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COMMITTEE ON FINANCIAL SERVICES

Hearing on Contributing Factors and International Responses to the Global Food Crisis
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Thank you Chairman Frank, Congressman Bachus and distinguished members of the committee for inviting me to participate in today's hearing.

There is a saying that "there are only seven meals between civilization and anarchy." The riots and social unrest around the world bear witness to this saying.

The severity of the global food crisis is undeniable. As the chart shows, prices of major commodities have increased substantially over the last three years, and especially, in the last few months. According to the World Bank, about 100 million people might be thrown back into the ranks of the poor because of these price rises (see chart attached). There have been riots in a number of countries, and the Bank has identified 33 as especially vulnerable. The poor are especially vulnerable because they spend the largest portions of their income on food. For example, in Nigeria, about 70 percent of income is spent on food, 75 percent in Vietnam, and 50 percent in Indonesia compared with 12 percent in the United States (though that figure is also now on the rise).

Unfortunately, pressure on food supplies, and associated high food prices, are likely to be a medium- to long-term reality because some of the driving factors— rising prosperity in the developing world which creates more demand, high fuel prices, stagnant agricultural productivity, and climate-change induced pressure on agricultural supplies —are also of a durable nature. That recognition is important because as the world and the especially the U.S. forge their response, there will be need for actions in the short, medium and long runs.

In my testimony, I will spell out what I think are the essentials of a comprehensive U.S. and international policy response to the crisis for each of these time frames, highlighting how enlightened U.S. leadership can make a difference to the problem we now face.

Short run

The immediate humanitarian imperative is to get food quickly and cheaply to the hardest hit parts of the world, and recent events in Myanmar are yet another grim reminder of this imperative. Preventing the loss of economic security, especially in vulnerable countries such as Egypt, Somalia, and Indonesia, is in the long-term U.S. interest.

President Bush announced two weeks ago additional funding for food aid of about $770 million for fiscal year 2009. This is in addition to the previously released $200 million worth of stocks from the Bill Emerson Humanitarian Trust and the administration has asked Congress for additional funding for this year. These are excellent initiatives, affirming U.S. leadership and commitment to responding expeditiously to international crises. But this could be complemented by two additional steps.

First, my colleague Peter Timmer of the Center for Global Development (CGD) and Tom Slayton have another excellent proposal which would help the rice market and hence millions of poor and hungry in Asia, which still accounts for the bulk of the world's poor

and where rice is the staple of the diet (http://www.cgdev.org/content/publications/detail/16028/ for full proposal). The rice market has essentially seized up because three major exporters Thailand, India, and Vietnam have either imposed export restrictions or are struggling to export. More food aid simply cannot resolve this problem. But Washington can take immediate action by exerting leadership to get new rice supplies, specifically from Japan and China, to the world market.

How can this be done? Japan has large stocks of rice (about 1.5 million tons) based on its WTO obligation to import rice. These stocks are not sold domestically; instead they are allowed to decay and then used as livestock feed. Last year about 400,000 tons of rice was disposed in this manner. WTO obligations prevent Japan from re-exporting this rice. But the U.S. can relieve Japan of these obligations which would allow Japan to sell its stocks commercially or as aid; food that is fed to animals could easily be used to feed starving people. This could also be a grand gesture ahead of Japan's G8 summit in July.

In addition to the release of Japan's rice stocks, China could get some badly needed good publicity by also taking a leadership role in this crisis. Beijing is holding rice stocks equal to at least four months of domestic consumption. Just as China helped stabilize the world rice market from 1973 to 1975 during the worst rice crisis ever, China could do so again now without repercussions on its own inflation rate. Alternatively, China could launch its own food aid program to help the world's poor and could call it "Olympic Rice", and could even make their first donation to Myanmar.

Second, on food aid, the U.S. can easily increase its assistance—by up to 50 percent—without providing any additional money. All it needs to do is to eliminate the current requirement that food be sourced from the U.S. My colleague, Kim Elliott of CGD (http://www.cgdev.org/content/publications/detail/11567) has noted that every dollar of food aid could go much further if the tying requirement is eliminated (just from the saving in increased shipping and distribution costs). That would mean feeding an extra million children annually from President Bush's recent food aid authorization without extra financial contributions.[1]

Tying food aid not only reduces the effectiveness of U.S. efforts, it also undermines its soft power because U.S. generosity is obscured by the perception that food aid is unduly influenced by considerations other than humanitarian ones. In this connection, I would like to draw your attention to the table in my written testimony (drawing upon the work done by my CGD colleague David Roodman, who compiles the Commitment to Development Index (CDI) which ranks donor behavior) which shows that the U.S. is almost unique (apart from Canada) in the practice and magnitude of tying food aid.

