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Challenges of poverty reduction and inclusive development amid high inflation

Challenges of poverty reduction and inclusive development amid high inflation and food prices in Asia and the Pacific

Note by the secretariat

Summary

High inflation and food prices remain a major challenge across much of the Asia-Pacific region, threatening to slow economic growth, poverty reduction, the achievement of the Millennium Development Goals and inclusive development. ESCAP has estimated that economies in Asia and the Pacific would lose 1.5 percentage point of gross domestic product growth cumulatively over 2011 and 2012 due to higher fuel and food prices as compared to 2010. ESCAP has also estimated that an additional 19.4 million people in the region remained in poverty due to increased food and energy prices in 2010 and that a further increase in fuel and food prices could keep up to 42.4 million additional people in poverty in 2011.

Inflationary pressures develop from both demand- and supply-side factors. Since current inflationary pressures in the region emanate more from the supply side, the use of monetary policy alone as the main tool for combating inflation may not be appropriate. To contain food inflation, greater emphasis should be placed on agricultural productivity and South-South cooperation on knowledge and technology. Buffer stocks of food should be established at the national and regional levels to stabilize food prices. Social protection should be strengthened through the distribution of food vouchers among the needy or targeted income transfer schemes to minimize the adverse impact on the poor. At the global level, ESCAP has been advocating decisive action by the G20 to moderate the volatility of oil and food prices, which is highly disruptive to the development process.

Member countries may wish to share their experiences regarding the impact of high inflation and food prices, and the Committee may wish to provide the secretariat with guidance on policy options for mitigating the adverse impact on poverty reduction, inclusive development and the achievement of the Millennium Development Goals.

* The late submission of the present document is due to the non-availability of relevant national data by the submission deadline.

Contents

I. Introduction

1. High inflation and food prices remain a major challenge across much of the Asia-Pacific region. They are threatening to slow economic growth, poverty reduction, the achievement of the Millennium Development Goals and inclusive development. Inflationary pressures can develop from both demand- and supply-side factors. However, current inflation rates in the region emanate more from supply-side factors, sometimes fuelled by increasing financialization of commodity markets, which has led to greater short-term price volatility. Monetary policy alone as the main tool for curbing inflationary pressures arising from the demand side may not be very effective. A more comprehensive policy mix is needed in order to address supply-side factors and constraints also. Moreover, targeted measures to protect the poor from the adverse impact of inflation are needed.[1]

2. The main objective of the present document is to analyse the causes of high inflation and food prices in the region and assess the impact on gross domestic product (GDP) growth and poverty in order to suggest policy options for containing inflationary pressures and protecting the poor and vulnerable sections of society. In section II, there is an overview of the poverty situation. The purpose of this section is to demonstrate that the region has made significant progress in reducing poverty over the past few decades but that the rate at which this has been done is expected to slow due to high inflation rates. Section III contains a review of recent changes in inflation in countries of the

[1] *Economic and Social Survey of Asia and the Pacific 2011* (United Nations publication, Sales No. E.11.II.F.2), p. 32.

region, followed by an analysis of the causes of high inflation. In section IV, the impact of inflation on GDP growth and poverty is examined. Finally, in section V, some policy options are suggested for containing inflationary pressures and minimizing their adverse impacts on the poor and most vulnerable in order to promote inclusive development.

II. Overview of the poverty situation

3. The Asia-Pacific region has made remarkable progress in reducing poverty over the past few decades. However, poverty remains a major challenge.[2] In 1990, roughly half of the population of the region was living in extreme poverty — defined as those living on less than $1.25 a day (at purchasing power parity). By 2007, the incidence of poverty had fallen by about 50 per cent, leaving about a quarter of the population of the region in extreme poverty. In absolute numbers, the poverty-stricken population came down from 1.55 billion in 1990 to 996 million in 2007, despite the fact that the total population of the region had grown from 3.3 billion to 4 billion over the same period.[3] On the basis of a trend projection, the number of people living in extreme poverty in the region is estimated to have fallen to 862 million by 2010. A faster reduction in the incidence of poverty of the region brought it closer to the world average rate until the two poverty rates became comparable in 2007. This means that the Asia-Pacific region was home to 61 per cent of the world's poor, which is the same as the region's share of the world population.

4. Among the subregions, based on the latest available data, the incidence of poverty is the highest in South and South-West Asia (36.1 per cent), followed by South-East Asia (21.2 per cent), East and North-East Asia (13.0 per cent), and North and Central Asia (8.3 per cent). Although the rate of poverty fell in all subregions from 1990 onward, East and North-East Asia and South-East Asia recorded a relatively faster reduction in the rate of poverty.

5. Many countries have their own national poverty lines, but poverty estimates based on those are not comparable across countries due to differences in poverty lines, nor are they comparable over time due to evolving computing methodologies and definitions of poverty lines. Keeping these caveats in view, China was able to reduce poverty from 6.0 per cent in 1996 to 4.2 per cent in 2008 (see table 1). In India, the poverty rate came down from 36 per cent in 1994 to 27.5 per cent in 2005. Bangladesh, Nepal, Pakistan and Sri Lanka also saw a significant decrease in the incidence of poverty over time.

6. As one of the countries most severely hit by the Asian economic crisis of 1997, Indonesia witnessed an increase in poverty immediately after the crisis but continued on a path of poverty reduction after that. As a result, its poverty rate fell from 17.6 per cent in 1996 to 13.3 per cent in 2010. In Thailand, poverty also increased in the wake of the Asian economic crisis, but it came down in subsequent years and by 2009 stood at 8.1 per cent. Viet Nam achieved a major success by reducing the poverty rate from 58.1 per cent in 1993 to 14.5 per cent in 2008 as its economy expanded rapidly. Most countries of North and Central Asia saw an upsurge in poverty levels during the early 1990s, as their economies were passing through the initial phases of the transition from centrally planned to market systems. However, they all

[2] *Paths to 2015: MDG Priorities in Asia and the Pacific* (United Nations publication, Sales No. E.10.II.F.20), p. 8.

