

# SMALLHOLDER AGRICULTURE AND FOOD SYSTEMS: RESPONDING TO THE CHALLENGE OF FOOD PRICE VOLATILITY



ISSUE PAPER  
**ASK. ANALYZE. ADVOCATE. ACT!**



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In 2008, Ka Lita, a woman rice farmer in the Philippines, stood in a long line to buy rice that was being sold by the National Food Authority (NFA), the government's rice trading agency. She had been standing under the hot sun for several hours, but she had no choice but to wait for her turn to buy rice from the NFA. The rice being sold by the government's rice trading agency was the only rice that she could afford with her money. A few months earlier, Ka Lita sold her family's harvest of paddy to a trader at a very low price, but the price of milled rice in the market had increased by at least two times since then. If she buys from rice retailers, she will not have enough to feed her family.

In many countries in Asia and the world, farmers were experiencing the same problem. Rice farmers and their families, like millions of poor people across the globe, faced hunger as the price of rice – a commodity which they produce – went up unexpectedly.

The sudden and unexpected increase in food prices in 2008 sent many people to hunger. It signaled to governments around the world that they have to find immediate and long-term solutions to food price volatility.

Food price volatility is the term used to refer to changes in the prices of food items that are so sudden and unexpected that governments are not able to immediately do anything to help people, especially the poor, cope with this problem.

In this issue paper, we will look at the reasons why food price volatility happens. We will also look at the work undertaken by farmers' groups, governments and other international institutions like the Food and Agriculture Organization (FAO) of the United Nations to address this. Finally, we will look at possible solutions to this problem.

### WHAT ARE THE REASONS FOR FOOD PRICE VOLATILITY?

After the food price crisis of 2008, the Food and Agriculture Organization (FAO) convened a group of experts, called the High Level Panel of Experts (HLPE) to look into the reasons why food price volatility happens.

According to these experts, there are three ways to interpret or look at food price volatility.

The first interpretation is that it is a result of factors that create major changes in food prices, or what they call excessive food price volatility. This excessive food price volatility is, in turn, influenced by rising food demand and limited supply, food trade policies, and increased speculation and financialization of agricultural markets.

The second interpretation is that food price volatility happens as part of a cyclical pattern, and can be partly attributed to patterns of decreasing support and investment in agriculture.

The third interpretation is that food price volatility is actually a signal of a growing lack or scarcity in agricultural products and production.

### WHAT ARE THE REASONS FOR EXCESSIVE FOOD PRICE VOLATILITY?

According to the experts, there are four reasons behind excessive food price volatility.

First, the demand for food is rising. As population grows bigger and as incomes go higher, so does the demand for food. This is especially true in many developed countries where people have high levels of income and, as such, are in a position to buy food regardless of how high food prices may be.

The increasing demand for biofuels is also driving up the price of food as many food items like sugar, cassava and coconut oil, to name a few, are also used for biofuel production. Moreover, in many countries, lands previously devoted to food production are now being used to produce inputs for manufacturing biofuel. This trend is likely to continue as more countries, like the US, Europe and even developing countries pass laws requiring people and industries to use more biofuels.

Second, food supply has become increasingly unreliable because of climate change. Climate change, which is evident in extreme weather events, such as typhoon, flooding, and droughts, has a negative effect on food production and supply. In many countries in Asia, food prices immediately go up after storms and typhoons destroy food crops.

Third, food trade policies of different countries also affect food prices and supply. In 2008, some rice exporting countries, like Vietnam and Thailand, announced that they will limit or sell only a small amount of their rice output to other countries in order to ensure that they have enough food for

their population. This contributed to the increase in the prices of rice as countries experiencing supply shortages showed willingness to buy rice even at high prices just to augment their food supply.

On the other hand, many farmers' groups believe that policies that freely allow food importation undermine domestic food production and supply, and contribute to greater food price volatility.

Fourth, the practice of some traders of buying future food production, or speculation, has also contributed to food price volatility. Some traders buy agricultural crops at a certain price, even before they are produced. If managed properly, this practice can help smooth out food prices because it can help lock in prices at a certain level. However, problems arise when many traders begin to demand and compete for future harvests of a particular agricultural commodity, as this will push the price of that product higher. Excessive speculation, or demand for future harvest of an agricultural product, can drive the price of that product higher, and contribute to greater food price volatility.

