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## **Government Issues: Inflation, Depression, and the Needs of the Common People In Central America**

The world is experiencing the consequences of an unhappy conjuncture for long term structural influences and short term factors. During the past two decades, demand for food has been increasing steadily, reflecting the rise in the world's population, positive improvements in incomes, and the diversification of diets. However, until 2004 food prices had been declining, thanks to record harvests and the use of world grain stocks. At the same time, average crop yields were flat or falling, as investment in agriculture, particularly in developing countries, declined. Moreover, low prices, especially for food staples, and distortions in agricultural markets, discouraged production particularly in low income countries. More recently, food price increases have become more pronounced, and, coupled with the rapid increase in oil prices, are posing serious economic and political problems. A rapid rise in commodity and food prices has taken place over the last few years. But food has been on a more steady climb as opposed to metals and oil which have spiked in the last year or so.

So the next question that is left unanswered is, why have food prices dramatically risen these past couple of years? One factor is that stocks have been slowly declining since 2000. In addition, there were bad harvests in the past three years. The recent strong growth of emerging and developing countries has been a factor as has rising biofuels production in advanced economies. With biofuels, one begins to see the interaction of higher oil price with food supplies. And biofuel production has also reflected generous policy support in some countries. Finally, high oil prices have driven up the cost of agricultural inputs like fertilizers and transport. Very recently, the introduction of export restrictions in some countries, to protect domestic supplies, tightened world market conditions for some key food crops, like rice. Speculation, and panic buying may also have played some role.

Despite several record-breaking harvests, world cereals production between 2000 and 2007 fell well short of consumption. The shortfall has forced the depletion of world grain stocks useful proxy for global food security which are now at their lowest levels in 25 years. There are several commonly acknowledged drivers behind the current food price spikes, including: High price of oil, manifested in increased fertilizer and fuel costs, increased demand for meat and dairy products in the developing world, which requires more grain be fed to livestock, diversion of crops for biofuel production, adverse weather conditions, commodity speculation by investors, and lack of access to improved inputs and markets amongst smallholder farmers in the developing world. These factors together have created a "perfect storm" that has driven food prices up. Although adverse weather conditions and commodity speculation may nudge food prices up in the short term, the rest of these drivers appear to be longer-lasting, and their effects are likely to be felt for several years.

But looking ahead, food prices are expected to ease gradually in the short term. Although corn prices continue to rise especially in light of the floods in the Midwest of the United States. But the outlook even for the next couple of years is uncertain and depends on policies put in place to encourage increased production. Nevertheless, the pressure on food prices from the underlying structural influences will likely remain and keep prices at higher levels than in the past.

The immediate problem is essentially a food price crisis rather than a global shortage of food. The rapid increase in food prices has had an adverse impact on poverty, and effectively denied many poor people access to food. This is mainly because the share of food in household spending is very large in developing and emerging economies. Some countries also tend to have relatively large parts of their consumption bundles allocated to food. And within these countries, the poorer spend more of their household income on food. Indeed, poverty levels, which declined this decade, are likely to increase as

higher food prices persist. Another concern is that the people who are suffering most from these rises are millions of the urban poor; now the world's largest population, and this is a new kind of food problem for the urban poor. It is not like a famine, where there is no food. The food is there - but they cannot afford it. So I cannot stress enough that the immediate challenge is to get food or the money to buy food to those most in need.

In the short term, efforts to get food to the most affected countries, and population groups within countries, must be complemented by measures to ease the burden of higher food prices on the poorest people. These measures include scaling up well-targeted social safety nets, expanding conditional cash transfer programs, temporary subsidies on a small number of products vital for the poor, expanding school feeding programs, and food-for-work programs. Some countries in this region have taken such measures, including Costa Rica with school feeding programs, supplementary income to the elderly poor, and transfers to poor families. El Salvador has expanded its cash transfer programs. Panama, El Salvador, Guatemala and Nicaragua have reduced or eliminated tariff on key food items.

But we must avoid policies that have negative effects on countries that rely on food imports. Export restrictions are harmful, not helpful, as are or direct price controls, which distort price incentives and discourage production. Countries should also avoid general subsidies to the extent possible, as these tend to be expensive and don't target those most in need. And often they become entitlements over the longer-term.

At the same time, we must begin to address the long-term factors that are driving up food prices, so as to ensure that supply increases rapidly enough to meet growing demand. Higher oil and food prices have already led to substantial increases in overall inflation, particularly in emerging markets and low-income countries. In Central America, average headline inflation, year-on-year was 11 percent in March 2008, with food price inflation doubling. The rise in the price of cereals and oil have contributed about 3 percentage points to headline inflation. In addition, in some countries domestic demand pressures have pushed up inflation.

The sharp increases in food and fuel prices, have led to higher import bills and strained the balance of payments position of many countries. Central America, as a net importer of fuel has seen its oil import bill rise by over 2.5 percent of GDP between 2004 and 2007. While the region as a whole is a net food exporter, the food price shock has largely affected cereals, of which the region is a net importer.

