



**A FOOD IMPORT COMPENSATION MECHANISM:  
A MODEST PROPOSAL TO REDUCE FOOD PRICE EFFECTS ON  
POOR COUNTRIES**

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## **A Food Import Compensation Mechanism:**

### **A Modest Proposal to Reduce Food Price Effects on Poor Countries**

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#### **Abstract**

Much higher food prices are putting the health and lives of the world's poorest at severe risk. This paper proposes a mechanism to compensate for the effects of higher import prices on the poor, which can be implemented immediately. Help against hunger must be without conditions. Historical experience suggests that in order to avoid undue conditionality creeping in, any meaningful compensation mechanism must be based at the UN, rather than the Bretton Woods institutions or any other organization dominated by the North. Finally, to emulate a successful feature of the Marshall Plan, self-monitoring by recipients preparing and implementing anti-hunger programs is proposed.

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High food prices have created grave problems for the poor. According to the World Food Programme (WFP), the “phenomenon is affecting everybody on the planet, but the poor and hungry are on the front line” (WFP 2008). The report quotes “[T]op international experts”, according to whom, “millions of people are being pushed deeper into poverty and hunger by high food prices. According to the World Bank, the number is at least 100 million. WFP’s research indicates that it could be as high as 130 million.”

It further notes that “approximately 1 billion people still live on less than US\$ 1 dollar a day, the threshold defined by the international community as absolute poverty, below which survival is in question”. Dramatic increases in food prices — on average, 54 per cent over the last year, cereal prices — have also affected aid programmes. Over the first four months of 2008, the WFP paid an average of US\$430 per metric ton of wheat, compared with US\$207 for the same period in 2007 — an increase of 108 per cent.

Obviously, the poor in the South have been much more seriously affected than the poor in the North. Social safety nets are better in the North. But more importantly, the poor in the South are much poorer than the poor in the North. Poor households spend a larger percentage of their income on food than richer ones. In developed countries, 10 to 20 per cent of income is spent on food, but in many poor countries, food expenditures make up 60 to 80 per cent of household budgets (WFP 2008). Moreover, the savings rate of the poor is either zero or close to zero, which means that they have financial reserves to draw from to cover increased expenditures, even if price increases are temporary. In some countries in the South, liberalization has reduced government revenues substantially, and debt servicing remains a substantial budgetary item, making government intervention to cushion price effects hard to finance.

Soaring food prices also affect the Millennium Development Goals (MDGs) drawn from the UN Millennium Declaration in 2000 agreed to by UN member states. Goal 1 (Eradicating extreme poverty and hunger) is most directly affected. The prevalence of underweight children under five years of age and the proportion of the population below minimum level of dietary energy consumption are bound to increase — instead of decreasing as stipulated by the first, and arguably most important MDG. For young children, the lack of food can be perilous since it retards their physical and mental development and threatens their very survival.

Recognizing the urgency and seriousness of the situation, the United Nations Secretary General announced the creation of a UN Task Force working with donor and recipient governments in order to find a solution. ECOSOC held a special session on the global food crisis to search for appropriate responses to the crisis. The UN Secretary General, Ban Ki-moon, informed the UN Conference on world food security in Rome in June 2008 that over 850 million people were short of food even before the present crisis began.

The UN’s *Millennium Development Goals Report 2005* (UN 2005: 6) indicated some progress against hunger, but slow growth of agricultural output and an expanding population have not helped. Since 1990, millions more people have been chronically hungry in sub-Saharan Africa and Southern Asia, where half the children under five are malnourished. In all developing countries, more than a quarter of children under age 5 are “malnourished” (UN 2005: 6). To get food, the poor increase their spending on food, which means they have less money left for other expenditures. High food prices thus also put the other MDGs at risk. Money available to pay school fees — as encouraged under structural adjustment programs — may no longer be available after food expenditures increase. Avoiding starvation may require foregoing education or health.

There is unanimous agreement that food scarcity per se is not the cause of the problem. Food is available, but the poor simply cannot afford to buy it. At the Rome Conference, the IMF Managing Director pointed out that “it was important to know that it was not a global food shortage: ‘In fact, there is enough food to feed the world’, he stated” (IMF 2008). Strauss-Khan identified the upsurge of prices as the reason and proposed that “we need to get food — the money to buy food — to those most in need”. This puts both problem and solution into a nutshell. It also highlights the importance of thinking how such purchases should and can be financed. The WFP (2008) agrees: “It is not a matter of availability, as we would see in a drought-like situation. It is about accessibility and it’s especially impacting populations who are reliant on the markets.”

The UN Secretary General (2008a: 10) pointed out that 55 per cent of developing countries are net food importers and almost all countries in Africa are now net importers of cereals: “According to FAO, the total cost of food imports for low-income food-deficit countries was 24 per cent higher in 2007 than in 2006, having risen to \$107 billion, more than twice the bill in 2000. The terms-of-trade losses have amounted to 0.5 per cent of GDP in low-income countries since the end of 2004. In 29 countries, those losses have amounted to 1 per cent of GDP and to nearly 5 per cent of GDP in the most-affected country.” Of the 50 least developed countries (LDCs), 47 are classified by the FAO as low-income, food-deficit countries, and 20 as countries in food crisis. According to the FAO, food imports presently account for 35 per cent of calorie intake in these countries, and higher food prices mean that poor households spend about 70 per cent of their income on food (UN Secretary General 2008c: 5). Compensating for the effects of more expensive food imports is therefore strongly recommended, and would have perceptible positive effects on many poor people.

The first MDG seek to halve the proportion of people living on less than a dollar a day and the proportion of people who suffer from hunger. These targets were formulated before the present food crisis, but even then, the task of totally eradicating hunger was not seen as realistic. However, even this less ambitious goal is less likely to be reached now. The Millennium Declaration promises: “We will spare no effort to free our fellow men, women and children from the abject and dehumanizing conditions of extreme poverty ... we are committed to making the right to development a reality for everyone and to freeing the entire human race from want.”

