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Why high food prices are not only bad for development

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Bonn, 28 March 2011. For the second time in a few years the world is witnessing a sharp rise in the world market prices of basic foodstuffs. The food price index of the UN's Food and Agriculture Organization (FAO) has now reached its highest level since being introduced in 1990. Maize and wheat are particularly expensive, but so too are meat, dairy products, vegetable oils and sugar. On the other hand, the price of rice, especially important for global food security, has yet not risen appreciably.

The underlying causes of the high prices are now sufficiently well known, although the relative importance of individual factors is still hotly disputed: demand is rising as a result of the growing population, urbanisation, greater demand for processed animal products and the promotion of bio-fuels. Although supply is (still) able to keep pace with demand, production volumes are fluctuating sharply. Reduced storage and increased speculation on spot markets and commodity futures exchanges are leading to higher risks and price fluctuations. Government interventions in export and import markets have contributed to further price escalation, this being especially true of the first food price crisis in 2007/08.

As a consequence of the high prices, the discourse currently centres on the rise in the number of people going hungry and on the political disturbances. The first crisis is believed to have led to an increase in the number of undernourished people by 125 million to more than a billion. Disturbances broke out in almost 60 countries. Many countries and investors therefore began acquiring land in developing countries on a grand scale (land-grabbing), which led to local conflicts. Observers see the high food prices in the current crisis as one cause of the widespread popular dissatisfaction in many countries of the Arab world that are particularly dependent on food imports and as therefore contributing to the political upheavals in this region.

One aspect of the high food prices that has yet to be properly appreciated is the positive contribution they are making to the development of agriculture in developing countries and so to the fight against rural poverty. It should first be realised that the figures on an increase in the number of the malnourished are statistical projections. They are based on the assumption that the changes in world market prices are passed on in full to local markets and impact on households when they sell the products concerned (effect on incomes) and when they buy them (effect on expenditure), as if nothing else changes (the familiar *ceteris paribus* approach in economics). This view may be acceptable for a short-term analysis of sudden price rises: urban households do not store much food and are affected directly. Farming households store some of their agricultural output, but as farmers cannot predict that prices will rise (so high), they will not produce more, and only a few of them will delay selling their products. They hardly benefit, therefore, and many even purchase some of their food.

Seen from the development policy angle, however, the short-term view described above is inadequate, since in the longer term higher agricultural prices often tend to trigger a positive cycle of development: farmers invest in the expansion of production, for which they need such inputs as fertilisers and above all, in most developing countries, workers from households that own little or no land. Besides scarce land, labour is the most important input in an agricultural sector which is, at best, partly mechanised. There is also empirical evidence of these theoretical links. After the first food price crisis, for example, production of the most important basic foodstuffs rose significantly in most developing countries, often by more than 10 per cent. Higher prices and higher output mean higher incomes for farmers. Together with the rise in the total agricultural wage bill (and also rising wages in the long term) and the stimulation of the sectors up- and downstream from agriculture (inputs, loans, trade, processing), they increase purchasing power in rural areas. This mainly benefits domestic and often local goods and services (and those who provide them). A positive cycle of rural development that does a great deal to reduce poverty is thus born.

This long-term perspective lies at the heart of the call voiced for decades by economists and development policy-makers for a reduction in the horrendous government support given to agriculture in the industrialised countries, which lowers farm prices in world markets. In recent years the rules of the World Trade Organisation (WTO) in particular have led to a steady fall in agricultural support measures in relative, though not absolute terms.

The risk associated with the excessive emphasis placed on low food prices as the key to reducing hunger is, however, that it will ease the pressure for further agricultural reforms in the industrialised countries. The Agriculture Ministers of the Organisation for Economic Co-operation and Development (OECD) recently agreed, for example, that their highest priority was to ensure an adequate supply of safe and nutritious foodstuffs for a growing world population – as if the developing countries were not capable of doing this themselves if they were allowed to and were given support.

A low-price policy for foodstuffs is not a panacea for poverty and malnutrition: on the contrary. While the food price crisis may have meant hunger for an additional 125 million people in the short term, the two thirds of the 850 million undernourished who are small farmers and cattle breeders were suffering because of low prices even before the crisis. This, too, explains why they are buying some food today. The productivity of the rural population in the developing countries should be the first choice for a coherent agricultural and development policy if the aim is to combat hunger in the world. For that, moderately higher farm prices are an important instrument. Adverse effects on poor consumers must be cushioned by social protection. Sharp price fluctuations, upward and downward, are harmful, because they do not permit sound investment planning. This should be one of the priorities of global food security policy.

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