[1] The World Food Program estimates that it takes 25 cents to fill one of the "Red Cups" that it uses to give hungry children a regular school meal of porridge, rice or beans. Three meals a day for a year then costs about $275. If the recent authorization of $770 million can go say another 40 percent without tying that would mean food for about 1.1 million additional people annually.

The two proposals relating to rice and untying food aid will encounter resistance from farm interests. But in the current context, farming interests will not be sacrificed for a simple reason: at this moment, we are in a supplier's market and farmers face little competition. A lot of the food will, in any case, have to be sourced from the U.S. in this environment of scarcity, as Josette Sheeran, Director of the World Food Program pointed out in a speech at the Peterson Institute. This is an excellent time to eliminate the tying requirement. Why not reap the commercial benefits without the tying requirement, which as I noted earlier reduces the dollar value of U.S. contributions and also entails reputational costs for the U.S.?

Medium run

To boost agricultural supply in the medium run, we need to fix the incentives facing agriculture globally. That in turn means efficient and food-friendly trade policies around the world. But not only are we far away from that objective, we are moving in the wrong direction.

In the U.S., the combination of the Renewable Fuels Standard (the ethanol mandates), the blenders' tax credit, and tariffs on imported Brazilian ethanol have diverted land, especially from wheat and soya bean production, and contributed to food price increases. Estimates vary on the magnitude of this contribution (one estimate by Professor Babcock of Iowa State University says that eliminating all three of these measures would reduce prices by 16 percent, while another by the International Food Policy Research Institute (IFPRI) suggests that a moratorium on biofuel production in developed countries through 2008 would ease corn prices by 20 percent and wheat prices by 10 percent), but as I will explain below, the question of exactly how much is less important than the fact that these three policies contribute to food price rises.

Meanwhile in the developing world, tightened restrictions on exports of foodstuffs are obstructing a long-term solution, even as import barriers come tumbling down (see the World Bank's study available at http://siteresources.worldbank.org/NEWS/Resources/risingfoodprices_chart_apr08.pdf which shows that about 18 developing countries have imposed some form of export restrictions in the current crisis). Each country is trying to keep domestic supplies high on the justifiable grounds of food security (and WTO rules do allow such restrictions). But export bans hold prices artificially low and keep the market from sending accurate demand signals to domestic farmers. This penalizes farmers, who can't get the full world price for their produce. That impairs efficiency, and undermines the incentives for investments that can increase long-term supply. Topping it all off, such measures subsidize high-income households, not just the poor.

Moreover, as more countries implement export controls, global supply contracts even further, pushing prices up. In ongoing research with Maros Ivanic, Will Martin and Aaditya Mattoo, we estimate that world prices go up substantially—up to 20 percent—due to export restrictions, with effects particularly harmful in the case of rice.

I would like to make a few general comments about trade and economic incentives. First, U.S. policies related to ethanol. There is a big debate about the contribution that they make toward raising food prices. The range of estimates will vary and we will never know the precise magnitudes. But that should not come in the way of action. We can be confident that eliminating or reducing the distortions generated by the ethanol program will help dampen food prices. Moreover, these policies are one of the few factors responsible for the crisis that we can control—more than we can control climactic factors that affect supply or the increased demand due to prosperity in the developing world. We need to act on the few things that U.S. policy-makers can control and eliminating or reducing the ethanol program is one policy lever we have.

Moreover, the ethanol issue should be seen not from the narrow perspective of its contribution to food but from two broader perspectives. With oil prices at US$126 a barrel, the market by itself is providing a lot of help and incentives for ethanol production. There seems little need for additional help and incentives at taxpayers' expense.

Furthermore, while ethanol interventions originally had good motivations (reducing dependence on fossil fuels and imported fuels), they have led to some unintended consequences that are now becoming evident. The question now from an environmental perspective is this: insofar as the U.S. government needs to provide incentives for the search for alternatives to fossil fuels, why favor one particular alternative, namely ethanol (which, according to experts is not even the most environmentally efficient one)? Why not level the playing field so that all new avenues, all potentially new ideas have a good shot at being explored and discovered? In other words, eliminating all the assistance to ethanol-based biofuels and providing broad-based incentives for alternative fuel research and production might be better food policy *and* better environmental policy. The aim of policy should not be to "pick" winners but to find winners.