As a result, the combined price shocks have led to deterioration in the region's trade balance in 2007, and is expected to do so again in 2008, although the effect will vary across the region. Fortunately, reserve positions of the Central American governments have generally remained strong and, thanks to continued capital inflows, the overall balance of payments position has not experienced stress, and depreciation pressures have not emerged.

Now, a word of caution about the strain on government budgets. All of the domestic measures to cushion the burden of rising prices have a fiscal cost either lower revenues from reduced taxes and tariffs, or higher expenditures on social safety nets or support measures for small farmers. Thus, governments have yet another challenge to confront in allocating scarce resources.

What can be done to confront these challenges? In due course, permanent price shocks will need to be fully passed through to consumers and producers. However, short-term measures can and should be used to mitigate the adverse short-term impacts. Of course, the task of policy makers is complicated by the uncertainty about the extent to which recent increases in food and fuel prices are permanent. But we should ensure short-term measures minimize disincentives for long-run supply responses.

It will be important for governments to assess, contain, and monitor the cost of mitigating measures, and some tough budgetary choices will need to be made. Some governments that are in good fiscal positions will have scope to spend more money. Others will need to raise revenue, reduce other types of spending, borrow, or secure foreign aid. It is important that mitigating measures be limited in

both size and duration the food price crisis should not provide an excuse for new entitlements.

But this is not just a country-by country problem, it is a problem that requires a coordinated international response. The cost of the longer term agenda is large, and financial support from the international community will be needed. However, it is important that these resources be additional to existing development assistance, and not be mobilized at the expense of support to other sectors, especially health and education.

Now that I have talked about some of the factors that are causing food prices to soar and food insecurity to grow, I will now talk about those factors just in Central America. Agriculture is crucial to a stable future in Central America, where subsistence farming predominates.

Despite rising average incomes, striking inequalities in the distribution of income, land, and opportunity condemn millions to poverty in Central America, generation after generation. One of poverty's several ugly faces is food insecurity: many of the region's inhabitants simply don't have enough to eat. Average per capita availability of calories in the region dropped from 2,500 per day in the 1980s to 2,300 in the 1990s. This is still slightly above the minimum daily requirement, but masks significant regional disparities in nutrition: about 15% of the population in Central America is underfed, including some 3 million children. In Guatemala and Haiti, for example, one out of every four children is malnourished. Economic strategies in the region in the latter part of the 20th century have emphasized urban-based industrialization and import substitution and neglected or actively discriminated against agriculture and rural areas. Worsening poverty in the countryside has fueled social unrest and large-scale migration to cities, where new arrivals often add to the growing ranks of the underprivileged.

Fortunately we can help Central American farmers by teaching them about more productive seed and cropping practices, but this effort will require a concerted effort among researchers, investors, enlightened officials, domestic seed producers, non-government organizations, and farmers themselves. Through out this paper I have talked about how we can help Central America, but I haven't really talked about the things they have already begun to do in order to decrease food insecurity and increase productivity.

Central American farmers have adopted conservation tillage which has allowed farmers to boost maize yields from 1.5 to 4.0 tons per hectare while halting erosion in an intensive, hillside, maize-sorghum rotation in El Salvador. Network researchers have refined and spread the practice to other parts of the region. In Azuero, Panama, for instance, at least 6 of every 10 farmers now use reduced tillage to save money, reduce weeds and herbicide use, and conserve soils.

As you can see agriculture can provide a firm foundation for broad-based economic growth in regions such as Central America. Stronger, environmentally friendly agricultural growth generates additional employment, income, and economic growth in both rural and urban areas. It contributes to overall rural development, improves the region's ability to meet growing regional and global food needs, and helps conserve natural resources. Given that so many women, indigenous groups, and poor people participate directly in agricultural production, processing, and distribution, a vibrant food and agricultural system will also promote social and economic equity. Aside from agriculture's relative share in the labor force, recall a simple truth: everyone eats food. It is difficult to find another sector of the economy for which the benefits of modernization will be so widely distributed and so biased in favor of the poor.

The most pressing issue in the future may be helping poor households in remote areas to improve their food security. Small land holders are in fact more important than their share of arable and permanent cropland would suggest. They commonly provide up to a third of basic cereal production, even though their share of cropland rarely exceeds 15%. If provided equivalent access to public goods and appropriate, cost-effective technologies, smallholders could hold their own with large producers and international competition under trade liberalization. In effect, they could move from an economy of subsistence and poverty to one based on surplus and accumulation.

**To Conclude:** I believe that Central America could be a region where they and their families can feed themselves from the farm, where modest surpluses from harvests can be sold to help meet other basic needs, improve operations, or invest in small agro-businesses, where careful crop management practices to conserve soil quality and avoid erosion could be practiced, without sacrificing yields, where improved productivity would help avoid the need to open tropical forests or other fragile lands for cropping, where improved nutrition and well-being would help reduce social conflict and where children could eventually choose to stay and work the land, or seek educations and livelihoods off-farm but on their own terms, rather than in a desperate flight from misery. I truly believe this reality is not so distant. I also believe that the United States could help Central American farmers to cross the bridge to a better life.

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