



Fiscal Implications of Food and Fuel International Price Increases

Fiscal Affairs Department
International Monetary Fund
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Increases present range of policy challenges for governments

- Efficiency considerations require full passthrough
 - Encourages appropriate responses by consumers and producers and mitigates macro impact
 - But decreases real incomes of households with adverse poverty impacts that requires mitigating measures
- Less than full passthrough dilutes responses and fiscal costs crowd-out other expenditures
 - Reducing taxes results in forgone revenues and price controls result in escalating subsidies
 - Benefits accrue mainly to higher income groups reflecting unequal distribution of consumption



IMF carried out survey to identify how governments were responding and associated fiscal costs

- Together with area departments, Fiscal Affairs Department collected information from 146 country teams on policy responses and fiscal costs
- Recent IMF study reports on these and broader dimensions of price increases
- <http://www.imf.org/external/pubs/ft/survey/so/2008/NEW070108A.htm>



Some Caveats

- Review of policy responses based on those reported by mid-June 2008 (from end-2006)
 - Numbers for 2008 based on known policy responses and projected world prices
 - Not possible to calculate fiscal cost for all policy responses
- Policy responses and fiscal costs for 2008 are changing
- Currently working on improving quality of responses and analysis



Countries have used a range of policy responses on the revenue and expenditure sides

- Expenditure measures have been more prominent in addressing higher fuel prices
 - Almost half of the countries increased fuel subsidies
 - Around one quarter reduced fuel taxes
 - Numbers may underestimate total subsidies if exclude off-budget subsidies
- Tax measures have been more prominent in addressing higher food prices
 - Over half the countries reduced food taxes
 - Around one quarter increased food subsidies



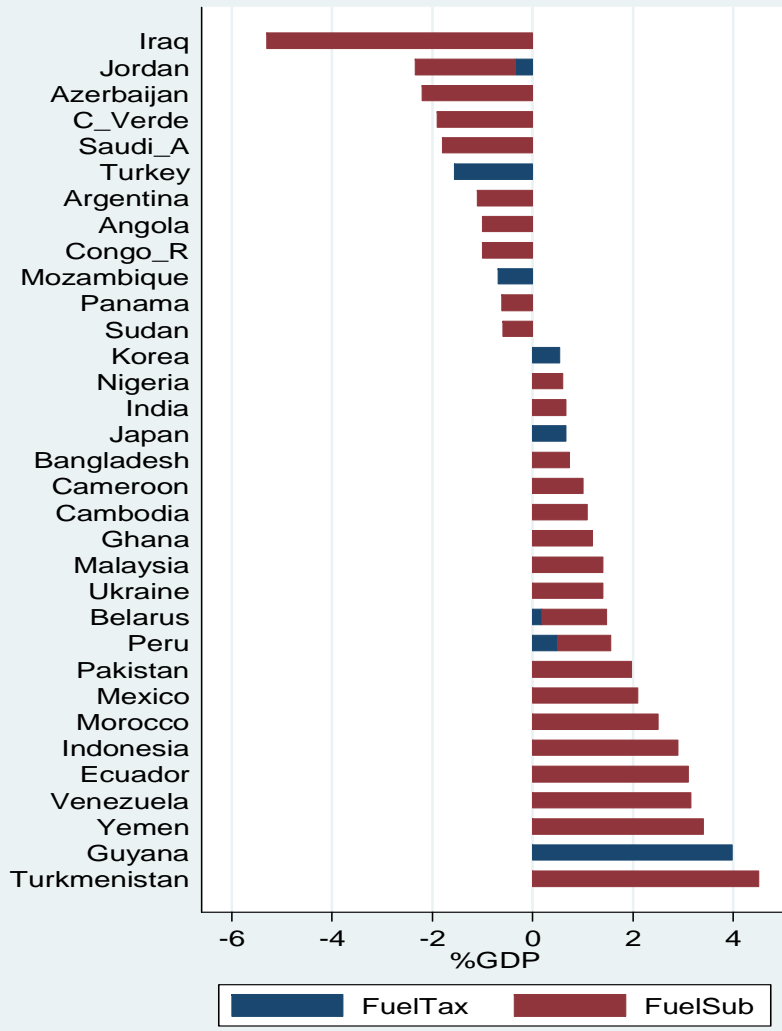
The fiscal cost of fuel tax decreases and subsidy increases has been large (probably increasing)

