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The Case of Consumer Food Subsidies in MENA

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Report summarizes CFS programs in MENA

- Objectives
- Costs
- Impact
- Reform efforts

Based on 1999 World Bank report "Consumer Food Subsidy Programs in the MENA Region"

(coverage: Algeria, Morocco, Tunisia, Egypt, Iran, Jordan & Yemen)

General objective of CFS: To ensure household food security via food price stability for essential goods, with a view to

1. alleviating poverty through increased purchasing power & nutritional status
2. raising welfare of entire population
3. achieving/maintaining political & social stability

Indirect objectives:

- Wage moderation ® higher employment, growth, international competitiveness
- Import substitution (food self-sufficiency) and export promotion by protecting domestic food producers

In MENA, the design of various CFS schemes varies from country to country

Designs include:

- universal subsidies
- self-targeted
- rationed
- alternative safety net programs

Table 1: Consumer Food Subsidy Programs in MENA			
Country	**Commodities**	**Universal**	**Mechanism**
Algeria *(through 1992)*	Cereals, milk, sugar, dried vegetables	Yes	Fixed prices, fixed margins
Algeria *(from 1993)*	Eliminated food subsidies, introduced safety nets to compensate losses	Targeted to elderly, handicapped, poor unempl.	Gradual price liberalization, indicator targeting & self-targeting
Egypt	Bread, wheat flour	Yes	Subsidy on inferior goods
	Sugar, cooking oil	No	Ration books, coupons
Iran	Wheat flour, bread	Yes	Price controls, overvalued exchange rate
	Sugar, oil, cheese, rice, meat, eggs, infant formula	Mostly	Coupons
Jordan *(1990-1995)*	Wheat, barley	Yes	Price controls
	Sugar, rice, powdered milk	Mostly universal with means-testing (cap)	Coupons
Jordan *(from 1996)*	Food subsidies replaced with cash transfers	No	Price liberalization & means-tested cash transfers
Morocco	Sugar, cooking oil	Yes	Price controls
	Low-grade flour	Yes[1]	Self-targeting via subsidy on low-grade flour
Tunisia *(through 1990)*	Cereals, cooking oil, sugar, milk	Yes	Price controls
Tunisia *(from 1993)*	Cereals, cooking oil, sugar, milk	No	Price controls & self-targeted
Yemen	Wheat, wheat flour	Yes	Overvalued differential exchange rates

[1] Flour subsidy subject to aggregate annual quota of 10 million quintals.

Different initial country-specific objectives, changed over time

Morocco: stabilize prices of strategic goods, no explicit focus on poor initially

Tunisia: stabilize prices of basic food staples, protect purchasing power of the poor, redistribute income to poor, improve nutritional status

Egypt: ration scheme introduced in WWII to ensure supply of essential goods; revised in 1980s toward poverty alleviation by focusing on inferior goods

Commonalities in MENA's CFS experience

1. Costly and inefficient (targeting, distorted prices)
2. Slow to reform compared to other regions
3. Poorly targeted compensatory measures following reform (i.e., did not prevent increase in poverty)
4. Fear of civil unrest and impact on political stability leads to resistance to reform

Impact of CFS programs can be assessed re:

- Fiscal and macro impact
- Distributional impact

Fiscal/Macro impact

Table 2: Food Subsidy Expenditure in MENA in 1995[1]

Country	***Algeria***	***Egypt***	***Iran***	***Jordan***	***Morocco[2]***	***Tunisia***	***Yemen[3]***
% of Gov't Budget	2.9	4.6	9.5	3.8	5.5	4.5	16.3
% of GDP	0.9	1.3	2.9	1.4	1.7	1.7	4.9

1/ Egypt and Iran data are reported for fiscal years ending March 20.
2/ For Morocco, over 1996-99, the net fiscal cost is about 0.3% of GDP because substantial revenues are collected at the border with tariff revenues.
3/ Implicit costs of Yemen's subsidy were 36% of budget and 10.6% of GDP in 1995. However since 1998 they have been reduced to 3.6% of GDP and in 1999 there are expected to reach only about 0.3% of GDP.
Source: Government data and World Bank reports. See Annex I.

