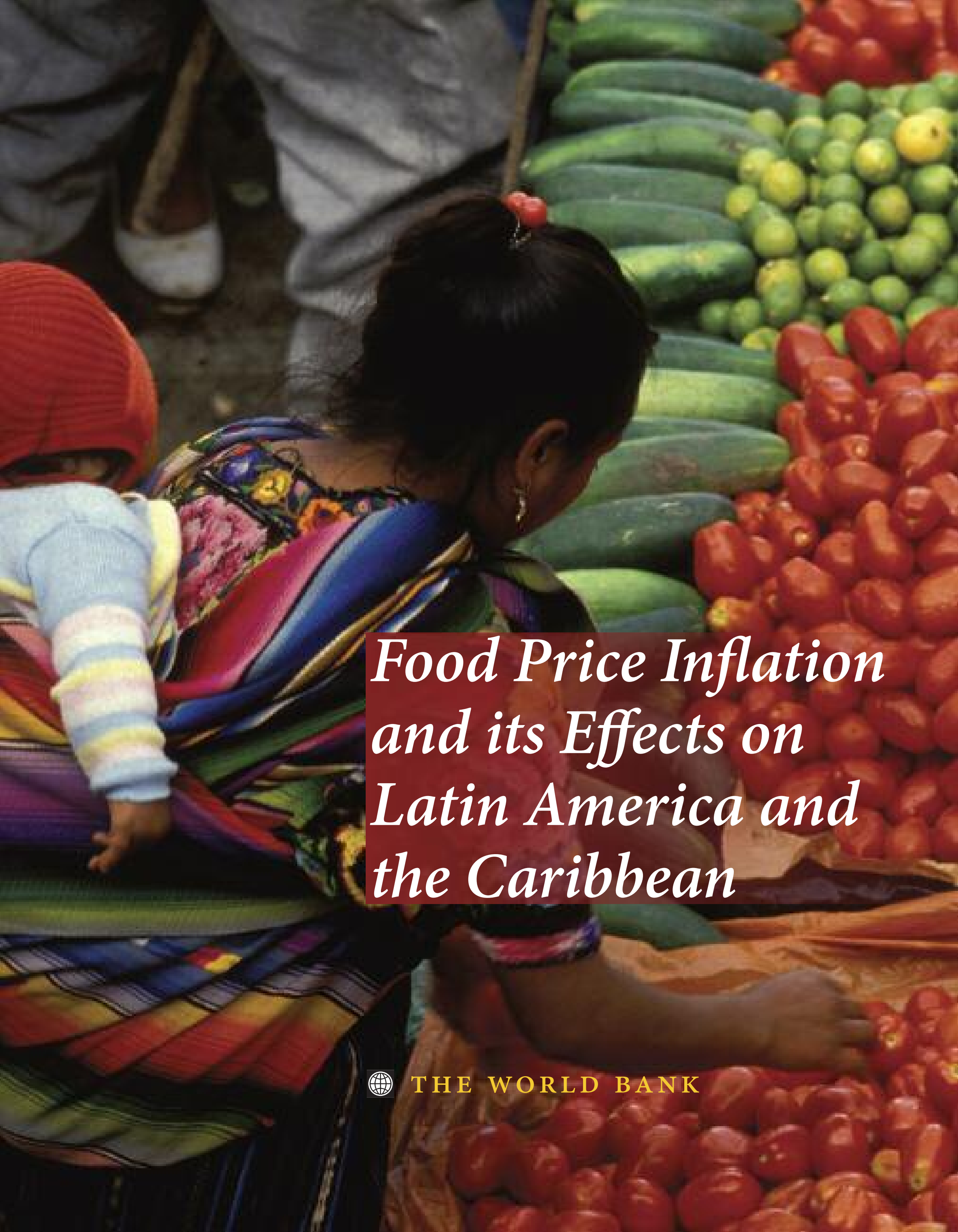


Food Price Inflation and its Effects on Latin America and the Caribbean

THE WORLD BANK

What is causing food price inflation?

Rising food prices are a growing policy challenge for both middle-income and low-income countries in the region. Between March 2006 and March 2008 the international food price index nearly doubled in nominal terms, rising 82 percent. It appears that a fundamental shift in global supply and demand is behind current food price inflation. This is due to increased biofuel production, higher energy prices, climate change and increased food consumption in emerging markets. Although these factors are structural and cyclical, we should expect that high food prices are here to stay.

