



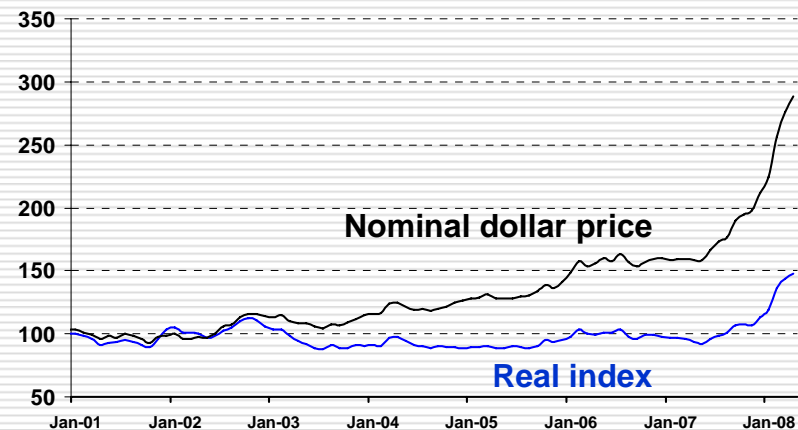
The Economics of Food Price Increases in Africa

Adapted from a presentation by Shantayanan Devarajan
and Delfin S. Go

I. The size of the external shock

- ❑ Nominal increase ranges from 72 to 103 percent since end 2006.
- ❑ The dollar weakening ameliorated the impact, but the real increase still ranges from 45 to 70 percent – historical highs
- ❑ Franc zone countries more affected by their imports of higher priced food – wheat and rice
- ❑ Middle income hurt by the alignment of their currencies to the dollar
- ❑ Land-locked, low income countries “relatively” less affected

Import price index
of food in SSA



II. Inflationary impact affected by

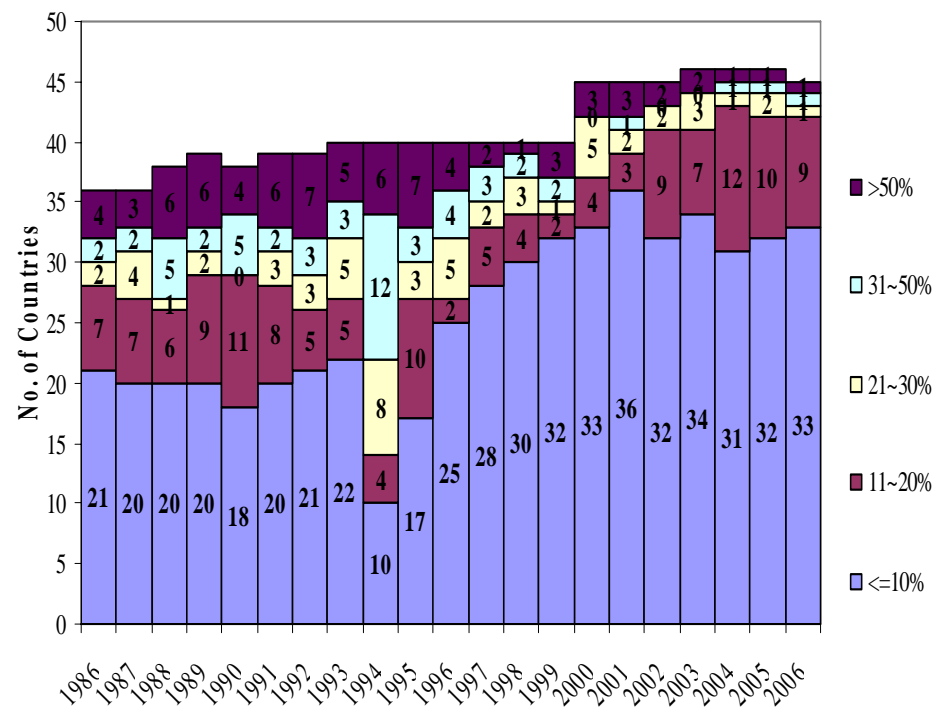
- Macroeconomic management
 - Exchange rate management
 - Fiscal policy (subsidies)
 - Monetary policy

- Amount of pass-through of food prices determined by
 - Relative importance of imported food in household budgets of urban and rural areas
 - Substitution with non-traded food (e.g. cassava, yams etc.)

