Food prices, poverty and development:

Underlying factors and policy response

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Underlying factors of particular relevance to poverty and development

1. Underinvestment in developing country agriculture

2. Market imperfections
   - financial/futures markets
   - market concentration
   - asymmetrical bargaining power

Underinvestment in developing country agricultural sectors

- Historically, investment in agriculture, growth in agricultural productivity, and gradually rising farm incomes has led to accumulation of capital and increased domestic demand. Together, these factors underpinned investment and consumption of goods produced by other sectors and increasing diversification (18^{th} and 19^{th} c. in West, 20^{th} c. in Asia)

Underinvestment in developing country agricultural sectors

- Today's poor countries and their donors turned away from this proven development path and adopted strategies inappropriate to their stage of development

- Export-oriented development
  - Specialize in "high value" export crops, industrial goods

- Import food from global markets

Underinvestment in developing country agricultural sectors

- This was justified (by World Bank, IMF, donors, national governments) based on low global prices for food commodities, need for foreign exchange

- Flawed analysis and strategy:
  - Fallacy of composition: if many countries enter market, prices fall (e.g., coffee, cut flowers, apparel)
  - Subsidies and protection by wealthy countries
  - Thinness of global food markets

Underinvestment in developing country agricultural sectors: results

- 30 years of failure to invest in agriculture by many developing countries and donors
  - 18% of ODA to agriculture in 1978; 3% today

- As a result, many countries with surplus arable land and surplus unskilled labor are today net food importers
  - Harmful to their poor, BOP, etc.
  - Harmful to all: reduces global food supply

Market imperfections

- Financial markets: commodities futures markets, land markets, etc.
  - Overshooting
  - Asset bubbles
  - Current financial crisis likely to exaggerate effects in agriculture-related markets

- Implication: food price volatility likely to increase in future

Other market imperfections

- Market concentration at global level: strategic behavior to gain market share; price manipulation

- Asymmetrical bargaining power, knowledge, capacity
  – Collectors, intermediaries in poor countries can pass price declines to farmers, retain profits from price increases

Policy implications

- Countries at early stages of structural transformation (from agriculture to other sectors) should be encouraged to produce food for domestic/regional consumption

- Investment in agriculture (irrigation, roads to market, extension services, research, etc.) in developing countries should be made a priority by donors and national governments

Policy implications, continued

- Developing country governments should create policy tools to address domestic agricultural market imperfections (e.g., regulation of intermediaries or direct role for government in credit, marketing)

- Governments should ensure adequate remuneration and some price stability to farmers to elicit greater food production and greater investment to increase agricultural productivity (e.g., minimum price support)

Policy implications, continued

- For some low income countries, the only tools available to ensure adequate remuneration and price stability may be tariffs and other border measures (issues in Doha Round)

- Today's trade policy regimes must leave adequate policy space for developing countries to use agriculture as an engine for development, as did the West and Asia in previous centuries