What are the effects of rising food prices on the region?

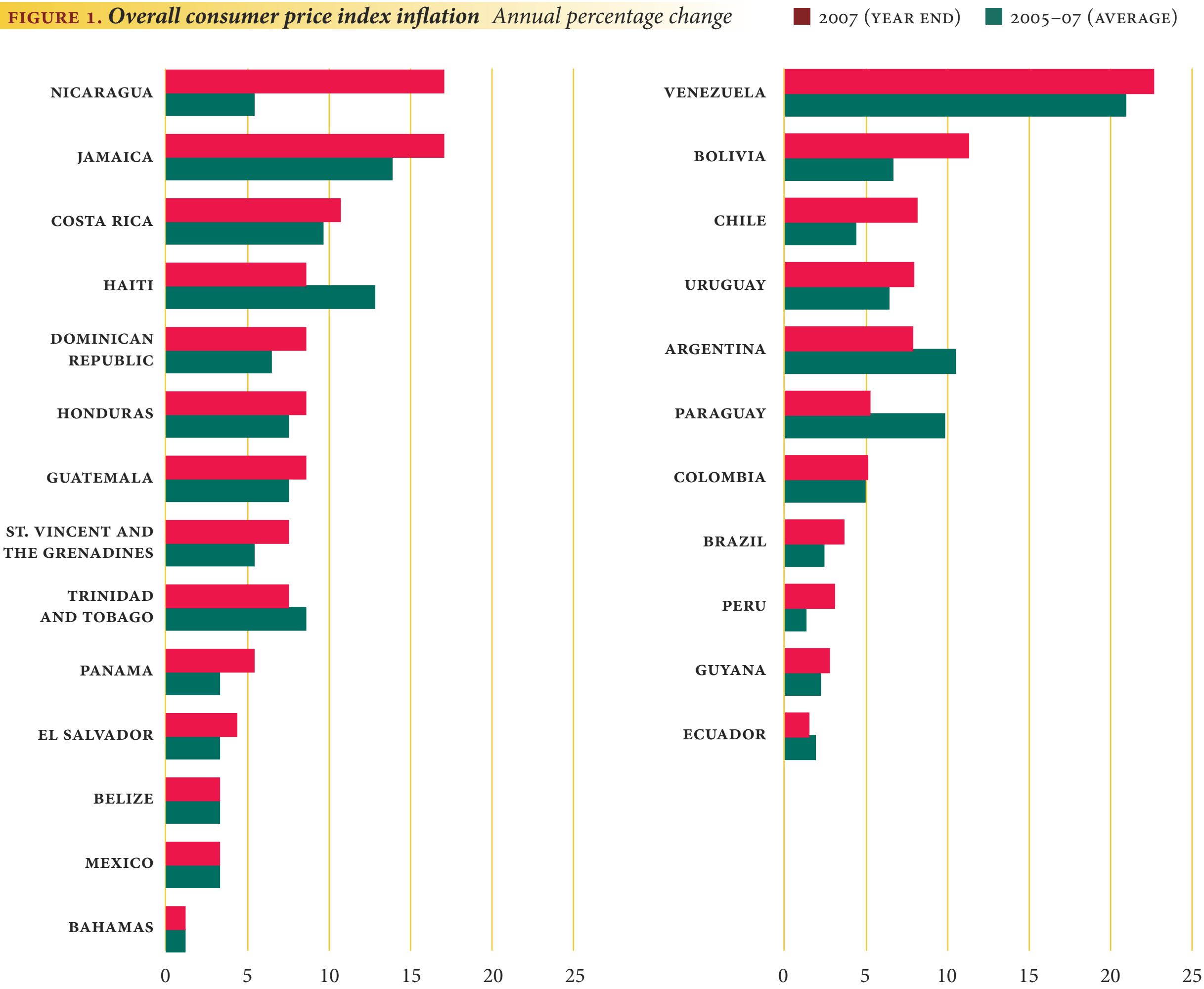
While the region as a whole is a net food exporter, food price inflation still has a detrimental impact on the income, nutrition, and health of poor consumers. Even in a country with strong agriculture, most people buy their own food and are adversely affected by rising food prices. Poor people are disproportionately affected because they spend a larger share of their income on food. Rising food prices thus reduce the real income of the most vulnerable people, with serious nutritional and health consequences. Additionally, the increase in food prices and differences in trade patterns can interact to create negative consequences even for food exporting countries. The price of some food staples has risen more than others: from March 2006 to March 2008 the international price of wheat increased 152 percent and the price of maize 122 percent, while the price of beef increased 20 percent and the price of bananas 24 percent.

