

April 7, 2007

BANGLADESH

PRICES OF ESSENTIAL COMMODITIES: RECENT TRENDS, UNDERLYING FACTORS AND POLICY OPTIONS

There is a concern in Bangladesh that prices of essential commodities—mainly food items including rice, wheat, pulses, sugar, edible oils, ginger, garlic, onion and potato—have shown an upward trend in the past several months. Media reports in recent weeks are full of government actions including pictures of personnel of Bangladesh Rifles manning fair price shops and selling essential food items to the lower and lower-middle income classes. The government's concern of the impact of rising food prices on the welfare of the poor is quite understandable. According to the 2005 Household and Income Expenditure Data, these food items account for more than one-third of the annual household expenditure of the bottom 20 percent of the population.

What is the true picture of rising food prices in Bangladesh? How much of the rise is due to changes in demand and supply in the international commodity markets? What domestic factors, particularly in the very short-run, i.e., a week to ten days, account for the price rise? What measures has the Government of Bangladesh taken to check the price rise and what other options exist to deal with the prevailing situation? This note addresses these questions.

I. Changing Food Prices: A Trend Analysis

A monthly trend analysis indicates that in Bangladesh (a) price of rice increased sharply until a year ago, following which it has remained stable in rural areas and the rate of increase slowed in urban areas; (b) wheat, pulses, and garlic prices have increased sharply in last twelve months in both urban and rural areas; (c) price of mustard oil has increased in rural areas while remaining stable in urban areas in recent months; (d) onion prices have been highly volatile; and (e) prices of potato, sugar and ginger have declined significantly. More specifically, these price changes can be classified in the following three categories:

(a) Sharp rises in the recent past

- A staple food of the country, **coarse rice** accounts for more than 30 percent of the annual household expenditure of the bottom 20 percent of the population. Its price in urban areas in the recent past was lowest at Tk 15.5/kg in August 2004 and then increased steadily to Tk 21.8/kg through May 2007. This translates into a 40.5 percent steady increase over a 33-month period, and in the last 12 months the increase was 16.4 percent. A similar picture emerges in rural areas: lowest at Tk 15.2/kg in August 2004 and then a steady increase to Tk 20/kg through May 2007, which is a 31.5 percent increase over a 33-month period. The increase was 9.4 percent in the last 12 months.
- A 30 percent increase in **wheat** prices in urban areas over the last 11 months—from Tk 19.9/kg in June 2006 to Tk 25.9/kg through May 2007. The corresponding rise in rural areas was 25 percent.
- A 33 percent increase in **moong pulse** in urban areas over a 12 month period—from Tk 53.1/kg in January 2006 to Tk 70.5/kg through February 2007. Since March 2007 the price started to decline slightly and in May 2007 price was Tk 69.6/kg, a 1.3 percent decline from

February 2007 price. In rural areas, the price increase has been 10 percent during the a 11 month period: from Tk 65/kg in March 2006 to Tk 71.6/kg by February 2007. In May 2007 price was Tk 69.4/kg, a 3.1 percent decline from February 2007 price.

- A 67 percent increase in **garlic** prices during 10 months in urban areas—from Tk 61/kg in April 2006 to Tk 101/kg by February 2007, followed by a 37 percent decline through May 2007 to Tk 53.5/kg. A 178 percent increase in rural areas during last 25 months followed by 20 percent decline in one month—low at Tk 36/kg in December 2004, increased steadily to Tk 100/kg by January 2007 before falling sharply to Tk 52/kg by May 2007.
- In urban areas, **mustard oil** was lowest at Tk 74/kg in November 2004, increased gradually to Tk 88/kg by May 2006, and then stable at Tk 88/kg through February 2007, then increased to Tk 99/kg by May 2007—which is 34 percent higher relative to the previous low. In rural areas, lowest at Tk 74/kg in November, 2004 to March 2005, increased gradually to Tk 80/kg by December 2006, and then increased sharply to Tk 95.5/kg by May 2007—a 19 percent increase in last five months and 29 percent higher relative to the previous low.