- The median fiscal cost of tax decreases was 0.3 percent of GDP
- The median fiscal cost of subsidies was 0.6 percent of GDP
- Some countries with already large subsidies required policies to reduce these to more sustainable levels
- Five countries have projected 2008 subsidies greater than 5 percent of GDP with eight countries greater than 2 percent

Fuel fiscal costs and subsidies

Fuel Fiscal Costs 2006-8

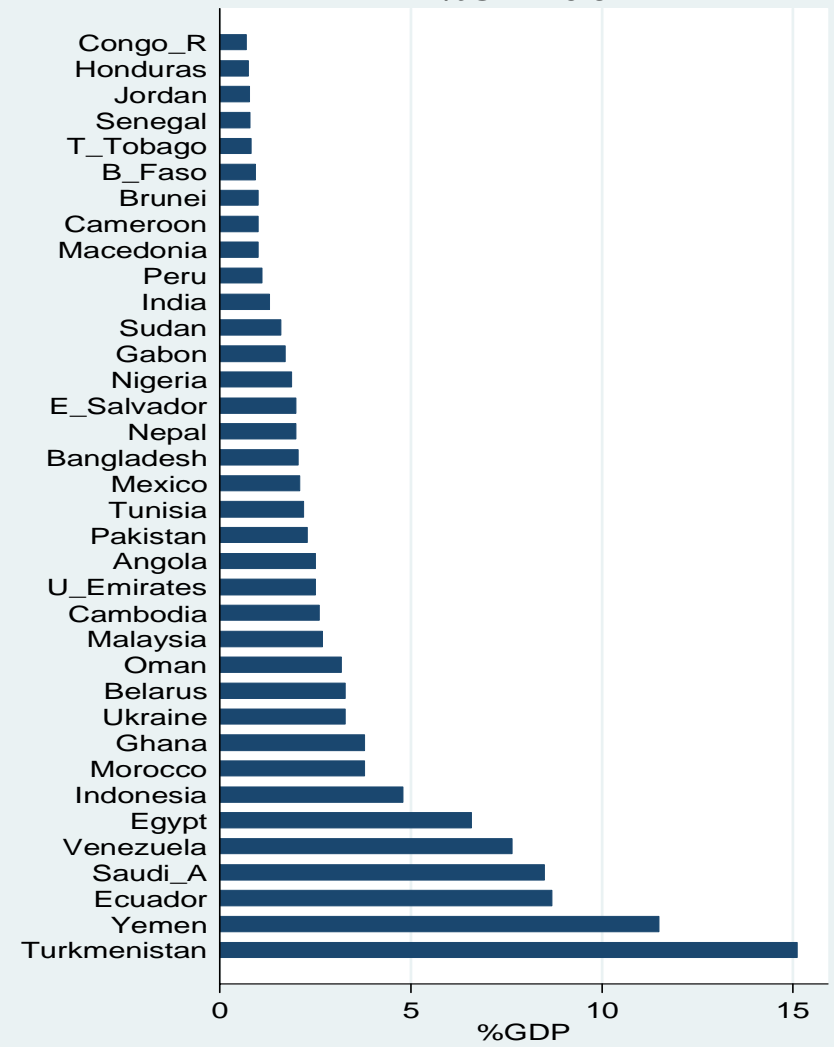
-0.5>%GDP>0.5



Source: IMF Survey

Total Fuel Subsidies 2008

%GDP>0.5



Source: IMF Survey



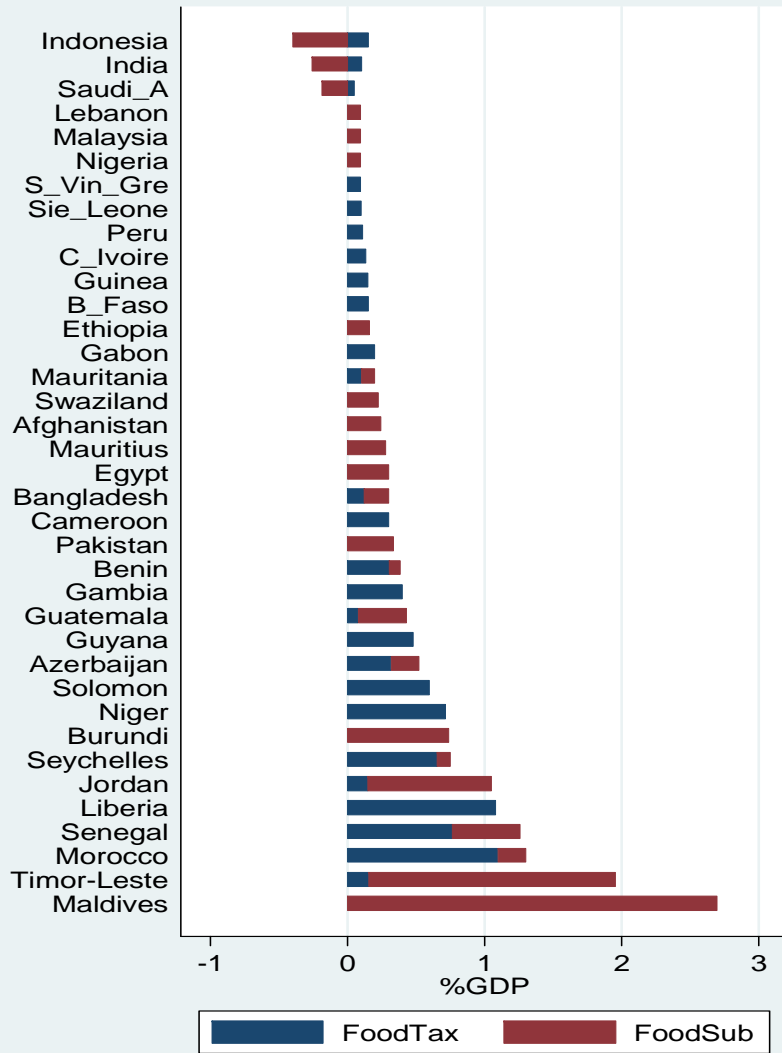
Fiscal cost of food policy responses although smaller is still substantial (probably increasing)

- The median fiscal cost of tax decreases was 0.1 percent of GDP
- The median cost of increasing subsidies was 0.2 percent of GDP
- Six countries have projected food subsidies in excess of 1 percent of GDP in 2008

