Food and Farm Subsidies in the Global Food System

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Key Points

- Food and farm subsidies if implemented for a restricted period, targeted to vulnerable groups and supported by programmes that encourage self-sustainability, can improve food security and provide a boost to food self-sufficiency.

- While poorly targeted food subsidy programmes may meet their stated goals of improving food consumption and nutritional status amongst the poor, they are not the most cost-effective method. The same goals could be achieved at much lower fiscal and economic costs.

- Ongoing food subsidy programmes create a fiscal drain that diverts resources away from investment in infrastructure, R&D, extension services and social safety nets that could sustainably support food security.

- Subsidy systems are associated with high levels of wastage and corruption; they also incentivise environmentally damaging production processes and are responsible for harmful distortions to both domestic and global markets.

Summary

A major feature of food systems in both developed and developing economies is the widespread use of subsidies, both to support agricultural producers and to make food more affordable for consumers. Farmers can be supported through the provision of agricultural inputs, such as water or fertiliser, either free or very cheaply. Another method uses income
support programmes that guarantee farmers will receive a certain floor price for their produce. By either reducing input costs or increasing prices received, agricultural subsidies encourage increased food production. Consumption-side food subsidies, such as food stamp programs, are also prevalent and aim to reduce the price that people pay for staple food items. The majority of agricultural and food subsidy programs are motivated by concerns about household-level food insecurity.

Future Directions International's Global Food and Water Crises Research Programme recently published a series of case studies, examining the role that subsidies play in global food systems. This strategic assessment paper draws together the findings of those studies to determine how subsidies impact on global and household-level food security in both the short and long term. It also considers whether or not they are a viable tool for combatting food insecurity.

The paper will assess the benefits and sustainability of both farm and food subsidies in developing world agriculture. It will then explore the impact that farm subsidies in the US and EU have on global food markets.

**Analysis**

**Food Subsidies**

In the 'Subsidies in the Global Food System' series, FDI examined the consumption-side food subsidies introduced in the GCC states, following global food price spikes in 2008 and 2011. The series also considered India’s new Food Security Bill, which aims to considerably extend the country’s existing food subsidy programme. This year, FDI has also looked closely at the food subsidy system in Egypt and its links to the political upheaval in that country and at Indonesia’s subsidy programmes and their impact on food security.

The primary function of food subsidy programmes when they are implemented is to reduce uncertainty at the household level, about access to affordable staple foods. The subsidies transfer price fluctuations from the consumer to the government, thus averting food insecurity for the population.

Experience has shown that, in most parts of the world, there is a close link between food security and political stability. This means that food subsidies, once introduced, quickly become a highly charged political tool. In Egypt, there is a strong relationship between food price spikes and political turmoil; subsidised bread has been a key part of the strategies of successive Egyptian governments for maintaining social stability, ever since violent protests erupted over reductions in food subsidies in 1977.

The implementation and extension of food stamps and handouts in the GCC states following the global food price spikes of 2008 and 2011, were a reactionary political response designed to avoid exacerbating social unrest as the Arab Spring swept through the region.

Consumption subsidies can have positive effects on real income and food security. They can also reduce the incidence of malnutrition, particularly when implemented as a short term measure, to address transitory price fluctuations or to target assistance to vulnerable sectors of the population. In the majority of cases though, food subsidies are not well
targeted; they reflect political expediency rather than supporting those most vulnerable to food insecurity. As a general rule, better-off households receive larger absolute benefits than poor ones and urban areas have far better subsidy coverage than poor rural populations. Very few of the existing food subsidy schemes in developing countries are effectively targeted to low income households.

Once implemented, food subsidies are very difficult to abolish, given the political sensitivity of hunger among the population and the aversion of governments to high levels of inflation. The majority of food subsidy programmes cover broad swaths of the population and run for long periods. In many cases they are not indexed to increases in the general price level, so the financial burden they place on the government increases over time.

As food subsidy systems become entrenched, they create a situation where corruption, graft and wastage become rife. India’s existing system of subsidy cards and ‘fair price shops’ is beset with rampant corruption, wastage and complaints about food quality. With programme coverage set to increase from 325 to 800 million people per year, there are serious concerns about the management of these issues.

Bulky, untargeted food subsidy programmes are an unsustainable fiscal drain for governments. Egypt’s expensive subsidy programmes cost 25 per cent of government expenditure each year and have come close to causing fiscal collapse over the past year. GCC countries, including Kuwait, have been warned by the IMF that the continuation of their food handouts is causing a rapid deterioration in public finances and could cause the country to run out of oil revenues by 2017 if spending policy is not scaled back.

Evidence from the majority of country studies shows that while untargeted or poorly targeted food subsidy programmes may meet their stated goals of improving food consumption and nutritional status amongst the poor, they are not the most cost-effective method. The same goals could be achieved at much lower fiscal and economic costs. Subsidy programmes tend to provide a ‘hand-out’, rather than a ‘hand-up’. They do not directly or sustainably address the root causes driving food insecurity. In the long-term, food subsidies may undermine the capacity of a country to achieve food security as the erosion of fiscal stability undermines the ability of governments to manage future food insecurity.

