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PERSISTENT STRUGGLE: NAVIGATING THE HIGH FOOD PRICES IN GEORGIA

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INTRODUCTION

Increases in food prices and their volatility are global challenges, particularly affecting import-dependent developing countries where spending on food is relatively high. While major concerns regarding price dynamics and volatility are typically driven by the physical availability and financial accessibility of food.

Over the past few years, food prices in Georgia have been rising – with the country experiencing double-digit food price inflation. According to the National Statistics Office of Georgia (Geostat), in May 2022, food prices in Georgia surged by 22% year-over-year, followed by some moderation that led to an average annual inflation rate of 17.9% in 2022. After this sharp rise, the average annual inflation rate decreased to 3.9% in 2023, although this still represented a rise considering the base effect. Thus far in 2024 (up to July), there has been deflation of 1%. Despite these fluctuations, the overall price levels have shifted significantly upward, with some food categories continuing to experience price rises.

High food price inflation is particularly concerning for Georgian households as they allocate almost half of their total budget towards food expenditure: the share on food in total household consumption expenditure increased from 43% in 2019 to 48.7% in 2021 and then returned to approximately the same level (43.3%) in 2023 (Geostat, 2024). In comparison, average household expenditure on food and non-alcoholic beverages in the EU stood at 14.8% in 2021, ranging from the lowest share, of 8.3%, in Iceland to the highest, 24.8%, in Romania (Eurostat, 2023). As a result, high food prices place significant financial strain on the general populace, with low-income families being particularly affected.

Increased food prices often force low-income families to make difficult choices between their essential needs, such as housing, healthcare, education, and nutrition. Furthermore, as food prices rise, low-income families may resort to cheaper, less nutritious options, thus increasing the risk of malnutrition and related health issues such as obesity and diabetes. Most notably, food insecurity can have long-term impacts on children's development, including cognitive and behavioral problems, poorer academic performance, and higher susceptibility to illnesses (Gundersen & Ziliak, 2015). Combatting food price inflation is also crucial for reducing poverty and for achieving targets 1 and 2 of the UN Sustainable Development Goals (SDG),[1] as it directly affects the ability of families to escape poverty and it ensures that all people, especially those in vulnerable situations, have access to sufficient food year-round.

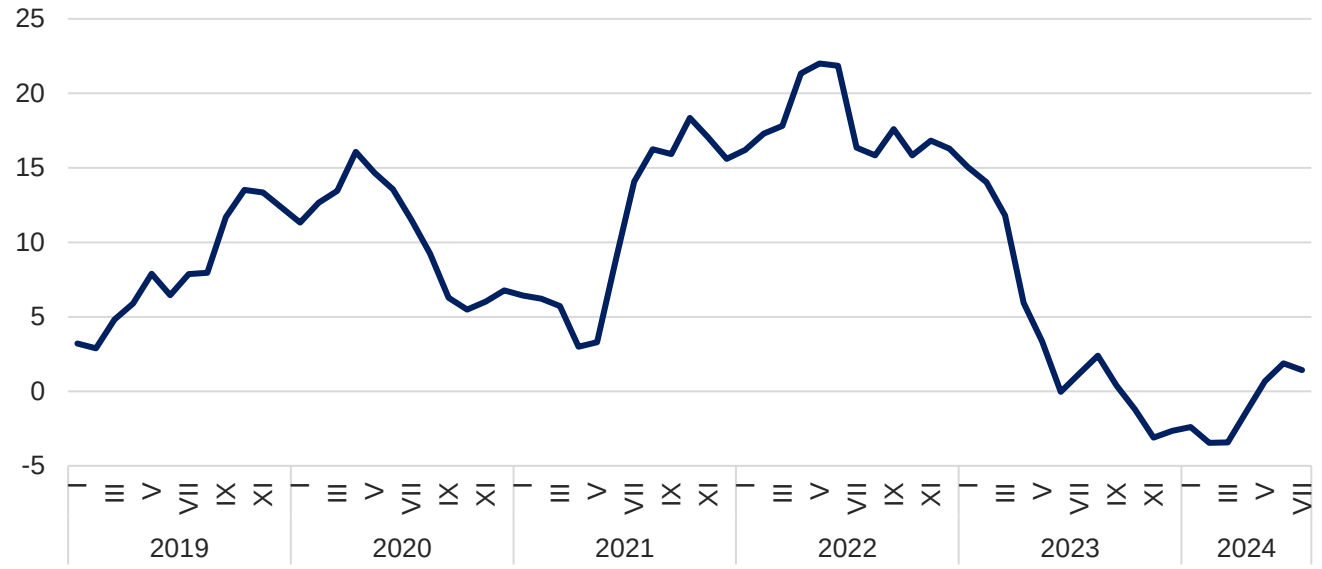
FOOD PRICE DYNAMICS

Over the last five years, from 2019-2024, annual food price inflation in Georgia has ranged from -3.5% to 22.0%. A noticeable upward trend began in the second half of 2019, reaching a peak in 2020 mainly due to disruptions in food supply chains associated with the COVID-19 pandemic, while depreciation of the Georgian lari against the US dollar also placed additional upward pressure on food prices. Although the trend in inflation decelerated in the second half of 2020 and in the beginning of 2021, it remains positive, indicating that prices are still rising. For the second half of 2021, inflation still accelerated because international market trends reflected concerns over decreased production, alongside