Along these lines, I propose a measure to reduce the impact of the present food crisis on the poor, through a *Food Import Compensation Mechanism* (FICM) by helping net food-importing poor countries maintain their pre-crisis levels of food imports. This paper:

1. outlines the basic features of the proposed FICM;
2. draws from past compensation schemes in order to incorporate appropriate features;
3. argues that FICM must be administered by the UN, e.g. by the World Food Programme (WFP), to avoid its abuse as means to impose undue conditionality;
4. shows that the negative effects of higher food prices on developing country net food importers had been expected as a result of trade liberalization under the WTO. Liberalizing further — as recommended by some — is no solution.

The food crisis and its consequences would have been much less pronounced if countermeasures against expected price increases had been implemented in time. Higher food prices demand some form of compensation scheme, particularly for highly indebted net importers and for LDCs — as promised to developing countries before signing the Uruguay Round agreement at Marrakesh — but denied to them after signature.

## **A Food Import Compensation Mechanism**

The mechanism described in this paper draws on a model initially proposed by Raffer (1997) as a meaningful way of implementing measures to compensate the WTO's possible negative effects on net food importing developing countries, as stipulated by Article 16 of the Agreement on Agriculture, and recognized by the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries (NFIDCs). However, compensation was ultimately denied to this group after they had signed the treaties. The Decision recognized "negative effects in terms of the availability of adequate supplies of basic foodstuffs from external sources on reasonable terms and conditions, including short term difficulties in financing normal levels of commercial imports of basic foodstuffs."

While this formulation referred to the lop-sided liberalization under the Uruguay Round it also describes the present situation quite well, even though doubtfully these effects are only short term. Obviously, implementing measures against expected price hikes in a meaningful way years ago under the WTO umbrella might, at least, have cushioned the present crisis, if not given greater protection to the poor. There was ample time to design and implement appropriate remedies, time that was not used — an omission for which the poorest now have to suffer.

The mechanism proposed here is a Food Import Compensation Mechanism (FICM) to differentiate this proposal to alleviate the present food crisis from the WTO-administered Food Import Facility (Raffer 1997). In light of the severity of the crisis and the large number of countries affected, changes to the initial model — drafted for a less severe situation — are made. In particular, this compensation mechanism must not be implemented under the umbrella of the WTO or the Bretton Woods Institutions. It is crucial that a different organization administers the FICM — another reason to give it a distinct name.

### ***Formulas to Calculate Compensation***

There are several ways to calculate compensation. This section does not present one formula as the only possible option, but considers three modes of calculating compensation as well as their effects. First, one can compensate the reduction in the quantity of food, for which the price has risen, which means

$$\text{Transfers} = (q_b - q_i) \tag{1}$$

The indices b and i indicate the quantities imported during the year(s) before and after the change respectively. Naturally,  $q_b$  could also be the average of several years, as in the concept of the base period in the Agreement on Agriculture, or as stipulated by the Lomé Treaties for Stabex, where export revenue (not import cost) compensation was stipulated as measured by the difference between the year in question and the moving average of the four years before the shortfall. Compensating  $(q_b - q_i)$  in kind — quantities of food — would be one possibility to ensure that the same amount of food remains available as long as demand functions have the usual properties. It is particularly useful for regions where food production falls well short of the food necessary to safeguard human wellbeing. Theoretically, this is not an elegant solution, because observed changes in quantities may result from factors other than prices as well requiring compensation higher than for price effects alone. However, when helping the hungry, one should be on the safe side of caution.



Variant (1) has drawbacks. Keeping the imported quantity constant, it does not compensate for the additional resources needed for actual commercial imports at higher prices: the sum of  $q_i(p_i - p_b)$  would go uncompensated, remaining a burden on poor economies. If demand were highly inelastic — as microeconomics supposes with good reason in the case of food — quantity reductions would be low, but the additional financial burden would be high. Thus, the reduction in quantity would be compensated for in kind, but the higher costs of providing  $q_i$  would remain to be covered by the poor country. No compensation would be paid whenever  $q_i$  increases beyond  $q_b$ , for instance because of a drought or other natural disasters affecting domestic production. In a Giffen case, transfers would be reduced or excluded. Unfortunately, this case is not unlikely when it comes to cheap staple foods. Unable to afford any other more expensive food, the poorest may increase their demand for what is still the relatively cheapest product — after a general increase in food prices — although its price has risen too. This would result in higher quantities bought at higher prices, or  $q_i > q_b$ . No support would be triggered.

To fight hunger, compensating for price increases is needed, particularly in the case of inelastic demand. To do so, transfers could be either

$$\text{Transfers} = q_b (p_i - p_b) \quad (2)$$

which is the price difference times the quantity of the base year(s), or

$$\text{Transfers} = q_i (p_i - p_b) \quad (3)$$

multiplied by current quantity.

Both variants accept the advantage that price differences are easier to determine than changes in quantity due to price changes. No transfers arise when the price falls below that of the base period, which is not necessarily so in case (1), but absolutely in line with the intention to protect against price increases. The Giffen case problem discussed above would be excluded by variant (3).

Variant (2) implies freezing compensation at quantities imported at time (period) b. With population growth, this would soon cause problems. Also, it may reduce incentives to increase domestic production. Like (1), it cannot react properly when imports increase beyond  $q_b$  due to natural or human disasters. Equation (3) would do well in this respect, but produce transfers too low in the normal case of downward sloping demand curves, where higher prices reduce  $q_i$  and thus transfers. Net importers would get no compensation though they cannot afford to import as much as before. The quantity of food available domestically would be reduced. The main goal of the mechanism — to guarantee the pre-crisis level of food available to the country — would be thwarted.

Assuming that increased imports because of disasters would usually be covered by emergency aid anyway (easily distinguishable from “normal”, non-emergency imports in a country’s statistics), one could prefer (2). In that case,  $q$  would be the quantity of non-emergency imports. A safer and more generous solution would be to use (2) when  $q_i < q_b$ , but (3) whenever  $q_i > q_b$ . This switch would facilitate reaching MDG 1. As rich countries have also committed themselves to sparing no effort to fight hunger, they bear the cost.

The administrator(s) of FICM should have the authority to switch from one formula to the other in order to adapt actually paid compensation to circumstances, including the authority to chose variant (1) where and if advised. Such decisions should be based on facts and the criterion of need. At present, data on poverty and deprivation, as well as experience

of anti-poverty programmes exist. Assessing needs and using this criterion should not pose too great difficulties.

