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INCREASING FOOD PRICES: A CALL FOR POLICY CHANGE

Consumer choices around the world may be driven by varying tastes and preferences, but each is currently being guided by an additional force, the sticky shock of soaring food prices. Food inflation has taken center stage in global headlines replacing stories of war and unrest. The strain is being felt especially in the ECA region where food accounts for 50 percent or more of the household budget. While headline news about high food prices is a relatively recent phenomenon, the broader upswing in commodity prices began in 2001. Large structural shifts in the global economy have been steadily reflected in commodity price increases. In this issue of the newsletter, PAAP has compiled from a number of news items discussing reasons for the soaring food prices, impacts to the poor and policy options for governments.

Wheat prices (US \$) have increased by 200 percent, and overall food prices (US \$) have risen by 75 percent since the turn of the century. Adjusting for exchange rates and domestic inflation reduces the price increases faced by developing countries-but these increases are still severe for millions of poor consumers. Soyabean prices hit an all-time high of \$ 14.22 a bushel while corn prices jumped to a fresh 12-year high of \$ 5.25 a bushel. The price of rice and wheat has doubled in the past year and that of processed foods have followed suit. A recent survey of the major food and grains wholesale markets in Kampala, Uganda shows that wheat flour prices have jumped by 50 percent over the past two months, rice prices by 33 percent, maize flour prices by 150 percent and salt by 300 percent. Locally, the price increase is linked to droughts in the north and eastern parts of the country, the post election violence in Kenya and a buying frenzy from relief agencies.

The grain price surge is not unique to wheat. Rice prices have surged to a 20-year high creating policy headaches in Asia, where more than 2.5 billion people depend on cheap and abundant supplies of the grain. Thai rice prices, a global benchmark, surged last recently above the level of \$ 500 a tonne for the first time since at least 1989, according to the United Nations Food and Agriculture Organisation. In the US, rice in Chicago, the benchmark for the world's fourth-largest exporter of the grain, jumped to a record \$ 400 per tonne – up about 75 per cent in the past year.

High prices and extremely tight supplies have prompted leading rice suppliers – including Vietnam, India and Egypt – to restrict exports in recent months in an attempt to keep local markets well-supplied and domestic prices under control while other countries are now seeking assurances over supplies. The Philippines, the world's largest buyer of rice has asked Vietnam to guarantee an undisclosed amount of rice for the 2008/09 season.

In spite of a record crop of about 420 metric tonnes in the current season, global rice supplies are lagging behind demand, which has risen to 423 metric tonnes, leading to a further decline in global rice

inventories, according to the US Department of Agriculture. Rice stocks have fallen this season to about 70 metric tonnes, the lowest level for 25 years and less than half the 150 metric tonnes held in global inventories in 2000. Prices for palm oil have doubled in 12 months boosted by strong demand from China and India, and increasing demand for biodiesel production. The rise in palm oil prices is also linked to the surging cost of other vegetable oils. Palm oil prices have risen by 27.5 per cent since the start of the year. Chinese buying is because the rapeseed crop was last recently damaged by extreme weather and because of plans by Indonesia, the world's largest palm oil producer, to lift exports taxes. 9,000 hectares of forest and plantation recently burnt down in Riau in Sumatra province in Indonesia which has added fuel to the buying fire.

Palm oil's strength has boosted the prices of other edible oil sources. At the Chicago Board of Trade, soyabean futures for March delivery hit a record high of \$ 14.47½ a bushel, double the price a year ago. In Paris, rapeseed futures for May delivery hit a record high of € 492 a tonne. As prices soar, the World Food Programme (WFP) sees the emergence of a "new era of hunger" in developing countries where even middle-class, urban people are being "priced out of the food market" because of rising food prices. Countries that had previously escaped hunger such as Indonesia, Yemen and Mexico are also being hit.

Causes of rising food prices

This rise in prices is a consequence of both demand and supply trends. On the demand side, food prices are rising on a mix of strong consumption growth in emerging markets, which in turn has been powered by those countries' impressive income gains. In recent years, the world's developing countries incomes have been growing about 7 percent a year, an unusually rapid rate by historical standards. China, for example, has accounted for up to 40 per cent of the increase in global consumption of soy-beans and meat over the past decade. The US Department of Agriculture forecasts that Chinese imports of pork- the country's staple meat will double over the next 10 years.

