



Why stable food prices are a good thing: Lessons from stabilizing rice prices in Asia

David Dawe^a, C. Peter Timmer^{b,*}

^a Agricultural Development Economics Division (ESA), FAO/Bangkok, Thailand

^b Cabot Professor of Development Studies, emeritus, Harvard University, USA

ARTICLE INFO

Article history:

Received 1 June 2012

Accepted 12 September 2012

Keywords:

Food price stabilization

Rice

Structural transformation

ABSTRACT

This paper describes the benefits and costs of managing food price instability in the context of promoting economic growth and poverty reduction in order to improve food security. Some key costs of stabilizing domestic food prices include disruption of international markets, crowding out of private traders if government procurement is too large or destabilizes expectations, and large financial costs if the gap between domestic and world prices is too large, although a well-run program need not incur most of those costs. In poor countries, stable staple food prices help prevent poor farmers and consumers from falling into poverty traps, promote farm-level investment, and encourage investment throughout the economy by reducing the “noise” in prices of other goods and by promoting social and political stability. Because of these benefits, domestic rice price stabilization has been an integral part of the development vision in Asia.

© 2012 Food and Agriculture Organization of the United Nations. Published by Elsevier B.V. All rights reserved.

1. Introduction

After several decades of relatively stable international grain and cereal prices, several major price spikes in the past five years have made price volatility once again a hot topic for discussion. Recent high-profile reports (FAO et al., 2011; HLPE, 2011; Tangerman, 2011) have discussed various measures to prevent, manage or cope with price volatility, and Galtier (in preparation) provides a useful way to categorize the various types of instruments that are typically used, advocated or criticized. This paper focuses on the advantages and shortcomings of one particular approach—national efforts to stabilize domestic prices.

The premise of this essay is that an early escape from hunger—achieving food security at the societal level—is not just the result of one-way causation from economic growth generated by private decisions in response to market forces. Improved food security stems *directly* from a set of government policies that integrates the food economy into a development strategy that seeks rapid economic growth with improved income distribution (Timmer et al., 1983). With such policies, economic growth and food security mutually reinforce each other. Countries in East and Southeast Asia offer evidence that poor countries using this strategy can escape from hunger in two decades or less—that is, in the space of a single generation. At the macro level, policy-makers created the aggregate conditions in which households at

the “micro” level gained access to food on a reliable basis through self-motivated interactions with local markets and home resources.

The dominance of rice in the diets of most Asians, coupled to the extreme price instability in the world market for rice, forced all Asian countries to buffer their domestic rice price from the world price. This clear violation of the border price paradigm, and the accompanying restrictions on openness to trade, seems to have escaped many advocates of the East Asian miracle, who saw the region’s rapid growth as evidence in support of free trade (World Bank, 1993). In fact, the Asian countries that have been most successful at providing food security to their citizens have based their strategies on *two* elements of their domestic food system over which they have some degree of policy control: the rate of income growth in the agricultural sector, and stability of food prices. Much has been written about the sectoral dimensions of pro-poor growth (Ravallion and Datt, 1996; Timmer, 2005), but the role of stable food prices in food security has been largely ignored by the development profession. The sharp spikes in food grain prices in 2007/08, 2010/11 and 2012 provide clear motivation for the main contribution of this paper, which is to put food price stability back on the research and policy agenda.

2. Food security: market outcomes or government action?

The modern escape from hunger to food security would not have been possible without the institutional and technological innovations that are at the heart of modern economic growth (Kuznets, 1966). But the record of economic growth for the

* Corresponding author.

E-mail address: ptimmer63@gmail.com (C. Peter Timmer).

developing countries since the 1950s shows that even in countries with relatively low levels of per capita income, government interventions to enhance food security can lift the threat of hunger and famine. The countries most successful at this task are in East and Southeast Asia, although the experience in South Asia has been instructive as well (Timmer, 2000).

Because they are poor and devote a high share of their budget to food, consumers in poor countries are exposed to continued hunger and vulnerability to shocks that set off famines (Anderson and Roumasset, 1996). Still, several poor countries have taken public action to improve their food security. The typical approach reduces the numbers of the population facing daily hunger by raising the incomes of the poor, while simultaneously managing the food economy in ways that minimize the shocks that might trigger a famine, shocks that are usually felt as rapidly rising food prices. These countries, some of them quite poor, have managed the same “escape from hunger” that Fogel (1991) documents for Europe during the 19th and early 20th centuries. Stabilizing domestic food prices was a key part of their strategy.

In particular, Asian governments sought to stabilize rice prices. Engel’s Law ensures that success in generating rapid economic growth that includes the poor is the *long-run* solution to food security. In the language of Dreze and Sen (1989), such economic growth provides “growth-mediated security.” In the meantime, stabilization of food prices in Asia ensured that *short-run* fluctuations and shocks did not make the poor even more vulnerable to inadequate food intake than their low incomes required (Timmer, 1991, 1996). Essentially, food price stabilization functioned as social protection, and Asian governments view it as such (although the academic literature does not). Indeed, most economists are highly dubious that such food price stability is financially feasible or economically desirable. Thus, price stabilization is not a key element of the “support-led security” measures outlined by Dreze and Sen (1989).

