

# Rising Food Prices Impacts – Opportunities – Challenges

## Introduction

Cambodia has suffered from high inflation as food prices increased by 24.2 percent between January 2007 and January 2008. High inflation and particularly an increase in food prices are recently serious and complex issues for Cambodia, as it creates potentially significant challenges to socioeconomic stability that could undermine prospects for restoring the combination of solid growth and low inflation that Cambodia has enjoyed in the past years.

Observations, concerns, and recommendations outlined below have been gathered during a number of meetings by NGOs on the topic of rising food prices as preparations for the Discussion Forum on Inflation and Poverty in Cambodia held on 6 May 2008 where representatives from the Royal Government of Cambodia (RGC), research organisations, donors and civil society organisations exchanged views on the topic and where NGOs presented their statement on rising food prices. The views reflected in this paper are also drawn from various discussions among NGOs who are members and non-members of the NGO Forum's Trade and Economic Development Network.

## Joint Monitoring Indicators

There are no joint monitoring indicators (JMIs) related to Inflation.

## Key Actions / Strategies from the NSDP

Section	Message
Table 4.1	Forecast CPI Inflation (% change): 3.5% for 2006 forecast and 3% per annual for 2007-2010 forecast
4.31	The goal of RGC is to ensure macroeconomic stability and growth process with containing inflation rate under 5%

The NSDP 2006-10 recognizes while the growth angles are crucial to reducing poverty in Cambodia, stable social, economic and political environments are enabling factors underpinning growth and development. To ensure favourable macroeconomic and financial environment to achieve stable economic growth in Cambodia, RGC recognises the importance of maintaining the inflation rate at below 5% per annum from 2006 to 2010.

Despite RGC's efforts to keep the inflation rate low, Cambodia was exposed to similar rises in commodity and oil prices as other countries and experienced an increase in inflation from 4.7% in 2006, to 18.7% between January 2007 to January 2008, and further peaking during the first half of 2008 to 25.1%, which then declined to 22% in July and August this year<sup>1</sup>. This phenomenon of high inflation has been driven by rising local and world food demands and increasing fuel costs. The phenomenon of rising food prices in Cambodia has created both negative impacts and opportunities.

<sup>1</sup> Consumer Price Index (CPI) data of Ministry of Planning and statements from the National Bank of Cambodia.

### **Impacts of Rising Food Prices and Its Implication**

Statistically, the 40% poorest of Cambodians spend 70% of their total expenditure on food (CSES 2004) and 65% of rural households (including 20% landless and 23% land-poor<sup>2</sup>) can produce just enough rice, or insufficient rice for their year-round consumption. This means a considerably large number of rural households have to buy more food to meet their consumption needs. However, the price of food items has dramatically increased. The prices of all varieties of rice have jumped by approximately 100% between May 2007 and May 2008. Meat prices increased by 50-70% and the price of fish and vegetables rose by 20-30% in the same period.

Consequently, groups of net food consumers such as fixed salary workers, landless and land poor are observed to be hard affected by soaring food prices. Fishing communities are suffering in particular since their fish-catch has declined and fish prices have increased by only 20-30% relatively to other products on the market. This verifies the findings from MOPS (CDRI, 2007) which alerts that the poverty increased between 2001 and 2004 in three of nine surveyed villages that are dependent on common property resources – fisheries and forestry. This should at large receive particular attention from policy makers.

Soaring food prices forces the poor to apply coping strategies like reducing the food-intake, consuming less nutritious food, reduced spending on education and health, migration, and sale of assets. Moreover, to accommodate such difficult circumstance of high food prices, poor households started to take loans. Of the 32% of the households engaged new loans in the first half 2008, more than 60% of them used the loans to buy food, cover health expenses, and buy agricultural inputs.

This facet of explanation informs that escalated food prices threaten poverty reduction effort and make Cambodia less capable to achieve the goals and targets set by its Poverty Reduction Strategy and Cambodia Millennium Development Goals.

### **Opportunities and Remaining Challenges**

Although soaring food prices result in some negative impacts, it also allows Cambodia to benefit - if appropriate policies, strategies and actions are employed to enhance agricultural development.

Though high inflation has largely been explained by soaring food prices, agriculture production costs have also escalated. While the costs of gasoline and day labour increased 50% and 40-50% respectively from May 2007 to May 2008, the 80% increased cost of diesel has caused the land preparation costs to increase by 35%. In addition, the cost of chemical fertilizers rose by 80-200% over the same period<sup>3</sup>. Nevertheless, despite such increase in production cost, farmers can still gain about 32% from their agriculture (CDRI, Policy Brief 2008). Alternatively, high production costs including cost of chemical fertilizers offer a chance for Cambodian agriculture to adopt quickly the low-tech methods such as organic farming and System of Rice Intensification (SRI) initiatives committed to by the NSDP 2006-10.