(b) Highly volatile around a stable level

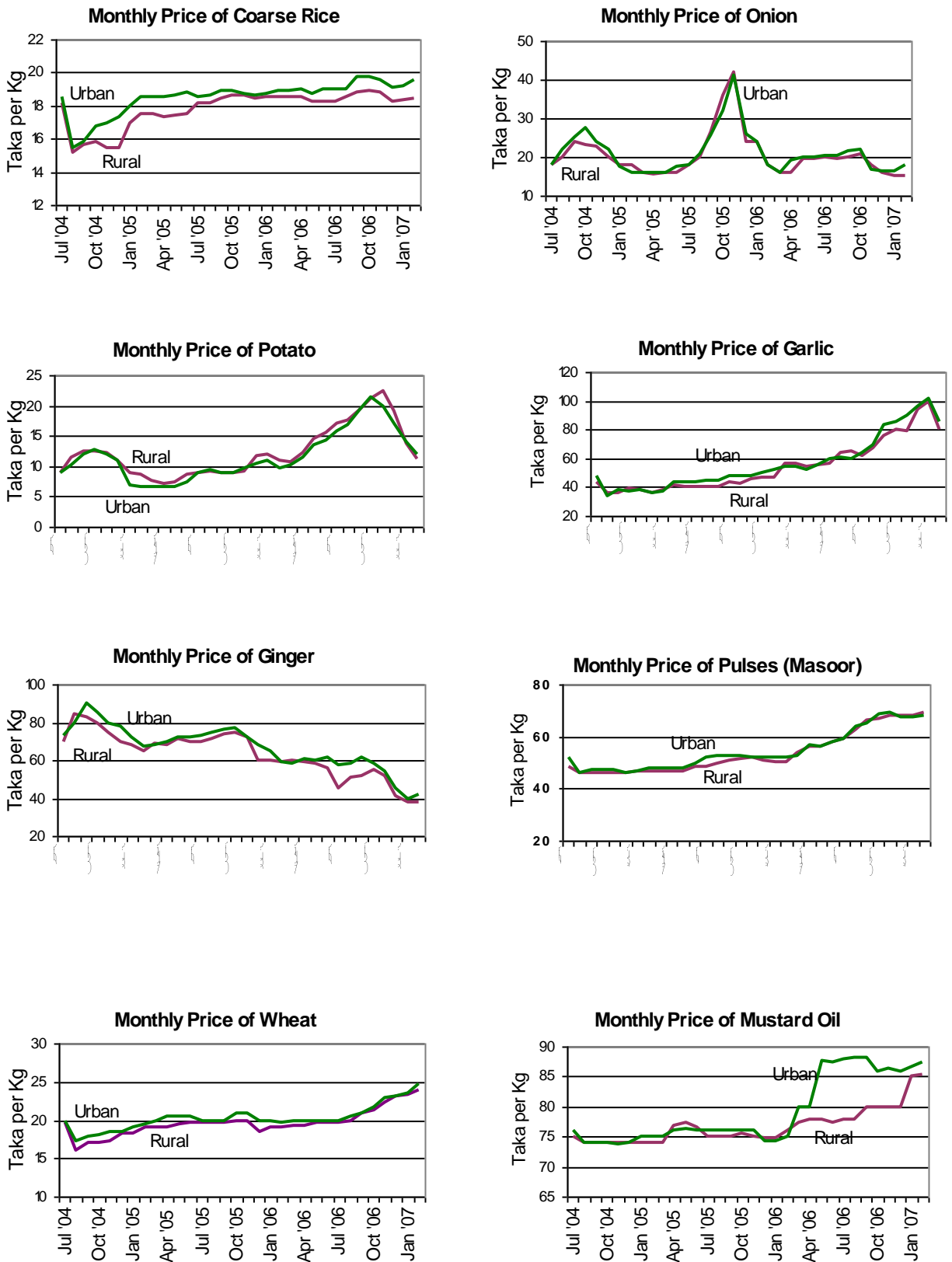
- Prices of **onion** are highly volatile but move around a stable level. It seems to be affected by very short-run supply shocks. The recent price trend indicates that in urban areas the low value was at Tk 16/kg during February-March, 2005, then increased sharply to Tk 41/kg by October 2005, returned to the previous low of Tk 16/kg in March 2006, increased gradually to Tk 22/kg by October 2006, and then declined to Tk 16.5/kg in January 2007 before rising to Tk 21.6/kg in March 2007. By May 2007 the price declined by another 26 percent to Tk 16/kg. An almost similar pattern emerges in rural areas.