Food fiscal cost and subsidies

Food Fiscal Costs 2006-8

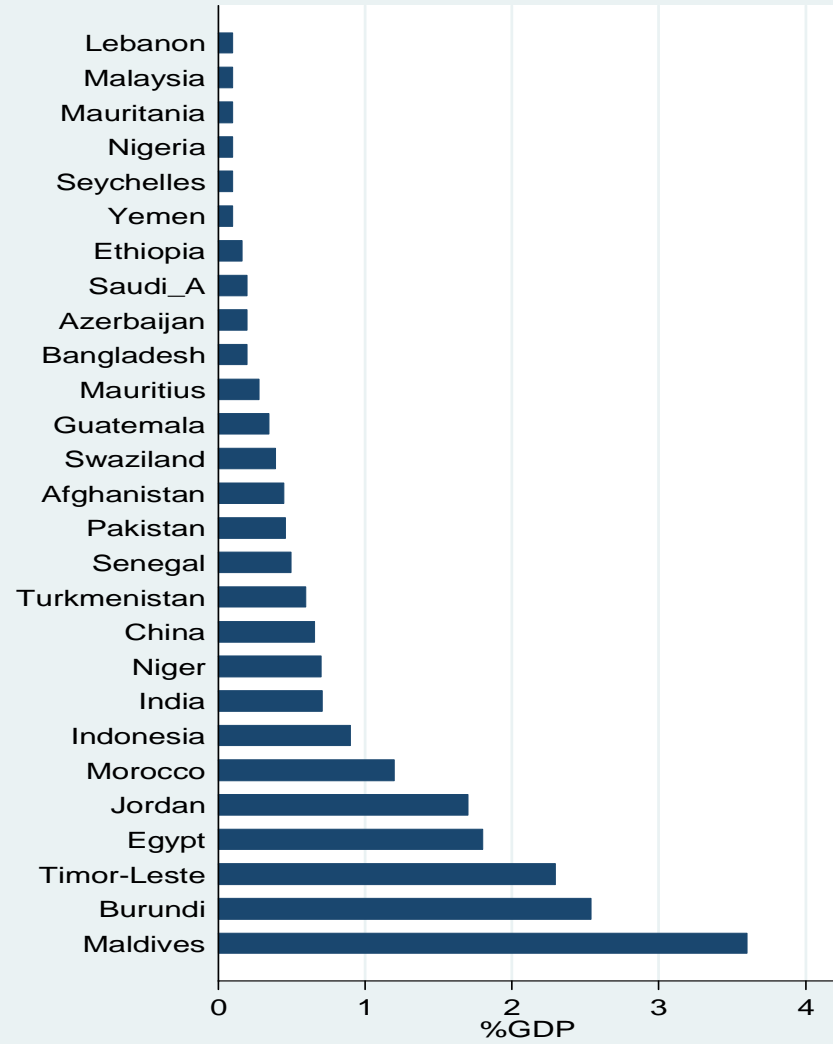
-0.1 > %GDP > 0.1



Source: IMF Survey

Total Food Subsidies 2008

%GDP > 0.1

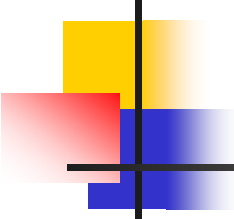


Source: IMF Survey



Targeted transfer programs can be a more cost-effective approach to social protection

- Targeted transfer programs have a number of advantages
 - They can substantially decrease the fiscal cost of protecting low-income households
 - Their design can be enhanced over time to generate lasting poverty impacts
- Where no existing safety net, countries need to develop a package based on existing programs
- Priority should be given to developing cost-effective targeted safety net programs in low- and middle-income countries

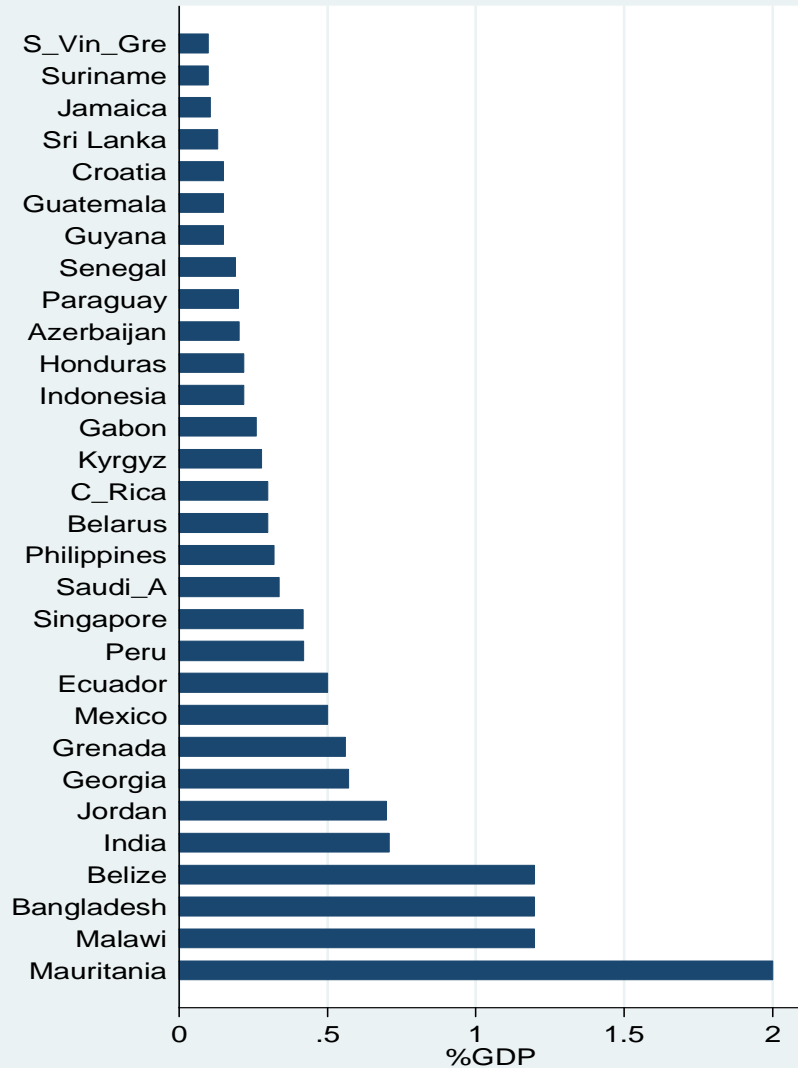


Many countries have used existing targeted transfers to mitigate the impact of rising prices