Given the condition that Cambodia is an agrarian society and a net exporter of agricultural products (rice and others), soaring food prices is viewed as a golden opportunity for the country to improve the livelihoods of rural Cambodia where 91% of the poor live and depend on agriculture, forestry and fisheries. On the other hand, small-farms have proven to be more productive than large farms (WB, 2007). This then implies that small-scale farmers are likely to contribute more to Cambodia's economic growth than large-scale farming. However, this opportunity can be realized only if it is facilitated by sound public policies and actions that would remove crucial challenges to the agriculture sector.

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<sup>2</sup> Households that own less than 0.5 hectare of farm land

<sup>3</sup> CDRI (Aug, 2008). Final draft of national survey on impact of soaring food prices

The remaining challenges include landlessness and land-poor, low productivity, rainfall-dependence, being vulnerable to disasters, and markets. While 46% of the rural households are landless and land-poor (WB, 2006), only 35% rural households can produce rice surplus (CDRI, forthcoming). And as the land issue is critical in Cambodia, only 16% of the poorest quintile households own land which is secured by a title and other 37% are secured by papers (MoP, Feb 2006).

The productivity of rice cultivation in Cambodia has improved from 1.3 tonnes per hectare in 1993 to about 2 tonnes per hectare in 2004-05 (NSDP 2006-10). The RGC recognizes that this increase primarily results from the introduction of high yielding varieties and agricultural techniques, and that it is still low compared to that in neighbouring countries which share similar agro-climatic conditions. This implies that there are potentials and a lot more to do to improve Cambodia's agricultural productivity.

Rain-fall dependency is also of critical concern and a limiting factor to Cambodia's agriculture production. Most Cambodian farmers can only harvest once per year and often are vulnerable to drought, flood and pest infestation. A Poverty Profile of Cambodia (MoP, Feb 2004) explains that more than 90% of the Cambodia's 40% poorest households are living in villages that have experienced natural disasters during the past five years. Low frequency of rice production is also explained by lack of irrigation system. In 2005, only 20% of Cambodia's agricultural land was adequately irrigated.

All of these factors are crucial to Cambodia's agriculture. Though farmers foresee the potential to earn more from their farming, being dependent on rainfalls which increases their vulnerability to disasters reduces the incentives for small-scale farmers, and also potential large-scale ones, to invest in high-yield seeds and other high-cost inputs. Therefore, opportunity created by high food prices will only be realized and benefit Cambodia if these challenges are properly addressed. However, public investment in agriculture, rural development and water management has been minimal and under-spent. The Ministry of Agriculture, Forestry and Fisheries (MAFF) and the Ministry of Rural Development (MRD) were able to spend only 50% and 74% respectively of their capital budgets in 2007 (NGOF, Budget Brief, Sept 2008).

Mr. Chhay Sarath and his brother live in Phnom Penh and own rice farm in kampong Preang, Sangke District, Battambang. 'On our ten-hectare land we earned a net profit of US\$ 2,000 from the sale of paddy rice upon the harvest last year,' Sarath says.

'Given high price of rice, we expand our farming on 40 hectares this year, but may make very little or no profit at all due to prolonged drought followed our sowing,' he continues.

*Interview with Mr. Chhay Sarath, 27 Oct. 2008*

### **Government Responses and Implication**

In response to inflation and soaring food prices, the Royal Government of Cambodia has taken immediate actions, namely<sup>4</sup>:

- o *Fiscal policy responses*: exempt VAT and reduce import duty on imported agricultural inputs; limit pass-through of high world market oil prices; reduce tax on petroleum imports thereby foregoing US\$ 240 million of Government revenues; subsidy to EDC of US\$ 41 million;
- o *Action programme to fight rising inflationary pressures*: prohibit exports of rice for two months and provide low interest loans for traders/millers to purchase

<sup>4</sup> Keynote Address by Dr. Hang Chuon Naron delivered at the National Workshop on Rising Food Prices and Responses on 25 September 2008, at CJCC and Impacts of Soaring Food Prices (CDRI, forthcoming)

- more rice to stock for domestic markets, sell rice at subsidized prices to urban people;
- o *Monetary policy responses*: double reserve requirement and stabilize exchange rate;
- o *Administrative measures*: base salary and family allowance has been increased for government officials and retirees; increase in salary of garment workers.

