“High Food Prices and Riots: Trade Policy vs. Safety Nets”

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Spikes in World Food Prices

- Post-2007 – world prices of key staple foods volatile around relatively high levels
- Different to pattern over past century where real food prices have trended downwards
- Historically, while price spikes are often intense, they have typically been infrequent
Real Food Price Trend

Food Prices*
Relative to US GDP deflator, log scale, 1900 = 100

Index

100

50

25


* Equal weighted (geometric) index of 11 commodities; extended from 2004 using IMF commodity price series; latest data point is 2011 to date
Sources: Global Financial Data; IMF; RBA; World Bank

Price spike
Recent Food Price Spikes

FAO Real Food Price Indices (2002-04=100)

- Food price index based on average of 5 commodity groups (meat, dairy, cereals, oils and fats, and sugar)
- Cereals prices index based on wheat, maize, and rice prices
Many developing countries have responded to food price spikes by directly intervening to stabilize domestic markets.

2008: 68 countries used trade policies and 35 released public stocks at subsidized prices (FAO, 2008).

Trade policies have consisted of export controls, import subsidies and tariff reductions.

In contrast, developed countries have typically not implemented such policies.
Standard Policy Advice

• 1945-80, focus on price stability through production, border and stock controls

• Post-1980, price stability considered less desirable - production, trade and storage decisions should be guided by market prices

• Policy advice: market-based risk-management tools in combination with safety nets

• Has drawn criticism after price spikes:
  - risk-management tools often unavailable
  - safety nets too complex to use
  - poor food importing countries hurt most
• Higher food prices found to increase poverty sharply in short-run (World Bank, 2012)

• Research suggests food riots are correlated with high food prices *not* volatility (Bellemare, 2011)

• Intervention a matter of political survival in countries with large poor populations

• Indian Prime Minister and Indonesian President both re-elected in 2009 after campaigns emphasizing ability to limit impact of food crisis in respective countries
Impact of Higher Food Prices

High Food Prices and Political Unrest

Source: Lafi, Bertrand and Bar-Yam (2011)
• If enough countries adopt trade policies, end result is increased world food price instability

• “...export restrictions play a direct role in aggravating food crises...” (Pascal Lamy, Director General of WTO, 2011)

• 40%, 19% and 10% of 2007-08 spike in rice, wheat and maize prices respectively due to trade policies (Anderson and Nelgen, 2012)

• Unless countries cooperate over not using trade policies, each has unilateral incentive to intervene, but collectively no better off
Safety Nets

- Mixed record of stabilization policies has led to focus on risk management and safety nets
- Latter are non-contributory targeted transfers designed to provide assistance to the poor following price shocks
- Various forms: cash transfers, food stamps, food-for-work, and cash-for-work programs
- Provide insurance to poor who have limited access to formal coping mechanisms – i.e., *entitlements* matter (Sen, 1981)
Safety Nets

- Often complement stabilization policies, which may be insufficient to protect purchasing power of poor

- In response to 2007-08 food price spike, 23 countries used cash transfers, 19 food assistance, and 16 chose policies to increase disposable income (FAO, 2009)

- Safety nets have been crucial in protecting poor from price increases – e.g., Mexico’s Progresa program

- Options for delivery improving
Safety Nets vs. Trade Policies

• Why are safety nets not used more often?
  ▪ Hard to scale up/down depending on need
  ▪ Fiscal constraints

• Trade policies often less costly, and also politically popular if safety nets leave share of middle-class unprotected

• Despite being targeted, safety nets may still distort world prices, i.e., result in exports being reduced/imports increased

• However, trade polices tend to over-react to shocks while safety nets tend to under-react
Disciplines on Trade Policy

• Trade policies often appear successful in stabilizing domestic prices, but end up exacerbating world price spikes

• Solution to prisoner’s dilemma is cooperation via a self-enforcing agreement, i.e., the WTO

• Current Doha Round pushing for reductions in tariffs and disciplines on export subsidies

• Developed countries also pushing for tighter WTO disciplines on export restrictions – but rejected by exporting developing countries
Reconsidering Biofuels Policies

• Developed countries did not use export policies in response to recent price spikes.

• However, developed country policies on biofuels have had an impact – approximately 30% of food price spike in 2008 (FAO; IMF).

• Need for safety valves, e.g., governments could purchase call options on grain from biofuels producers (Wright, 2001).

• Focus should be on developing cellulosic-based biofuels that have a less distorting effect on world prices.