Other factors include a rising global population with changing diets from carbohydrates to meats and processed foods. This means more grain is needed to feed farm animals to meet human needs. Increasing urbanisation due to rural urban migration and conversion of agricultural land to settlement and other uses has cut the acreage given over to cultivating the grain. Globally, the newly urbanized and newly affluent are seeking more protein and more calories; a phenomenon dubbed "diet globalisation." Demand is growing for pork in Russia, beef in Indonesia and dairy products in Mexico and bread in Nigeria. Rice is giving way to noodles, home-cooked food to fast food.

At the same time, a series of supply-side disruptions in key commodity markets ranging from more frequent floods and droughts caused by climate change to disease have been at work. Australia, one of the world's key wheat producers was hit by its worst drought in 100 years which halved the winter wheat crop to 12 million tonnes in 2007. Reports of drought and water shortages in north-west China, where most of the country's wheat is grown, and bad harvests in Argentina and Brazil have also compounded the problem. Unusually cold weather last year in places such as Ukraine also hurt production.

But perhaps the most important drivers of price gains over the past year are developments in world energy markets. High oil prices have encouraged a policy focus on biofuels, including significant subsidies for the development of the biofuels industry in industrialised economies such as the US and the EU. Production has responded quickly to these incentives: the World Bank reports that the US has used 20 per cent of its maize production for biofuels (about 40 metric tonnes of maize or 4 percent of global production of coarse grains) and the European Union 68 per cent of its vegetable oil production reflecting an unprecedented growth in the biofuels industry's appetite for grains. This change in usage has boosted prices, reduced the supply of these crops available for food and encouraged the substitution of other agricultural land from food to biofuel production. Demand for alternative energy sources has led farmers to sow less wheat and convert land to crops such as corn, sugarcane and rapeseed, which can be turned

into biofuels. But this means there is less land for growing food crops. World grain stocks are at record lows and next year's prices depend on the success of the next harvest in the northern hemisphere. In seven of the last eight years, world wheat consumption has outpaced production. Stockpiles are at their lowest point in decades.

Freight costs have also increased sharply on the back of rising fuel prices. The record shipping rates have made food yet more expensive in the poorer, importing countries that need to buy it most. High fertiliser prices have also increased the cost of producing food. Fertiliser prices have increased 150 percent in the past five years. This is very significant, because the cost of fertilizer is 25 to 30 percent of the overall cost of grain production in the US (which supplies 40 percent of world grain exports). All over the world, countries are resorting to "starve thy neighbour policies." The main reason behind the most recent sudden rise in wheat prices was a decision by Kazakhstan to impose export tariffs to curb sales. Kazakhstan, a big exporter of wheat, said the curbs would help it battle an inflation rate of nearly 20 percent. The move follows similar restrictions imposed by Russia and Argentina (The top five wheat exporters are US, Russia, Canada, Argentina and the EU).

The scramble by corporate consumers and relief agencies to secure scarce grain and speculative buying by investors has led to the surge in prices for high quality wheat used in bread to an all-time high of \$ 24 a bushel – the highest yet paid for any wheat contract and a three-fold increase from a year ago. Commodity prices have also soared as commodities have found favour among investors struggling with poor returns in other markets. Stock markets have lost ground as the world economy slows and the fallout from the sub-prime crisis continues.

Is the price surge a temporary phenomenon?

In the long run, the food supply could grow. More land may be pulled into production, and outdated farming methods in some countries may be upgraded. Moreover, rising prices could force more people to cut back. The big question is whether such changes will be enough to bring supply and demand into better balance.

Already supply seems to be responding to the high price; more wheat having been planted in the northern hemisphere over the winter. The US Agriculture Department forecasts that world wheat production will increase 8 percent this year. With climate change and environmental degradation threatening agricultural capacity in several key regions, and the significant reduction in world food stocks, the elasticity of past supply responses, however, may prove to be a poor guide to the future. Similar sentiments are shared by the Food and Agriculture Organisation of the United Nations (FAO). The FAO has called for significant increases in production of more than one season's cereal crop if markets are to regain their stability and for prices to decline significantly below the recent highs.

