusion. Small farmers implement traditional risk prevention strategies (activity diversification, etc.) because they are unfamiliar with insurance systems or believe them to be irrelevant or too expensive.
- Heavy public investment would be needed in order to provide countries with the means of calculating index values (weather stations, satellite image interpretation, etc.), covering some operating costs, insuring against large risks (reinsurance), structuring intermediary actors, and convincing farmers of the relevance of these mechanisms.

★ Future Markets

To cover price-related risks, the Agricultural G20 favors recourse to financial markets. Farmers can agree in advance to sell a set quantity of their crops for a set price in the framework of forward contracts or “futures” negotiated in an organized futures market.

The use of futures markets requires a certain number of conditions be met, in particular good mastery of financial tools, homogenous production (standardized products) and low inter-annual variability in production volumes. Without all this, producers take a considerable risk by selling in advance products they are not sure to obtain. In addition, the cost is far from negligible for producers. These conditions currently seem to be far from reality for most farmers and their organizations in developing countries.

What is more, futures markets do not lower overall price volatility. In fact, they need high volatility to attract speculators and be active markets; in turn, their activity can generate higher volatility. Farmers who do not have access to hedging mechanisms are the largest victims.

At the same time, the efforts of governments and the international cooperation system to promote such mechanisms should absorb a share of national agricultural budgets and aid budgets.

★ Contracting

Contracting consists of guaranteeing farmers a price in advance, in exchange for a promise to deliver the harvest to the buyer and, often, to





Madagascar © Dominique Violas

comply with a strict set of specifications (cropping practices, input application, etc.).

In developing countries, contracting generally concerns only a limited number of products destined for export. While contracting can improve farmers' visibility on prices for the coming crop year, it generally does not reduce volatility from one year to the next. In addition, the terms of the contracts—and especially the contract price—merely reflect the existing balance of power, which is often to farmers' disadvantage. Forming farmers' groups to bargain collectively can, however, help improve the balance of power.

Private Mechanisms and Public Policies

International organizations and G20 countries claim that recourse to market mechanisms is relevant to offset the effects of price volatility, but no serious assessments taking into account financial transfers and economic impacts from the standpoint of developing countries seem to have been done. This is worrying, as is the ease with which recourse to market regulation mechanisms is brushed aside on the pretext that it would be ineffective and costly.

Yet, alternative solutions exist and have been assessed. A recent publication by the Groupe de Recherche et d'Échanges sur la Régulation des Marchés Agricoles (GREMA, agricultural market regulation research and exchange group) based on several case studies in Africa and Asia (Gérard

et al., 2011) shows that combining trade policy measures (quantitative limits, taxes, and/or import or export subsidies, depending on the situation) and internal policies—notably recourse to buffer stocks—can contribute on the country or regional level to relative domestic price stability within acceptable price bands for both producers and consumers. This was, for example, the case with the rice price stabilization policy applied by Indonesia between 1969 and 1996, which contributed to strong growth in production.

The study showed that satisfactory results can be obtained when policy:

- is based on solid knowledge, which raises the question of staff training and market information systems;
- follows clear and transparent rules that allow visibility for operators (farmers, traders, processors);
- receives the necessary funding to anticipate the costs of State intervention if needed (storage, achieving surpluses);
- integrates possible production limiting measures if structural surpluses emerge;
- is monitored and assessed;
- is based on consultation with the various private actors concerned so as to take into account the characteristics of the country and the different interests, optimize their potential participation, and ensure their real cooperation; and

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- falls within the framework of agricultural policies that are favorable to farmers (credit, technical support, etc.) and, more generally, within appropriate economic policies (infrastructures, education and other public services, macroeconomic environment).



In Conclusion

★ *The Agricultural G20's recommendations are unsuited to the challenge of ensuring food security*

It will be difficult for the vast majority of farmers—and smallholder farmers in particular who have a vital role to play in food security in developing countries—to access the risk management tools promoted by the Agricultural G20. They will continue to suffer from the effects of price volatility and insufficiently remunerative price levels in the poorest countries that were unable or did not choose to protect and support their agricultural systems. Food security in these countries risks being compromised even further. Efforts to promote and implement these tools could absorb a large share of international cooperation funding.

★ *Reintroduce Market Regulation Tools*

A less ideological approach to the effectiveness and efficiency of various regulation tools needs to be promoted, and the issue of national, regional and international market regulation mechanisms (storage and trade measures)—which implies modifying World Trade Organization rules—needs to be put back on the international agenda.

Without delay, developing countries should resist current fads; they should not renounce market intervention tools that, when certain conditions are met, continue to prove their usefulness in many countries that had the will and ability to resist the pressure to liberalize their agricultural markets. ●

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