[3] *Statistical Yearbook for Asia and the Pacific 2011* (United Nations publication, Sales No. E.11.II.F.1).

achieved successes in poverty reduction subsequently. For example, in Kazakhstan, the poverty rate fell from 34.6 per cent in 1996 to 15.4 per cent in 2002.

7. Thus, the region has seen fairly consistent declines in the incidence of poverty, but the trend is less clear for income inequality. An aggregated measure of inequality is the Gini index, which takes into account the complete distribution of income. On this basis, inequality in Cambodia, China, Georgia, Nepal, Papua New Guinea, the Philippines, the Russian Federation, Singapore, Turkey, Turkmenistan and Thailand is relatively higher, with the Gini coefficient having a value over 40 per cent as per the latest available data.[4] Unlike poverty, inequality exhibits no clear regional trend. Since the early 1990s, inequality seems to have increased in Sri Lanka, Bangladesh, Nepal and Cambodia but decreased in Indonesia, the Islamic Republic of Iran, Malaysia, Pakistan and Thailand, as well as the Russian Federation and most North and Central Asian countries.

Table 1
Percentage of population below the national poverty line in selected countries

Country	Period	First year	Middle year	Final year
Armenia	(1999, 2001, 2009)	54.8	48.3	26.5
Azerbaijan	(1995, 2001, 2008)	68.1	49.6	15.8
Bangladesh	(1992, 2000, 2005)	56.6	48.9	40.0
Cambodia	(1994, 1997, 2007)	47.0	36.1	30.1
China	(1996, 1998, 2008)	6.0	4.6	4.2
Fiji	(1996, 2003, 2009)	25.5	35.0	31.0
India	(1994, .. , 2005)	36.0	..	27.5
Indonesia	(1996, 1999, 2010)	17.6	23.4	13.3
Kazakhstan	(1996, 2001, 2002)	34.6	17.6	15.4
Kyrgyzstan	(1997, 2003, 2005)	51.0	49.9	43.1
Lao People’s Democratic Republic	(1993, 1998, 2008)	45.0	38.6	27.6
Malaysia	(1993, 2004, 2009)	13.4	5.7	3.8
Mongolia	(1995, 1998, 2008)	36.3	35.6	35.2
Nepal	(1996, .. , 2004)	41.8	..	30.9
Pakistan	(1999, 2002, 2006)	30.6	34.5	22.3
Papua New Guinea	(1990, 1996, 2002)	24.0	37.5	39.6
Philippines	(1994, 2000, 2009)	40.6	33.0	26.5
Sri Lanka	(1996, 2002, 2007)	28.8	22.7	15.2
Tajikistan	(1999, 2003, 2009)	74.9	72.4	47.2
Thailand	(1996, 2000, 2009)	14.8	21.0	8.1
Viet Nam	(1993, 2002, 2008)	58.1	28.9	14.5

Sources: United Nations Millennium Development Goals Indicators, available from http://mdgs.un.org/unsd/mdg /Data.aspx (accessed 15 July 2011); World Bank, *World Development Indicators online database 2011*; and national sources.

8. The region as a whole made a significant progress in bringing down the level of poverty. However, high inflation, especially with regard to food, is threatening this progress by making it difficult for many people to emerge from poverty while simultaneously forcing others into poverty. Before assessing the impact of high inflation and food prices on poverty reduction, trends in inflation in countries of the region and the underlying causes of those are analysed.

[4] Ibid.

III. Trends in inflation

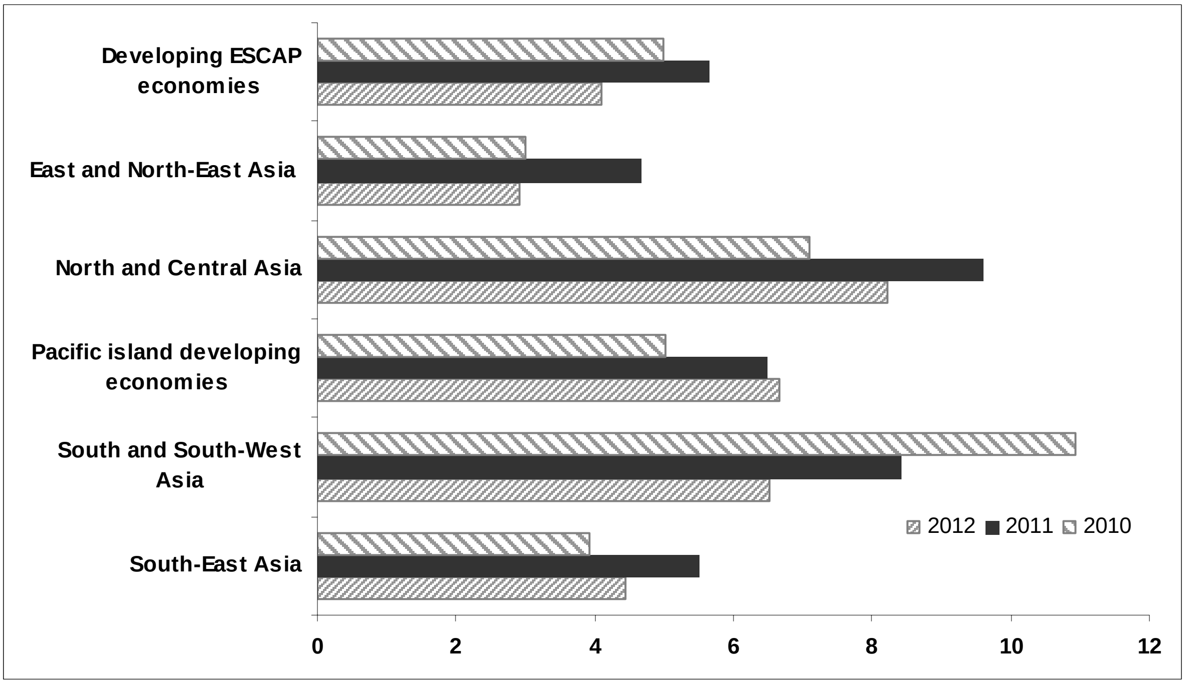
9. While inflationary pressures peaked in the Asia-Pacific region in 2007-2008, the onset of the global financial and economic crisis brought inflation down significantly in 2009. As economies began to recover, inflationary pressures appeared once again, triggered by higher global commodity prices, especially for fuel and food. Consequently, inflation increased rapidly in developing economies of the region in general in 2010. Inflation is expected to increase again in 2011, when inflation in developing economies is estimated at 5.7 per cent, as compared with 5 per cent in 2010. Amid uncertainties surrounding global commodity prices, particularly for fuel and food, it is difficult to make projections about future inflation. However, some deceleration in inflation is expected in 2012 as a result of weakening demand in the developed world, and while that might be welcome news, it is important to remember that prices already at high levels are going to rise further, causing difficulties for economies and severe hardships for those in lower income groups.

