Policy Brief No. 2



POLICIES FOR THE EFFECTIVE MANAGEMENT OF FOOD PRICE SWINGS IN AFRICA

IMPROVING ACCESS TO FOOD DURING PRICE SWINGS: TRADE MEASURES, CONSUMER SUBSIDIES AND FOOD SAFETY NETS

INTRODUCTION

Policy reaction to the food price surge has been prompt and governments in many developing countries have initiated a number of measures to offset domestic price increases. These measures have included trade and tax adjustments and general consumer subsidies, which aim to reduce the cost of food in the country. Other policies, such as targeted food subsidies and safety nets, were designed to mitigate the adverse impact of the price upswing on vulnerable households.

This brief provides a review of these measures and examines their effectiveness in offsetting the impact of food price increases, as well as their costs. In summary, this examination suggests that:

- import tariff reductions consist of an immediate response to price rises, but may not be very effective in stabilizing domestic food prices;
- tax reductions reduce the cost of food, if food markets are competitive;
- general consumer subsidies allow for a quick response, but are costly and difficult to be removed;
- targeting through already existing food safety nets, or by subsidizing foods that are exclusively consumed by the poor is a preferable policy reaction; and,
- public works programs may provide a good vehicle for protecting the poor if other safety nets do not exist.

TRADE POLICIES

Trade policies consist of restrictions on food imports or exports through border measures such as **import tariffs**, export taxes or the imposition of export bans. In general, the reduction or the elimination of import tariffs on food products has been the most widespread policy response for net food importing countries. As world prices increased, many countries lowered applied tariffs, with some eventually eliminating them, in an attempt to stabilize domestic food prices.

Import tariff reductions may have not been effective in lowering food prices

The effectiveness of such tariff reductions is determined by the initial level of applied tariffs. Available tariff data suggests that the majority of developing countries do not generally apply high tariffs on basic foods, and so the scope for tariff reduction is limited. For example, for a sample of 60 low income food deficit countries surveyed in 2008, applied tariffs on cereals and key vegetable oils fell within the range of 8 and 14 percent respectively. Tariffs were much lower than these averages for a majority of these countries, suggesting that these applied rates, when reduced to zero, were adequate for offsetting only a small part of the overall rise in the international prices.

Export bans may discourage production and harm traditional trading partners

Many developing countries have implemented some form of **export restrictions** in an attempt to lower domestic prices and ensure domestic food security. Completely banning food exports has been a common reaction to the food price crisis in Africa. Although, in general, export restrictions lower domestic food prices and are seen as supporting consumers, their effectiveness is undermined due to informal trade which is common in the Eastern and Southern African region[1].

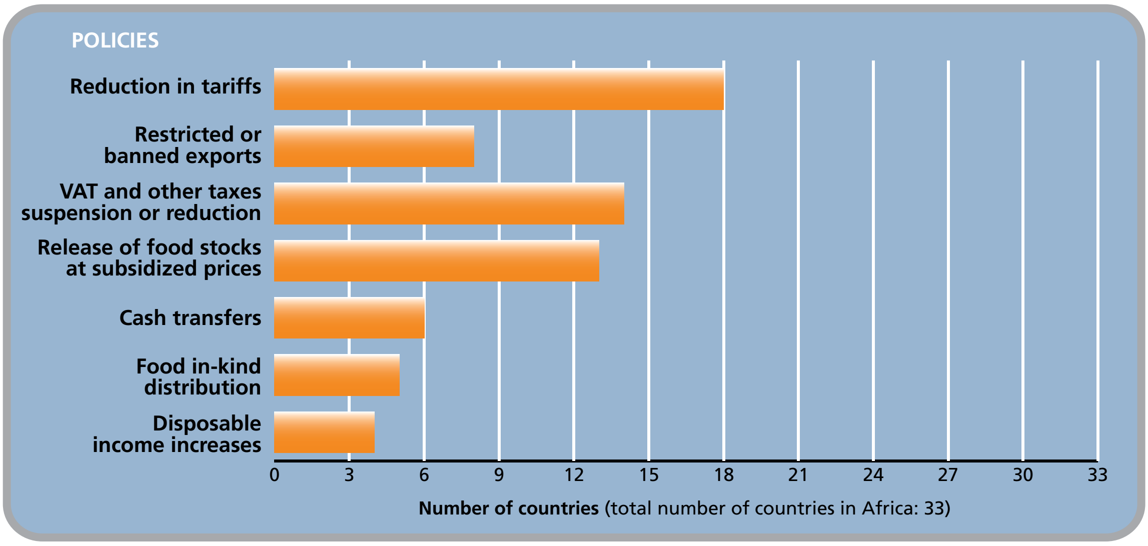
There are also a number of negative consequences. First, export bans imply a tax to producers and lower the incentive to respond to the international price rise by increasing supply. In the long run, export restrictions may discourage investment on agriculture and have negative implications for food security. Second, in the short run, concerted implementation of export restrictions by important exporters renders the international market unreliable as a source of food and harm traditional trade partners. For example, in the autumn of 2008, the imposition of export bans by a number of Eastern African countries limited the Kenyan government's options in harnessing the price upswing.