[1] Available at: https://sdgs.un.org/goals

pandemic-related restrictions. Furthermore, trade restrictions imposed by Georgia's major import partners have exerted additional upward pressure. Food prices have since risen further, pushing inflation to its highest point by 2022. This increase arose from escalating tension in the Black Sea region, followed by Russia's full-scale invasion in Ukraine, which amplified the pressure on international food markets that were already struggling with soaring prices. As Ukraine and Russia are both important trade partners for Georgia, these ongoing trends have rapidly been transmitting into local prices. In 2023, there was a decreasing trend predominantly arising from the base-year effect. Ultimately, a slight deflationary trend has emerged, starting from the end of 2023 and moving into 2024.

Graph 1. Food Price Index for 2019-2024 (YoY), percentage

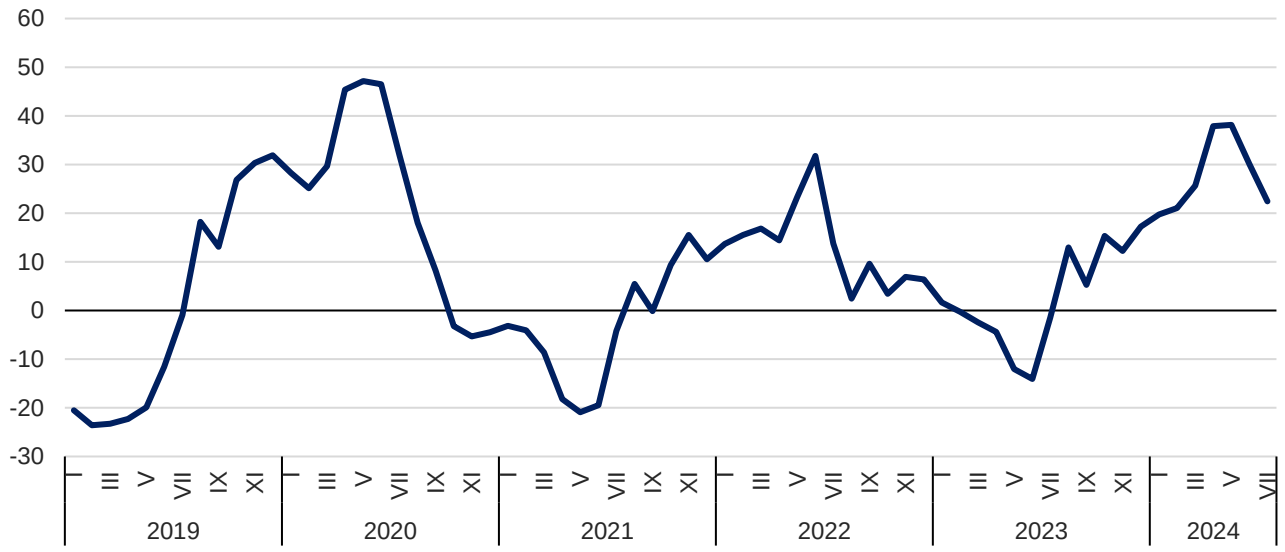


Source: Geostat

Under the food sub-categories, the most volatile prices and those exhibiting the highest increases were within the vegetable category, reaching 51.1% of the inflation rate in May 2022 and 46.4% in August 2023. Notably, the annual inflation rate fell to -4.5% in 2024. The most concerning recent development can be seen in prices within the fruit and grapes category, which has exhibited 27.9% average annual inflation in 2024.

Fruit and grapes. During the spring of 2024, food prices in the fruit and grapes sub-category showed a notable upward trend. The underlying reason behind this most likely lies in the low levels of local production. In 2023, local production levels declined by 14.3% (from 568 ths. tons in 2022 to 486.9 ths. tons in 2023). In particular, prices have risen for the following fruits in terms of average annual inflation: peaches (48.2%), apples (44.4%), and plums (41.1%). Respectively, the local production of peaches declined by 6.7%, by 34.3% for apples, and 23.2% for plums in 2023. According to producers, this decline in local production was due to unfavorable weather conditions.

Graph 2. Annual inflation rate for fruit and grapes, percentage



Source: Geostat

Vegetables. The local production of vegetable products experienced notable fluctuations over the last four years, from 2019 to 2023, with an average annual decline rate of 2%. In 2020, it increased by 9%, followed by declines of 15% in 2021 and 13% in 2022. However, in 2023, production rebounded with 10% growth. The self-sufficiency ratio ranged from 52% to 63% between 2019-2023, remaining almost unchanged from 2019 to 2021, averaging at 62%, and then it gradually fell in both 2022 and 2023, amounting to 52%. Due to decreased local production over recent years, vegetable imports rose by 19% in 2022 and 10% in 2023 on a year-over-year basis. Vegetable consumption equally varied in past years, with annual changes ranging from -7% to 12%. Consequently, the significant variation in local production levels and the increased dependence on imports caused such fluctuations in the price of vegetables.