Macroeconomic management -

- ❑ African countries have achieved macro stabilization
- ❑ The regional inflation rate has fallen to less than 10% since 2002
- ❑ Higher food and oil prices will test countries and threaten achievement
- ❑ Only one severe case of hyperinflation – Zimbabwe
- ❑ But a number of countries are now experiencing a significant rise in inflation: Ethiopia, Burundi, Uganda, South Africa, Cameroon

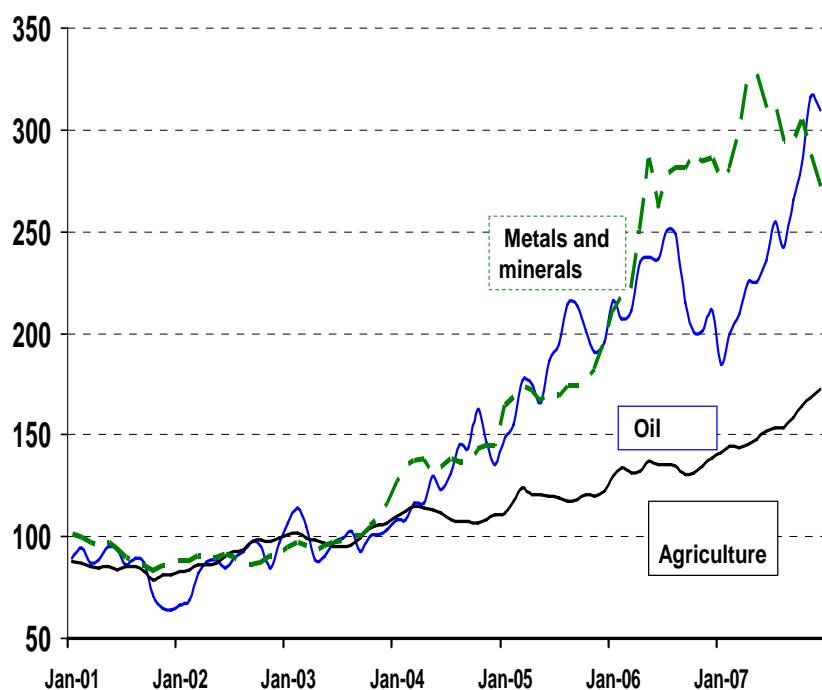
Inflation Pattern in Africa



III. Terms of trade shock: Rising commodity prices have generally been beneficial to SSA's terms of trade up to 2007

□ Commodity and oil prices

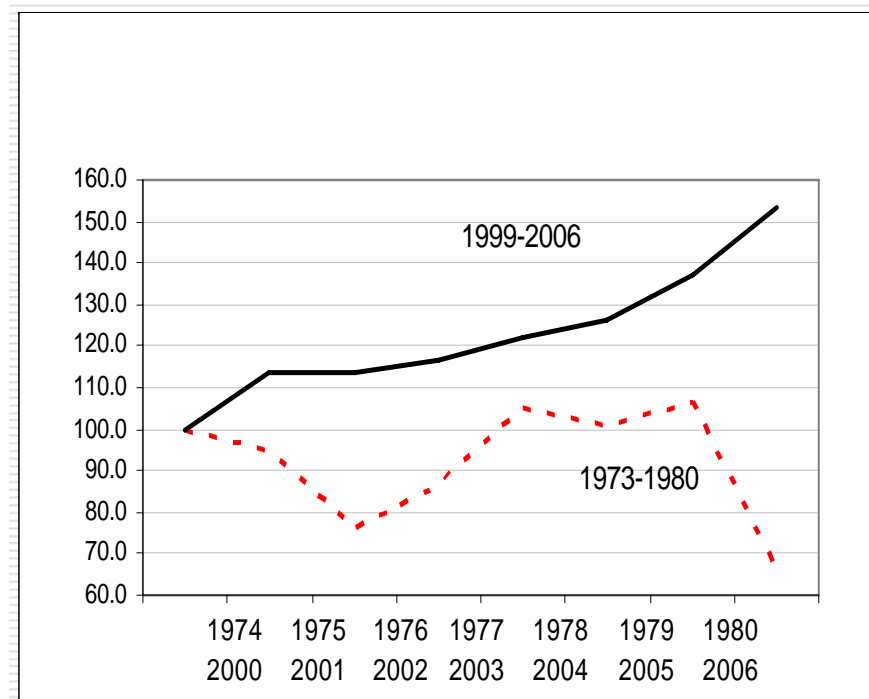
■ (Price indices, 2000=100)



□ Terms of Trade Index in SSA

1973-1980 and 1999-2006

(1973, 1999 = 100)



Potential vs. actual terms of trade impact will likely differ across countries

- Potential TOT impact given trade quantities shows some countries could be affected adversely.
- TOT shock for many countries mitigated by overall buoyant commodity prices: for example, higher fuel and food prices in Ghana offset by higher prices for cocoa and for gold.
- Some countries: eg. Lesotho, Ethiopia having difficulty meeting import bills

