National Policy Responses to High Food Prices

- Soaring food prices are a threat to many countries' growth and development
- Governments can intervene at the market or micro level
- The appropriate policy response depends on the root causes of the price shock

Introduction

The prices of many staple food commodities have increased substantially over the past year[1]. As a result, many developing countries are facing larger food import bills. The cereal import bill of the world's poorest countries is forecast to rise by 56 percent in 2007/08, following an already significant increase of 37 percent in 2006/07. Given the growing dependency of many developing countries on imported food commodities and on foreign aid, as well as their generally high levels of debt, increasing food prices have important implications for growth and development.

At the micro level, poor households in both food importing and food exporting countries are exceptionally vulnerable to increases in food prices, given the large share of food in total expenditure and the constraints they face in terms of low income and capital endowment. However, higher global food prices present an opportunity for agriculture.

Many countries are currently faced with difficult choices on how to respond to the global increases in food prices. High prices have prompted a number of policy responses by governments aiming to ensure food supplies at more affordable domestic prices. Several food importing countries have reduced or suspended their import restrictions, while many exporting countries have limited, or even banned, exports in order to avoid food shortages and higher domestic prices. Other countries have released stocks in order to stabilize domestic prices. Furthermore, a range of measures have been taken to mitigate the adverse impacts of high prices on vulnerable households, including subsidized food sales or food distribution to targeted households in distress.

The purpose of this policy brief is to highlight a number of issues that countries ought to be aware of when designing national policy responses aimed at the market - and at micro-level. These policy responses address two basic challenges:

- *to ensure the provision of adequate food supplies through domestic market management or trade, or in stimulating a short-run supply response from the domestic agricultural sector; and*
- *how best to provide direct support to consumers, especially to most vulnerable population groups, to assist them in maintaining adequate food consumption levels, including through what are known as "safety net" measures.*

Consequences of food price shocks

The impact of increasing prices on the wider economy is determined by a number of structural characteristics. Typically, low income food importing countries that rely heavily on tradable cereals for their diets (deriving most the country's dietary energy needs from imports) and are already experiencing high levels of foreign debt, are most of vulnerable to global food price shocks. Given high levels of exposure to world markets, food price increases directly affect purchasing power, increasing the incidence of poverty, as well as government expenditure and debt. A deterioration of the terms of trade may destabilize the economy and hinder economic growth.

Households react differently to price increases depending on their initial endowment and production structure, their consumption patterns, the investment constraints they face, and the policies that are in force. Urban and rural households that are net food buyers may lose, as they have to pay more to maintain adequate consumption levels. However, some rural households, especially those that are net producers of staple foods, or those whose wages may increase by more than the increase in food prices as a result of increased demand in rural labour markets, could benefit. Female-headed households tend to be more vulnerable to food price increases as they normally spend a greater share of their income on food, as compared to male-headed households. Female-headed households also stand to lose, as they often lack access to productive resources.

Policy responses to high food prices

Two interrelated categories of response are considered:

- *market-level policy responses through trade and market management; and,*
- *direct support to consumers and vulnerable groups at the micro-level.*

Market-level responses

Policies aimed at directly influencing domestic markets include trade policies and market management policies. In the context of soaring food prices, two types of trade

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policies have been used by many countries: reductions in import tariffs and export taxation, or restrictions.

Reducing or eliminating import tariffs on food products

Reducing or eliminating import tariffs on food products has been the most widespread policy response for stabilizing domestic food prices. However, for this type of intervention to succeed and have a meaningful impact, applied tariffs need to be sufficiently high at the time when world prices begin to rise. Among 60 low-income, food-deficit countries surveyed in early 2008, applied tariffs on cereals and vegetable oils were already fairly low, with 2006 data showing on average rates of only 8 and 14 percent respectively.[2] Hence, even when reduced to zero, reductions in tariff levels were able to offset only a small proportion of the overall price rises of food imports.

Export prohibitions, restrictions and export taxation

Of the 60 low-income, food-deficit countries surveyed, about one quarter resorted to some form of export restrictions in response to soaring food prices. Export restrictions lower domestic prices but also reduce government revenues where exports are taxed. In addition, export restraints exacerbate price instability in world markets and negatively affect importing countries. Export restrictions also have longer-term implications, as they discourage producers in exporting countries from investing in agriculture.