According to leading economists, the price surge is not a temporary hump but rather a structural change, a sustained move to a new and higher plateau for prices. The US Department of Agriculture warned that high agricultural commodities prices would continue for at least the next two to three years. The root causes of the phenomenon of rising food prices - high energy and fertiliser prices, the demand for food crops in biofuel production, and low food stocks - are likely to prevail in the medium term. Energy and fertilizer prices are projected to stay high.

The lag in supply response to the stimulus provided by higher prices may also prove to be of greater duration than its predecessors, to the extent that the current changes in world energy markets – and hence the associated demand for biofuels – are likely to be lasting ones. The demand for biofuels will probably rise. A quarter of the US maize crop (11 percent of the global crop) went into biofuel production this year, and the US supplies more than 60 percent of world maize exports. Notably, the US - one of more than 20 countries to require biofuels use - has just doubled its biofuels mandate by 2015. In

addition, surplus production capacity is scarce. The EU's "set aside" lands, originally intended to keep surpluses low, have already been brought into production and US Conservation Reserve lands would give low yields, even supposing legislation to move them into production was in the works.

Reduction in food aid

On February 13, the FAO announced that 36 countries are in crisis as a result of higher food prices and will require external assistance, 21 of the countries being in Africa. In some, such as Lesotho and Swaziland, drought has affected production; others such as Sierra Leone lack widespread access to food from local markets for various reasons, including very low income and very high food prices; and more than a dozen, including Ghana, Kenya and Chad, are undergoing severe localized food insecurity. In January, in Davos and in Addis Ababa, World Bank President Robert Zoellick called for action to tackle hunger and malnutrition in a world of rising food prices, noting that hunger and malnutrition is the forgotten Millennium Development Goal. Between 1990 and 2005 the proportion of children under five who were underweight declined by one fifth. But that progress is now under threat. Rising food prices mean that malnutrition and starvation once again threaten many of those at the bottom of the world's economic ladder. Despite the urgency and potency of the matter, the World Food Programme (WFP) is drawing up plans to ration food aid in response to the spiraling cost of agricultural commodities. The agency's budget requirements were rising by several million dollars a week because of escalating food prices. The World Food Programme may have to cut food rations or even the number of people it reaches, unless donors provide more cash to pay higher prices.

Impacts of rising food prices

Impacts on the poor

During the extended period in which supply continues to lag behind demand there are likely to be significant social and economic costs. Three in particular stand out. Most important, a period of protracted higher food prices will be bad news for many of the world's poorest people and its poorest economies. While the share of food in the consumption basket of a rich country such as the US is relatively low, at about 10 per cent, it averages about 30 per cent in China and more than 60 per cent in sub-Saharan Africa. Hence the unrelenting increase in prices is likely to bode evil to the pursuit of the millennium development goals on poverty, malnutrition and hunger, especially for the poor countries. Countries that are most vulnerable are the low-income net food importers. Because of the surge in food prices, the world's poor countries will have to pay 35 per cent more for their cereals imports, taking the total cost to a record \$ 33.1 billion (in the year to July 2008, even as their food purchases fall 2 per cent, according to the UN's Food and Agriculture Organisation).

The world's poorest economies are also some of the largest importers of food grains; which makes the food security crisis serious. Striking a balance between importing food at exorbitant prices and assuring food security for the poor is a hard task for any government. Higher food prices add more strain to import bills that have often already been stretched by higher energy prices. Several of the poorest economies fall into this category and are heavily dependent on food aid to meet their needs. But the worldwide volume of such aid has stagnated for the past two decades and, what is worse; the quantity of aid delivered tends to fall as prices rise, given that a large proportion comprises a fixed annual dollar amount. Next, there are important social strains to be managed. These may be particularly problematic for those emerging markets that are already struggling to deal with the consequences of growing inequality. Granted, higher food prices are something of a two-edged sword here, since higher agricultural earnings could reduce rural-urban income disparities. But the big losers are likely to be the urban poor, typically a politically volatile group, while many of the rural poor will also suffer. While the urban poor are most affected, it is worth remembering that most rural people are buyers rather than sellers of food. There

could well be severe effects for landless rural workers whose subsistence wages may not increase apace with food prices.