The only requirement for disbursements should be proven facts, i.e. presenting statistics proving that import costs had indeed increased as calculated by the formula chosen by the administrator — or in the case of variant 1 that import quantities had indeed decreased — a purely statistical exercise. Such automatism, as proposed for FICM beneficiaries, has worked. There is a historical precedent. Automatic compensation in favour of a group of developing countries existed and worked, although it was rolled back and finally abolished in recent decades. As the reason for disbursement is to help the hungry, FICM should work like an insurance scheme. Documented shortfalls are to be compensated. Conditionality must not creep in, as it has with the IMF's Compensatory Financing Facility (CFF) or the Stabex compensation scheme, described below.

### ***Grants, Rather than Loans, and Self-Monitoring***

Disbursements should preferably be grants, especially so in the case of very poor countries. Using existing facilities of the Bretton Woods Institutions is not an economically sensible alternative — with the possible exception of International Development Association (IDA) grants as far as financial terms are concerned. However, in the case of emergencies there must not be any commitment charge, a condition presently satisfied by the IDA for grants, although up to 0.5 per cent may be taken off as a front end fee if Executive Directors set the level that high. However, IDA's conditionality would disqualify this option, as is argued below. Since the Bretton Woods Institutions are again eager to lend money for financing anti-food-crisis actions this must be stressed. Financing expensive food imports by increased borrowing is not good advice to debt-ridden countries, especially if they are already unable to service debts on time and are amassing huge arrears. Multilateral loans require that consumption be financed by loans carrying interest. Even at IDA-conditions this still means 0.75 per cent a year in hard currency that countries have to earn, as well as up-front commitment charges of 10 basis points at present. In the case of heavily debt-ridden, poor countries even such soft loans increase the debt overhang —presenting a recipe for disaster. New multilateral loans for consumption, which increase the debt overhang, will not alleviate this problem. They will become part of unpayable debt burdens that have to be reduced eventually. This might be different in the case of loans to finance long term improvements in agriculture although these are not “problem-free” either. Regarding poor countries, if and as these loans increase domestic production, the conversion of domestic currency into the foreign exchange needed for repayment may be a problem unless all or a substantial part of this increase is exported.

In spite of debt relief initiatives so far: “Many beneficiaries of the debt initiatives are still perceived, however, as being at high risk of incurring renewed unsustainable debt” (UN Secretary General 2008b: 6). Therefore, the UN Secretary General's Report (2008b: 28) recommends “Providing additional assistance solely through concessional financial flows for countries, including least developed countries at high risk of incurring unsustainable debt levels, and developing a uniform agreed definition of concessionalality”.

In this situation new loans to buy food are not advisable. Disbursements must either be grants or — at worst — grants or loans that are dependant upon the development stage of the country entitled to receive transfers. Loans, if any, should carry no interest, as in the Stabex compensation scheme under Lomé I, so as not to overburden countries that already have debt problems or are likely to acquire them, as is usually the case for poor countries.

As a measure against the abuse of funds, recipients themselves could monitor their use in the way the US allowed self-monitoring by recipients under its Marshall Plan, a generous program that included a substantial amount of food aid. A unique feature of the Marshall Plan was that recipients were allowed to monitor each other, something unthinkable so far in the North-South context, in spite of the undisputed success of the Marshall Plan and its procedures.

In 1948, recipients of Marshall Plan aid signed the convention establishing the Organization for European Economic Co-operation (OEEC), which was reconstituted as the OECD at the beginning of the 1960s. The OEEC served as a monitoring agency for Marshall aid recipients. Europeans were encouraged by the US to monitor one another's performance, and "the heavy hand of the US government was kept out of it" (Streeten 1994: 126). Each Western European government submitted a plan which was inspected, vetted and monitored by other European recipient governments in the OEEC. Streeten does not fail to point out that "Control by peers rather than superior supervisors is also a principle advocated in business management". This successful precedent should be copied (cf. also Raffer and Singer 1996: 197f). There is no reason why it could not be implemented in the case of food aid within appropriate country groups. These groups would approach the administering organization(s), demanding resources for action plans the beneficiaries have agreed on. There is even less reason why it should not be worth trying.

### ***Protecting Domestic Food Production***

To avoid damaging domestic food production, imported food must not simply be given away free of charge to people in general. It could be distributed free of charge to specifically defined groups that lack the purchasing power to buy domestic produce. Direct payments to poor households might be an option in some countries, while some other forms of targeting might be necessary in others. This can be financed by the revenues from selling imported food inside the country. Since Structural Adjustment took the U-turn of including direct measures for the poor in the late 1980s, a lot of experience has surely been gathered. If food received as an international grant is sold on the domestic market, funds in domestic currency accumulate. Any money left can be used for several purposes. This money can either subsidize the poorest households, enabling them to cover their food needs at prices that will not ruin domestic production, or it can be used to subsidize domestic production directly. Transfers compensating the negative effects of price increases can be used to increase domestic food production, in line with official intentions. WTO rules allow not only food security or regional assistance programs but a range of other subsidized activities (Raffer 1995). LDCs could invoke Article 15(2) of the Agreement on Agriculture. Resources that accumulate under a program of selling imports could finance improvements in production, including infrastructure, which is particularly bad in some poor countries and has decayed further due to debt management's slimming down of government activities and cutting down on public infrastructural expenditures. However, direct help to the starving must have absolute preference over accumulating counterpart fund resources, useful though they might be.

### **Illustrating Rough Financial Dimensions**

How much such a scheme would cost is a difficult question to answer. To do so one would need recent data on import quantities of all net food importing poor countries considered eligible for compensation. Also, the precise sum obviously depends on the base year(s)

chosen by those establishing FICM. The further back this year — or the period for which the average is calculated as the basis — the more expensive FICM becomes. Finally, the question as to what would be considered food for which price changes are to be covered determines the outcome. “Eligible food” might be some basic staples or a longer list of products.