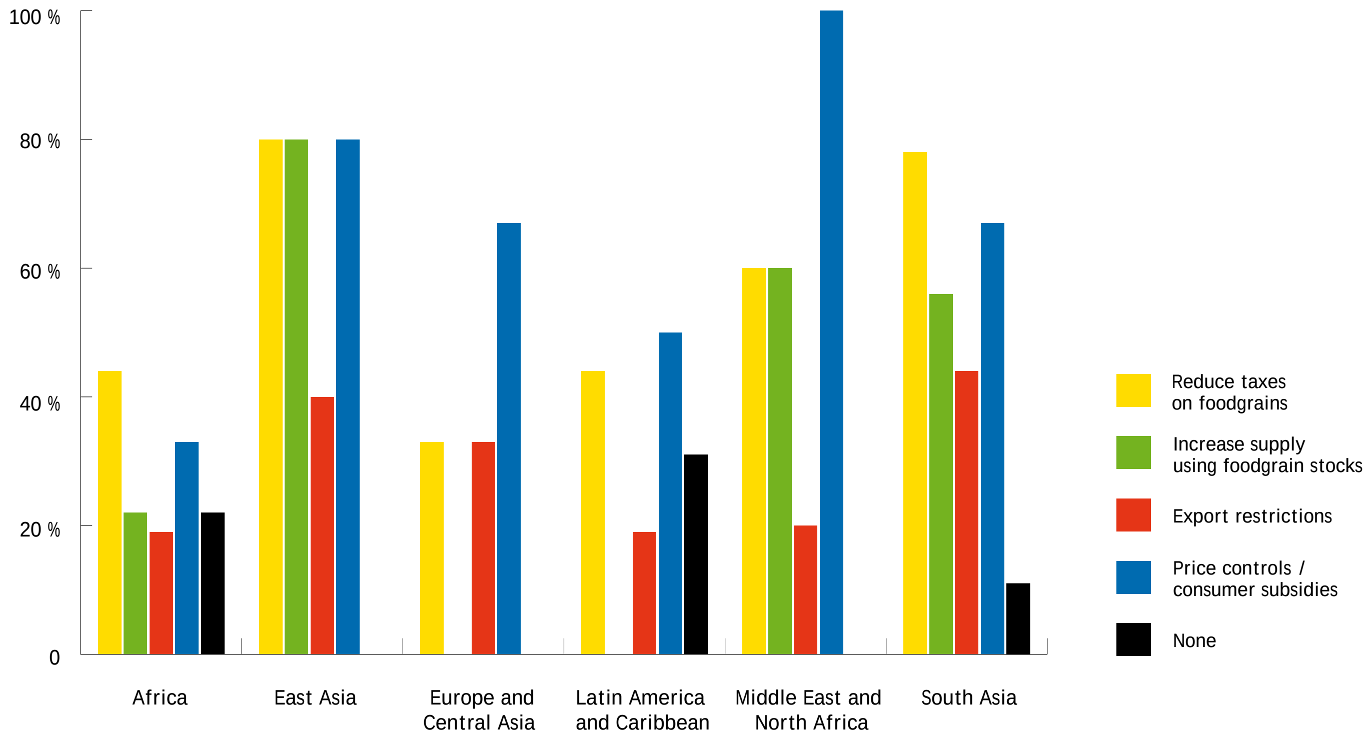
Market management policies

Market management policies include measures such as price controls through administrative orders, restrictions on stockholding by private traders, restrictions on inter-district movement of foods and open market operations, such as selling public stocks of foods to reduce market prices. These measures, which aim to control prices in the short run, were applied widely in the 1970s and 1980s, but have generally been discontinued given a number of disadvantages, including high costs of maintaining stocks, negative impacts on producers, leakages in the sense that the operations also benefit rich consumers and discouragement of private sector engagement in food markets.[3]

Market management measures may be effective for very short periods, but can be destabilizing in times of food shortages, and can promote hoarding, which contributes to further price rises. The concentration of market power in government-appointed agents or agencies is perceived by many as a major source of market instability in developing countries. For long-run market stability, policies that improve the functionality and competitiveness of food markets are needed.

Responses to increased food prices in a sample of 77 countries surveyed in early 2008 vary by region (Figure 1). In Asia and in the Middle East and North Africa, both trade and market management policies were widely used.

Figure 1: ***Market responses to high food prices by region in 2007-8***



Source: FAO (2008) Soaring food prices: Facts, perspectives, impacts and actions required. HLC/08/INF/1

In Africa and in Latin America and the Caribbean, fewer interventionist policies were used, with a significant proportion of sampled countries not having intervened at all.

Given the high costs associated with open market operations and their unintended effects, the preferred policy has been to rely on trade for price stabilization. Where governments perceive trade to be an unreliable source of food at short notice, stockholding and open market operations are still carried out. The experience of soaring food prices provides an opportunity for food importing countries to reassess their relative reliance on trade and stocks.

Direct support at the micro level

Micro-level interventions implemented in response to increased food prices are generally motivated by the reduction in the ability of poor consumers to purchase sufficient quantity and quality food and the associated adverse effects on their nutritional status. The characterization of "net buyer — net seller" status of rural households provides a partial guide to the short-run impacts of high prices but needs to be modified in medium- and longer-run analyses to account for substitution in consumption, increases in production and the effects that these changes can have on local food and labour markets.