The implications for trade

Costly food will disrupt the trade balances of relatively few countries, because the majority will see largely offsetting gains in other commodity exports. Countries most adversely affected include Jordan, Egypt, the Gambia, Lesotho, Djibouti, and Haiti. Looking at the global landscape, sustained high food prices could lead rich countries to be more willing to reduce agricultural subsidies and that could improve the prospects for a successful Doha Round. Trade policy, once motivated by surplus food, now faces a reversal of circumstances.

The range of government responses

Political tensions are building: the World Food Programme, for example, now thinks a third of the world's population lives in countries with food price controls or export bans. Governments are responding in a number of ways, some of which provide immediate relief but risk confounding the problem in the long term. In response to increasing food prices, Egypt has widened its food rationing system for the first time in two decades while Pakistan has reintroduced a ration card system that was abandoned in the mid-1980s; Oman has also introduced food subsidies. Countries such as China and Russia are imposing price controls while others, such as Argentina and Vietnam, are enforcing foreign sales taxes or export bans. Cereal importing countries are lowering their tariffs.

The world's largest importer of wheat is Egypt; currently the government cannot raise the prices of subsidised food, so every increase [in international prices] is absorbed by the state. The bread subsidy alone went up by around \$ 820 million last year to reach \$ 2.45 billion. Food price inflation has forced the Egyptian government for the first time in 20 years to relax the rules about who can receive subsidised food. As a result, officials say they expect an additional 10.5m people to be added to the list. Pakistan recently launched ration cards to provide subsidised food for nearly 7million households after the price of wheat and edible oils, key staples in the country, soared. Food ration cards in Pakistan were mostly abandoned in the 1980s. Thousands of paramilitary troops have been deployed since January to guard trucks carrying wheat and flour. Malaysia, trying to keep its commodities at home, has made it a crime to export flour and other products without a license. Russia, is implementing price controls on selected types of bread, cheese, milk, eggs and vegetable oil.

The American Bakers Association last month took the radical step of suggesting that American exports be curtailed to keep wheat at home, though the group later backed off. Cereal traders said it was unlikely Washington would support export curtailments, but added that the call highlighted the tightness of the market. Banning exports to keep domestic prices low, for instance, can severely affect producers who are often poor themselves. This also reduces the supply response needed to meet future demand growth. However, these short term controls are being operated to stem a probable spill of violence from a populace that may feel deprived of food. Politically, it's difficult for these countries to continue to export if prices are high domestically. Already since last year, the rising cost of food has attracted violence in many places around the world.

Last year, tens of thousands of Mexicans marched in a protest against the rising price of tortillas after the price of the flat corn bread soared by over 400 percent. In Italy, a one day pasta strike was declared to protest against the rising cost of pasta, the country's national staple with each Italian eating on average 28 kg of pasta every year. In West Bengal, there have already been disputes over food-rationing. In Yemen, children marched in public to call attention to child hunger. In Africa, the crisis has revealed the potentially destabilising impact of rising global oil prices on Africa, where many countries have seen fuel import bills soar. In Cameroon, the government plans to pass the cost on to consumers by raising the

price of subsidised petrol sparked one week long protests by taxi drivers in the commercial centre Douala, crippling the country's main port. Cameroon pumps about 85,000 barrels a day of oil and the port is a lifeline to landlocked Chad and Central African Republic. The unrest spread to the capital, Yaounde, and towns in the south. This violence shows how soaring oil and food prices on global markets are threatening the patronage systems of political leaders on the continent. Similar demonstrations linked to surging inflation have swept across Niger, Ghana, Senegal, Mauritania, Guinea and Burkina Faso in the recent past.