- However, the actual impact will likely differ given financing constraint
 - trade quantities will change,
 - Substitution from cheaper alternatives, and
 - the real exchange rate will likely adjust

IV. Impact on the poor : Possible channels and issues

□ Consumption channels

- Cost of same basket more because of higher prices
- Food is over 50 percent of consumption of poor households
- In rural areas, impact is dampened for households with own-produced food
- Substitution between traded and non-traded food will affect outcome

□ Production channels

- Income gains from selling food at higher prices, especially in rural areas
- Wage gains in agriculture sector & for unskilled labor
- Supply response in agriculture will also add to income

IV. Impact on the poor: Some facts

		Share of Food Expenditure in Household Budget of 23 African Countries (%)				
		National	Rural	Urban	Q1	Q5
□ Household food budget share averages 55% in 23 African countries	Ave of 23 African Countries	55	61	48	63	48
	Income Level					
□ The share is higher in rural areas, low income, countries, and lowest income quintile	Low Income Countries	59	64	50	67	52
	Middle Income Countries	45	54	42	51	38
	Degree of Urbanization					
□ Highest national food budget shares in Burundi, DRC, Niger, Tanzania, Zambia, Kenya, Cameroon, Madagascar	Low Urbanization	61	65	48	68	54
	Medium Urbanization	60	66	54	67	52
	High Urbanization	49	56	45	56	42
	Region					
	East	64	71	46	73	56
	West	53	60	47	62	46
	South	57	62	51	66	49
	Central	50	55	49	50	45

Source: Household Expenditure Survey Database, Africa Region, The World Bank

Poverty Impact May be Sizable

- A 50% increase in selected food prices will increase poverty by 1 to 8 percentage points depending on the combined consumption and production effects based on projections prepared by Quentin Wodon
- Countries with potentially large impact on poverty include Niger, Liberia, Mali, and DRC
- Higher costs of food also limits availability of emergency assistance

IV. Impact on the poor: Additional facet

Issue is more than food prices:

Food prices index in May: 275 (2000=100)

Fuel price index: 425

Fertilizer index: 490

Increase is both large and rapid

	Jan-Dec 2006	First half 2008
Urea	223	434
Phosphate	44	288
Potassium	174	420

Implication for Subsistence Farmers

Net food purchaser might need income support (at least until wages adjust)

Net producer may need increased credit but can recoup cost with high prices of output

Subsistence farmer that achieves that state with, say, one bag of DAP on one hectare will be hard pressed to stay at subsistence

Some subsistence farmers, however, use few inputs; they may be relatively unaffected in short run but overall development path might have to adjust to current prices

Increasing world prices for food and fuel present a range of policy challenges

- ❑ **Not passing** through price increases is undesirable on fiscal and efficiency grounds
- ❑ **Passing** through price increase is undesirable on equity grounds
- ❑ High return to developing a targeted social safety net: serves to address climate variability as well
- ❑ The policy challenge in short-term in low-income countries is to compensate for absence of safety net and targeting capability

V. Policy Responses

- Trade policies
 - Export restrictions and taxes (“beggar thy neighbor”) aggravate price increases elsewhere, encourage smuggling, and lower returns to domestic farmers
 - Lowering import tariffs may provide temporary relief to consumers, but also lower fiscal revenues
- Agricultural policies
 - Government policies and regulations may hamper supply response
 - Transport and other infrastructure bottlenecks
 - Higher costs of fertilizer and seeds
- Social protection policies
 - Which targeted social assistance programs can be scaled up?
- Fiscal policies
 - How to protect the poor without jeopardizing macroeconomic stability
 - Price controls can be counterproductive (create shortages)
 - Untargeted consumer subsidies can be fiscally costly

Concluding remarks

- Africa's decade-long resumption of growth and poverty reduction is threatened by the sharp increase in food prices
 - Higher inflation undermines macroeconomic stability
 - Terms-of-trade shock could slow economic growth
 - High budget shares of food means poverty will increase
- But:
 - Inflationary pressures in only a handful of countries
 - Terms-of-trade shock can be managed, especially since overall terms of trade are rising for many countries
 - Impact on the poor can be contained by expanding targeted social assistance programs and avoiding counterproductive policies such as price controls and export restrictions
- And:
 - High food prices are an opportunity for African farmers, provided their producer prices rise and some of the constraints facing them, such as infrastructure and access to fertilizers and seeds, are relaxed