In general, NGOs highly appreciate the RGC's attention and response to high inflation and rising food prices in particular. The measure to increase the base salary and family allowance for civil servants is particularly welcome since their current salary is low and around 12% of this population group are poor (MoP, Feb 2006). This measure additionally reflects the RGC's commitment to increase salary for civil servant as part of its reform programme. Though the US\$6 per-month top-up for garment workers was not comparable to the rate of inflation, NGOs again appreciate the government's intervention. They regret however, that the government did not employ mechanisms to ensure that garment factories actually applied this top-up amount. Measures to exempt VAT and reduce import duty on imported agricultural inputs are of value to assist farmers. However, these measures are intended to satisfy all farmers and the rich or large-scale farmers tend to benefit more as they consume more of these inputs. From the NGOs perspective given limited resources the government has and because poor suffer most from inflation, it would be more effective if such interventions targeted the poor specifically. Support could be provided to small-scale farmers through mechanisms such as farmer associations, farmer cooperatives, and other community groups which are recognized to be important and effective by the NSDP 2006-10.

However, to enhance farmers' profits and to avoid overuse of pesticides, the RGC sees the need to promote low-input and low-cost methods of agricultural production such as System of Rice Intensification (SRI). Given the potential of Cambodia's organic farming, the RGC also recognizes the need to promote the export for its niche product such as organic farm products (NSDP 2006-10). As such, the increased cost of chemical fertilizers would give Cambodia and its farmers a chance to focus on SRI and organic farming. This would allow them to avoid high cost and increase profitability while soil and environmental sustainability can at the same time be maintained. It is therefore concluded that interventions to reduce the cost of chemical fertilizers are not the best option, but removal of other constraints in agriculture would be worthwhile such as small irrigation, expansion of SRI and organic farming, strengthening and expanding community groups such as farmer associations and cooperatives, saving groups, rice banks, water user groups, and so forth.

Because rising fuel price is a factor of inflation, the government's measure to reduce tax on petroleum imports is at least one option which will help to curb high inflation. Of course, the increased fuel cost drives up prices across other items including agricultural production costs. However, NGOs find that tax reductions on fuel tends to benefit the rich more than the poor since the richest quintile spend 12.4% of their expenditure on transportation and communication which is 20 times more than the poorest quintile (CSES 2004).

The subsidy of US\$ 41 million to Electricité Du Cambodge (EDC) is also very much rich- and urban-bias. Statistically, only 1% of the poor are living in Phnom Penh (MoP, Feb 2006) and their electricity consumption is far too little compared to the rich. Though the claim may refer that subsidy would help maintain industry competitiveness, transportation and utility costs are not the only factors for Cambodia's cost competitiveness. On the other hand, the sale of milled rice at subsidized price was also meant to benefit urban poor.

## Conclusion and Recommendations

In general, NGOs welcome the government's consideration and responses to address the issues of high inflation in general and increasing food prices in particular. However, we observe that while some measures address macroeconomic management as a whole, others tend to benefit urban and rich people more than the rural poor that were most affected by inflation and increasing food prices. This means the government's responses have not yet been effective in reaching the most affected groups.

In principle, rising food prices appear to be an opportunity for rural poverty reduction. To ensure realization of such potentials, NGOs would recommend the following:

- Though the rice yield has been increased, the current level of productivity can still be further improved. While productivity could be enhanced through selection of high-yield seeds and improving agriculture techniques, attention should also focus on agriculture intensification and diversification. This requires increased investment in agricultural research and extension.
- As small farms have proven to be more productive than large ones and given large number of landless rural households, provision of social land concessions under land reform programme should continue to be high priority agenda of the Royal Government and its development partners. Additionally, due to ongoing insecurity of land tenure, accelerating land-titling for rural people must remain a high priority for the government and development partners.
- Reducing dependency on rainfall as well as intensifying the use of agricultural land clearly requires attention from both the Royal Government and its development partners to actually increase investment in water management and expansion of irrigation system. Increasing investment in rural development is also another priority for rural roads and small-scale irrigation.
- Being vulnerable to natural disasters such as floods and droughts in particular calls for strengthening disaster management through developing mechanisms to reduce or mitigate the risks, for instance, the preparedness programme. On the other hand, vulnerability can be reduced through increased social protection programmes.
- As the government has undertaken a number of measures to tackle the inflation phenomenon, NGOs would like to suggest that the Royal Government reviews all measures employed so far in order to learn whether they are effective for the economic growth and poverty reduction. NGOs call on the Royal Government and development partners to further employ target measures that would directly address the issues and concerns of the poor, especially through community group mechanisms such as farmer associations and cooperatives, rice banks, water user groups, saving groups, fishery folks and so forth.

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