In Indonesia, hundreds of meat sellers took to the streets in Jakarta late February to complain about the rising price of beef. The Indonesian government had to introduce an export tax for crude palm oil. It also cut import taxes for soy-beans, wheat and flour as part of a \$ 4 billion package to tackle the problem. In Indonesia the price of *tofu* has jumped 50 per cent in the past year; rice is up 25 per cent and cooking oil almost 40 per cent. Indonesia, a big producer of crude palm oil, is one of the beneficiaries of the booming biofuels sector. But at the same time the price of local cooking oil has soared. Jakarta is sensitive to price-related social unrest. In 2005 a doubling or more in the cost of fuel sparked protests. The government continues to spend nearly 35 per cent of its entire budget on fuel and electricity subsidies. This year it expects to spend nearly \$ 12 billion on fuel subsidies and almost \$ 6 billion keeping down the cost of electricity. Apart from leading to more popular protests, higher food prices are also starting to work their way through the inflation numbers. Consumer prices were 7.4 per cent higher in January than a year ago, a 16-month record and above the country's full-year inflation target of 6 per cent.

Required policy action

Higher food prices call for tighter monetary policy if governments are to effectively manage their economies. Given the disparity in the share of food in consumption baskets, and the fact that rich country central banks tend to exclude food prices from their core inflation measures, the policy reaction will tend to be greater in developing economies. However, rich country central banks will also have to keep a close watch on any spillover effects that tighter monetary policy could have on non-food prices. Governments need to take focused action, with direct subsidies for the poor rather than the whole country. Income transfers or food assistance for poor people will work more efficiently and sustainably than more general steps such as price controls and other direct measures at the national level.

Investment in agriculture has remained low in sub-Saharan Africa, and the level of external aid to the sector had been falling since 1995. It is crucial that more resources go to agriculture. The United Nations Food and Agriculture Organisation has called on the oil-producing countries of the Middle East to invest more of their oil windfalls in developing agriculture in their region, in order to address the serious threat to food security posed by water scarcity and climate change. Water scarcity is a main constraint on agriculture in the region, which has only 2 per cent of global fresh water resources and 11 per cent of global population. Climate change is expected to make the situation worse, as changing rainfall patterns and global warming mean that more water is lost through evaporation. Hence oil producing countries should consider the possibility of investing in Africa to ensure the security of food supply.

The food crisis points to capital and resource misallocation. If the world today were a rational economic place, then regions such as the Gulf which are food-constrained ought to be investing heavily in agriculture. And since the globe still has large tracts of undeveloped arable land, the gulf should reallocate oil windfalls to areas where agriculture is possible but resources are a major constraint. Without such market failures, the Gulf leaders would not be considering desalinating sea water to plant wheat in the desert – while the world is trying to turn corn into fuel at the expense of food consumers. Although serious challenges to increasing food production: limits to available land, soil degradation and access to water among them abound, over the next few years, prices will stabilise as supply increases and stocks are rebuilt especially through the new biotechnology drive which has the potential to drive up output if well harnessed. In the meantime, governments that are subsidising biofuels need to come up

and help fund the World Food Programme. The environmental benefits of maize biofuel are ambiguous at best and it should not be favoured over growing maize for food. The world has enough food to feed everybody – if there is the will to do so.

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COMMUNICATION

Call for Consultants: ASARECA/TUUSI

ASARECA invites applications for consultancies under Technology Uptake and Up-scaling Support Initiative (TUUSI) in two areas:

- i. Consultant to catalogue and evaluate available community/farmer-based seed Enterprises on African Indigenous Vegetables (AIV) in the ECA
- ii. Consultant to carry out a study to profile sub-regional and national farmers' organizations in the ECA in terms of functional attributes and to identify priority farmer empowerment and organisational strengthening needs.

Further details about the projects are available at www.asareca.org

The African Fellows Programme: 8th Call for Pre-Proposals.

Pre-proposal concept notes are invited for the seventh round of this Programme. Pre-proposals should be submitted by 17:00 hours (GMT) on **Wednesday 6th August 2008**, preferably by email.

Applicants can obtain further details and guidelines from the Rothamsted International web site:

http://www.rothamsted-international.org/HTML/Fellowships/AFP_main_page.html

Further details can also be obtained by email (rothamsted.international@bbsrc.ac.uk), or by writing to the AFP Coordinator, Rothamsted International, Harpenden, Hertfordshire, AL5 2JQ, UK.

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