

Price Volatility in Food and Agricultural Commodity Markets:

Policy options on how to better mitigate and manage the risks associated with the price volatility of food and other agriculture commodities

June 2011

I. Introduction

BIAC welcomes the French Government's move to make the global food crisis and its consequences on food security one of its top priorities for the 2011 G20 agenda. Price volatility has dramatic effects in developing and developed countries alike, and the impacts are by no means limited to the food and agriculture sector. In many cases, price volatility and food shortages have been associated with increased poverty, social unrest and political turmoil, increased malnutrition, and other negative economic and welfare impacts.

From the point of view of the business community, price volatility creates uncertainty and undermines investor confidence, which is particularly damaging given that, at the same time, the food and agriculture sector is facing the long-term challenge of continuing to increase investment in order to boost production to meet rising food demand. An international coordinated public-private effort to address price volatility of food and other agriculture commodities is therefore essential, while recognising that a mix of policies will be necessary.

BIAC is pleased that the OECD, together with the FAO, IFAD, IMF, UNCTAD, WFP, World Bank, WTO, IFPRI and UN-HLTF, has been called upon by G20 leaders at the November 2010 Seoul Summit, "to develop options for G20 consideration on how to better mitigate and manage the risks associated with the price volatility of food and other agriculture commodities without distorting market behaviour, ultimately to protect the most vulnerable"¹.

Recognising that the G20 also calls on the above-mentioned international organisations to "work with key stakeholders"² in this task, BIAC is pleased to herewith provide some OECD business community perspectives. We would welcome future opportunities to provide business input to the OECD work in this process.

¹ G20 Seoul Summit (November 2010) Multi-Year Action Plan on Development, p6.

² Ibid.

II. Policy Options for Mitigating and Managing the Risks Associated with the Price Volatility in Agricultural Markets

From the outset, we wish to clarify that instability in agricultural prices over time is a normal feature of agricultural markets, often with well-anticipated patterns. This variability is not in itself harmful. The term “volatility” is used in this BIAC paper, however, to describe extreme price instability which is both highly uncertain as to timing and potentially extremely damaging in its impact, and for which current policies are either not sufficiently developed or implemented in practice in order to be able to cope. A recent example of such a period of extreme price instability was the 2007-08 price spike (which has been followed by the resurgence of food and agricultural commodity prices in 2010-11).

When considering options for mitigating and managing price volatility in agricultural commodity markets, BIAC believes that it is important to make the distinction between underlying structural factors on the one hand (i.e. issues pertaining to supply and demand and market adjustment processes), and exogenous factors on the other (i.e. sudden shocks, such as extreme weather events, disease outbreaks and over-hasty and misdirected policy decisions). Clearly both sorts of factors can impact on each other, potentially amplifying their individual impacts. It is important for policy makers to make this distinction between structural factors and incidental factors, as each set of factors requires different policy responses, with policies to address structural factors by mitigating risk, and policies to address exogenous factors by helping to manage risk.

Policy options for Structural Factors:

- **Improve the overall investment environment:** In order for the private sector to be able to play its role most effectively in investing in agriculture, both for scientific advances and for appropriate infrastructure, human resources and capacity building, it is essential that a predictable and enabling overall investment policy framework is in place. This should be based on open and competitive markets with equivalent sustainability standards, high quality intellectual property rights, and strong human capital formation. Approaches for innovative financing in periods of crisis should also be considered, together with robust risk assessment and mitigation systems.
- **Reduce all forms of trade barriers:** BIAC would like to stress the importance of reducing all forms of trade barriers and ensuring open and competitive markets which will allow increased volumes of trade and more participants in world markets. Such barriers harm production and trade in agricultural commodities, and can distort the transmission of price signals, while also contributing to increased volatility in world markets. Due attention should also be given to exchange rate policies and their potential implications for trade flows and production location investment decisions. BIAC supports efforts to eliminate all kinds of export subsidies in both developed and developing countries, and to reduce trade distorting domestic support and market access barriers applied in practice (not just in nominal terms through WTO tariff bindings) in the agricultural sector. In this regard, issues specific to food and agriculture, such as sanitary and phytosanitary (SPS) measures and differing private

standards, and the bodies which set them, need greater attention from policy makers. Despite the current setbacks in the WTO negotiations, governments should focus on concluding the WTO Doha Development Round in order to reduce tariff levels and subsidies. Furthermore, all forms of export restrictions need addressing in parallel to the treatment of export subsidies, while issues of adulteration, counterfeiting and smuggling of crop protection products are major problems in some countries and need to be addressed under national and WTO rules. Fostering greater market integration and regulatory harmonisation would also help foster regional trade and access to inputs.

