THE IMPACT OF THE GLOBAL ECONOMIC AND FINANCIAL CRISIS ON FOOD SECURITY AND THE AGRICULTURAL SECTOR OF EASTERN EUROPE AND CENTRAL ASIA

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EXECUTIVE SUMMARY

Since the 1998 Russian crisis, the region was characterized by a booming economy, which had a positive impact on the evolutions in the agricultural sector and on poverty reduction. Agricultural output and productivity strongly increased and over 60 million people moved out of poverty in the region. The recent financial crisis risks reversing the region's recent gains and exposes the region to significant adverse economic and social impacts as the economies in Eastern Europe and Central Asia are forecast to experience the deepest contraction among all emerging and developing economy regions.

The financial crisis affected the region with some delay. In the second half of 2008, as risk premiums for emerging countries rose and cross border lending decreased, the position of the countries in Eastern Europe and Central Asia particularly worsened, also by the collapse of commodity prices. In general, the crisis affected the economy in the region through reduced capital flows, including a decline in investments, a decline in domestic production and exports, and a decline in remittances. By mid 2009, international financial markets recovered and confidence indicators stabilized. However, the ripple effects of the crisis on industry and households became clear, with significant effects on unemployment, exchange rates and non-performing loans.

Effect of the financial crisis on the agricultural sector

The liberalization of the sector in the beginning of the 1990s caused a dramatic decline in agricultural output and productivity, but recently output and productivity increased again. The crisis will have a negative impact on this recovery. First, one could expect an overall decrease in investments, because banks provide less credit to individual households and (foreign and domestic) investors reduce their investments in the sector. This could cause a stabilization in the recent productivity growth, depending on the extent to which the sector depends on formal credit. Second, the financial crisis is expected to lead to a decrease in demand for higher value agricultural products and a switch to basic products due to a decrease of the household's disposable income. Finally, governments in some countries reacted to the crisis by increasing their expenditures on agriculture. These government interventions could be positive if they boost investments. However, one should be careful it does not lead to a (partial) reversal of reforms in the agricultural sector, which could have a negative effect on efficiency.

Effect of the crises on poverty and food security

Poverty and food security was improving strongly in Eastern Europe and Central Asia before crisis periods hit the region. In the first half of 2008, the region was confronted with rising food prices as consequence of a worldwide food crisis. Later, in the second part of the same year, a second shock affected the region, when the effects of the worldwide financial crisis became clear. Although the food and financial crisis developed from different underlying causes, they are interacting trough their implications for financial and economic stability, food security, and political security.

The financial crisis and the accompanying slow down of the economy reversed the increase in commodity prices (caused by the food crisis), yielding benefits for the food security and poverty of net consumers of food. However, at the same time, a reduction in real wages and employment and a decline in remittances affect negatively the income of households in the region and increases poverty and food insecurity. The first results (in Tajikistan and Russia) show that the second effect is more important and that the financial crisis caused an increase of overall poverty in the region.

In addition to the impact on household income, the crisis also negatively affects government budgets. This could have a negative impact on government spending on social assistance programs, while these programs in fact need to be expanded given the expected increase in poverty.

Policy recommendations

- **Enhance economic growth.** The best strategy to reduce poverty, improve food security and enhance agricultural productivity in the past, has been economic growth. It will reduce poverty in two ways. First, an increase of household income has a direct effect on poverty and second, the increase in government budget can be used to enhance social safety nets, helping to push the poor over the poverty line. In the agricultural sector, growth of the non-agricultural economy is necessary to absorb the surplus labor and to enhance investments and research in the sector.

- **Enhance investments.** Increased investments have been a major driving force behind the recent economic growth. In the agri-food industry in other more economic advanced transition countries, such as the new member states of the EU, foreign investments have been one of the, if not the, main engine behind productivity growth, quality improvements, and enhanced competitiveness. The task of the government will be to provide a favorable institutional and regulatory environment for stimulating more FDI. This can be done by promoting R&D in the agricultural sector and by enhancing the rural infrastructure, but in this perspective it will also be important to continue the process of reforms.

Currently, there is a marked slowdown in reforms, but the number of reforms that are dismantled is still well below that during the crisis that affected the region in the 1998. It will be important for governments in the region to continue the reforms as soon as the economy recovers. This is needed to create a more stable economic, political, institutional and legal environment, which is crucial not only to attract domestic and foreign investments, but also to encourage the growth of more productive firms.

- **Enhance social security safety nets.** Preliminary data from a few countries found a significant decrease in the number of beneficiaries between June 2008 and June 2009, the period when more households have become vulnerable. This trend needs to be reversed and social safety nets need to be strengthened to deal with the expected increase in poverty. All countries need to scale up targeted programs that reach the poorest quintile of the population and they need to consider to introduce new poverty-focused programs (or change the eligibility criteria of existing programs) that focus on the people that will fall into poverty because of the crisis and that are not reached by the existing social security programs.

- **Avoid short run policies that conflict with long run development goals.** In the current environment, it is very important that governments do not implement inappropriate short run policies that may have welfare consequences larger than the welfare losses resulting directly from the shocks themselves. An example of such as policies are trade restrictions that some countries imposed in response to rising food prices. Such policies redistributed income away from rural food producers to urban consumers. Additionally, it is important that policy responses do not conflict with the key longer-term reform agenda. For example, many of the restrictive trade and price controls that governments in the region adopted in response to the food price increases in 2007 have not been reversed and with lower food prices, these policies could be expected to further increase the poverty gap between urban and rural areas.