The choice of the base year(s) — the decision up to which level price increases should go uncompensated — is of utmost importance. Table 1 shows the recent food price evolution:

**Table 1: FAO Food Price Index**

2000	92
2001	94
2002	93
2003	102
2004	114
2005	117
2006	127
2007 June	150
2007 December	186
2008 June	216

(Source: FAO 2008b)

While, for instance,  $p_i$  in June 2008 is  $2.35p_b$  if we use 2000 as the base, the price difference ( $p_i - p_b$ ) is only  $0.16p_b$  if the base were December 2007, admittedly an unusual base only used to illustrate the large differences that may result from the choice of base periods. This choice itself reflects the level of willingness to alleviate hunger — or the level of tolerance of the effects of high food prices on the poor. In parentheses it should be noted that food prices did not increase at the same rate everywhere. The FAO (2008a) points out that the North has fared better as regards higher import expenditures: “This is in stark contrast to the trend prevailing for developed countries, where year-to-year import costs have risen far less.”

Nevertheless, some very crude, back-of-the-envelope estimates of the financial dimensions we are talking about may be helpful. From the FAO-figures quoted above by the United Nations Secretary General, costs of approximately \$20 billion in 2007 would result, if 2006 served as the base year, and if one disregarded import quantity changes (which would not be of importance if my proposal to base compensation on the larger quantities is accepted). This is about a fifth of the total sum of ODA granted by Development Assistance Committee (DAC) members in 2006. It would have increased from 0.31 per cent of DAC-members’ combined Gross National Income to 0.37, or about half of the famous 0.7 per cent target.

The FAO’s (2008a) *Food Outlook* of June 2008 forecast, import bills of total food and major food commodities for Least Developed Countries (LDCs), Net Food-Importing Developing Countries (NFIDCs), and Low-Income Food Deficit Countries (LIFDCs) for 2007 and 2008. LIFDCs are countries listed by the FAO according to the criteria low per

capita income and net trade position for a broad basket of basic foodstuffs, unless a country meeting these criteria itself demands to be excluded from this list. At present 82 countries are listed. The forecast increases in import bills for these three groups between 2007 and 2008 are (in million US\$):

LDCs	6 674
LIFDCs	47 896
NFIDCs	12 720

As I propose to use either  $q_b$  or  $q_i$ , whichever is higher, these figures would be the costs of compensation. They constitute the maximum amount because less generous compensation rules would mean lower costs. In particular, one could think of not using import quantities but net imports in the formulae. In that case typical tropical exports such as coffee, cocoa or bananas, which differ perceptibly from readily edible food, must not be counted.

While import bills are not the same as net import costs, one may question whether — with the possible exception of LDCs — changing to net imports would really make a lot of difference. Technically, net food imports can, of course, diverge. In that case quantities eligible for compensation would be lower if net imports were used by the formulae.

With the exception of LIFDCs, admittedly a very large group, these maximum costs are not unrealistically high. Since LDCs as recognized by the Economic and Social Council of the United Nations are already included in the list of NFIDCs, the sum necessary for NFIDCs already covers LDCs. Expressed in percentages of total DAC-ODA actually granted in 2007, the costs for LDCs and NFIDCs would amount to 6.4 and 12.3 per cent respectively. Such ODA-increases have historically happened and are not beyond *realpolitik*. Quite recently, for instance, total DAC-ODA increased by 34.8 per cent in dollar terms from 2004 to 2005 according to the DAC's updated time series of April 2008, by 15.0 per cent between 2003 and 2004, or by 18.5 per cent between 2002 and 2003. Of course, shifting the calculation base year(s) back would increase costs discernibly.

Regarding costs, it must be pointed out that not financing increased food import costs at all does not necessarily mean saving all that money. In that case, higher import expenditures are very likely to accumulate as additional debts on top of debt sustainability problems that already exist in quite a few poor countries. Larger debt relief made necessary by the unwillingness to act against food price crises earlier, would mean that this money is eventually lost — fully or mostly — as well. In a very roundabout way, higher food costs would be paid by Industrialized Countries, just in another way. In contrast to direct and immediate help, this latter result would draw a lot of criticism by NGOs and the public at large, both as regards the refusal to help the poorest and — as the record of various debt reduction schemes clearly shows — with regard to the way debt relief is likely to be implemented. Whether the few pennies one might admittedly save that way are worth the political costs as well as a further loss of Northern credibility — especially but not exclusively in the South — is up to OECD-governments to decide.

## **Learning from Other Compensation Schemes**

Although no precedents exist according to agreed rules for food import stabilization in the South, FICM could draw on experience with compensation schemes and proposals.

Integrating features that worked in the past proves their technical feasibility. Naturally, modifications may be advisable or necessary.

The IMF's Compensatory Financing Facility (CFF) was introduced to make up for shortfalls in export earnings beyond the control of Developing Countries. The CFF was initially introduced without any real conditionality attached, precisely because beneficiaries were not blamed for these external shocks.

For some agrarian commodities, the Lomé Convention, a treaty signed by the European Union (EU, then still called European Economic Community [EEC]) and a group of countries from Africa, the Caribbean, and the Pacific, the so-called ACP-group (cf. Raffer and Singer 2001: 99ff), introduced a scheme for the stabilization of export earnings, or Stabex (v. Raffer and Singer 1996: 90ff). Compensating ACP countries for shortfalls in export earnings of those agrarian exports listed as Stabex-products (at first iron ore was the one exception on the list), initially worked like an insurance scheme for exporters. Under Lomé I the only requirement was proving facts, i.e. statistics showing that export income had indeed decreased. It was like an insurance contract: if and once damages are proved, the insurance agency pays, naturally without any conditionality attached, as was initially the case with Stabex. Stabex was the compromise offered by the EEC to avoid a price stabilization scheme requested by the ACP-group, and the South as part of their demand for a New International Economic Order.

Compensation was calculated as the difference between earnings in the year of the shortfall and the gliding average of the four previous years. Initially the small minority of relatively richer ACP-countries received interest free loans to be repaid after export revenues would have recovered all others grants. Unlike IDA credits, these loans carried no interest, service or other charges. Soon, all Stabex payments became grants.