(c) Volatility around a trend value

- The price of **potato** in urban areas was low at Tk 6.6/kg in March 2005, increased sharply to Tk 21.4/kg by October 2006 and then declined to Tk 12/kg by February 2007. Then it increased by 48 percent to Tk 17.8/kg in May 2007. In rural areas, the low level was at Tk 7.3/kg in April 2005, increased sharply to Tk 22.5/kg by November 2006, and then declined to Tk 11.3/kg by February 2007 before increasing to Tk 18.2/kg by May 2007, a 62 percent increase in just 3 months.
- **Sugar** prices were low at Tk 31.7/kg in November 2004, increased steadily to Tk 36/kg by July 2005, and then a sharp increase to Tk 57.4/kg by April 2006 before a rapid decline to Tk 31.4/kg by May 2007. These changes reflect a 43 percent decline in last one year. The price situation is pretty similar in both urban and rural areas.
- **Ginger** prices peaked at Tk 77.3/kg in October 2005, decreased to Tk 58.1/kg by March, 2006, rising back to Tk 61.8/kg in June, 2006, declined sharply to Tk 40/kg in January 2007 before rising to Tk 44.2/kg in March 2007, then declined again by 12.7 percent to Tk 38.6/kg by May 2007. Overall the prices declined by 35 percent in past one year. Again, a similar picture emerges for urban and rural areas.

See Figure 1 below for more details.

Figure-1: Recent Trends in Average Monthly Price of Essential Food Items



II. Reasons for Price Changes and Near-term Outlook

Being a net importer of all the above mentioned food items, prices in Bangladesh are set by international prices plus the opportunity cost of bringing goods to the domestic market. As long as there are no quantitative barriers to imports, domestic demand and supply conditions should have no impact on prices; they only affect the quantity of international trade. Domestic prices of commodities in globally integrated markets depend only on world prices, nominal exchange rate, transport & storage costs, and taxation policy with respect to imports.

There are two main reasons for increase in food prices in Bangladesh. First, the steady **9.3%** depreciation of Taka in FY06 has played its role in increasing food prices as imports have become costlier. Second, domestic prices have risen due to a rise in international prices. Agricultural commodity prices have increased for five months running (through January 2007) in international markets, up more than 10 percent, led by strong gains in fats & oils and grains—up 23 and 14 percent, respectively.¹ There has been a steady increase in wheat prices over the past three years mainly due to shortfalls in production. Global wheat production is expected to decline in 2006-07 by over 5 percent. Facing a crisis of its own, India has banned all wheat exports starting February 9, 2007. Bangladesh imports a large quantity of wheat from India² and therefore, any supply restriction from India is likely to have an impact on domestic prices in Bangladesh. Earlier in June 2006, India had also banned the export of pulses. Import through formal channels will naturally stop while informal channels risk premium will rise even if imports do not stop completely.

Notwithstanding Bangladesh's net import situation in trading these items, in the very short-run (say, on a week to ten-day basis), domestic supply and demand conditions seem to matter the most in determining food prices. In recent years, production and import of rice have varied generally in opposite direction; wheat production declined during FY04-06, while imports have been variable, rising in FY05 and then declining somewhat in FY06; production of onions increased impressively, while imports declined in FY05 and then increased significantly in FY06; production of potato increased in FY05 and then declined significantly in FY06 and imports have been negligible; sugar production has declined, while imports increased in FY05 and then declined in FY06; production of lentils declined and so did imports; and garlic production increased significantly while imports decreased in FY05 and then increased slightly in FY06 in nominal dollar terms.

Controlling Supply Chain through Syndication. There have been some talks of market control through syndication and the resultant increase in prices. Unfortunately, there are no data to identify such cases. However, information exchange through some traders suggests that the presence of market power either through collusion between two or more traders or because of the existence of large individual traders may be a problem at the import stage. There are roughly 10 to 20 trading houses in Bangladesh who have the capability to import in bulk³ (edible oil, sugar, wheat, pulses) and the financial capacity to hold on to the stocks in order to influence prices. But they too face constraints: commodities are perishable, there is competition from small suppliers and there are vagaries of international prices. In the supply chain of good produced domestically, there are just too many traders at the levels of beparis (traders collecting from producers),

¹ World Bank, External Environment for Developing Countries, DECDG, March 2007.

² Private sector importers bring in substantial quantities of wheat every month—an average of 150 thousand tons, totaling 1.8 million tons per year in 2004/05 and 2005/06.

³ 12500 MT and above.