10. The aggregated regional figures mask the diverse performance of subregions and individual countries. A better insight into inflationary trends can be gained through disaggregated data. In the East and North-East Asian subregion, inflation is on the rise, although at a modest and manageable rate: from 3.0 per cent in 2010 to an estimated 4.7 per cent in 2011 (see figure 1). Higher international commodity prices and strong domestic demand are putting upward pressure on prices, but the appreciation of currencies, in general, tempers imported inflation. Among the components of inflation, the rapid rise in the prices of grains and other foodstuffs is a cause for concern. South-East Asia is another subregion witnessing an upsurge in inflation rates, but levels are still low in comparison with other subregions. Inflation in the subregion is estimated at 5.5 per cent in 2011, as compared with 3.9 per cent in 2010.

11. On the other hand, high inflation is a major challenge in South and South-West Asia, where it has been in the double digits in recent years, reaching 10.9 per cent in 2010. Although inflation is expected to decelerate to 8.4 per cent in 2011, risks are on the upside. As inflation affects the poor disproportionately, it is a major cause of concern in many countries of the subregion that have a high incidence of poverty. Among other factors, high budget deficits in general are fuelling inflation. Ironically, when subsidies, for example those on electricity and petroleum products, are slashed to contain budget deficits, that also leads to higher inflation. North and Central Asia is another subregion which has been experiencing high inflation. It is estimated that inflation there will rise to 9.6 per cent in 2011 from 7.1 per cent in 2010.

12. The Pacific subregion, in particular its developing economies, is facing inflationary pressures, with inflation in the developing economies rising to 6.5 per cent in 2011 from 5 per cent in 2010. While inflation has been driven by higher global prices for oil and commodities, accelerating price pressures in some of the trading partners of the Pacific island developing economies, particularly Australia and New Zealand, are also partly responsible.

Figure 1
Consumer price inflation by subregions, 2010-2012



Source: ESCAP, based on national sources; International Monetary Fund, *International Financial Statistics databases* (Washington, D.C., August 2011); Asian Development Bank, *Asian Development Outlook 2011* (Manila, 2011); CEIC Data Company Limited; and web site of the Interstate Statistical Committee of the Commonwealth of Independent States, www.cisstat.com, 4 August 2011.

Notes: Rates of inflation for 2011 are estimates and those for 2012 are forecasts (as of 8 August 2011). Asian and Pacific developing economies comprise 37 economies (excluding those in North and Central Asia). East and North-East Asia in this figure excludes Japan. The calculations are based on the weighted average of GDP figures in United States dollars in 2010 (at 2000 prices).

13. At the country level, high inflation rates are being experienced by most countries in South and South-West Asia (see table 2). Pakistan has been experiencing double-digit inflation for some years now. Inflation decelerated from 20.8 per cent in 2009 to 11.7 per cent in 2010 and increased to 13.9 per cent in 2011. Increases in electricity and natural gas charges and an upward revision of petroleum prices in the wake of rising global oil prices have been increasing production costs and the prices of other consumer goods as well. High inflation is becoming a major concern in India, with an adverse impact on its strong economic growth momentum. Consumer price inflation (for industrial workers) surpassed 12 per cent in 2010. Food prices, which are heavily weighted in the consumer basket, remained elevated. Some deceleration in inflation to 7.5 per cent in 2011 is expected. In Nepal, inflation, which stood at 10.7 per cent in 2010, has remained close to double-digit levels in 2011. Inflationary pressures also re-emerged in the economy of Bangladesh as the consumer price index (CPI) increased to 8 per cent in 2011 from 7.3 per cent in 2010. Sri Lanka, after a respite from high inflation in 2010, is again experiencing rising inflation. The Islamic Republic of Iran has been experiencing high inflation for several years, and inflation there remained in the double digits in 2010 and is expected to continue throughout 2011.

14. In North and Central Asia, most countries experienced inflation above 6 per cent in 2010. In Turkmenistan, inflation was at 12 per cent in 2010 and is estimated to remain in the double digits in 2011. Inflation in Uzbekistan and Kyrgyzstan is expected to reach double digits in 2011. In Kazakhstan, the

average annual inflation rate stood at 8 per cent in August 2011, up from 7.1 per cent in 2010; it is expected to reach 8.8 per cent by year-end. Inflation in the Russian Federation, which had been 6.9 per cent in 2010, stood at 8.6 per cent in August 2011; it is expected to rise to 9.3 per cent by year-end. In most other countries, inflation is expected to rise in 2011 as compared to 2010 due to growing domestic demand and rising real wages as well as higher food and energy prices.