- **Foster innovation and technological change:** Improving productivity through innovation, education and capacity-building is essential in order to help address numerous challenges, including increasing demand, changing diets, climate change, competing claims for limited resources, and preserving and enhancing the environment. This is particularly true for many developing countries which, as a consequence of limited and/or ageing infrastructure, have greater difficulty in absorbing exogenous shocks. Policy makers should focus on sustainable production and supply involving public-private collaboration and modern technologies integrated with local and traditional knowledge. Use of breeding technologies and biotechnology should be encouraged and actively promoted. For example, crops tolerant to drought and other stresses can reduce the impact of agriculture on climate change and resource utilisation, while enhancing the sustainability and availability of food. To encourage innovation and technological change, public information campaigns and sharing of best agricultural practice and tools should also be actively promoted.

In this context, effective and efficient intellectual property rights (IPR) regimes are necessary to provide incentives to take risks and encourage the creation and adoption of new technologies in all areas. IPR regimes maintain the balance between exclusive protection for a defined period and disclosure of IP in accordance with internationally established IPR policies. At the same time, the access and diffusion of IPR for innovation can be accelerated through a range of collaborative mechanisms, including Public-Private-Partnerships (PPPs), as well as newer mechanisms such as through emerging global knowledge and innovation networks and markets, and private-private and south-south collaborations.

Extension programmes that educate local growers and livestock producers, including women farmers, are needed to drive technology adoption and to increase smallholders' productivity. The main vehicle for the transfer of technology will be the private sector, through its day-to-day business activities of technology development, investment and technology sales and dissemination, but the transfer of technology needs to be supported through collaborations with government services and other stakeholders. OECD countries should continue to work with emerging and developing countries to establish appropriate incentives to foster trade and investment liberalisation to encourage the spread of technologies through open markets and partnerships.

Substantial investment in food and agricultural research will be central to foster innovation and technological change. While most funding for R&D comes from the private sector, public research investment remains crucially important, in particular for fundamental pre-competitive research, which can serve as an important leverage for private research. There should also be better design and use of public-private partnerships, as well as greater emphasis on international R&D collaboration, in order to minimise duplication and maximize opportunities for cooperation.

BIAC believes that establishing a high-level forum for dialogue between the public and private sectors on R&D investment is necessary and timely. Recognising that much of the research necessary to encourage the next decade's innovation has already been undertaken, the issue of getting the results disseminated and applied in practice ("knowledge transfer") needs better extension services and more attention from decision makers in both public and private sectors.

- **Address competing claims and resource scarcities:** Cost-effective approaches are needed to address issues of resource scarcity, as competing claims from other sectors for access to land, water, nutrients and energy sources are putting unprecedented pressure on agricultural systems as a whole, as well as on commodity markets. Policymakers need to be better informed on the extent to which these various factors are contributing to the volatility of food prices. Governments should focus on sustainable intensification that helps to increase productivity while reducing the footprint of agriculture. This includes: infrastructure issues, such as investing in more sustainable water management systems, and storage and distribution capacity; technological advances that can increase crop yields and therefore reduce the amount of land needed for production; proper use of biowaste for energy production and nutrients recycling; biofuel feedstocks that can be grown on degraded or abandoned land; and rebuilding of the content of organic material (carbon) in the soils through agricultural management practices such as sound crop rotation and incorporating crop residues in the soil³.