### **WHAT IS THE LINK BETWEEN FOOD PRICE VOLATILITY AND INVESTMENTS IN AGRICULTURE?**

The study conducted by FAO's High Level Panel of Experts cites studies that show that food price volatility is a rare but regular occurrence in world history, happening every three decades or so. This pattern is largely related to declining support and investment in agriculture by government and private sector. This means that when there is little support for agriculture and small food producers, food production and supply go down, leading to higher food prices, and greater food price volatility.

FAO predicts that high prices will likely continue in 2012 unless there is substantial investment in agriculture.

### **WILL FUTURE INCREASES IN AGRICULTURAL PRODUCTION ADDRESS FOOD PRICE VOLATILITY?**

The demand for food and other agricultural products is continuously growing.

Because of this, some experts believe that the food price volatility that we are experiencing today is actually a signal of a growing lack or scarcity in agricultural products and production. Simply put,

we have to produce enough to adequately meet the world's ever-increasing demand and need for food and agricultural products.

However, other experts believe that future increases in agricultural production will be smaller because the green revolution has already reached the limits of its production potential. In the 1950s, farmers were able to substantially improve their production and get high yields from their farm because they used chemical intensive farming technologies that were introduced to them under government's green revolution program. However, they can no longer get the same level of output from their soil today. They are also finding it hard to further increase their yields and output because of soil degradation and other factors.

The challenge now for many governments is how to increase agricultural production in a way that does not contribute or add to environmental and soil degradation. In the past, there is a tendency to equate efficient and increased production with plantation types of farms. However, more and more people today are recognizing the limitations as well as the environmental dangers of the chemical intensive farming technologies that are used in these types of farms.

Many farmers' groups, like AFA, are advocating for the adoption of sustainable farming technologies as a way of increasing food production in a manner that is sustainable and that significantly reduce contribution to global warming.

### **WHAT ARE THE EFFECTS OF FOOD PRICE VOLATILITY ON FOOD SECURITY?**

Food price volatility heightens food insecurity. When food prices drop unexpectedly, farmers lose income and, consequently, their ability to buy food. On the other hand, when food prices go up, poor families will not be able to buy food. According to the FAO, the 2008 food price crisis pushed 140 million people into hunger. By the end of that year, the number of undernourished people in the world was up to 963 million, from 934 million in 2007

### **BUT DON'T FARMERS BENEFIT WHEN PRICES OF RICE GO UP?**

Farmers often do not benefit from high food prices. In fact, the experiences of AFA members show that, in many cases, farmers were also negatively affected by food price volatility.

For instance, in Cambodia, the Farmer and Nature Net (FNN) reports that farmers produce food but often suffer when food price increases, because they sell their produce early and at a cheap price to middle men and traders who buy and store the produce and wait for price to rise. Most farmers are also not able to keep some of the harvest for their own food consumption.

In Thailand, Sor Kor Por reports that most farmers borrow capital from middlemen and traders, and are forced to sell their harvest to these traders. As such, the traders, and not the farmers, are able to gain from high food prices.

Other AFA members also report that they are not able to benefit from rising food prices because of the high cost of chemical inputs and decreasing farm outputs due to reduced soil fertility. For many farmers, the cost of production is so high that bulk of their income is used up to pay for chemical inputs and other costs.

Moreover, AFA members observe that government imports food during times of high food prices. The entry of imported goods into the market pulls down farm gate prices, resulting to lower incomes for many farmers. At the same time, imported food also competes with locally produced food crops.

Finally, most farmers are also consumers. For instance, rice farmers produce paddy but buy milled rice from the market. Because of this, they are also negatively affected when food prices go up.

### HOW DID GOVERNMENTS RESPOND TO FOOD PRICE VOLATILITY?

Governments tried to respond to food price volatility in different ways. In many cases, they tried to address the problem of rising food prices by importing food and distributing this to the market at a lower or subsidized price. However, as mentioned earlier, increased food importation had the effect of pulling down farm gate prices, which negatively affected small farmers. At the same time, the fact that many countries decided to import food at the same time drove food prices even higher in the international market.

In some countries, government provided price support to make rice more affordable to consumers, but farmers report that the quality of rice provided under these types of programs is very poor and suitable only for animals. People who want to eat better quality rice need to pay

more. The elite in the village are often the only ones who can afford it.

In general, there was a recognition that governments and international institutions were not very well prepared to cope with food price volatility. At the same time, there was a realization that they need to look more closely into how to improve food production and distribution at the national, regional and international levels to ensure that this problem is minimized and effectively addressed in the future.

### WHAT ARE FARMERS DOING TO ADDRESS AND COPE WITH FOOD PRICE VOLATILITY?

Many farmers' groups, including AFA members, are doing a lot of things to help address and cope with food price volatility.

