



Consequences of unintended food policies: Food price dynamics subject to the Israeli–Palestinian conflict



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ABSTRACT

Israel's imposition of military security measures in the Palestinian territories as a consequence of the long-lasting violent conflict between them has negative economic effects on all parties concerned. One crucial outcome is the limited ability to carry out trade, which brings about welfare losses. Conflict-induced policies such as security measures can result in sizable unintended externalities that shape the markets of and the trade in food. We assess the dynamics of daily wholesale prices of food produced in Israel and the West Bank that is traded between them and is therefore subject to restrictions on movement. To do so, we suggest a regime switching cointegration model which is estimated using a novel extension of the Johansen estimation method. We find that the two major wholesale markets of the two regions are integrated with regard to these main trading products. Deviations from price equilibria are quickly adjusted. The model suggests that movement restrictions temporarily cut off markets from each other. Implications of conflict-induced closures for welfare depend on the direction of trade and are harming both Palestinian and Israeli consumers.

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Introduction

Public policies are instruments of governments established for the purpose of attaining various objectives and can take many forms. For example, the government might intervene in economic processes to correct market failures or to support target groups based on the principle of distributional justice or due to the political power of interest groups. The OECD groups such policies in the area of agriculture into budgetary transfers, market price support and revenue foregone (OECD, 2009). While decision makers generally try to design targeted and effective instruments, policies implemented in order to meet a certain objective occasionally yield indirect unintended consequences. For example, food markets can be significantly affected by policies implemented in seemingly unrelated fields of public decision-making.

Cases of noticeable indirect effects of such policies on food markets have been discussed thoroughly in the literature. Frequently debated examples include support measures for energy crops (e.g., Mitchell, 2008; Tilman et al., 2009), health regulations (e.g., Horrigan et al., 2002) and sustainability and environmental protection (e.g., van Meijl et al., 2006). More generally, policies intended to deal with supply and demand shocks caused by events on national scale have significant impacts on the economy as a whole and on food markets in particular. Examples include coping with catastrophes such as the leaking of nuclear energy and natural

disasters, significant changes in the geopolitical arena, the division or unification of land and the management of violent conflicts.

We focus on a particular case of such side effects – the implications of political decisions taken in the context of violent political conflict for trade in food between the parties of the conflict. Under the usual conditions of peace, any policies affect the lives of economic agents to a greater or lesser extent. However, in cases of violent conflict, their consequences may be substantial because they can result in extraordinarily strong side effects that impose additional stress on the civilian population exposed to the economic effects of a violent political struggle. A popular example is the control of the movement of people and commodities in conflict zones by one or all of the parties to the conflict. Such policies have been implemented in recent violent conflicts in areas such as Sudan, Sri Lanka or the Basque region in Northern Spain.

We focus on the political conflict between Israel and the Palestinians¹ and examine the consequences of security policies imple-

¹ International law refers to the area that was captured by Israel in the Six-Day War in 1967 and in which Palestinians currently reside as *Palestinian territories occupied by Israel*. The territories consist of the West Bank, Gaza and East Jerusalem. With the exception of East Jerusalem, these territories have not been formally annexed by the state of Israel. On 29 November 2012, the UN General Assembly passed a motion changing Palestine's "entity" status to that of a "non-member state" and therefore recognizing for the first time the Palestinian territories as an independent country. Although according to international law these territories do not belong to Israel, they are not treated as foreign by Israeli authorities. In practice, the two sides in the conflict coexist next to each other with various security-based measures that keep them apart.

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mented by the Israeli Defense Forces (IDF) on the price dynamics of the bilateral fruit and vegetable trade. Given that this long-lasting, unresolved political conflict has substantial implications for the political stability of the Middle East, both the international community and many human rights groups have gathered extensive databases to monitor the conflict's development. These data provide information for quantitative scientific research. While the violence and numbers of casualties of this long-lasting conflict attract a great deal of attention of politics and media, our main goal is to examine its economic side effects for the Israeli–Palestinian food trade. In particular, we study the implications of the complete closures of the commercial terminals of the West Bank Barrier,² which connect the two economies with each other, for price dynamics and market participants both in Israel and the West Bank during the post-Second Intifada era.³

Recent economic literature has increasingly addressed the economic consequences of conflict. Blattman and Miguel (2010) provide a comprehensive account of the state of the art of research on the economic dimensions of civil conflict. However, the interdependencies between prices and political conflict have only very occasionally been addressed. A small body of literature focuses on the causal relationships between prices and violent conflict (Angrist and Kugler, 2008; Besley and Persson, 2008; Dube and Vargas, 2009; Brückner and Ciccone, 2010; Savun and Cook, 2010; Bazzi and Blattman, 2011). However, this literature focuses largely on overview analyses or cross-country comparisons of highly aggregated macro-economic variables such as yearly data that might also be aggregated to the national level. Blattman and Miguel (2010) emphasize the need for increased research on the economic consequences of conflict and call for more micro-level analyses and case studies.