Trade measures should be implemented in cooperation with the private sector

Import tariffs can easily be scaled-up or down to manage the price swing in a counter-cyclical manner. Nevertheless, abrupt reductions could negatively affect the operations of private traders who may experience decreases in the value of their stocks, as cheaper imports become available. Therefore, greater consultation between government and the private sector is necessary to minimize the negative effects.

[1] See for example Regional Agricultural Trade Intelligence Network. 2008. East Africa food and trade bulletin, No. 49, May and Famine Early Warning System Network. 2008. Informal cross border trade in Southern Africa. Issue 42, May.

Figure 1 – Number of African countries implementing trade and tax measures and safety nets



Source: Demeke, M., Pangrazio, G. and Maetz, M. 2009. Country responses to the food security crisis: Nature and preliminary implications of the policies pursued. Agricultural Policy Support Service, FAO.

The importation of food can also be facilitated through **loan guarantees or subsidized loan interest rates for traders**. Such policy options are especially appropriate in the context of credit ceilings for imports which are often applied by financing institutions in developing countries. Credit ceilings often make it difficult for traders to obtain adequate financing to import sufficient volumes of food.

Additional finance for commercial food imports in excess of the amount determined by the traders' liquidity and normal credit ceilings may be necessary in order increase the availability of food. Once again, the above policies work with the market and thus require close cooperation between the government and the private sector. These two entities must work together in estimating the amount of food that meets the country's requirements and the corresponding food import bill, as well as the amount that cannot be met due to finance constraints.

TAX POLICIES

Many countries initiated **cuts in taxes** in a number of food products. Such reductions offset part of the increase in food prices and provide some relief to poorer consumers who spend a large share of their income on food. In addition to tariffs, tax reductions can also be used in order to manage the price swing in a counter-cyclical manner. In developing countries where a VAT system is in place, governments can consider applying different VAT rates to food items.

Reductions in taxes will lower the cost of food in competitive food supply chains

Tax related policies are effective in lowering food prices only if the food wholesale and retail sectors are competitive. If there are too few traders or retailers in the supply chain, they may exercise their power over the market and increase their price margins, thus hindering the pass-through of tax reduction to the consumers. It is important that a competition authority is present to monitor retail food prices and to regulate and enforce competition and consumer protection laws.

Although, as in the case of import tariff reductions, tax reductions will benefit both poor and non-poor consumers, a degree of targeting could be achieved if taxes are reduced selectively on foods that are consumed primarily by poor households, such as broken grain cereals.

CONSUMER SUBSIDIES

Many countries responded to the price boom by subsidizing food. **General food subsidies** do allow for a quicker response in improving access to food and in offsetting the first round impact of price increases. Nevertheless, general subsidies are costly and do not effectively target those who really need support. Removing or scaling down food subsidies also tends to involve a high political cost (see Box 1).

General food subsidies are costly and some degree of targeting is necessary

As households react to price changes by substituting one food item for another, governments can subsidize foods that are 'self-targeted', that is foods that are 'inferior', or typically consumed by the poor. This is difficult as there are few commodities that are both consumed exclusively by the poor, and at the same time consist of a large share of the food expenditure of poor households. In Eastern and Southern Africa, yellow maize, which is mainly used for animal feed, may be suitable as a self-targeted commodity in times of need[2]. For example, during the 1985 drought in Kenya, the distribution of yellow maize resulted in an equitable allocation of the benefits, as consumers who could afford to purchase white maize chose not to consume yellow maize. Within the context of the recent food price upswing, in Zambia, a number of policy experts argued that consumer subsidies should target the poor only by placing it on "roller" meal, a relatively inferior product as compared with breakfast meal that is preferred by non poor households[3].

[2] See Dreze, J. & Sen, A.K. 1989. Hunger and public action. Clarendon Press, Oxford.
[3] See Chapoto, A, Haggblade, S. Shawa, J. Jayne T. & Weber M. 2008. Marketing policy options for consumer price mitigation action in the 2008/09 maize marketing season in Zambia. Food Security Research Project – Zambia , Brief No. 31, September.