15. Viet Nam is another country suffering from high inflation. Driven by credit expansion, inflation in that country was over 23 per cent as recently as 2008. After moderating to 7.1 per cent in 2009, inflation rose to 8.9 per cent in 2010 and again went into the double digits—14.7 per cent—in August 2011. Inflationary pressure is also increasing in Indonesia with rising food prices and transportation costs. Inflation as of August 2011 reached 6.1 per cent as compared to 5.1 per cent in 2010. Many other countries in South-East Asia and East and North-East Asia have comparatively low inflation rates, but increases in recent years are causing major concern in those countries. For example, inflation in China was 3.3 per cent in 2010, but a hike in 2011 is forcing the Government to take measures to contain inflation, especially because of the rise in food prices. Inflation in China reached 5.1 per cent in August 2011. Similarly, inflation in Thailand is expected to reach 4 per cent in 2011 from 3.3 per cent in 2010.

Table 2

Rates of consumer price inflation in selected economies of the ESCAP region, 2008-2012

(Percentage)

	Inflation[a]				
	2008	2009	2010	2011[b]	2012[c]
Bangladesh	9.9	6.7	7.3	8.0	7.5
Cambodia	25.0	-0.7	4.0	5.1	5.2
China	5.9	-0.7	3.3	5.1	3.0
Fiji	7.7	6.8	5.4	3.8	3.9
India	9.1	12.4	12.0	7.5	5.0
Indonesia	10.1	4.8	5.1	6.1	5.8
Iran (Islamic Republic of)	25.4	10.8	12.4	17.0	12.5
Kazakhstan	17.2	7.3	7.1	8.8	7.6
Kyrgyzstan	24.5	6.8	8.0	20.0	8.7
Lao People's Democratic Republic	7.6	0.0	6.0	7.0	6.0
Malaysia	5.4	0.6	1.7	3.3	2.9
Mongolia	25.1	6.3	10.1	16.4	16.0
Nepal	7.7	13.2	10.7	9.5	7.5
Pakistan	12.0	20.8	11.7	13.9	12.0
Papua New Guinea	10.8	7.0	6.0	8.4	8.7
Philippines	9.3	3.2	3.8	4.3	4.3
Republic of Korea	4.7	2.8	2.9	4.2	2.9
Russian Federation	14.1	11.7	6.9	9.3	8.0
Sri Lanka	22.6	3.4	6.2	7.4	7.3
Thailand	5.5	-0.8	3.3	4.0	3.2
Turkmenistan	13.0	10.0	12.0	15.0	12.0
Uzbekistan	12.7	14.1	9.4	11.6	12.3
Viet Nam	23.1	7.1	8.9	18.8	12.2

Sources: ESCAP, based on national sources; International Monetary Fund, *International Financial Statistics databases* (Washington, D.C., August 2011); Asian Development Bank, Asian Development Outlook 2011 (Manila, 2011); CEIC Data Company Limited; and web site of the Interstate Statistical Committee of the Commonwealth of Independent States, www.cisstat.com, 4 August 2011.

[a] Changes in the consumer price index.

[b] Estimates.

[c] Forecasts (as of 29 September 2011).

IV. Causes of inflation

16. A number of factors have contributed to inflationary pressures in countries of the Asia-Pacific region. While factors specific to some individual countries have been mentioned above, the discussion here is focused on some major causes that are applicable to many countries of the region.

17. *Economic recovery:* Developing economies of the region staged a strong recovery from the global economic crisis of 2008-2009. The GDP growth of developing economies rose to 8.8 per cent in 2010 from 4.7 per cent in 2009.[5] Some slowdown in this growth is expected in 2011, but the growth momentum is expected to remain strong. Higher demand, as a result of the strong growth momentum, has driven the prices of goods and services up. Changes in commodity consumption patterns which have resulted over the years are related to economic growth. Demand for meat, dairy products and other protein-rich products has increased. At the same time, supply responses have been slow, with the marginal cost of production of these products as well as their prices running high since the production of meat and dairy products requires large amounts of grains in the form of livestock feed.

18. *Global commodity prices:* Stronger than anticipated global demand for commodities caused a broad-based increase in prices. Fuel and food prices picked up in the international market, which is a major cause of the surge in inflation in recent years. Fuel and food commodity markets are characterized by low short-term demand and supply price elasticities, and this adds to the volatility of their market prices. Prices react sharply to news about events affecting present or future demand or supply. Since early 2010, oil prices have been going up rapidly, with increased global demand due to growth recovery in emerging markets coupled with a number of supply shocks, particularly resulting from geopolitical instability in the Middle East and North Africa. Projections by the International Monetary Fund indicate crude oil prices stabilizing at about $103 per barrel on average in 2011, which is approximately 30 per cent above 2010 levels.[6] However, a drop in oil prices in August 2011 may bring the average price for the year down somewhat.

19. Along with oil prices, global food prices have been on a sustained upward trend since early 2010. The Food Price Index of the Food and Agriculture Organization of the United Nations (FAO) for December 2010 broke its previous record, which had been registered in 2008 before the onset of the economic crisis. Since crossing this level, the Index continued to set new records in subsequent months, with an increasingly dire impact on the livelihoods of the poor, and, in turn, causing increasing social upheaval across the globe. The dramatic increase in the price of crude oil has been driving up the cost of applying fertilizers, operating agricultural machinery and transporting food to markets. High costs of energy result in a higher cost of cultivation and consequently higher prices of output. On the supply side of food, there have been numerous disruptions due to adverse weather conditions in recent years. The wheat production of major exporters, such as the Russian Federation, Ukraine, Kazakhstan and Canada, was affected by bad weather. In August 2010, the Russian Federation announced a ban on exports of wheat that also contributed to a price rise. While wheat is not a major staple for many countries in the region, the impact of wheat prices on the prices of other staples due to increased demand for substitutes has been of more concern. Export

[5] *Economic and Social Survey of Asia and the Pacific 2011* (United Nations publication, Sales No. E.11.II.F.2), p. 16.