Due to the asymmetry between export earning shortfalls and food import costs, transfers cannot be simply modelled after Stabex. Compensating export revenues (price times quantity sold) is not meant to compensate cases when price decreases are compensated by increased quantities. Neither is it meant to compensate cases when and if price increases are made up by reductions in demand, because the country's export revenue remains unchanged in both cases. Mathematically, this would also hold true in the case of food import costs. Sharply reduced imports due to sharply increased prices might still result in the same amount of money needed to pay for these reduced imports. Rising prices and falling quantities could even out at constant expenditures. However, in this case the aim is not to keep revenues or expenditures stable (or to reduce volatility), but to assure that people can afford food even though it has become more expensive. Compensating increases in food import costs (price times quantity bought) over those of a base period would bring problematic results. Heavily affected net importers would receive no support if expenditures remained equal, although they could not afford to buy the same quantity any longer and would have to pay higher prices. Physical availability of food to the poor must be guaranteed. Therefore a formula is needed, which — in line with official intentions — compensates negative effects on the availability of adequate supplies, thereby securing adequate access to food. This goal speaks in favour of authorizing the administrating organization(s) to choose which compensation formula to apply, as proposed above. What FICM should emulate is the automaticity of compensations of the initial Stabex.

In contrast to measures to smooth out trade impacts in order to allow longer transitions periods to adapt, such as Stabex or the Food Import Facility, where the necessity to stimulate domestic food production within net food importers is dominant, emergency-determined mechanisms such as FICM must be available when and if the risk of hunger

exists. Gliding averages are therefore not a meaningful option. Rather than smoothing out external shocks without interfering with the underlying market trend, FICM must guarantee a minimum of food available to people whenever needed. It must not allow systemic reductions in food aid that may occur simply because the poor can afford to buy less and less food.

Naturally, long term policies to stimulate production and food security are called for as well, and should be financed. For such measures an automatic phasing out, as within Stabex or proposed for the Food Import Facility, can be envisaged. Stimulating domestic food production is a long term necessity to ensure a higher level of food security.

Incentives to domestic food production correspond to economic reasoning as well as to the intentions of the WTO's Decision on Possible Negative Effects. However, the primary aim of FICM must be fighting hunger. Further measures have to be financed in addition to this main, short term aim. At the very least, if money is scarce — as we may unfortunately suppose often to be the case — anti-hunger interventions must always be unconditionally prioritized. If money should be available from selling food after providing for the poor, these resources may be used for long term agricultural policies as well. The amounts received for or allotted to such investments should be slowly reduced after some years, according to a predetermined time schedule. Such schemes would be temporary, giving net importers time to adjust. This is the kind of breathing space considered so essential by Industrialized Countries for adjusting in an orderly manner to avoid disruptive effects in the case of textiles and clothing. The time needed by the North to adjust in this sector could serve as an indicator for the period envisaged.

Under duress, some Developing Countries have introduced price controls and export bans, measures that orthodox theory and thus the IMF oppose fiercely. Are they right to do so? Probably: there are no easy answers. It is important to note that not doing so may also be problematic. Although any interventions including those in the food sector, can be done in a clumsy or damaging way, this need not necessarily be the case. Banning exports may indeed be a sensible short run measure, and it is difficult to see why a country exporting food should allow its people to starve just to be in line with orthodox sentiments and theory developed by people who did not usually go hungry. This is not a plea for generally restricting and hampering trade — but in this very difficult situation the choice is between banning exports and feeding one's own people or not doing so and feeding other, richer people elsewhere, while starving one's own population. It seems difficult to qualify such actions necessarily and sweepingly as “actions that make things worse” (IMF 2008), which should be avoided. Those who would starve because of “free trade” might vehemently disagree. As food would be exported because foreigners are able to pay more — consider that if domestic prices were higher than world market prices export restrictions would make no sense — removing such export restrictions means re-allocating hunger globally. Hunger in richer countries and of richer people would be alleviated at great cost to poorer countries and poorer people. Why should this kind of re-allocation improve things in general? It is difficult to believe that OECD-countries in the same situation would opt for free trade and feeding others rather than keeping the food they produced within their own borders.

## **Where Should The FICM Be Based?**

The character of an emergency measure to help the hungry, as well as that of its mandate, would clearly and forcefully suggest that the WFP is the ideal organization to administer FICM or any similar mechanism that the international community might agree on. But there exists another important point: this mechanism must not slowly and surreptitiously be

transformed from assistance with no strings attached — as help alleviating catastrophes should be — to another means of demanding and enforcing conditionality. Reducing misery must not be “granted” in exchange for reducing policy space. No one should be allowed to thrive on the hunger and misery of the poor. Historical experience teaches us that the choice of the administering institution is usually critically important.

The Compensatory Financing Facility (CFF) is a prime example, for it emphasizes that this compensation mechanism must not be administered by the IMF. Initially introduced to make up for shortfalls in export earnings beyond the control of Developing Countries — a clear parallel to FICM, where the poor are not to blame for food prices — the CFF was soon subjected to stricter conditionality. In a deplorable mission creep, the IMF had conditionality gradually introduced. J.J. Polak (1991: 9), a leading theoretician of the Fund, justified this illogical evolution: “Over the years, however, the Fund has increasingly come to the realization that even though a country’s export shortfall was both ‘temporary’ and largely beyond its control the country might still have ... inappropriate policies”. Thus, the IMF wants to make the country change policies that are not causing the problem at all. To compensate countries for events beyond their control, such as soaring food import prices, transfers without such undue conditionality are mandatory.

This point is further corroborated by the fact that reforms forced on Highly Indebted Developing Countries (HIDCs) by the Bretton Woods institutions have exacerbated the problem. UNCTAD (2002) identified severe negative impacts of these institutions’ debt management on the poor, for instance via shifts in taxation from corporate, personal income and trade taxes to regressive consumption taxes, falling real incomes of unskilled workers (declines often exceeding 20 per cent), rising input prices for food crops accompanied by declining output and increasing fertilizer prices, the collapse of rural infrastructure such as rural roads, declining levels of rural credits, the transformation of rural property regimes taking away user rights from the poor, user fees in the sectors of education and health constituting an important impediment to access for the poor, the “exorbitant costs of drugs” (UNCTAD 2002: 43), and the decline in public service institutions. Similar results were found by SAPRIN (2004), as well as by the famous UNICEF report, *Adjustment with a Human Face* in the late 1980s (Cornia, Jolly & Stewart, 1987). Early on, the International Bank of Reconstruction and Development (IBRD) (1980: 62) put the problem in a nutshell: the “major drawback” of efficient food subsidies is that they are costly, often using up “scarce foreign exchange or aid”. In other words, money that could be used to pay creditors was used up to feed the hungry. Some years ago, the IMF and the IBRD were accused of having forced Malawi to sell maize from its National Food Reserve to repay debts. After harvest problems in 2002, famine struck and 7 million people out of a population of 11 million were severely short of food according to Action Aid (Pettifor 2002; cf. on this issue also: Treasury Select Committee 2002). Allowing institutions whose previous advice has severely damaged the poor to give new advice on how to protect them is difficult to justify.