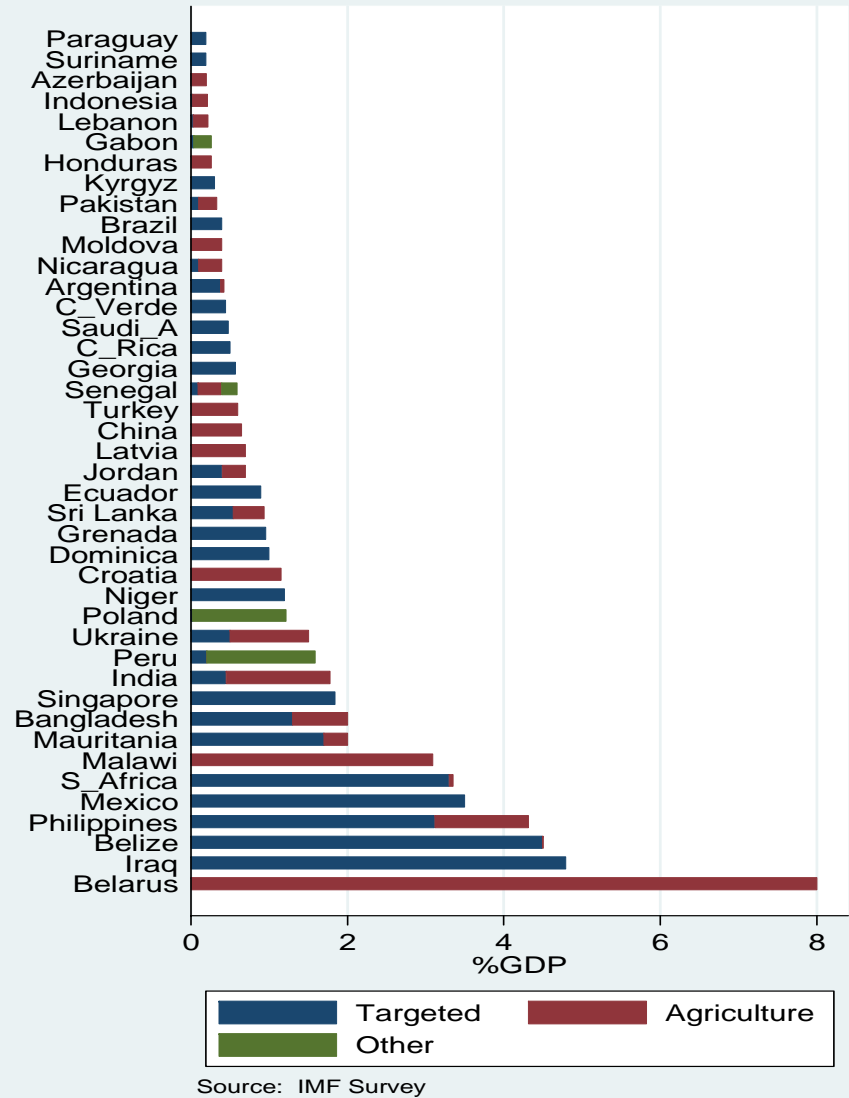
- Over a third of countries had expenditures on targeted transfer programs (including safety nets and agricultural subsidies) in 2008
 - 21 countries had targeted social safety net programs
 - 15 countries reported expenditures on agricultural subsidies
- Nearly 40 countries expanded targeted transfer programs, with an associated median fiscal cost of 0.2 percent of GDP