There are at least four main “theoretical” objections to using trade restrictions to stabilize food prices. First, it is argued that trade restrictions reduce economic efficiency. Second, it is argued that trade restrictions are not targeted to the poor and thus waste scarce resources. Third, it is argued that given the persistence of shocks to world prices, it is not possible to stabilize domestic prices without substantial fiscal costs. Fourth, it is argued that trade based domestic stabilization policies destabilize the world market, thus making it worse for consumers in other countries relative to the counterfactual of no trade restrictions (see Anderson, 157–166). While all of these objections have merit, they are all overstated.

In terms of economic efficiency, it is true that trade restrictions reduce aggregate welfare in a short-run sense: in order to maximize economic welfare it is necessary to let prices fluctuate freely on a month to month basis, indeed even day to day. This is true, however, only in a world where farmers (and other investors) can costlessly move in and out of investments (see Section 3 below). For example, it is often argued that damping price spikes reduces the incentives of farmers to invest. This is true in the short-term, but many countries have a long-term vision of stabilization that also eliminates sudden price declines. On balance, then, farm incentives are not affected, and the decreased volatility may actually facilitate investment (Subervie, 2008).

It is also argued that trade restrictions are not targeted to the poor. This is true, but it misses a key point. A policy to protect the poor should not be evaluated on whether it also delivers benefits to the non-poor, but rather on the costs of reaching the poor. If there is a low cost policy that delivers benefits to the poor, and at the same time that policy happens to deliver benefits to the non-poor at zero or low marginal cost, then the benefits to the non-poor (i.e., the lack of targeting) should not be considered a disadvantage. Instead, the policy should be evaluated on the basis

of its total costs relative to the benefits delivered to the poor. A well implemented price stabilization policy based on trade could have very low costs, and in an economy with reasonably well functioning markets would deliver benefits to nearly all of the poor. In such cases where the policy is low cost, it makes sense to minimize the number of poor people who are excluded from its benefits even if many non-poor also reap some benefits. Minimizing the number of poor who are excluded is important because it is not only the chronically poor who need to be protected, but also those who become poor as a result of a shock (HLPE, 2011).

Another objection to price stabilization policies is that shocks to world prices can exhibit long lasting persistence, so that stabilizing the domestic price at a given level will incur substantial fiscal costs that are most likely to be much greater than any benefits. Again, this is true, but it assumes that the target price remains unchanged from year to year. If the target price is allowed to adjust (but slowly) to changes in world prices, then fiscal costs can be managed and domestic prices can follow the long-run trend of world prices without being subject to sharp year to year variability. Even if the target price adjusts, it is still inevitable that, given a large enough shock, the scheme will eventually collapse in the sense that it will become bankrupt or will fail to prevent a surge in prices. But such long run inevitability is not a relevant guide to real-world policy: in the famous words of Keynes, “in the long run we are all dead.”

Finally, it is also argued that trade-based domestic stabilization policies shunt price instability from domestic markets to world markets (FAO et al., 2011). Again, this is true—but instability must be absorbed somewhere when there are exogenous shifts in supply or demand in the world food economy (Dawe, 2010). There are only a few possible shock absorbers: world market prices, stocks, safety nets, or consumer and producer welfare. Strong arguments can be made that, in poor countries, consumer and producer welfare should not serve as the shock absorber. If safety nets that include all of the poor are difficult to implement in a cost-effective manner, then the remaining possible shock absorbers are stocks and world market prices, and the choice between these should depend on costs and benefits. Since stocks are expensive to hold, trade policies deserve some consideration, even if they destabilize world prices. To the extent that one is worried about unstable world prices due to domestic price stabilization, one possible solution would be to allow only the poorest countries to implement such stabilization under the auspices of the WTO.

Probably the most serious objection to price stabilization programs is the practical difficulty that many governments have in implementing them in a cost-effective manner without destabilizing expectations (FAO et al., 2011; HLPE, 2011). India operates a very expensive program because the government procures a very large percentage of the crop and places controls on private trade (Rashid et al., 2008; Cummings, 2012). Corruption is widespread in many countries, especially when the government plays a major direct role in securing supplies (either domestically or on world markets). Price stabilization, which should ideally lead to domestic prices being equal to world prices on average over the medium-run, can also lead to domestic prices being consistently above world prices for extended periods of time, which hurts the poor because most of the poor are net buyers of food (FAO, 2011). This outcome has occurred in the Philippines, where price stabilization has turned into price support for farmers, even though this worsens poverty (Balisacan et al., 2010). It has also created large rents for traders, thereby causing huge financial losses to the government.

Despite these undeniable problems, several countries in East and Southeast Asia have stabilized domestic rice prices while allowing the private sector to procure and distribute 95% or more of the crop (Timmer, 1996; see Fig. 1 for the case of Indonesia;

Download English Version:

<https://daneshyari.com/en/article/1047595>

Download Persian Version:

<https://daneshyari.com/article/1047595>

[Daneshyari.com](https://daneshyari.com)