In parentheses, an evolution similar to that of the CFF may be noted in the case of Stabex. Initially granted by Lomé I without any strings attached, later treaties changed its nature more and more, introducing restrictions and making payments conditional before this useful mechanism was finally abolished by the Cotonou Treaty. This hardly dispels doubts as to whether institutions or arrangements under Northern control are capable of avoiding all tendencies towards abusing an emergency mechanism as another means to put pressure on Developing Countries and to reduce the very small policy space they still have.

The WTO’s Committee on Agriculture has a mandate to monitor the follow-up to the Decision on measures in favour of net importers pursuant to Article 16(2) of the Agreement



on Agriculture. This made me suggest that a Food Import Facility compensating price increases expected after Marrakesh, should be established at the WTO as a contractual insurance scheme without conditionality, like the original Stabex in Lomé I (Raffer 1997). Unfortunately, even without any specific facility to help NFIDCs as promised, conditionality immediately crept into the WTO as well — more quickly than money, so to say. As noted above, the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries (NFIDCs) recognizes “negative effects in terms of the availability of adequate supplies of basic foodstuffs from external sources on reasonable terms and conditions, including short term difficulties in financing normal levels of commercial imports of basic foodstuffs.” This echoes the *raison d’être* of the IMF’s CFF. Much more quickly than in the case of the CFF, emergency situations of NFIDCs that exist through no fault of their own — at least no other fault than signing the WTO-treaty — was to be used as a means to exert pressure on them. A WTO list of NFIDCs exists meanwhile, consisting of LDCs and other Developing Countries. However, the Committee on Agriculture (1996, para 10) underlines that being listed does not “confer automatic benefits since ... donors and international organizations concerned would have a role to play.” While negative effects result automatically from the treaty, benefits do not. Negative effects caused by the world market and the WTO systems are used to extract concessions from the victim.

Clearly, any meaningful mechanism to genuinely help the hungry must not be based at any of these organizations where actual help seems not to be the main objective or concern. Conditionality must not creep in eventually as it did with Stabex and the CFF, and as it would do if based at the WTO. To be useful for fighting hunger, FICM must be based either at the WFP, the FAO, International Fund for Agricultural Development (IFAD), or possibly at the UN Office for the coordination of Humanitarian Affairs. The FAO, IFAD and the WFP have already collaborated in an institutionalized way for some time, which might be a good argument for as suggesting that they jointly administer FICM. Technically, several UN family organizations could form an administration board or unit. Due to its experience with children, UNICEF could be part of this administrative group. The administering unit would closely co-operate with self-monitoring groups, especially providing organizational support and helping countries to implement the projects agreed upon.

Procedures should be as simple as possible. All affected poor countries must be entitled to compensation for price increases. Several possibilities to determine the group of eligible countries exist. Because the length of any list of potential beneficiaries will strongly depend on the generosity of donors, several possibilities are presented. Net-importing LDCs and Low Income Countries (LICs) must obviously get help. Further, the WTO-list of NFIDCs is clearly an option. Compensating all LDCs is the absolute minimum one can consider. Naturally, if enough money can be raised, the list might be enlarged.

Given the fact that agrarian subsidies including export subsidies with nefarious long term effect on Southern agricultural production, and speculation in food markets are largely if not uniquely caused by the North, connecting payments to the amount of agricultural subsidies paid would be optimal and perfectly justified. This would connect market disruption, which is enormous in the case of food, and compensation, crime and punishment, so to speak. Of course, any other countries would be welcome to contribute. Historically, non-OECD countries have already been very generous in crises. To cushion the effect of higher crude prices on fellow Developing Countries, OPEC members increased their ODA substantially after 1973-74. In particular, they financed the IMF’s Oil Facility, which was established in 1974. Ironically, Britain and Italy were among the first countries benefiting from it, ranking amongst the largest borrowers.

More recently, the single most generous donor to the WFP in support of its fight against hunger was a country from the South: Saudi Arabia. Entirely dependent on voluntary contributions, the WFP issued an emergency appeal to government donors in March 2008 to close the growing funding gap in its programs caused by soaring food and fuel prices. It urged them to be as generous as possible in helping to close this gap — US\$500 million on 25 February 2008, but already put at US\$755 million at the end of May. Saudi Arabia donated US\$500 million, the whole sum initially asked for and more than all other countries combined.

One could think of Southern net exporters contributing, but as these countries have suffered such a long time under highly subsidized Northern exports and are still unlikely to have a level playing field in world food markets, exempting them does not seem fair. The North, which effects the bulk of food exports anyway and is responsible for the bulk of market distorting agrarian subsidies and trade barriers, the North should basically finance the Mechanism. This could be done either in kind (food) or in cash.

Food shortfalls should be reported to the WFP or the administrative board of UN-organizations, where entitlements — and thus transfers — are calculated and checked. Ideally all transfers should be grants. As with the original Stabex one could consider zero interest loans without any front end fees for countries that are not LDCs. Maturities and grace periods could be agreed on, or one could make repayment contingent on the evolution of food prices or the evolution of the trade balance of food of the recipients. One may wonder whether such two-tier financing makes sense if the group consists exclusively of very poor countries. One would have to see whether the additional administrative work connected with administering both loans and grants is really worthwhile. In any case, this emergency help must not be financed by interest bearing loans in foreign currency, as is argued in detail below.