Targeted transfer programs

Change in Transfer Costs
%GDP>0.1



Total Transfer Costs 2008
%GDP>0.2

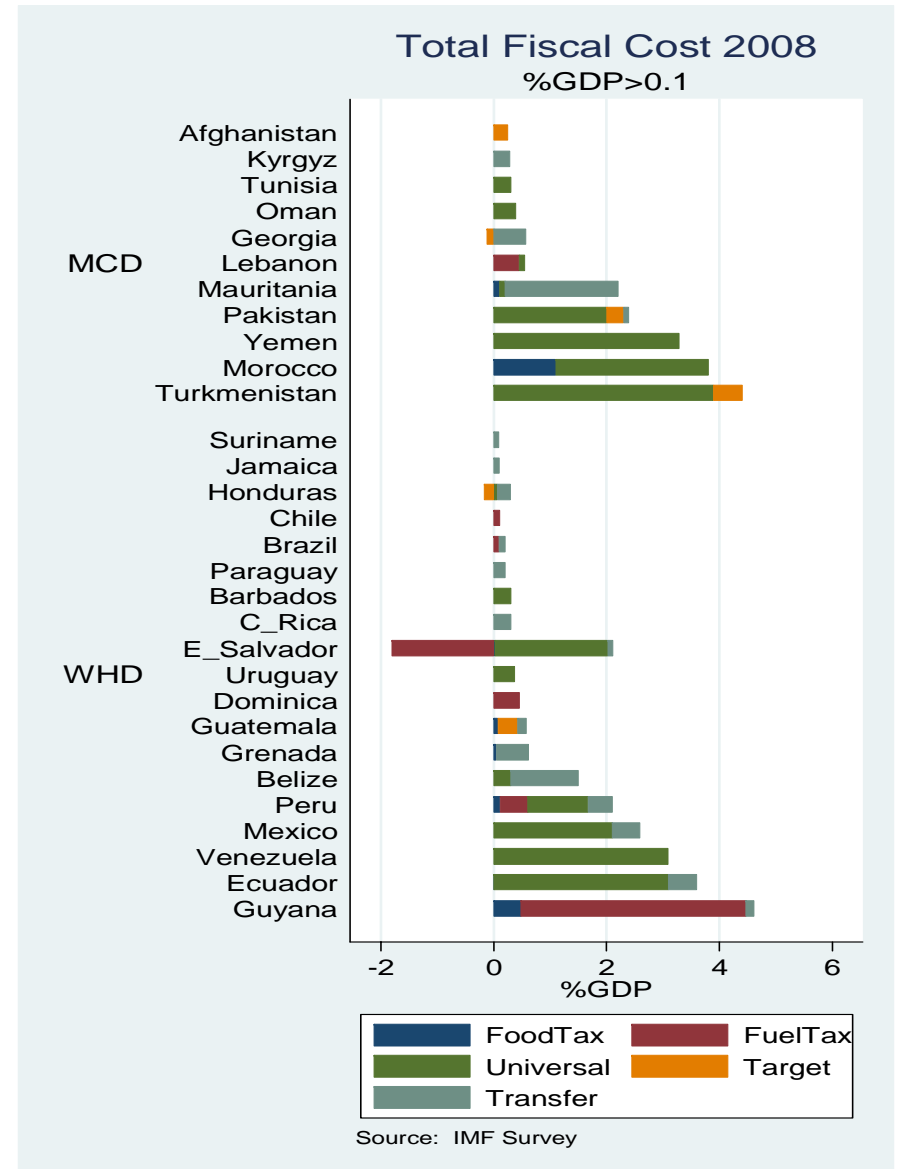
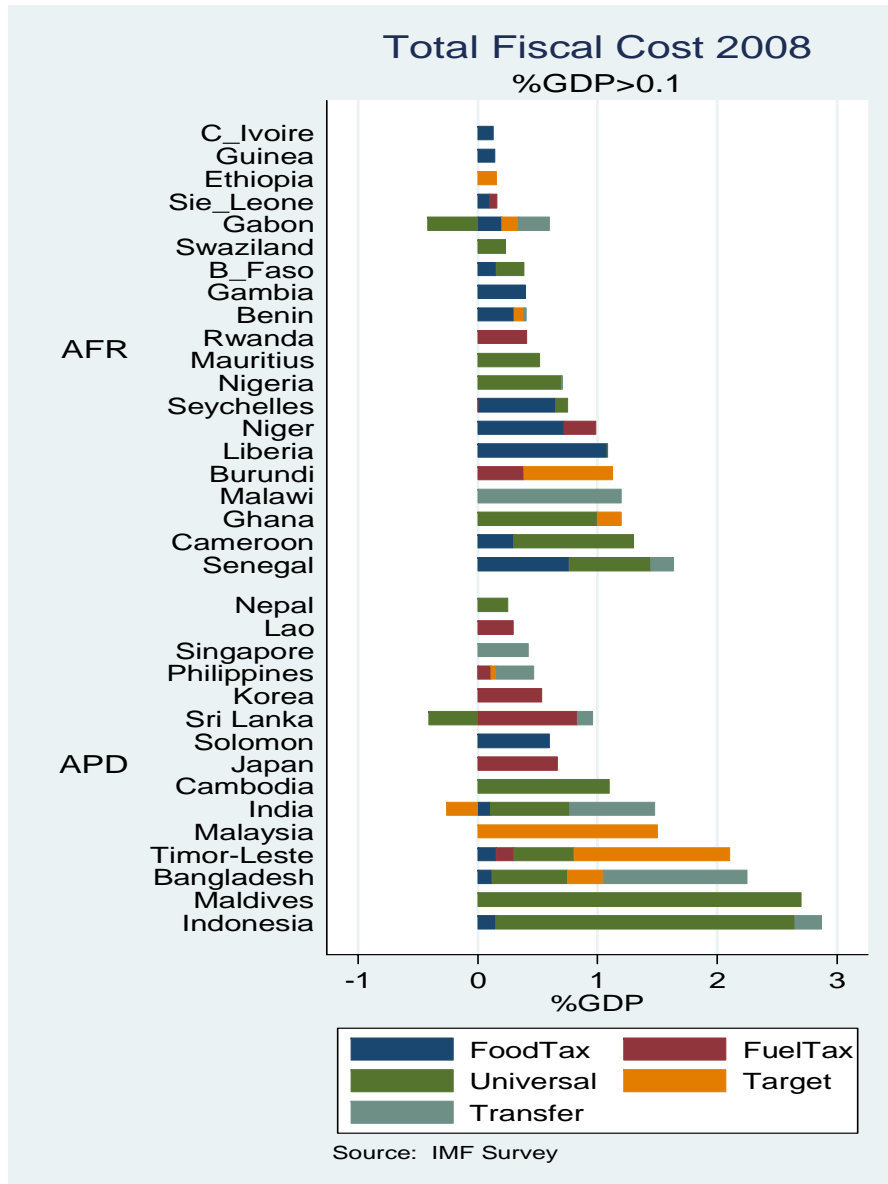