Aratdars (link between beparis and wholesalers essentially performing a storage and matching functions), wholesalers and retailers for syndication to be possible.

Extreme caution is needed in the drive against syndication. Indiscriminate crackdown on traders can aggravate the problem by creating panic in the trading system. To play it safe, traders may choose to cool their business for a while by not importing at all or not importing as much as they would have imported under normal conditions. As a result, a real shortage can emerge and domestic prices increase even in the absence of collusion.

Near-term Import Outlook. Letter of Credit (L/C) openings in the first seven months of FY07 for imports of rice and wheat, sugar and salt, pulses and spices had healthy growth relative to the first seven months of FY06 (See Table 1 below). Yet the Indian ban on export of wheat and pulses may not allow these imports to materialize. The recent crackdown by the Caretaker Government (CTG) against hoarders also caused panic and many businessmen appeared to have responded by refraining from opening new L/Cs. LC openings for the import of food grain declined by 18 percent in January 2007 relative to January 2006 and by 19 percent relative to December 2006. The slowdown continued through the first half of February, according to media reports.

Table 1. Letter of Credit Openings in the First 7-Months of FY07
(in US \$ million)

Items	July-Jan. FY07	July-Jan. FY06	Growth (%)
<i>Rice and wheat</i>	320.2	279.6	14.5
<i>Sugar and salt</i>	221.9	75.5	194
<i>Edible oil</i>	3.3	3.3	0
<i>Pulses</i>	140.9	101.6	38.7
<i>Onion</i>	44.3	49.3	-10.1
<i>Spices</i>	37.9	19.6	93.4

Source: Bangladesh Bank

Typically there is a two to three weeks lag between LC openings and the arrival of the imported merchandize. The impact of the slowdown in January and the first half of February on domestic supplies could have surfaced in March, causing a hike in food grain prices again. The good news is that the initial panic seems to have eased following assurances given by the CTG that genuine businessmen can go on doing their business as usual. As a result, LC opening for the import of food picked up in second half of February so much so that total LC's opened in February, 2007 increased by 153% relative to February 2006. According to media reports quoting Bangladesh Bank,⁴ L/C openings increased by 12.9 percent in the first 22 days of March, 2007 relative to the corresponding period in March, 2006. LC openings increased for the import of rice, wheat, sugar, milk food, edible oil and onions.

III. Efficacy of Recent Government Interventions and Other Options

In response to the rising food prices and its likely impact on the poor, the CTG has taken a number of policy and institutional steps. In the past two months, it has reduced import duties on

⁴ The Financial Express, March 28, 2007.

rice and wheat, organized toll free trading centers, taken actions against “hoarding” and opened “fair price” shops.

- **Duty Reductions.** The government removed the 5 percent custom duty on rice and wheat with effect from **March 8, 2007** in an attempt to contain their prices. The government is under further pressure from the business community to lift duties on other food items and to convert ad-valorem rates into specific duties. The proposed structural change of converting ad-valorem rates into specific rates will soften the impact of any international price increase in the duty inclusive domestic price. When prices of essential commodities rise, most developing country governments reduce import and other related duties as a measure to create an incentive to the private sector to increase imports. For example, faced with a higher and rising wheat prices, the Government of India allowed imports of wheat at zero duty from September 2006, in addition to banning all wheat exports. Similarly, to check rising prices of pulses, it allowed imports at zero duty from June 2006, banned exports and the National Agricultural Cooperative Marketing Federation (NAFED) purchased *urad* and *moong* pulses from overseas.

Bangladesh faces a similar situation of rising food prices. Any further adjustments in duties including any structural changes, need to be resolved quickly and decisions need to be taken in an informed manner. To ensure an informed judgment, it might be useful to constitute an inter-ministerial task force comprising of the Ministry of Commerce, Ministry of Law, the Ministry of Finance and other relevant ministries and a committee to monitor the impact of duty reduction on domestic prices.