First, they are constantly finding ways to improve agricultural production so that they produce sufficient food for their household and the market, while increasing their incomes and improving their ability to buy food. Many of them are moving away from expensive chemical-based farming, which not only harms the soil, but also drives up their cost of production. They are beginning to adopt and implement sustainable agriculture and farming methods, which help them get good incomes, while restoring the natural productivity of the soil.

Second, some farmers are organizing themselves to form cooperatives, through which they buy, stock and distribute rice and other food and agricultural output. Through these cooperatives, they are able to negotiate for higher prices for their products. It also helps them limit the role of traders and middlemen in the marketing of their harvests, allowing them to earn more from their harvests. Moreover, the stocks in cooperatives also serve as food reserves and give them access to food at affordable prices when food supply is low or when food prices are high.

Some farmers try to earn more from the value chain by selling directly to buyers instead of through many middlemen. In Indonesia, the Aliansi Petani Indonesia (API) has a project, which aims to help farmers connect to the buyer more directly and earn more from their harvest. In Korea, farmers from Korea Advanced Farmers Federation (KAFF) and Women Advanced Farmers Federation (WAFF) also sell directly to consumers by using the internet.

Third, farmers' groups are constantly calling on government to provide them with sufficient support

services, like irrigation, research and technology, extension assistance, and credit, among others, to help them improve their productivity. They understand that the only way to sustainably improve their food production is by having access to these productivity enhancing support services.

Farmers' groups like AFA are also encouraging governments to review their trade policies so that these support local food production. For them trade policies that freely allow food importation even though there is sufficient local food supply discourages food production, which in the long run will have a negative effect on food self-sufficiency.

## HOW CAN THE WORLD MINIMIZE AND ADDRESS FOOD PRICE VOLATILITY?

There are many recommendations on how to address food price volatility both at the national and international level.

At the international level, the HLPE paper on food price volatility has the following recommendations:

### *Slow down and regulate speculation*

As mentioned earlier, the fact that there are many traders who speculate or indicate that they will buy agricultural output even before they are actually produced tends to drive up food prices. There are now proposals to set up strict rules to regulate speculation in order to minimize its impact on food prices. These proposals include requiring transparency in commodity market trading, having a strict oversight mechanism in commodity markets, among many others.

### *Restore confidence in the international trading system*

One of the concerns during the 2008 rice price crisis is that food-exporting countries would not readily sell to countries that have food production shortages. This contributed to greater uncertainty in the world market and further pushed world food prices higher. In Asia, for instance, reports that Thailand and Vietnam are prohibiting rice exports by implementing



export bans or restrictions, drove countries like the Philippines to buy or import rice even at very high prices.

Some experts believe that it is important that countries are able to rely on the international trading system. Countries want to have the assurance that the exporters will not withhold food stocks arbitrarily or without a viable reason, especially during times of food price volatility.

### *Create reserves at the regional and national level*

One of the things being considered to help countries cope with food price volatility is the creation of food reserves. A reserve is a mechanism through which a country commits to allocate or pledge a portion of its food production for use in cases of food emergencies or supply shortages. It can be operated at the regional level where countries in the region make pledges or promise to allocate a certain volume of food for the reserves.

In the region, the Association of Southeast Asian Nations (ASEAN) has the ASEAN Emergency Rice Reserve (AERR), as well as the ASEAN Plus Three Emergency Rice Reserve (APTERR). However, the experience of the 2008 rice price crisis shows that these ASEAN reserve mechanisms did not function very well during times of extreme food price volatility. ASEAN needs to review these mechanisms to improve their efficiency and effectiveness in helping ASEAN Member countries cope with sudden food price changes.

Many civil society groups believe that a good regional and global reserve mechanism should be able to effectively respond to food price volatilities and emergencies. However, it should have enough safeguards to ensure that it is not used as a mechanism through which food exporters dump and trade their excess food products.

### *Invest in agro-ecological agriculture*

One good thing that happened during the food price crisis of 2008 is that it made governments and international policy institutions

realize the importance of investing in agriculture and food production. It also emphasized the current limitation of modern or conventional agricultural production due to climate change and environmental damage and degradation.

Governments are now realizing that they have to invest in agro-ecological agricultural production in order to sustainably attain food security and self-sufficiency. This has been a long-standing advocacy of AFA and other farmers' groups and civil society organizations.

### *Limit the demand for food in developed countries*

As mentioned earlier, the demand for biofuel is one of the many factors that contributed to the rise in food prices. Developed countries such as the US and EU, which consume a lot of fuel, are now demanding for more agricultural output and limited agricultural resources like land and water, not for food, but for energy. There is a need to urge developed countries to revisit their energy policy to ensure that these do not compete with food production.