Second, on the trading system, Nancy Birdsall, president of CGD, and I have argued that we need a new global compact on agricultural trade (http://www.petersoninstitute.org/publications/opeds/oped.cfm?ResearchID=921). Note how we have ended up having the worst of all possible worlds. Under normal agricultural conditions, we have huge distortions in terms of costly taxpayer support to reduce imports and encourage production and exports. Under abnormal conditions, such as we are seeing now, we see the opposite where countries liberalize their imports but prevent exports. We need a system where *both* imports and exports remain free to flow in good times *and* bad. This is especially important if trade is to remain a reliable avenue for food security. If in bad times, importing countries are subject to the export-restricting actions of producing countries, they will consider trade an unreliable way of maintaining food security and will reconsider how to manage their agriculture; there will be a greater temptation to move toward more self-reliance as insurance against the bad times; this is exactly what the European Union (EU) agriculture minister had in mind when he recently said that vulnerable African countries should think of emulating the EU's policies to attain greater self-reliance in agriculture. And if in good times, exporting countries cannot

have access to markets because of import barriers and other subsidies, they will be reluctant to give up the right to restrict exports during bad times.

Unfortunately, the ongoing Doha Round of trade negotiations won't on its own address these problems. And that's not just due to the poor prospects for completing these negotiations in the current environment. The round has been devoted to traditional forms of agricultural protection—trade barriers in the importing countries and subsidies to food production in producing countries—which are becoming now less important as food prices have soared and import barriers have declined. We need to enlarge the trade agenda so that biofuels more broadly (including the European Union's biodiesel policies), and all trade barriers, import and export, are put on the trade agenda. The United States has a key role to play in bringing all countries—industrial and developing—together, so that comprehensive and sensible policies that are good both for trade and for food can be negotiated. A key point here is that there is need for collective action: each exporting country is acting rationally but they must collectively desist and somebody, clearly the U.S., must lead the international effort to bring about collective agreement.

Long run

If there is one positive fallout from this current crisis it is to bring agriculture, which has long-suffered from inattention, back into focus. For example, in 1980, 30 percent of annual World Bank lending went to agricultural projects, but this declined to 12 percent in 2007. The overall proportion of all Official Development Assistance going to agriculture is currently only 4 percent (see http://siteresources.worldbank.org/NEWS/Resources/risingfoodprices_backgroundnote_apr08.pdf). In response to the recent crisis, the World Bank has recently announced that it will nearly double its lending to agriculture to about $800 million over the next few years.

If there is one valuable contribution that the U.S. and international community can make, in addition to providing greater finance for agricultural projects in developing countries, it is to go on a war footing to engineer a new green revolution, particularly in and for Africa. Africa has not had technological productivity improvements in agriculture to the extent that Asia and Latin America have had. The green revolution was the result of agricultural research done by Nobel Peace Prize laureate Norman Borlaug and others with the assistance of the Ford and Rockefeller Foundations. According to the *World Development Report 2008*, investment in agricultural research "has paid off handsomely," delivering an average rate of return of 43 percent in 700 projects evaluated in developing countries.

Today, we need similar initiatives both in the public and private sectors. Private sector initiatives alone will not be enough to generate research for African agriculture because of the limited purchasing power in Africa. If markets are small, returns are correspondingly small, reducing the incentives for private sector research. Nancy Birdsall and I have argued that (http://www.cgdev.org/content/publications/detail/14625) the international community, under the leadership of the U.S. and the World Bank, needs to fund more such research in

African agriculture. The international consortium of agricultural research under the aegis of the Consultative Group on International Agricultural Research (CGIAR) needs to be revitalized and provided with extra funding. For example, Monsanto, the private corporation that is a major player in agriculture, spends about $700 million on R&D compared with total spending by the international public agricultural research institutes of only about $100 million (of which less than $20 million is spent on agricultural research for Africa). One possibility would be for the World Bank to devote substantially more financial resources for CGIAR as well as to strengthen its capability more broadly to assist agricultural research in and for the poorest countries.