**Farm Subsidies**

The second variety of subsidies prevalent in the global food system is production-side farm input subsidies. Agricultural subsidy programmes can vary considerably in approach. The case studies that FDI has looked at in the developing world, include Malawi’s Farm Input Subsidy Programme (FISP) and India’s agricultural subsidy scheme. FISP was introduced by the Malawian government in 2005. The programme provides farmers with coupons to purchase fertilisers and grain seeds at heavily discounted prices. Subsidies are distributed to the poorest 50 per cent of Malawian farmers. In India, the government has supported a similar long-running programme that provides farmers with unlimited access to free water and electricity, as well as subsidised seed, chemical fertilisers and transport.
The goals of programmes like these are to support rural communities, raise farmers’ incomes, increase domestic food supply and self-sufficiency and, through these measures, support national food security.

Agricultural subsidy programmes can have a considerable impact on a country’s food self-sufficiency. Since the introduction of FISP in 2005, Malawi has experienced a string of bumper harvests that reduced the number of people living below the poverty line from 60 per cent in 2004, to 45 per cent in 2009. India’s ongoing programme has enabled the country to maintain high levels of grain production, which have kept prices low and limited food insecurity. Despite these benefits, for programmes to provide a long-term solution to food insecurity, they must encourage farmers to become self-sufficient and avoid dependency traps.

Malawi’s FISP has provided an important boost to the agricultural sector; however, experts now fear that the impressive yield gains have not provided a sufficient boost to incomes to allow farmers to afford their own fertilisers. They are warning that a cycle of dependence on subsidised chemical fertilisers could develop, which would necessitate costly long-term support for the sector.

Long-running programmes like India’s, which encourage reliance on certain modes of farming, can lead to wastage, environmental harm and market distortions. In India, unlimited access to water is causing groundwater reserves to be depleted far faster than recharge rates, while overuse of chemical fertilisers is causing soil nutrient depletion. The harmful environmental impacts of the input subsidies could therefore undermine future food security, by threatening the productivity of agricultural systems.

If agricultural subsidy programmes fail to provide self-sustaining boosts to the farming sector, they become an ongoing fiscal drain. Estimates indicate that FISP costs the Malawian Government nearly 16 per cent of its annual budget and between half and two-thirds of the country’s total agricultural budget. This is a matter of concern, as high costs divert resources away from public investment in infrastructure, research and development, extension services and social protection; investments that could create a more sustainable farming sector and have better long-term impacts on food security.

**Agricultural Subsidies in the EU and USA**

Outside of the developing world, farm subsidies are also heavily employed by the United States and the European Union to support their agricultural sectors. The agricultural policies of the US and EU are widely criticised for their impacts on the global food system.

Price and income supports provided to farmers in both regions have serious distortionary effects on global grain commodity markets. By creating a fixed price floor, the subsidies encourage overproduction and artificially deflate the market price. When these products flood the global market at artificially low prices, farmers in the developing world cannot compete, despite having a low-cost comparative advantage. This can prevent the development of viable agricultural sectors in the developing world that could increase incomes and boost long-term food self-sufficiency.
The subsidies also have detrimental domestic impacts for the US and EU. Agribusiness companies, rather than independent farmers, receive the majority of the subsidies. Over 75 per cent of US commodity subsidies in 2012 went to just 10 per cent of subsidy recipients. The programmes act as a wealth transfer to agribusiness companies; they continue because of the disproportionate power of the farming lobby in the US.

The farm subsidies of the EU and US are a major impediment to the establishment of a fair global food system that is supportive of the long-term food security of developing countries.

**The Future of Food and Farm Subsidies**

New programs in the US Farm Bill and the European Union’s Common Agricultural Policy (CAP) are expected to lead to total farm subsidy costs declining by approximately 10 per cent over the coming decade. However, the programmes could continue to make large payments in years of low yields or market downturns. It is highly unlikely that the old policies of price and income support will fade from policy debates, as might have been expected in the high-price environment that has existed since 2008.

If the US adopts a new Farm Bill along the lines currently anticipated, other countries will feel little motivation to limit their own distortionary supports and subsidy systems. Programmes in the developing world also seem likely to continue because of the central – if inefficient – role that they play in reducing food insecurity in their populations. In both the US and EU, and in the developing world, subsidy programmes are too difficult to abolish because of their extreme political sensitivity and the risk that their removal will lead to political instability.

**Subsidies and Global Food Security**

Food and farm subsidies if implemented for a restricted period, targeted to vulnerable groups and supported by programmes that encourage self-sustainability, can improve food security and provide a boost to food self-sufficiency.

In many cases, however, food insecurity or production shortfalls are symptoms of fundamental underlying issues with economies or food systems that subsidies cannot remedy. In these cases, subsidies often function as a political quick-fix, to avert or avoid having to deal with long-term issues in food systems. Due to the difficulty in abolishing food and farm subsidies, programmes are often continued beyond the point where they are providing a cost-effective solution to problems. In these cases, while the subsidies may achieve their stated goals, they do so in a manner that is not economically efficient and may prevent the implementation of lower cost, sustainable alternatives.

Furthermore, large, unwieldy subsidy systems are associated with high levels of wastage, corruption, incentivising environmentally damaging production processes and are responsible for harmful distortions to both domestic and global markets. In the long-run, both food and farm subsidies pose a threat to household-level and global food security. While subsidy systems must be carefully dismantled, to avoid causing political instability, their replacement with targeted social safety nets and greater investment in agricultural research and development, and extension services, would have beneficial impacts on long-term global food security.
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