One predictable objection against this Mechanism is that the resources needed might crowd out other aid. Present trends in aid justify fears that donors might just divert resources within their aid budgets to honour any new commitment. Considering present trends, this is not unlikely. Shifts would be transparent if the OECD published contributions to this Mechanism as a separate item—as going practice suggests and one can well expect it to do. This would put moral pressure on donors. Unfortunately, moral pressure is a weak tool, for in the end no donor can be forced to give or increase ODA. Even self-binding by donors is often useless and always unenforceable, as the famous 0.7 per cent target shows. On the other hand, there is also no guarantee that ODA will not fall anyway without this Mechanism. A real risk exists that with or without resources for net food importers less and less aid will be available. But this must not be allowed to silence well justified demands.

## **Liberalization in the Past and the Expected Food Crisis**

In spite of the experience with liberalization from debt management and from the WTO, liberalizing trade further is now often propagated as a means to alleviate food problems, especially so by the IMF. Even if one assumed against historical experience that liberalization would work in the long run, food scarcity and food riots are occurring now. An immediate solution is mandatory. But it must also be shown that — judging from historical experience—this advice is no solution at all.

Under present market-rigging conditions, liberalization of food trade logically tends to increase prices. If the substantial export subsidies of Industrialized Countries were discontinued, prices would have to increase substantially. Already while negotiating the WTO framework, hefty price increases for food were expected, precisely for this reason,

especially so before actual cuts in subsidies turned out to be so much less than initially heralded. Unlike the present liberalization argument, this conclusion was fully in line with basic logic.

Simulations by Goldin and van der Mensbrugghe (1995: 94f; stress KR), for instance, indicated overall gains by the Round, but “these should not mask the *losses, particularly as these are concentrated in vulnerable least developed countries where the consequences of higher food prices could be particularly severe. For those countries, vigilance and the guarantee of the support of the international community is required*, so that the overwhelming gains of the Uruguay Round are not tarnished by the unacceptable suffering of those unfortunate enough to suffer the marginal-negative consequences.”

The authors think that factors they had been unable to incorporate into their modelling might offset “any possible negative effects associated with higher food prices” (ibid.). While possible it is not really likely that unforeseen factors might undo what seems rational to expect. Also, revenue losses due to liberalization are particularly problematic for poor countries lacking the administrative capacity to run complex tax systems, such as VAT schemes. This, in turn means that less money is available in the budget to finance or subsidize necessary investment in food production. It’s also unavailable for social expenditures to help the poor. It reduces both fiscal space and policy space. UNCTAD (1995: 23) estimated annual losses of \$300 million to \$600 million from higher food prices and the erosion of trade preferences for the LDCs.

In the year when the Final Act was signed, agrarian export prices started to rise: agricultural raw materials rose by 10 per cent in 1994 and 5 per cent in 1995, while cereals rose by 7 and 17 per cent respectively (WTO 1996: 16). These significant price increases for cereals “were followed by the even more dramatic increase of 48 per cent in the first half of 1996” (WTO 1996). The WTO noted that this evolution had been attributed by some observers to the agrarian reforms of the Uruguay Round, while others had pointed out that these had largely not been implemented yet, so that “the price movements represent ‘normal’ price fluctuations.” This is supported by mentioning — without bibliographical details — studies predicting much smaller impacts on prices even after the full implementation of reforms, as well as quoting an unpublished paper. At that time, the argument that it could be too early for impacts of the Round may have carried some weight. But one could assume with equal justification that markets reacted quickly, anticipating implementation. Whatever the case might be, Article 16 of the Agreement on Agriculture demands measures in favor of net importing Developing Countries.

The WTO Committee on Agriculture (1996, para 18) of the WTO recommended to the Singapore Ministerial Conference that it “consider the scope of establishing new facilities or enhancing existing facilities for developing countries experiencing Uruguay Round-related difficulties in financing normal levels of commercial imports of basic foodstuffs.” In this spirit, I proposed the Food Import Facility to be administered by the WTO some ten years ago (Raffer 1997).

Implementing the Decision on net importers, the WTO approached the IMF and the IBRD to discuss improved conditions for access to existing facilities, a softening of conditionality, new facilities for net food importers, and “ways in which the WTO could assist the IMF and the World Bank to be more forthcoming in these matters” (Committee on Agriculture, 1996, para 17). Apparently, assistance was not welcome. Although Developing Countries expressed their disappointment regarding the accessibility of existing facilities, the Fund and the Bank denied the necessity of Uruguay Round related facilities, referring to the range of facilities available. Obviously, low conditionality finance is considered unnecessary.

The Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries also located the solution for net importers experiencing difficulties in financing commercial imports in getting money “in the context of adjustment programmes”, which soon turned out to be de facto the only available option. This increases the strong dependence of debtor countries on the IMF and the IBRD. At the moment, both institutions again offer loans to cover food expenditures under present crisis conditions. In this Decision within the WTO-framework, ministers agreed “to adopt guidelines to ensure that an increasing proportion of basic foodstuffs is provided to least-developed and net food-importing developing countries in fully grant form and/or on appropriate concessional terms in line with Article IV of the Food Aid Convention 1986”.

Clearly, this agreement cannot be logically reconciled with the actual outcome of referring net-importers to existing facilities without establishing any specific help on softer terms. Thus, the problem of un-affordably high food prices for the poor was seen early on, but no one considered it a priority to protect the most vulnerable in the South. In spite of foreseeing the possibility of a crisis, no mechanism to help those affected by WTO-liberalization was put in place.

Differential treatment of Developing Countries regarding export credits and full consideration by donors to improve agricultural productivity and infrastructure by aid were agreed on within the WTO framework years ago. But it must be questioned whether donors are really going to reduce their own export outlets by subsidizing Southern agricultural production. Actual aid performance justifies scepticism. Commenting on the reduced share of agriculture in bilateral aid, the OECD (1996: 93) concludes: “Depressed food grain prices and surpluses of many agricultural commodities in the late 1980s and early 1990s may also have curbed donors’ interest in directing resources to agriculture”. Structural Adjustment and other debt management measures have further put the poor at risk.

In fact, both commitments and actual food aid declined after Marrakesh. The Committee on Agriculture (1996) therefore recommended efforts to establish a level of food aid sufficient to meet the legitimate needs of Developing Countries during the reform programme, when renegotiating the Food Aid Convention. To do so Sir Hans (Singer 1994) proposed doubling the minimum commitment of food aid in the new Convention to 15 million tons in terms of cereals, the actual level when the Final Act was signed. Thus the quantity of food aid would not be reduced.

