

Concerns mount over rising food prices

High prices can be an opportunity for food-exporting countries in Latin America and the Caribbean, but net importers will have to redouble their efforts to raise productivity, attenuate the effects of climatic events and strengthen their social protection networks.

The prices of the main commodities are even higher now than they were during the 2007-2008 crisis: world markets are nervous, grain prices are volatile and there are growing concerns about the possible social implications.

Analysts are divided as to whether this is a new, separate development or the resurgence of the 2007-2008 crisis. Some believe that the looming crisis will be more serious than the one that erupted in 2008.¹

Others feel that it is a continuation of the same crisis and that the respite in price increases was due to the financial meltdown and the severe global economic recession it triggered in 2008. According to this interpretation, the economic upturn, especially in the emerging countries, is pushing up prices again simply because the factors responsible for the upward trend continue to exist.

In August 2010, IICA published a [report](#) in which it highlighted the instability in world wheat markets due to the problems in Russia and the impact of that country's temporary ban on exports. We concluded that the effects would not be serious, recommended keeping an eye on futures prices and warned that there would be knock-on effects on other grains.

During the first weeks of 2011, there have been reports of bigger and more generalized increases than in 2007-2008, because tropical products such as coffee, cacao, sugar and dairy and meat products have also been affected. The prices of these commodities hardly rose at all during the last crisis.

The recent increases are **accelerating the food inflation rate**, already having an impact on governance, for now, in African and Asian countries, and reigniting concerns about food security.

In the long term, **IICA anticipates a sustained upward trend in prices** due to structural factors. Developments in the short term, however, are subject to temporary aspects that are difficult to predict. The latter are what make the situation volatile and uncertain, and affect producers the most.

Some forecasts (FAO-OECD²) suggest that prices will continue to rise, while others (World Bank³) predict a less severe situation because global supplies of wheat, corn and rice are bigger than in 2007-2008. Production is also expected to rise during the 2010-2011 cycle, with prices falling as inventories swell and fertilizers remaining stable.

Given the uncertainty surrounding developments in the short term, it is worth considering the causes of the present spike in prices.

The factors underlying the rise in prices

The **structural factors** that push up prices appear to be present again:

- World demand for food commodities is growing faster than the global supply (China and India are playing an especially important role in this regard).
- Oil prices have rebounded and are close to US\$100 per barrel, which will push production costs higher and make the efforts to produce biofuels attractive again, accompanied by the more widespread adoption of regulations to increase fuel mixture ratios.
- A few countries account for an increasingly large slice of the production and export of the main agricultural commodities, while a small number of intermediaries are responsible for the commercialization of those commodities in global agrifood chains.

Most of the **short-term factors** that make prices volatile and account for the short-term trends are also in evidence:

- Countries that play an important role in world commodity markets have been subject to highly unstable climatic conditions: there have been serious floods in Australia; droughts in Russia and Ukraine; floods in Pakistan; heavy frosts in the United States and Europe; and droughts in Brazil, Argentina and Uruguay.
- Some commodity-exporting countries continue to implement restrictive trade policies, aggravating the imbalances in agrifood markets.
- The specter of opportunistic trading and speculative purchasing has reappeared. Although analysts were unable to demonstrate the impact of this factor conclusively in 2007-2008, news reports at the end of 2010 suggested that surplus liquidity was being pumped into agricultural markets, contributing to the spike in prices. For example, it was reported that, during the northern summer, financial speculators at the Chicago Exchange bought futures contracts involving about 40 million tons of corn. That is more than the amount of corn consumed annually in Brazil.⁴

Nonetheless, there are certain important differences with respect to the 2007-2008 crisis:

- At that time, stocks of the main agricultural commodities stood at historically low levels; since then they have risen considerably, thanks to the national policies implemented to guarantee food security. In some countries, those policies have boosted production to meet part of the domestic demand, and limited the transmission of international prices to local markets.
- The price of rice has not been affected by the latest developments, despite the fact that rice was the crop whose price increased the most during 2007-2008. Beginning in the second half of 2008, the price of rice fell, a trend that only petered out during the second half of 2010. Nor have the prices of fertilizers risen this time around.

Possible impact on Latin America and the Caribbean

Although the transmission of international prices to domestic markets, and especially to producers' income, is not yet evident and will probably not become apparent for some time, the effects in 2007-2008 varied from country to country. The crisis **benefited the countries that produce and export** the commodities that rose in price and **adversely affected the net grain and oilseed importing countries**. Consumers, especially those with low incomes, were badly hit and income support and protection policies had to be implemented.

The current situation is not so clear-cut because the price hikes are more generalized and because the **weakness of the United States dollar** (the currency in which most commodities are traded) against other strong currencies has made exports of U.S. agricultural commodities more competitive. On the other hand, the currencies of most Latin American and Caribbean (LAC) countries have **strengthened against the dollar**, making the region's agricultural exports less competitive and reducing the expected potential benefit.

Having a stronger currency helps the countries of LAC to attenuate the effect of higher commodity prices on consumers by making imports relatively cheaper and reducing their impact on the food component of inflationary processes.

This last point is important because the inflationary impact of food price rises varies: it is considerably greater in less developed countries – whose inhabitants spend a large slice of their income on food – and in those that are net importers of the products whose prices are rising most sharply, such as grains, oils and sugar.

Policy options

Increases in the prices of agricultural commodities, and other commodities such as metals and energy, provide an **opportunity** for many exporting countries in LAC, but also pose a formidable **challenge** for countries that are net importers of the products that are becoming more expensive and for the poorest countries and segments of the population.

Unlike three years ago – when the region had enjoyed a period of growth and was in a healthy fiscal situation – most countries face ongoing fiscal constraints that will limit the possibilities of implementing compensatory measures. It should be remembered that the 2007-2008 crisis and subsequent recession led not only to higher unemployment, but also to increased undernutrition.

Like most international agencies and the G-20 itself, IICA has stressed the need to make a major effort to increase the levels of **investment in technology and innovation in agriculture**, with a view to improving yields and thereby increasing global food supplies to meet the global demand for food, which is set to double by around 2050, and preventing the imbalances that drive up prices. Actions also need to be taken in the short term to **address the growing climatic variability** that is contributing to price volatility and, in the long term, to **adapt to the effects of climate change**. This has to be part of a combined global and national effort.

Other actions call for a **coordinated effort at the regional level**, such as initiatives designed to improve the availability of and access to timely information; coordinate reserves of products, especially grains; and enhance the operation and transparency of markets.

¹ R. Zoellick, January 15, 2011 (Interview on BBC Mundo)

² Agricultural Outlook 2010-2019

³ Global Economic Prospects January 2011: Annex

⁴ BBC Mundo – news item on October 16, 2010.