Does food price inflation affect countries equally?

Food price inflation has increased across the entire Latin American and Caribbean region, affecting both food exporting and food importing countries. Food price inflation was high worldwide in 2007, and this region was no exception. Seven countries in the region saw double-digit food price inflation (Figure 1). This is a significant increase in food prices that follows five years of relatively subdued inflationary pressures. The increase in food prices has a direct impact on overall inflation in most countries because the consumer price index weighs food costs heavily. In addition, higher food prices can be expected to indirectly drive inflation by raising inflationary expectations and pushing wage inflation.

In 2007 food prices rose substantially faster than the overall rate of inflation for most countries in the region. Food prices grew the most in Bolivia, Brazil, Chile, Costa Rica, Jamaica, Nicaragua, Trinidad and Tobago, and Uruguay. Only in Argentina, the Dominican Republic, and Haiti were food and overall inflation roughly equal. International food prices are now affecting the price of Latin American food staples, even in countries where local food is consumed more than imported foodstuffs. This may be the result of Latin American and Caribbean countries' integration into the world economy, although there is no research to prove or disprove this.

FIGURE 1. ***Overall consumer price index inflation*** *Annual percentage change*

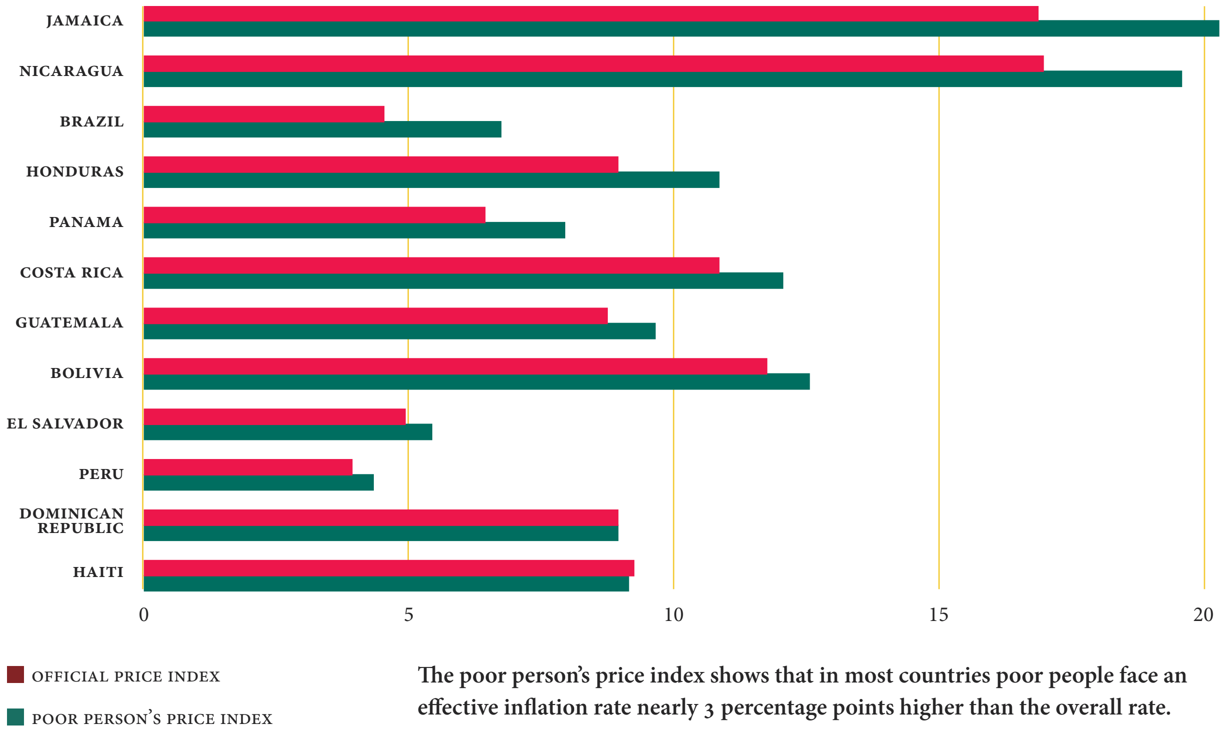


Source: National statistical institutes as reported to LABORSTA *database.*

Can the poor cope?