Three main categories of micro-level interventions designed to mitigate adverse consequences of higher food prices have been identified:

- *cash-based transfers;*
- *food access-based approaches; and*
- *food supply-based approaches.*

Cash-based transfers

Cash-based transfers can include the distribution of cash or cash vouchers and can be tied to cash for public works programmes and/or microfinance initiatives. They are appropriate where food markets function well and the key constraint that households face is insufficient income. In addition to providing the ability to procure higher priced food, unrestricted cash transfers allow households to make their own decisions on how to spend or invest the cash. Such interventions can foster local market development in food and other goods by providing greater incentives to the private sector to engage in higher volume, more stable marketing channels. However, where markets work imperfectly, for example where they are geographically isolated and poorly integrated with other markets, or where there is limited supply response to increased prices, such interventions can result in further food price increases due to the increase in the households' purchasing power in conjunction with fixed local food supplies. Where food prices are increasing rapidly, adjustment to the value of transfers will be necessary to maintain purchasing power and this can pose significant administrative difficulties.

Food access-based approaches

Food access-based approaches include food stamps or vouchers and restricted cash transfers (for example, in exchange for attendance at schools or clinics). As with cash transfers, these interventions are appropriate where local food markets function well and improving access to food is the objective. Vouchers can become a parallel currency in food and other goods' markets. As such, they can have some of the positive effects of unrestricted cash transfers in fostering local market development, but, due to their restrictive use, tend not to be used for investment. The schemes also tend to have higher transaction costs than cash-based measures.

The design of these interventions can be complicated. For example, school feeding programmes can miss target populations, such as poor households without children, or whose children do not attend school. It is also important to determine ex ante any potential disruption to private marketing channels. Such policies should only be implemented in combination with targeted food sales through public food stores if private channels are constrained in their ability to scale up distribution. The choice and design of intervention also needs to recognize that the transaction costs associated with the different interventions will vary significantly depending upon the specific context in which they are to be implemented. Schemes appropriate for densely populated cities with well developed financial services may be inappropriate in sparsely populated rural areas.

Food supply-based approaches

Food supply-based approaches consist of interventions primarily aimed at alleviating the effects of short term emergencies and those targeted at increasing supply to local markets in the longer term. Short-term approaches, such as the distribution of food aid, are most appropriate where insufficient food supply is the main reason for reduced consumption. Longerterm measures work through facilitating access to inputs, and/or improving technologies and infrastructure to increase the production of food. The former include productive safety nets (for example, seed and fertilizer distribution), subsidies to selectively reduce the cost of inputs, and support to finance institutions to help alleviate credit constraints. Where input markets are working well and inputs are available, but producers are cash-constrained, voucher systems may be best, as free distribution of inputs could undermine input markets. Where input markets are not functioning well, starter packs could be distributed. However, if local output markets are not well integrated with larger markets in the country, interventions for increased production could result in a significant fall in local food prices to the detriment of producers and wage labourers.

Most micro-level interventions can be designed as either universal or targeted programmes. The case for universal coverage is that targeting is administratively too expensive and that in many cases the costs of targeting can exceed the benefits. The case for targeted interventions can be made on budgetary cost grounds or to avoid leakage to non poor populations. The main issue that should be highlighted is that unless a safety net with targeted interventions already exists, any speedily arranged programme is likely to lead to leakages and could be ineffective.

Selecting the appropriate response

In determining the appropriate policy responses to rising food prices, the root causes of the price shock need to be well-understood. Questions to consider include:

- *Does the price shock have its origins in factors external to the country, such as world markets, or in domestic market fundamentals?*
- *To what extent are the factors that have led to the price shock structural or transitory?*
- *What is the level of uncertainty concerning the factors that may influence the future course of price development?*

Answering these questions is not easy and there may be legitimate differences of opinion among analysts. However, the choice of policy interventions should be based on:

- *Compatibility with existing targeted transfer and safety net programmes*
- *The relative efficiency of output and input markets*
- *The different factors that cause households to be negatively affected*
- *Ensuring that policy choices do not diminish the signals to producers to increase production.*

1 *The FAO food price index increased by 57 percent between March 2007 and March 2008, compared to an increase of 9 percent in 2006.*

2 *FAO (2008) Soaring food prices: Facts, perspectives, impacts and actions required. HLC/08/INF/1. http://www.fao.org/fileadmin/user_upload/foodclimate/HLCdocs/HLC08-inf-1-E.pdf*

3 *In Asia, one still finds that open market operations using publicly held food stocks are used. Examples are open market operations by the Food Corporation of India, BULOG's operations in Indonesia and the Rice Marketing Board operations in Vietnam. Government parastatal organizations maintain food reserves with domestic purchases or imports, including food aid, and release the stocks when food prices rise above certain levels, either because of seasonal price fluctuations, or due to increased prices in world markets.*

Further information

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