At the same time, there is a need to encourage and promote judicious food consumption and lifestyles. There is a lot of food wastage in many developed countries and, sometimes, even in urban centers in developing countries. Minimizing, if not eliminating, wastage can help ensure that there is sufficient supply of food.

One way to help achieve this is to promote a more efficient food production and distribution system – one that ensure that food supply is not concentrated in developing countries and in urban and city centers, but is able to reach even the most remote areas in developing countries.

### **HOW CAN COUNTRIES HELP MINIMIZE AND ADDRESS FOOD PRICE VOLATILITY?**

The HLPE paper identified several policies and programs that help countries minimize and address food price volatility. These include price control policies, such as setting a floor or a minimum price for farm gate prices to ensure that farmers get fair returns for their output. It also includes putting a cap or limit on wholesale and retail prices to help consumers buy food at reasonable or affordable prices. Other policies focus on strengthening poor people's access to food, such as through subsidies,

or in some cases, by directly giving cash or food (cash or food transfers) to poor people.

The HLPE paper observes that during times of food price volatility, government reacts by importing more food in order to increase local food supply. However, many farmers believe that this will only be effective in easing food prices in the short term. In the long run, constantly depending on imports to meet production shortfall will discourage farmers from planting food crops, and will have negative effect on a country's capacity to produce enough food for its population.

Governments can help people cope with food price volatility by implementing policies that provide safety nets to groups that are most vulnerable to sudden and unexpected food price changes. This can include targeted food subsidies for poor consumers, and guaranteed farm gate prices and agricultural input subsidies for smallholder farmers, among others. Governments can also help farmers by providing them with risk-coping financial products, such as weather-based insurance, in light of climate change and its negative impact on smallholder agriculture in the region.

### **WHAT CAN FARMERS DO TO ADDRESS AND PREPARE FOR FOOD PRICE VOLATILITY?**

FAO predicts that there will be continued food price volatility ahead. Farmers need to be able to help find solutions and prepare to address this problem. Farmers' groups like AFA are already undertaking a lot of initiatives and using a broad range of interventions towards this end. These interventions can generally be grouped into two.

The first set of interventions focuses on organizing and empowering farmers. This includes:

- Building farmers' capabilities to improve food production and incomes by adopting sustainable farming methods - securing land rights, crop diversification, alternative pest management, seed banks, food banks, local food storage, water management, agro-ecology practices;
- Empowering them to have a greater role in the value chain, especially in gaining control over how, when and where to market their products - food banks, local food storage, value addition of their products (community based food processing);

- Organizing themselves into cooperatives and associations that can effectively negotiate with suppliers and traders and enable them to secure better prices and terms for their harvests – direct farmer-consumer relationships, direct selling and buying, establishing cooperative shops.

The other set of interventions focuses on pushing for national and global policies that can help small women and men farmers improve food production. This includes:

- Greater public investment in sustainable agriculture as a way of increasing farmers' productivity and incomes, and improving their resilience to climate change; farmers are proposing that government spending for agriculture should account for at least 10% of the national budget;
- Trade policies that support and encourage domestic food production and consumption; food production to meet domestic needs must be prioritized over cash crop production for exports; similarly, developing countries must push for greater trade policy space and resist IFI and WTO conditions to unconditionally open agricultural markets to imports;
- Review of policies related to biofuel production in light of its possible impacts on food production;
- Support the creation of local, national and regional food reserves as well as food banks; in Southeast Asia, ASEAN must review the APTERR, in consultation with regional civil society groups, with the end in view of making it operational and effective in helping ASEAN Member States cope with food price volatility;
- Policies that stop land grabbing and instead support the redistribution of lands to small men and women farmers who can use it to grow food;
- Policies aimed at helping small men and women farmers gain access to other productive assets such as land, seed, water, farm inputs, credit, social insurance, research and extension support, basic infrastructure, storage and transportation, among others;
- Adoption and implementation of land use policies that promote sustainable land resource use management;
- Public investment in climate change mitigation and adaptation, as well as in watershed management, development and rehabilitation;
- Maximizing the use of traditional farming systems, especially in determining agricultural research targets; this will require combining the best of ecological science with on-the-ground farmer knowledge to encourage practices that reduce costly inputs, produce higher yields, and increase farm incomes;
- Curbing of financial speculation especially in food commodities, through compulsory registration of traders in commodity futures, setting position limits on individual holdings and banning institutional investors from commodity index trading.

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