- **Toll Free Trading Centers.** The Bangladesh Rifles (BDR) has opened “toll” free trading centers where businessmen are allowed to trade their merchandize without paying any toll—legal or illegal—to the organizers of the centers. According to media reports, following the opening of 25 toll free trading centers by the BDR in Dhaka, prices have tended to be stable. Keeping these centers free from “mastan” (mafia) capture and syndication is a key challenge in sustaining the beneficial impact of the centers on consumer prices. These centers are nothing but a poor short-term substitute of proper regulation of commodity markets to protect both consumers and producers. Moreover, due to lack of proper infrastructure, these centers’ will be difficult to operate in the coming harsh summer and monsoon months. What is needed is a firm government stand on penalizing those who indulge in illegal hoarding and market capture. At the same time, the government needs to reassure the business community that it does not intend to intervene in the market by controlling prices and/or harassing dealers. Its sole effort should be to protect the poor, but without tampering with the open market system. An information campaign through electronic and print media is a good option to calm the markets.
- **Fair Price Shops.** The Bangladesh Rifles (BDR) has also opened a number of sales outlets in Dhaka city to sell a few essential commodities at “fair” prices. It plans to extend these outlets at district levels. As is the case of Toll Free Trading Centers, this intervention can only be a temporary measure, and is unsustainable both administratively and financially. The government should concentrate on ensuring free functioning of commodity markets.
- **Improving Information Flows.** The government can play a very useful role by regularly monitoring prices in major wholesale markets all over the country and making them public at regular intervals through both the electronic and print media. The Government of India, for

instance, has recently put in place a system for monitoring of prices of each and every essential item on a weekly basis.

- **Monetary Policy.** In the medium-term, food prices are sensitive to macroeconomic conditions affecting aggregate demand in the economy. While Bangladesh Bank's Monetary Policy Statement has always reaffirmed commitment to a cautious monetary stance, translation of this commitment into tighter policy action has been intermediated by concerns about risking economic growth and by fiscal compulsions emanating from shortfall in domestic revenue mobilization and external foreign financing. It would help to bring monetary growth back in line with nominal GDP growth without necessarily curbing the growth of credit to the private sector. Many central banks have continued with pre-emptive monetary tightening to mitigate the rise in inflation. The Reserve Bank of India has tightened monetary policy twice in February, 2007, and again in March 2007 (though it needs to be noted that one possible reason for such actions is to counter the overheating Indian economy).

Annex: Tables

Table A1: Structure of Duties, FY05-07
(in percent)

Items	CD			VAT			SD			IDSC			AIT		
	05	06	07	05	06	07	05	06	07	05	06	07	05	06	07
<i>Rice</i>	7.5	6	5	0	0	0	0	0	0	4	4	0	3	3	0
<i>Wheat</i>	7.5	6	5	0	0	15	0	0	0	0	0	0	0	0	0
<i>Lentils</i>	7.5	6	5	0	0	15	0	0	0	0	0	4	0	0	3
<i>Sugar (raw)</i>	25	25	12	15	15	0	15	0	0	4	4	0	3	3	0
<i>Onions</i>	0	6	5	0	0	15	0	0	0	4	4	4	3	3	3
<i>Garlic</i>	15	13	12	0	0	15	0	0	0	4	4	4	3	3	3
<i>Ginger</i>	15	13	12	0	0	15	0	0	0	4	4	4	3	3	3
<i>Mustard seeds</i>	0	0	0	0	0	15	0	0	0	0	0	4	0	0	3
<i>Potato</i>	25	25	25	0	0	0	0	0	0	4	4	4	3	3	3
<i>Soybean oil</i>	7.5	6	5	15	15	15	0	0	0	0	0	0	0	0	0

Source: National Board of Revenue.**Table A2: Shares of Food Items in Household Budget, 2005**

HIES 2005	Rice (coarse)	Wheat	Masoor Dal	Moong Dal	Potato	Sugar	Mustard Oil	Soybean Oil	Onion	Ginger	Garlic	Total
Q1	30.5	0.5	0.8	0.0	2.0	0.3	1.2	1.5	1.0	0.3	0.1	38.3
Q2	22.7	0.4	0.9	0.0	1.7	0.4	1.1	1.6	1.1	0.4	0.2	30.4
Q3	17.1	0.4	1.1	0.0	1.6	0.6	0.9	1.8	1.1	0.4	0.2	25.2
Q4	11.5	0.6	1.2	0.0	1.3	0.7	0.7	1.9	1.0	0.3	0.2	19.4
Q5	5.1	0.6	1.0	0.0	0.9	0.7	0.4	1.6	0.8	0.3	0.2	11.5
All	17.3	0.5	1.0	0.0	1.5	0.5	0.9	1.7	1.0	0.3	0.2	25.0

Source: Household Income and Expenditure Series, 2005, Bangladesh Bureau of Statistics.