[6] International Monetary Fund, *World Economic Outlook*, September 2011.

prices of rice increased significantly in the fourth quarter of 2010 due to strong demand partially related to the wheat substitution effect as well as weather-related shocks in Australia, Pakistan, Thailand and Viet Nam.

20. The outlook for food prices is mixed: there are prospects for better weather in the wheat-growing areas of the Russian Federation and Ukraine and above-average output in India, but China and Pakistan have again suffered floods that have left large crop-growing areas under water. Uncertainty continues to bedevil oil supplies from a number of countries. On balance, although FAO expects supplies of major crops in 2010/11 to be adequate, there appears to be little likelihood that food price pressures will ease in the short term. These developments have led to food inflation rising faster than overall inflation.

21. *Conversion of food into biofuels:* While market forces play a role in the price behaviour witnessed in recent months, additional man-made factors have exacerbated the price increase and therefore significantly increased the hardship of the poor and vulnerable. Rising oil prices have been one of channels through which man-made policies have further increased food prices. Critically for the poor in the region, the increase in oil prices would indirectly lead to greater pressure on food prices through biofuels. This would have a greater impact on the poor as food expenses account for a higher proportion of spending for the less well-off than energy. The food-energy price nexus is very visible as oil prices have rebounded from the relatively low levels seen during the crisis. Since biofuels require a high oil price to be viable, such fuels have begun to emerge as a competing use for grain, soya beans, sugar and vegetable oil, and such pressure will increase if the price of oil rises again. Governments are encouraging the production and use of biofuel by providing subsidies and tax credits to promote renewable energy sources and sustainable development.

22. *Role of financialization of commodities:* The integration of fuel and food markets with financial markets has been contributing to the soaring of fuel and food prices. It is now increasingly clear that a significant portion of the increases in price and volatility of food and energy commodities can only be explained by a trend towards growing financialization of commodities backed by liquidity expansion in the developed countries. Most observers agree that the growing presence of financial investors in commodity markets has contributed to increased volatility by causing prices to react quickly, and often overreact, to new market information. The United Nations Conference on Trade and Development reports that the share of commodity assets under management in global GDP increased more than fourfold during the period 2008 to 2010 and that there have been short-term correlations between commodity prices and financial positions.[7] The current pressure for speculation is perhaps even more severe due to massive liquidity expansion resulting from easy money policies in the advanced countries in the aftermath of the crisis. Moreover, lack of faith in the paper money assets of the developed world is creating an increasing stock of investible funds and generating interest in assets based on tangible goods, such as commodities, as well as gold and other metals.

V. Impact of high inflation and food prices on growth and poverty

23. High food and energy prices affect, directly or indirectly, several macroeconomic aggregates, including consumption, investment, output, overall

[7] United Nations Conference on Trade and Development, *Trade and Development Report, 2011* (United Nations publication, Sales No. E.11.II.D.3).

inflation, trade balance and fiscal balance. The impact on overall inflation is obvious. Moreover, when fuel and food price rises pass from the first-round impact, on domestic prices, to the second-round impact, on wages, interest rates are usually raised in an effort to contain inflationary expectations. A rise in the interest rate would negatively impact investment, and a high inflationary environment creates uncertainties that would discourage new investment. For food- and energy-importing economies, increased import prices would certainly lead to deterioration in the terms of trade and the trade balance and consequent pressure for exchange rate depreciation and higher prices for other imported consumption goods and inputs for production. Fiscal balance would come under pressure when governments implement social protection measures or provide price subsidies to protect the poor. Managing the adverse impact of food and energy price rises through increased use of government resources would reduce the availability of government funds for other policies to support growth and poverty reduction.

A. Impact on economic growth

24. Deterioration in macroeconomic fundamentals would negatively impact GDP growth, which would remain below its potential level. The degree of impact would vary across economies and depend on a number of factors, such as the extent of dependence on food and energy imports, the extent of government subsidies on food and energy prices, the relative importance of food based on the income level of the economy and the relative importance of energy based on the energy efficiency of the economy.

25. The quantitative impact of rising fuel and food prices on macroeconomic variables can be estimated through counterfactual analysis. Such an analysis brings out the outcomes with and without fuel and food price increases, and the difference between the two scenarios reveals the impact on macroeconomic variables. For example, the GDP growth rates of a particular country can be estimated with and without fuel and food price increases, and the difference between the two rates would show the impact of fuel and food price hikes. For net importers of fuel and food, this impact is expected to be negative, meaning lower GDP growth if fuel and food prices rise.

26. On the basis of this methodology, ESCAP estimates that developing economies in Asia and the Pacific as a whole could suffer an economic loss of 1.5 percentage points of GDP growth cumulatively over 2011 and 2012 due to higher fuel and food prices in those years as compared to 2010.[8] The impact varies across countries, with the Philippines at the top of the range in terms of percentage point growth loss (2.4), followed by Thailand and Malaysia (2.3), India (2.2), Indonesia (1.9), and China (1.2).