The World Bank created a poor person's price index for selected countries to simulate how food price inflation affects poor people's purchases. In general, the overall consumer price index for each country is constructed using a basket of goods intended to reflect what a "typical" person consumes. But poor people's consumption patterns are different than the general population. More important, more of a poor person's budget is spent on food than the average consumer in the same country, so food price increases affect them more. This can be seen through an alternative price index—the "poor person's price index"—that re-adjusts the food and nonfood components of the overall consumer price index to reflect the higher share of food in poor people's consumption.

FIGURE 2. ***Change in overall price index and poor person's price index, selected countries, 2007*** *Percent*



Source: World Bank staff calculations.

The poor person's price index shows that in most countries poor people face an effective inflation rate nearly 3 percentage points higher than the overall rate. Because food is a greater part of the household budget for poor people, and because food prices have risen faster than overall inflation, the poor person's price index has risen faster than the overall consumer price indices in all countries where data were available except the Dominican Republic and Haiti (Figure 2).

Food price increases have eroded poor people's purchasing power—especially the extreme poor and the rural poor. In effect, poor people have grown poorer—or, in the language of poverty measures, the poverty gap has increased. This change is reflected in official poverty figures depending on how poverty data are calculated in each country.[1] Rising food prices also push more people into poverty.

What can be done to help?

Food policy interventions fall into two main categories: coping and curing. Latin American and Caribbean countries have been focusing primarily on consumer coping strategies (Table 1). These policies seek to provide consumers with access to basic food stuffs, increase poor people's real income and thereby their consumption of staples, and insulate consumers from volatility in food prices. Food subsidies are critical. Evidence shows that as poor people's current income increased the proportion spent on food and the amount of food consumed increased as well.

1. *Specifically, official poverty data capture the impact of rising food prices on poverty when the consumption basket used to calculate the poverty line reflects the higher food share of the poor and when the nominal value of the poverty line is regularly updated using the actual prices of the basket components. This is the case for most countries in Latin America and the Caribbean. But in some countries the food basket reflects mean or median patterns of consumption, and in other the value of the poverty line is adjusted using the overall consumer price index.*

The most efficient policies are targeted food vouchers and price subsidies. However, an untargeted price subsidy or food voucher scheme may lead to inefficiently high consumption of the covered foods by nonpoor households.

Easing import restrictions increases food trade and boosts consumption and consumer surplus. Lifting tariff and nontariff import barriers is a step in the right direction. Moreover, there is room for further tariff reduction on certain products. While wheat imports are largely tariff-free in most countries, corn tariffs and wheat flour tariffs are high across many countries in the region.

Rapid responses from the region

Conditional cash transfer programs (CCTs) deliver additional cash to poor households and help offset the risk of malnutrition, school absenteeism, or forgoing healthcare services.[2] Income generation programs make sense in urban areas, where the households most affected are likely to have surplus labor. Workfare programs concentrate the available funds on wages and can be geared up fast. Social funds can generate employment and income in poor communities. Many countries have municipal programs that offer cash transfers or free food—such as soup kitchens or comedores populares.

2. Even without an increase in benefits, conditional cash transfer programs reduce the risk that negative income shocks will reduce school enrollment and routine healthcare because withdrawing from the services leads to still further income losses.