The total fiscal cost of the measures introduced has been substantial in many countries

- The median fiscal cost was 0.6 percent of GDP
- The fiscal cost exceeded 1 percent of GDP for about one-fifth of countries (largely driven by increasing fuel subsidies)
- The median fiscal cost as a percentage of total revenue plus grants was 1.9 percent
- Of the 79 countries reporting net fiscal costs, 50 were classified as vulnerable to balance of payments pressures
- Half of the countries were PRGF-eligible, this share being higher for countries with large fiscal costs relative to GDP

Total fiscal cost of policy responses





Summary & Conclusions

- Countries have introduced a range of broad tax and expenditure measures to mitigate adverse impacts of increasing world prices
- These measures have a number of shortcomings
 - Inefficient: no incentives to increase production, decrease consumption
 - Badly targeted: not cost-effective approach to protecting poor
 - Fiscally costly: so crowd-out higher priority expenditures
- Partly reflect absence of better targeted measures



Summary & Conclusions

- Policy challenge going forward is to
 - Replace these with better targeted and better designed safety nets
 - Persuade middle classes that the budgetary savings from reform will be channeled to higher priority expenditures to promote growth and poverty reduction
- The IMF is ready to support countries in improving these policy responses through developing more efficient and equitable tax and transfer systems
- Developing cost-effective targeted safety net programs and improving effectiveness of public expenditures generally are key components of this strategy and the IMF will support the World Bank in promoting this strategy