B. Impact on poverty

27. Food price increases resulting from fuel price increases and other factors directly impact the livelihood of the poor and those in the lower income groups. Food inflation eats into real incomes and expenditures and can

[8] Due to a highly volatile oil price situation, it is difficult to make assumptions about future oil prices. Brent crude oil price was $79.50 per barrel, on average, in 2010. For this exercise, it is assumed that the average oil price would be $110 per barrel in 2011 and 2012. Food prices would rise by about 25 per cent in 2011 and remain relatively stable in 2012. If oil and food prices remained at the 2010 level, countries in the region would achieve higher growth. Growth losses due to higher oil and food prices are given in the main text. Rather than placing too much emphasis on exact numbers, this exercise shows that GDP growth losses do occur and they are substantial.

undermine decades of poverty reduction gains that developing countries have achieved. Higher food prices have a two-pronged impact on poverty: people who are unable to emerge from poverty due to lower economic growth and people who are driven into poverty due to a fall in real incomes. For instance, people living just above the poverty line are likely to fall into poverty as a result of food price increases. Combining these two groups gives the total impact of food price hikes on poverty (see figure 2). Needless to add that those who were already living below the poverty line may suffer enhanced hardships due to higher food prices.

28. Rising prices of staple foods affect the poor in another way also. Depending on whether they are net sellers or net buyers of staple foods, increases in the prices of staple foods would raise the income of households that are net sellers and add to the hardship of poor households that are net buyers. Hardship for the poor arises because they have to spend a larger share of their income on essential foods, leaving less to spend on other food items, which are important as complementary sources of energy and nutrients, and non-food items, including health care and education. In general, unexpected rises of staple foods have an immediate negative effect on the urban poor since most of them are net buyers. To a lesser extent, the same is true even in rural areas; for example, studies of rural income-generating activities found that 91 per cent of the rural poor in Bangladesh in 2000 were net buyers of main staple foods.[9]

29. Economies in various parts of the Asia-Pacific region have seen food prices increase by 10 to 40 per cent from January 2009 to June 2011. Higher food prices exert upward pressure on inflation, particularly in lower-income economies, where such prices account for a major proportion of the inflation basket. For example, China, India, Indonesia and Thailand have CPI weightings between 33 and 46 per cent for food. Rising food prices have exceeded headline CPI numbers in many economies in 2010/2011, representing a key factor in the rise in overall CPI (see figure 3). Beyond the impact on CPI, rising food prices are of intrinsic concern because they represent a higher proportion of spending for the poorest citizens than for the general population, even in lower-income economies. The 2008 food crisis forced millions into destitution in Asia and the Pacific.[10] Similarly, the poor, in both rural and urban areas, particularly net food buyers, the landless, and female-headed households, are expected to be the most affected by current high food prices.

[9] Food and Agriculture Organization of the United Nations, "Soaring food prices: facts, perspectives, impacts and actions required". Document for the High-Level Conference on World Food Security: The Challenges of Climate Change and Bioenergy, Rome, 3-5 June 2008. Available from http://www.fao.org/fileadmin/user_upload/foodclimate/HLCdocs/HLC08-inf-1-E.pdf (accessed on 22 August 2011).

[10] An estimated 76 million became undernourished owing to the food crisis of 2008; the proportion of undernourished jumped by 4 percentage points during the crisis. See *Economic and Social Survey of Asia and the Pacific 2009* (United Nations publication, Sales No. E.09.II.F.11).

Figure 2
Impact of high inflation and food prices on poverty

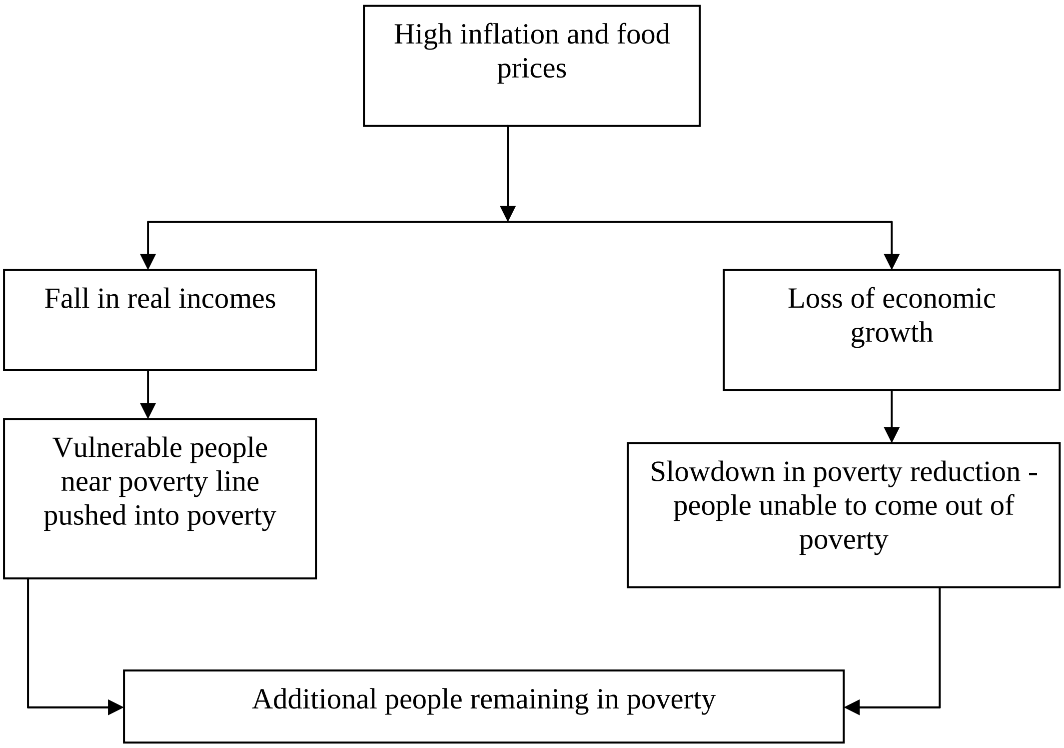
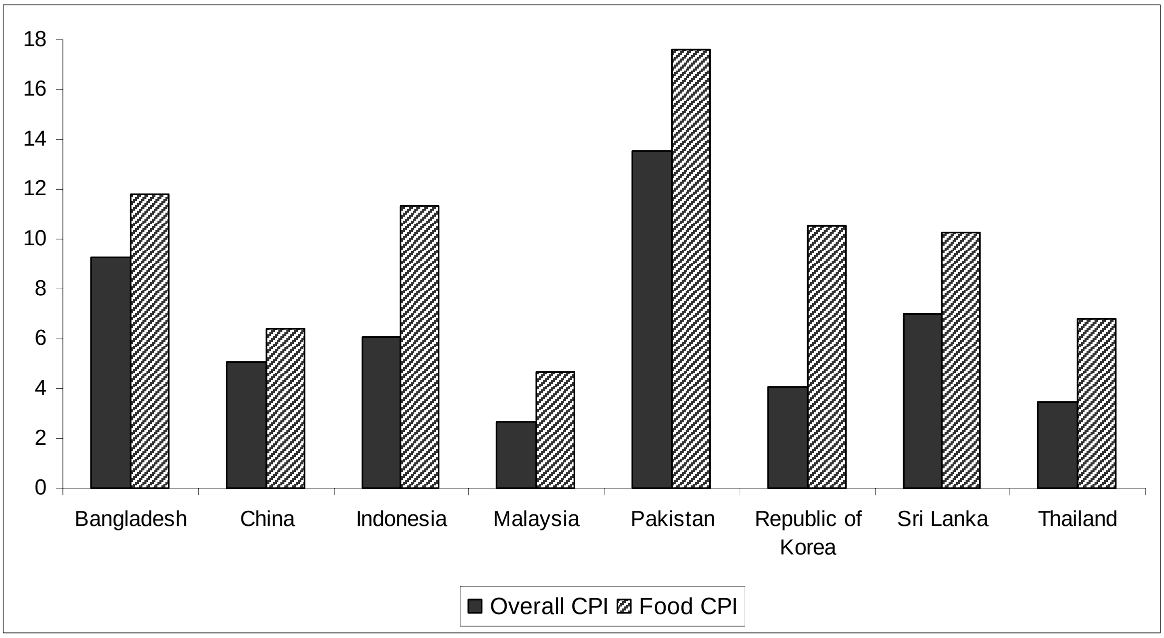