Similarly, there is very limited literature on both the effects of conflict on food prices in general and the effects of movement restrictions in the context of the Israeli–Palestinian conflict in particular. Most research deals with the dimensions of politics and violence in this conflict. Jaeger and Paserman (2008) examine the causality cycle of violence of both involved parties, Miodownik et al. (2011) study the distribution and causes of violence, and Ben Bassat et al. (2012) analyze the relationship between economic costs and personal political attitudes towards the conflict. The literature assessing economic consequences of the closures is also very limited. While World Bank (2008b) assesses the costs of the movement restrictions, Miaari and Sauer (2011) focus on the labor market costs for both parties. World Bank (2008c, 2010b, 2011) also assesses the macro-economic, gender and poverty implications of the restrictions on movement for Palestinians. To our knowledge, World Food Programme (2009) provides the only publication dealing with the effects of movement restrictions on food trade in the context of the conflict. It provides a detailed analysis of the market structures of various products and the results of a comprehensive survey of Palestinian wholesale and retail traders.

This paper makes several contributions to the literature. First, it sheds light on the economic consequences of violent political conflict for food prices in general. It also develops the topic of unintended consequences of policies adopted in the context of political conflict for food markets, consequences that potentially have significant welfare effects for the parties involved. In addition,

the paper provides a detailed micro-level analysis of the economic effects of the Israeli–Palestinian conflict by using a unique disaggregated dataset. While the literature often uses low frequency, typically annual, data for market analysis, this dataset of daily price observations allows us to model the day-to-day effects of the trade barriers. On the methodological side, we propose a flexible time series model and illustrate a suitable extension of the Johansen (1988, 1991) cointegration estimation procedure. Next, we elaborate on the concept of unintended policies that may affect food markets and on the particular context of the Israeli–Palestinian conflict. This is followed by a detailed discussion of the market background and the data used. Afterwards, we present and discuss the econometric model, its estimation and results. In the last section, we conclude and discuss policy implications.

Intended and unintended food policies

We focus in this paper on certain types of public policies that, to the best of our knowledge, have not attracted explicit scientific attention so far. Such policies are implemented in order to attain certain public goals in other seemingly unrelated policy areas, but have sizable indirect impacts on the policy area of interest. Such policies can be thought of as *unintended policies* because they differ markedly in the extent and intensity of their side effects from policies that are well designed according to OECD standards (OECD, 2007). These latter policies are *intended policies* in the sense that they seek to achieve one or more objectives in a policy field by inferring into decisions of its stakeholders and try to avoid noticeable side effects. In other words, while intended policies are precisely targeted, unintended policies are the result of poor targeting according to the definition of the OECD: “Targeted policies are those which pursue specific and clearly-defined outcomes set in policy objectives while minimizing transfers to unintended recipients and negative spill-over effects” (OECD, 2007, p. 7).

Examples of intended policies are many agricultural and food policies that are the subject of the GATT/ WTO negotiations and are of interest to the OECD and other international institutions (for overviews see, e.g., OECD, 2012, or Croser and Anderson, 2011). They interfere in the food markets intentionally by impacting one or more of the following aspects: food production, processing, trade or consumption. However, forms of governmental intervention are not always designed to be as targeted as possible. Such unintended policies, in contrast, are public measures yielding sizable externalities in different policy areas. Examples of such unintended food policies are many: gender policies that have significant side effects on food security (FAO, 2011), the influence of the minimum wage on the fast food industry (Aronson, 2001; Katz and Krueger, 1992), economic recovery plans and food prices (Alderman and Shively, 1996) and subsidies supporting the production of biofuels at the expense of shifting agricultural land from food production (e.g., Banse et al., 2008; Huang et al., 2012). Given that in some cases such policies can be perceived as more important in the national perspective, policy makers may not internalize their indirect effects on other policy areas. In extreme cases, unintended policies may even overpower the regulatory efforts to achieve the objective of the intended policies. As Blattman and Miguel (2010) advocated, we focus on the externalities of policies adopted in the context of violent political conflict on food trade and provide a micro-level study of the economic effects of conflict. Political conflict can have complex consequences that affect various aspects of life and society. Military or security policies adopted to meet the challenges emerging from a conflict are one example of policy measures that have major external effects in many other areas, among them, food markets.

² The West Bank Barrier is a physical separation being built by Israel along the 1949 Armistice Line (‘Green Line’) and divides the Israeli residents from the Palestinians living in the West Bank (see Fig. 4).

³ The Second Intifada (aka *Al-Aqsa Intifada*) was a period of intensified Israeli–Palestinian violence that erupted shortly after the failure of the peace summit in Camp David in the summer of 2000 and lasted until late 2004 (see, e.g., Ben-Ari et al., 2010).

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