Fiscal/Macro impact

Why high fiscal costs?

- **High degree of subsidization (e.g., Yemen pre-reform subsidized 85% of total wheat costs)**
- **Poor targeting**
- **International price fluctuations (e.g., wheat price in mid-1990s) ® higher import costs,**
  macro imbalances (current account), fiscal deficits

Distributional impact

- Absolute incidence: which income groups consume more subsidized goods?

- Relative incidence: what share of total expenditure goes to subsidized goods?

- Nutritional impact: what share of caloric and protein intake is accounted for by subsidized goods?

Absolute and Relative Incidence of Universal Food Subsidies

Quintile:	Poor 1	2	3	4	Rich 5
Algeria (1995):					
Absolute	**12.1**	16.3	19.3	23.1	**29.2**
Relative	**20.8**	16.5	14.0	22.7	**8.1**
Egypt–Urban (1997):					
Absolute	**20.7**	21.4	22.1	18.9	**16.8**
Relative	**6.4**	4.6	3.4	2.1	**1.1**
Egypt–Rural (1997):					
Absolute	**19.5**	18.9	19.5	21.0	**21.0**
Relative	**8.7**	6.1	5.1	4.2	**2.6**
Morocco (1995):					
Absolute	**15.3**	18.1	20.4	21.3	**24.9**
Relative	**4.0**	3.0	2.4	1.7	**0.9**
Tunisia (1990):					
Absolute	**17.0**	20.0	21.0	22.0	**20.0**
Relative	**8.7**	6.2	4.8	3.5	**1.6**
Yemen (1992):					
Absolute	**6.7**	11.0	15.4	21.5	**45.4**
Relative	**10.8**	11.1	11.8	10.5	**10.4**

- Nutritional impact in MENA benefits the poor
- Diets are dominated by cereals, oil and sugar (all heavily subsidized)

Nutritional Importance of Food Subsidies in Algeria, 1995

Caloric Intake from Subsidized Goods (% of Total Intake)								
	D1	**Q1**	**Q2**	**Q3**	**Q4**	**Q5**	**D10**	**D10/D1**
Semolina	**23.6**	21.6	16.9	15.3	13.5	11.2	**10.5**	**0.4**
Pasta	**0.9**	0.8	0.8	0.9	0.9	1.2	**1.2**	**1.4**
Couscous	**0.7**	0.7	0.6	0.6	0.7	0.8	**0.9**	**1.2**
Flour	**2.8**	2.5	1.7	1.5	1.3	1.1	**1.1**	**0.4**
Bread	**5.3**	5.6	6.7	6.4	6.5	6.2	**5.6**	**1.1**
Pasteurized Milk	**1.7**	2.0	2.7	3.1	3.4	3.8	**3.9**	**2.3**
Powdered Milk	**3.3**	2.9	2.4	2.0	1.8	1.2	**1.0**	**0.3**
Total Subsidies	**36.3**	34.5	30.5	28.9	27.6	25.4	**24.4**	**0.7**
Total Caloric Intake	**1237**	1505	2194	2657	3181	4143	**4510**	**3.6**

Despite large expenditures on subsidies and relative benefit to the poor, stunting affects 10-30% of children under 5.