Figure 3
Comparison between overall and food consumer price index in selected developing economies, August 2010 to August 2011, period average



Source: ESCAP calculations based on data from CEIC Data Company Limited, available from http://ceicdata.com/ (accessed 18 July 2011).

Note: Data for Pakistan refer to the period from July 2010 to July 2011.

30. ESCAP has estimated that, based on $1.25 a day per capita poverty line, an additional 19.4 million people in the region remained in poverty due to increased food and energy prices in 2010.[11] Of these, 15.6 million were prevented from escaping poverty, and another 3.7 million were forced below the poverty line.[12] ESCAP simulations show that, given different possible scenarios for food and fuel prices, anywhere from 9.8 to 42.4 million additional people could be prevented from escaping poverty in 2011. Given the low rate at which staple food prices changed in the first half of 2011, the effect is more likely to be towards the lower end. It is important to note, however, that even a halt in the rise of food prices in 2011 would still have an impact on poverty, as the poor would still have to contend with a substantially higher level of food prices than in 2010. The results show that a spike in food prices in 2010 and 2011 could retard the achievement of the Millennium Development Goal on poverty reduction by up to half a decade in many countries of the region, including least developed countries, such as Bangladesh, the Lao People's Democratic Republic and Nepal.

VI. Policy options for containing inflation and minimizing the adverse impact on the poor

31. Inflationary pressures develop both from demand- and supply-side factors. Current inflationary pressures in the region are more from the supply side. Therefore, the use of monetary policy alone to combat inflation may not be appropriate. Rising international commodity prices can reduce aggregate demand in net commodity-importing countries, and the tightening of monetary policy excessively under such circumstances could weaken growth. However, when supply-side factors, such as increases in global oil and food prices, lead to higher wages and domestic prices of other commodities in the second round, the use of monetary policy can help curb inflationary expectations. The tightening of monetary policy can help the exchange rate to appreciate, and this can provide some insulation from imported inflation due to higher commodity prices. Countries in the region with exchange rate appreciation tend to have somewhat lower rates of domestic food and energy price increases.

32. Since early 2010, many countries in the region have started tightening monetary policy, mainly by raising policy rates, in an effort to contain inflationary pressures. These rates had earlier been lowered to stimulate the economies and help their recoveries in the wake of the global financial and economic crisis.

33. As the root causes of the current high inflation and food prices are on the supply side, some supply-side policy options to tackle those are discussed below in some detail:

(a) *Agricultural productivity*. The main long-term supply factor for food inflation has been a marked decline in the growth rate of crop yield associated with the neglect of investment in agriculture over the past two decades. Therefore, sustained efforts should be made to enhance agricultural productivity through continued support for crop and rural development, instituting a new, knowledge-intensive green revolution. The use of modern

[11] *Economic and Social Survey of Asia and the Pacific 2011* (United Nations publication, Sales No. E.11.II.F.2), p. 29.

[12] Given the economic dynamism of Asia and the Pacific, the effect of higher prices of staple foods on poverty was not an increase in the total number of poor people but, rather, a slowdown in the rate of poverty reduction. Nonetheless, if the increase in prices had been larger, the number of poor people could indeed have risen.

technology, new seed varieties and better financial systems for providing farmers with credit should be promoted. A fundamental reason for chronic supply-driven inflation is that real wage growth tends to exceed that of labour productivity even in economies with high unemployment and/or under-employment. The solution is not to seek to reduce or restrain wages but to raise both total factor and labour productivity, especially in agriculture, by reversing the neglect of agriculture in public policy through better price incentives, refocusing on agricultural research and extension programmes and easier access to credit and other inputs. Higher agricultural productivity is especially important because, as stated above, food prices have been proven to be a critical inflation trigger. Higher productivity increases the real wage and exchange rates compatible with low inflation, thus breaking down the inflation propagation mechanism;