TABLE 1. ***Policies in use in the Latin America and the Caribbean region***

POLICY MEASURE	COUNTRY
Targeted food for work program	Brazil
Food ration or food stamp program	Argentina, Brazil
School feeding program	Bolivia, Brazil, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Panama, Paraguay, Peru, Uruguay, Venezuela
Conditional cash transfer program	Argentina, Bolivia, Brazil, Chile, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Panama, Paraguay[a], Peru, Uruguay
Consumer price subsidies	Bolivia, Ecuador, Jamaica, Nicaragua
Fertilizer or input subsidies	Bolivia, Guatemala, Haiti, Mexico
Increasing supply using food grain stocks	Ecuador, Honduras
Export ban on food staples	Argentina, Bolivia, Ecuador
Easing restrictions on imports by reducing tariffs and easing nontariff trade barriers or government purchase of food abroad to sell at home at controlled prices	Bolivia, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Paraguay, Venezuela
Food price controls in selected government markets or in all markets[b]	Argentina, Bolivia, Honduras, Mexico, Panama, Paraguay
Bilateral agreements on food or grain imports	Bolivia, El Salvador, Honduras, Mexico, Panama, Venezuela
Reducing value added tax on food or grain	Venezuela

a. Paraguay's conditional cash transfer program is being scaled up from the 17,000 households that were covered at the end of 2007.
b. Includes temporary price controls on specific products. In some countries (such as Argentina) price controls allow for pass-through of cost increases.

Many school feeding programs are well targeted but underfunded, so feeding is erratic. Providing every poor child with a meal every day could help offset the income effect of higher food prices on household budgets and also reduce the risk of reduced school attendance.

The best way to maintain regular basic heath care during income shocks is to ensure that basic heath care is free for poor households. Free health insurance programs targeted to households in the lowest wealth quintiles are most effective. They already exist in several countries in the region and should be strengthened, and other countries should be encouraged to establish them.

A lack of contributory pensions remains a major problem for vulnerable old people in the region. Countries should be encouraged to establish social pensions for the elderly poor, who are most vulnerable to food price increases.

What can the World Bank do to help?

The Bank stands ready to support governments through financing and technical assistance. The Bank is prepared to assist through a mix of coping and curing strategies, including both rapid response programs and those that require a longer horizon. The objective should be to act now while thinking about how best to advise and assist in the implementation of sustainable and effective policy in the medium-term. The components of Bank support to regional governments therefore would include financing, technical assistance, and analytical work. These components can only be implemented through intensive policy dialogue with governments in order to ensure tailoring to country-specific circumstances while bringing to bear operational lessons from cross-country experiences.

Rapid response will require a combination of emergency financing support and quick evaluation of the feasibility of scaling up existing programs. Information gained regarding vulnerable households from existing targeted schemes, such as CCTs, will serve as a critical input in short notice policy response. In addition the Bank can scale up financial support to cash transfer programs when doing so does not compromise efficacy. Accelerating disbursements on existing loans is a means to providing emergency financing support, as is quick provision of grants to International Development Association (IDA) countries, and donor coordination to facilitate concessional financing. The deferred drawdown option can provide a contingent line of credit in case of future strain on public finances.

To provide immediate assistance, the World Bank announced on May 29, 2008, a new US$1.2 billion rapid financing facility to address immediate needs. This fund will support international efforts to overcome the global food crisis, including US$200 million in grants for the most vulnerable. Haiti already has been approved for US$10 million to cope with the food crisis and support its poverty reduction strategy. The new facility also includes a Multi-Donor Trust Fund to facilitate policy and operational coordination among donors and leverage financial support for the rapid delivery of seeds and fertilizer to small farmers for the upcoming planting season. Additionally, the World Bank will boost its overall support for global agriculture and food to US$6 billion next fiscal year, up from US$4 billion.

In the longer term, the Bank's focus needs to be on sustainable policy options. The current episode of food inflation has refocused the world's attention on the role of food policy. The Bank has a significant role to play in transforming the policy debate into sustainable action aimed not only at managing the current crisis but enacting longer term measures. In the medium and long term, the Bank can assist governments in incorporating insurance strategies into their food policy planning, through financing and technical support. The Bank's expertise in agricultural policy can help improve supply responses – for example through rural development programs and measures aimed at enhancing agricultural productivity. This also applies to school feeding, food for work, food stamps, and other kinds of targeted consumer subsidies. The Bank can provide technical assistance and all necessary support to create or expand such programs.

For more information on the food crisis in Latin America and the Caribbean, please visit: www.worldbank.org/lac

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