- worse in rural areas (e.g., 33% in rural Tunisia, compared to 22% in urban Tunisia)

- worse where CFS are untargeted (e.g., 44% in Yemen)

CFS have high efficiency costs

High fiscal and economic costs relative to benefits:

- **It would be much cheaper to close the poverty gap with a direct cash transfer (<<1% of GDP compared to subsidy program costs of 1-5% of GDP)**

Opportunity cost:

- **Absolute incidence favors middle and high income groups**

Þ resources could be better used elsewhere

- **Trade-off between transferring a small amount of $ to many people vs. improving living conditions for the entire population (e.g., through education and health spending to raise quality of life, labor productivity)**

NB. spending on CFS was comparable to total health budget

CFS have high efficiency costs

Leakages:

- Along the distribution chain, from importers to retailers (e.g., through import restrictions, over-valued or multiple exchange rates)
- Upstream interventions Þ gains to suppliers at expense of consumers
- Leads to diversion to private outlets at market prices (e.g., in Yemen, 20% of total wheat stock smuggled out of the country)

CFS have high efficiency costs

Link with agriculture sector policy:

- **Price distortions ® misallocation of productive resources such as land and water**
- **Producer protection and CFS may drive each other**

  - priority to farmers → protection, higher domestic prices that hurt consumers where there is no subsidy

  - priority to consumers → tax farmers by paying them sub-market prices
- **Substitution**

  - Unintentional in Yemen, where wheat consumption replaces sorghum and millet, depressing prices of these alternatives

  - Intentional in Tunisia, where subsidized imported vegetable oil reduces demand for olive oil, thus increasing Tunisian olive oil exports

Subsidy reform in MENA

Reforms that were undertaken in much of the region during the 1990s reduced fiscal costs…

BUT

-leakages persist

-universal subsidies remain

-structural distortions in production, distribution and consumption are widespread, and

-impact on the poor is unknown.

Subsidy reform in MENA:

The case of Tunisia

In 1991, shifted to self-targeting, quality differentiation:

- Improved targeting of inferior goods
  - shifted subsidies from pasta and couscous to semolina
  - cut subsidy on *baguettes*, retained subsidy on *pain unique*
- Raised prices of superior goods
- Reduced production and distribution costs of subsidized commodities

Results:

- Program costs fell from 4% to 2% of GDP
- Poor benefit more in absolute <u>and</u> relative terms (reversing regressive effects)

Subsidy reform in MENA:

The case of Jordan

Old system of universal subsidies on a broad range of goods was replaced in 1990 with subsidized wheat and barley prices (universal), and universal coupons (subject to quotas) on sugar, rice and powdered milk.

In 1994, introduced maximum income cut-off for food coupons.

The case of Jordan

Subsequent reform:

- In 1996, eliminated universal wheat subsidy, raised prices of wheat, barley and bread (from JD0.085/kg to JD0.220/kg, subsequently reduced to JD0.200/kg), concurrently introduced cash transfer subject to income cut-off (same eligibility criteria as for sugar, rice and powdered milk coupons)
- Raised price of animal feed (accompanied by compensatory cash payments to small breeders)
- Raised price of *baladi* bread (consumed by poor), and introduced a universal monthly cash transfer
- In 1997, replaced food coupons with additional cash transfer (added to bread cash transfer); both transfers became subject to maximum income criteria (i.e., means-tested)
- In 1999, eliminated general cash transfers, subsequently liberalized price of bread

The case of Jordan

Results:

Cost fell from 3.4% of GDP in 1990, to 1.7% of GDP in 1991, to 1.2% of GDP in 1994, to 0.7% of GDP in 1998, and 0% of GDP from 2000 onward.

Conclusions:

Although much improved, CFS in MENA are still costly and inefficient, partly due to fear of consumer protests, vested interests

Chapter 2 summarizes lessons from international experience at managing reform

Remaining agenda for CFS reform

- Link with broad poverty alleviation strategy (complementary safety net programs)
- Choose best timing (i.e., don’t wait for fiscal desperation)
- Simultaneously reduce producer protection (requires careful planning, consensus and coordination)
- Improve targeting
- Account for political factors (gradual, staggered approach; sensitize stakeholders to the necessity and rationale for reform)
- Reallocate savings to priority social sectors (education, health services, basic infrastructure targeted to the poor)