The “alternative” given to these net-importers in the 1990s — using existing facilities of the Bretton Woods institutions — is not economically sensible. In contrast to the wording of the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries (NFIDCs), which speaks also of “short term difficulties in financing normal levels of commercial imports of basic foodstuffs”, difficulties for most food importers were not likely to be short term problems, comparable to a phase of illiquidity quickly overcome. *Ceteris paribus*, higher food import prices are likely to create a permanent additional demand of foreign exchange, compounded by impacts of lop-sided liberalization. This non-transitory effect calls for other measures than multilateral loans. Financing expensive food imports by increased borrowing is not necessarily good advice, especially to debt ridden countries already unable to service debts on time and amassing huge arrears. Even IDA-conditions of 0.75 per cent a year in hard currency (plus commitment charges) will be too high for some poor countries. As argued above, new multilateral loans for consumption will necessarily increase the debt overhang. They would certainly not alleviate debt problems but increase the share of unpayable debts

that will have to be reduced eventually, as the present HIPC Initiatives and the Multilateral Debt Relief Initiative (MDRI) document. These initiatives became necessary because multilateral resources did not fund economically viable — and thus self-liquidating — projects and programs, and because HIPC I did not deliver. It also casts doubt on the results of financing long term measures in agriculture by multilateral lending. Their record is another convincing reason for not referring net importers to the Bretton Woods Institutions is not appropriate. Solutions other than multilateral lending must be found to compensate or at least mitigate the negative effects of higher food prices.

It is difficult to see how or why concluding the Doha Round would help the hungry. Calling Doha a “Development Round” may lead one to believe that development problems including poverty are finally to be tackled. The name, however, is mere “spin”, as a quick look at the issues, such as large tariff cuts by Developing Countries, shows. The North presses for further changes mainly, if not exclusively, in its own interest. The Singapore issues (investment, competition policy, transparency in government procurement, trade facilitation) or market access for non-agricultural products (NAMA) are hardly overwhelmingly developmental interests, although benefits for some advanced Newly Industrialized Countries (NICs) should not be excluded. One must point out, though, that while liberalization was presented as a reason for higher food prices before Developing Countries signed the WTO treaties to counteract concerns, liberalization is now presented as a means to bring about lower food prices. The UN Secretary General’s (2008a: 17) Report warns: “The net food buyers in developing countries may be affected by liberalization and may need assistance if they are to adjust to the change and have the ability to eventually benefit from the liberalization”.

Unfortunately, the idea of using interest bearing loans for emergency measures to feed the poor is again being propagated and implemented. The IMF (2008) announced that it had “doubled financial assistance to four low-income countries affected by food and fuel price hikes”, and that it “was giving an extra \$21 million to the land-locked West African nation of Mali ...”. As IMF projections — mostly too optimistic rather than too cautious — assume that in “about one half of African countries the increase in the cost of food imports could exceed 1 percent of GDP this year” (even 3 per cent is mentioned in this source) new hunger-created debts could be substantial.

Similarly, on 29 May 2008, the IBRD Group announced a new \$1.2 billion rapid financing facility to address immediate needs, including \$200 million in grants targeted at the vulnerable in the world’s poorest countries. This means that loans amounting to \$1 billion are to cover immediate needs, which logically can only mean urgently needed food for consumption. The Bank also announced to boost its overall support for global agriculture and food by \$2 billion. While emergency help must not be financed by loans, agricultural investments in order to change production capacities are different, as pointed out above. Once again, net-food importers are encouraged to rely on multilateral financing, as they were more than a decade ago. The reality of the present food crisis casts severe doubts on the efficiency of this solution.

About a decade ago, Raffer and Singer (1996: 209f) proposed financing institutional reforms and social agenda exclusively by grants — precisely because such expenditures, necessary and laudable as they are, do not create self-liquidating returns. Projects for the poorest must therefore be financed by grants unless a recipient is sufficiently liquid, which is extremely unlikely in the case of most poor Developing Countries, and rather unlikely for most Developing Countries where many people now suffer from hunger due to price increases.

In countries where debt service already puts heavy strains on the government or money is scarce for other reasons, (new) loans that do not earn their own amortization and interest service are bound to worsen the country's debt situation further or to lead to the next debt crisis if granted on a larger scale. The highly negative economic consequences of such lending are apparent. The "near-market" interest rates of the IBRD or regional development banks will often be too high in many countries if loans are not self-liquidating, as lending for pro-poor activities usually is. Therefore urgently needed anti-poverty projects must be financed by other means, preferably by grants, often even in relatively richer Developing Countries. If helping the starving is really as important to donors as their rhetoric claims, they should be prepared to finance these commendable activities.

## **Conclusion**

This paper presents a modest, but viable and feasible mechanism that would significantly attenuate the present crisis of high food prices, and provide substantial help for the poor. As all OECD countries distort global agrarian markets substantially, for instance, with subsidies undermining domestic producers in the South, subsidies for bio-fuel production and even large payments to farm owners for not producing anything on their land, they have contributed to producing the present crisis. Furthermore, speculative activities have also contributed to food price increases. Little if any of this occurs in developing countries or is driven by investors from the South. Finally, debt management by Northern official creditors and multilaterals under their control have both worsened the situation of agriculture and the poor in the South over the decades. OECD countries should therefore pay for helping the poor. As they have all committed themselves to spare no effort to reach the MDGs they should provide the money to finance the emergency FICM.

FICM is a workable relief mechanism, and can be implemented at once. Clearly, it can be further refined, but should be established immediately along the lines described. Even less than sufficient funding would alleviate the hunger problem of. If protecting people from starvation is truly an important goal of industrialized countries, this is the time to prove it. Especially after the disappointing response by OECD donors to the WFP call for help, proving real commitment would dispel any misunderstanding about their genuine concerns about hunger and the poor. As economic theory suggests that the willingness to pay reveals an actor's true preferences, this would be a splendid opportunity for donors to shame all those who accuse them of not practicing what they preach.

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