Box 1:
Indonesia:
An example of food subsidies

In Indonesia the government introduced a universal subsidy on rice, following increased domestic prices brought about by a drought in 1997 and the impact of the devaluation of the currency. The cost of the program rose to 1.6 percent of the gross national product, while it also provided incentives for re-exporting subsidized rice. This universal subsidy was replaced by a targeted subsidy program based on a quota determined by household survey data. Later, although the economy improved and the price of rice stabilized, this subsidy remained in place well into the current decade.

Alderman, H. And Haque, T. 2006. Countercyclical safety nets for the poor and the vulnerable. Food Policy 31 pp. 373-383.

FOOD SAFETY NETS

During food price swings, safety nets are important instruments in mitigating the impact of the shock and maintaining the purchasing power of the vulnerable. If safety nets are in place, the short run response to food price increases is to scale operations up. This is achieved by either increasing the spending per person or by expanding the targeted population groups through the relaxation of the eligibility criteria. If safety nets are small and fragmented or non-existent, as in many developing countries, the number of policy options to protect the vulnerable is limited.

In an environment of rapidly increasing food prices, the provision of subsidized food or cash to poor through safety nets improves their ability to cope with increased food expenditure and prevents households from selling out assets that are important for their well-being, such as animals, or from cutting down expenses on important activities, such as education.

It is important that food safety nets can be scaled-up rapidly. This presents significant difficulties.

- Firstly, the safety net program should have the administrative capacity to expand.
- Second, if expansion takes place through the relaxation of the eligibility criteria, so as to provide protection to households that became vulnerable due to the temporary food price increase, additional targeting mechanisms should be employed. Well-targeted programs are difficult to design and often are integrated into the existing social safety net system. Quick targeting may be achieved through combinations of geographical, demographic and self-targeting criteria, however, compromises will have to be made on the accuracy of the targeting.
- Finally, such mechanisms ought to have a counter-cyclical budget so that operations can be scaled-up as need increases and scaled back subsequently. Such budget requirements present significant difficulties – especially for many low income developing countries – as when food prices surge, decreases in government revenue and increases in social expenditures happen at the same time.

A number of mechanisms, including cash transfers and food access approaches through in-kind distribution and food vouchers, can target vulnerable population groups and ensure food safety at the household level.

Cash transfers are the best option but require well-functioning food markets

Targeted cash transfers constitute the best option. Such measures are appropriate where food markets function and improved access to food is the objective of the intervention. Within the context of food price increases, in addition to providing the ability to procure higher priced food, cash transfers also allow households to make decisions as to how to spend or invest the cash. For example, households that have produced sufficient food may need the cash for non-food consumption, or may have to finance investment. Cash transfers can also foster local food market development by providing greater incentives to the private sector to engage in higher volume, more stable marketing channels.

Food voucher distribution schemes have a higher administrative cost than cash transfers, but can also become a parallel currency in food and other goods' markets. As such, they can have some of the positive effects of cash transfers in improving local market development, but tend not to be used for investment.

In some contexts, **increasing the wages** of lowly paid public servants and workers as a means of transferring cash can assist poorer urban consumers. For example, the proposal to increase public sector salaries by 30 percent in Egypt was a response to the unrest over the high cost of food. Many low-paid public servants in Egypt are included amongst the poor and vulnerable[4]. However, poor households that are engaged primarily in informal sector activities may not benefit.

These programs can be scaled-up in the event of price upswings by adjusting the value of cash transfers and the quantity of food vouchers in order to maintain poor households' purchasing power. Nevertheless, if prices increase rapidly, scaling-up can be administratively difficult. Scaling down spending when prices fall can take place in a phased manner by reducing the value of benefits or the numbers of beneficiaries. In addition, for both cash-based and food voucher distribution schemes, it is important to avoid any potential disruption to private marketing channels. If private traders are unable to scale up the distribution of food, these approaches should only be implemented together with targeted food releases through public food reserves. This is necessary in order to avoid further food price increases.

In-kind food aid is the best option when markets do not function

The **distribution of food aid** is most appropriate where insufficient food supply is the main reason for reduced consumption and when food markets do not work. For example, local markets may be isolated, or local producers may not be capable of responding to high prices by increasing supply. In these cases, cash transfers or food vouchers can result in food price inflation, thus exacerbating the negative impact of the food price upswing. Food aid is more appropriate in such situations, as it increases food availability without exerting additional upward pressure on local market prices.