Of course, the recent crisis has also made clear that food prices are now inextricably linked to fuel prices. Higher fuel prices add to the cost of agricultural production. More importantly, they increase the attractiveness of diverting land and agricultural products toward producing fuel. With grain used for fuel rather than for human consumption, food is now fodder for fuel. Any long-run strategy to increase food supplies will need to include action to reducing dependence on fossil fuels.

Conclusion

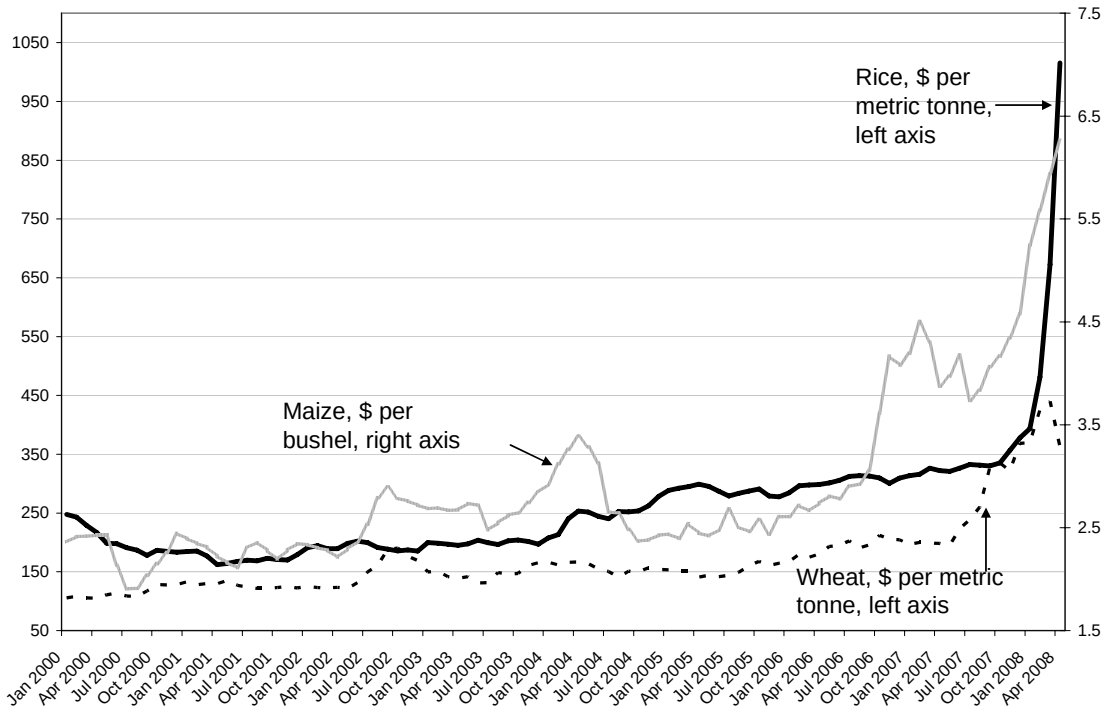
In conclusion, the U.S. can make an important contribution to the current food crisis. In the short run, the U.S. should make aid available faster, allow Japan to re-export its rice, and eliminate the tying of food aid. In the medium run, it should get all countries together in the WTO to eliminate all the distortions in agriculture and agricultural trade, including its own biofuels program, replacing it with policies that can find winners rather than pick winners. And, in the long run, it should revitalize the organizational and financial effort to boost agricultural research and productivity in developing countries, especially Africa.

Table 1: Tied Food Aid Commitments by Donor (as % of total food aid)

Donor name	*2005*	*2006*
Australia	25%	0%
Austria	0%	0%
Belgium	0%	
Canada		100%
Denmark	0%	0%
EC	0%	0%
Finland		
France		0%
Germany	25%	25%
Greece	0%	0%
Ireland	0%	0%
Japan	0%	0%
Luxembourg	0%	0%
Netherlands	0%	0%
New Zealand	0%	0%
Norway	0%	0%
Portugal		
Spain	0%	0%
Sweden	0%	0%
Switzerland		
United Kingdom	0%	0%
United States	88%	69%

Source: OECD's DAC CRS Database
The completeness of reporting to DAC varies by country and there is no auditing or enforcement
Zero values could refer to no tying or no reporting of tying

Chart. Prices of Three Major Commodities, 2000-April 2008



Source: International Monetary Fund's, *World Economic Outlook.*