Some major biofuels-producing countries set volumetric biofuels production targets. While such policies can act to encourage the development of domestic biofuels production, these mandates are considered to have been among the factors contributing to the 2007-08 price spike⁴, although the extent of their effect is contentious. Government support for biofuels in the form of volumetric targets should be temporary, should not cause undue market distortions, should consider the lifecycle impacts of biofuels mandates, and should focus on options for biofuels production that will make them commercially viable without the need for government support in due course.

³ See for example the Global Report of the International Assessment of Agricultural Knowledge, Science and Technology for Development (IAASTD), released on April 15, 2008.

[http://www.agassessment.org/reports/IAASTD/EN/Agriculture%20at%20a%20Crossroads_Executive%20Summary%20of%20the%20Synthesis%20Report%20\(English\).pdf](http://www.agassessment.org/reports/IAASTD/EN/Agriculture%20at%20a%20Crossroads_Executive%20Summary%20of%20the%20Synthesis%20Report%20(English).pdf)

⁴ OECD 2008 Economic Assessment of Biofuel Support Policies

-
- **Foster policy coherence at national and international levels:** The 2007-08 food price spike demonstrated the extent to which uncoordinated policy responses can distort markets and ultimately lengthen price spikes in agricultural commodity markets. Policymakers need to take a whole-of-government approach (particularly in light of the close relation between, for example, agriculture, energy and water). In addition, countries need to work in a concerted effort to mitigate the potential political, economic and social impacts of price volatility.

Policy options for Exogenous Factors:

- **Avoid sudden protectionist policy decisions:** During the 2007-08 price spike, 43 out of 81 developing countries reduced import taxes and 25 banned exports for specific products or increased export taxes⁵ for particular agricultural and food products. Abrupt policy decisions intended to protect national markets during food price crises or other crises, such as hoarding, price controls and export restrictions, discourage the necessary additional investment required for agricultural production, impede access to agricultural raw materials, increase the amplitude of price movement and threaten food security. Short-run emergency measures must not create long-term market distortions.
- **Increase transparency in agricultural markets, particularly stocks:** Stocks have an important role to play in managing price volatility. However, in order to be effective, there is a clear need for more transparent, timely and precise information about the levels of existing stocks, stock-to-use ratio, crop supply, demand and export availability which could reassure policymakers and other actors, and enable them to plan and act appropriately. Available information, in particular on stock levels, has revealed many deficiencies, in quality and in quantity in the past years, and this hinders the market from functioning efficiently. The international community needs to develop a system of peer pressure that prevents countries “gaming” world commodity markets by withholding entirely, or only releasing partially, information on their domestic stock levels.

BIAC would recommend involving international traders’ expertise as a means to cross-check on countries’ reported stock levels, while recognising that trades themselves cannot always have the answers. Nevertheless, they offer an alternative and often better-informed perspective.

With respect to policy discussions concerning financial speculation in commodity markets, BIAC recognises the lack of international consensus (or indeed, any proven causality) on whether the increased presence of non-commercial participants in futures markets significantly contributes to world commodity market price volatility. However, increasing transparency in derivative markets should nevertheless be enhanced, which will have the benefit of allowing investors to make informed

⁵ FAO (2009), Country Responses to the Food Security Crisis: Nature and Preliminary Implications of the Policies Pursued. By Mulat Demeke, Guendalina Pangrazio and Materne Maetz of the Agricultural Policy Support Service, FAO.

decisions. Again the issue of technical measures to make commodity markets work more effectively and so reduce the potential scope for extreme price fluctuations needs addressing – issues such as publication of positions held by commercial and non-commercial investors in all markets, the setting of limits on price movements in a trading session and/or day, limits on stock positions, etc.

- **Encourage the use of set-aside land during periods of crisis:** An option to supplement stock holding is to encourage farmers to keep set-aside land in good agricultural conditions for periods when additional and rapid production increases are necessary.

III. Conclusion

Extreme volatility in food and agricultural commodity prices creates uncertainty and undermines investor confidence, posing a threat to global food security. BIAC policy perspectives underline that an international coordinated public-private effort to address price volatility of food and other agriculture commodities is essential. In this context, BIAC looks forward to co-operating closely with the OECD in its continued work on price volatility.