[4] Demeke, M., Pangrazio, G. and Maetz, M. 2009. Country responses to the food security crisis: Nature and preliminary implications of the policies pursued. Agricultural Policy Support Service, FAO.

In-kind food distribution places a lower budgetary strain on government resources, as often foreign assistance is available in terms of food aid in kind. In addition, targeting in-kind food distribution is relatively easy. School feeding programs improve school attendance and allow poor households to continue investing in children's education. However, such programs may miss target populations, such as poor households without children. Health centre, or clinic attendance feeding schemes also target the vulnerable, nevertheless they impose significant costs on the beneficiaries who have to travel in order to access the food.

Box 2: The Productive Safety Net Program in Ethiopia: An example of public works schemes in an environment of increasing food prices

In 2005, the Government of Ethiopia initiated the Productive Safety Net Program or PSNP, in order to provide reliable and timely support to chronically food insecure households in more than 260 counties. In 2008, the number of beneficiaries reached more than eight million. Technical and financial support is provided by a joint donor group that includes DFID, USAID, the World Bank, the European Commission and WFP, among others. PSNP is designed with the objective of mobilizing labour for public works activities that build infrastructure and assets to promote agricultural productivity and access to markets (e.g. feeder roads, soil and water conservation, micro-dams for irrigation). Food insecure people are offered guaranteed employment for five days a month in return for transfers of either 15 kg of cereals or the cash equivalent of US$4.00 per month for each household member.

In response to the food crisis, the Government of Ethiopia relied on donors to provide additional support to PSNP participants. The wage rate for public work programs was increased by 33 percent in January 2008. As prices continued to rise in August 2008, safety nets strained to provide sufficient support. Demand for food transfers increased sharply in the areas covered by PSNP, as the majority of households preferred food only (54 percent), followed by half food, half cash (36 percent), while less than one in ten said they would prefer cash only (9 percent).

The recent price episode highlights that vulnerability remains a major challenge, even if safety nets are in place. Addressing the problems of drought and land degradation, which are the main causes of vulnerability, requires a higher level of support at the household level and a major investment in irrigation, soil conservation and alternative sources of livelihoods.

Adopted from Demeke, M., Pangrazio, G. and Maetz, M. 2009. Country responses to the food security crisis: Nature and preliminary implications of the policies pursued. Agricultural Policy Support Service, FAO.

Food or cash for work form the basis of a number of safety nets implemented by governments and non governmental organizations. Within an environment of increasing food prices, such public works programs increase the income of the poor and improve their access to food. These programs serve an insurance function, as they prevent the poor from depleting their assets and, in addition, create indirect benefits in the form of better infrastructure, such as roads and water and irrigation facilities.

Public works can be 'self-targeting'. This is achieved through setting the wages at a level which is attractive for the poor who are not employed, but not attractive to people who are engaged in income-generating activities, such as agriculture. In this manner, only those who are really in need participate in these schemes. It is important that the public works wage is set so employment in the program does not replace other productive activities. For example, in rural areas where employment opportunities are non-existent, public works should be well-timed in order not to disrupt seasonal agricultural work.

Food for work is an option when no safety net is in place

Nevertheless, with such schemes it is difficult to achieve sufficient geographic coverage to support all vulnerable groups in the country. On the other hand, public works provide an important means of assistance to the poor when no other safety nets are in place. Therefore, governments have to target areas where poverty is both widespread and deep.

DFID Department for International Development

Policy experts suggest that such programs can effectively be targeted and scaled-up in times of need[5]. Scaling-up may be based on plans made at the community level that include a number of feasible public works and investments that can be undertaken in times of need. Such plans ought to be based on sound technical and environmental assessments so the programs have specific investment objectives and are not implemented in haste.

More importantly, the financing of public works schemes during international food price booms requires the ability to accommodate counter-cyclical budget expenditures. Countries may utilize their own revenues, or hold specific reserve funds for financing public works in times of need. In any case, during international price upswings or other country-wide shocks, the extent to which governments can meet the budgetary requirements is limited and foreign support will have to be mobilized.

[5] Alderman, H. And Haque, T. 2006. Countercyclical safety nets for the poor and the vulnerable. Food Policy, 31 pp. 373-383.

FOOD AND AGRICULTURE ORGANIZATION OF THE UNITED NATIONS
Trade and Markets Division
March 2009

The project "Policies for the effective management of food price swings in Africa" is sponsored by DFID, the UK Department for International Development and implemented by the FAO Trade and Markets Division

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