(b) *South-South cooperation to enhance agricultural productivity*: Vast gaps exist in agricultural productivity in terms of crop yields across countries and regions throughout the world. These gaps can be reduced through South-South and triangular cooperation on knowledge and technology transfer. This will help in accelerating the introduction and adoption of higher-yielding varieties as well as the delivery of new post-harvest technologies to reduce losses. Existing endeavours on cooperative agricultural research should be promoted and their results should be made available across countries. In this regard, it is useful to note that the system of institutes of the Consultative Group on International Agricultural Research (CGIAR), which includes the International Rice Research Institute (IRRI) in the Philippines and the International Crops Research Institute for Semi-Arid Tropics (ICRISAT) in India, has garnered new knowledge and technology in agriculture and made it available to national agricultural research systems for adaptation to their geoclimatic conditions. South-South and triangular cooperation in the area of agriculture can play an important role in fostering a second green revolution in Asia and the Pacific;

(c) *Buffer stocks of food grains*: Buffer stocks of food grains at the national level should be established and utilized in a countercyclical manner in order to moderate price volatility. However, the establishment and management of national food stocks can be very costly, especially for small countries. For this reason, the establishment of food stocks at the subregional and regional levels for managing price shocks is a better option. An example of such a scheme is the ASEAN+3 emergency rice reserve initiative, which is planned to be formally established by the member countries in October 2011. Another positive initiative is the agreement, signed in 2007, to establish a South Asian Association for Regional Cooperation (SAARC) food bank, which would maintain food reserves and support national as well as regional food security through collective action among member countries;

(d) *Social protection policies*: Without social protection programmes, high inflation and food price increases leave the poor with limited, often harmful, coping mechanisms – such as reducing the number of meals, selling live-stock and other assets, or taking children out of school. Some of these coping mechanisms may alleviate hunger temporarily, but they may, over a longer period, also lead to malnutrition, harm livelihoods, and jeopardize the future of children. The coverage of basic social protection programmes is generally very low in developing countries of the Asia-Pacific region. For example, only 20 per cent of the population has access to health-care assistance; 30 per cent of the elderly receive pensions; and 20 per cent of the unemployed and underemployed have access to labour market programmes, such as unemployment benefits, training, or public works programmes, including food for work programmes.[13] Strengthening social protection programmes can help the vulnerable sections of a society cope with crises such as spiralling food prices. Therefore, social protection should be strengthened through the distribution of food vouchers to the needy or targeted income transfer schemes to minimize the adverse impact on the poor, who usually have higher expenditure on food. Mid-day meal schemes in schools, as have been implemented in certain parts of the region, are important for minimizing malnourishment among children. Moreover, public distribution systems should be strengthened to protect the vulnerable sections of the population from rising prices of food items;

(e) *Inter-connections between energy, food and financial markets*: A comprehensive policy approach is needed when strong interconnections between energy, food and financial markets exist. Crude oil and food prices have become increasingly linked in recent years, partly due to the conversion of food commodities into biofuel. Therefore, policies aimed at moderating the demand for crude oil, such as promoting energy efficiency, are conducive to improved energy security and food security. Also, abundant liquidity in international financial markets led to a growing presence of financial investors in commodity markets, and speculation is likely to have played a part in exacerbating commodity price booms and busts. Therefore, it is important to promote policies aimed at stabilizing international financial markets, which in turn will also contribute to the stability of international commodity markets;

(f) *Global response*: Given the seriousness of the problem, measures to contain inflationary pressures at the national and regional levels may not be sufficient. Global cooperation is needed as well. ESCAP has been advocating decisive action by the G20, as a major forum for global economic cooperation, to moderate the volatility of oil and food prices that are highly disruptive to the process of development. Regarding oil price volatility, the G20, as the group representing all major consumers, can match the power exercised over the oil markets by the Organization of the Petroleum Exporting Countries (OPEC). It may convince OPEC and other oil producers to agree to a fair price for oil and restrict oil price movements within a band around such a price. The G20 could also adopt other measures to moderate volatility in the oil markets, such as creating a global strategic reserve and releasing it counter-cyclically.

34. In order to contain the volatility of commodities prices, speculation needs to be curbed, and regulation of commodity markets should therefore be stepped up. Global markets where commodity-based financial derivatives are traded and priced should be more closely supervised so that speculative bubbles do not develop. Legislation at the national level for this purpose may not be enough. Therefore, financial speculation in international commodity prices should be addressed through international cooperation. Global legislation on the regulation of speculative activities can be carried out through forums such as the United Nations or the G20. To restore the proper operation of commodity markets, tighter regulations should be introduced, including the imposition of position limits and the banning of proprietary trading by financial institutions that are involved in hedging the transactions of their clients.[14] To curb food price volatility, the G20 could also agree on regulations concerning the conversion of cereals into biofuels, implementing the so-called L'Aquila

[13] *Economic and Social Survey of Asia and the Pacific 2009* (United Nations publication, Sales No. E.09.II.F.11).

[14] United Nations Conference on Trade and Development and Arbeiterkammer Wien, *Price Formation in Financialized Commodity Markets: The Role of Information* (Geneva, UNCTAD, 2011), p. 52.

Food Security Initiative, which includes provisions for financing mechanisms to assist developing countries in attaining food security.[15]

35. In conclusion, policymaking in an uncertain environment with multiple objectives has become very complex. The region has to sustain its growth momentum while dealing with inflationary pressures. Therefore, the policy mix should have instruments for containing inflationary pressures with minimum disruptions to growth. To make this growth more inclusive, vulnerable and poor people should be protected from the harmful effects of inflation through social protection policies.

[15] *Economic and Social Survey of Asia and the Pacific 2011* (United Nations publication, Sales No. E.11.II.F.2), p. 46.