Graph 3. Annual inflation rate for vegetables, percentage

Source: Geostat

Meat products. The local production of meat has been increasing over the last four years, with an average annual growth rate of 3.2%. While the self-sufficiency ratio ranged from 47% to 51% between 2019-2023. The volume of import decreased in 2020 and 2021, however it spiked in 2022 marking a 19.3% increase from 2021. In addition, it grew by a further 7.4% in 2023. Both the rise in local production and import aimed to meet the considerably increased consumption in 2022 (6.1%) and 2023 (13.1%). This likely relates to the rising inflow of migration from Ukraine and Russia. As local production was unable to sustain the increased demand, additional imports were therefore required. Consequently, international prices had a greater influence on domestic price levels.

Graph 4. Annual inflation rate for meat, percentage

Source: Geostat

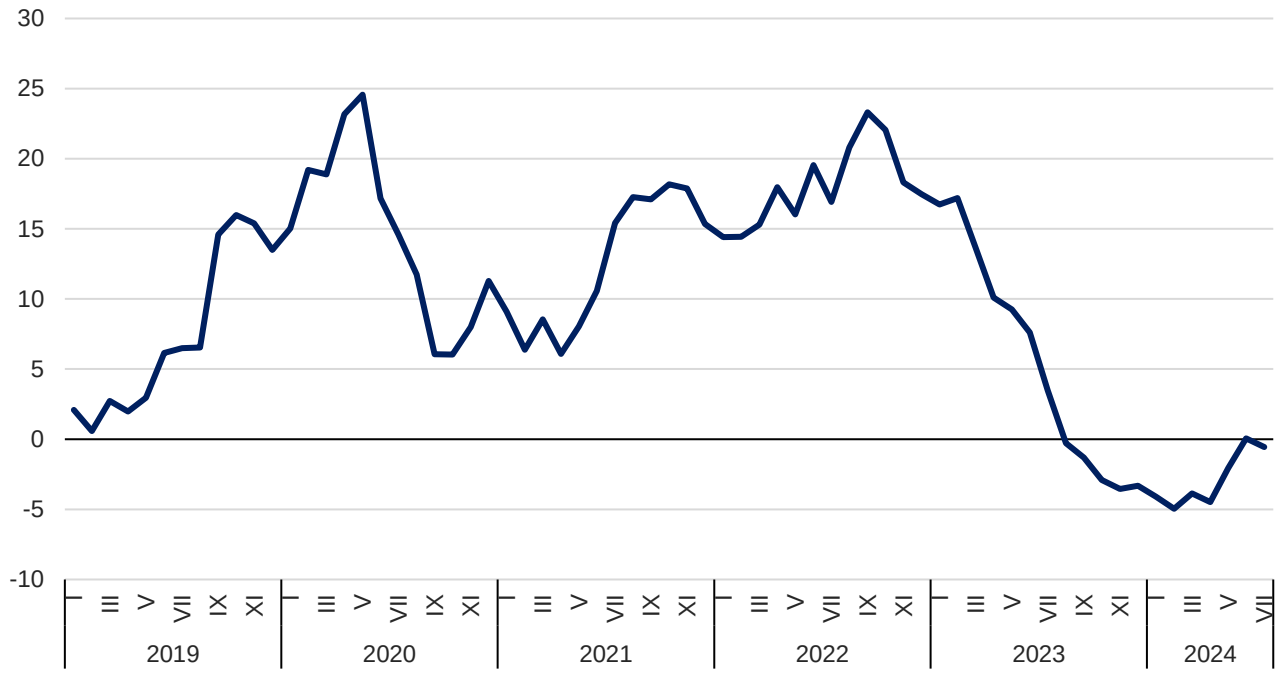
Milk, cheese, and eggs. From 2019 to 2024, the price of milk, cheese, and eggs in Georgia experienced substantial yearly inflation, peaking at 25% in May 2020. The fluctuations in this category largely follow the general drivers behind food price inflation. After years of inflation, the prices began to decline in August 2023, with the most notable decrease, of 5%, occurring in February 2024. Besides the base-year effect, this decline was also driven by stabilization on the global market and its gradual recovery from previous shocks.

Despite Georgia's high self-sufficiency ratio for dairy products (75-81%), the country's milk production showed only a slight annual increase (1%) on average (from 2019 to 2023 the increase reached 4%). Meanwhile, dairy consumption grew at an average rate of 2.8% per year (an 11.5% increase in 2023 compared to 2019), leading to an average yearly increase of 8.5% within imports. Resultingly, the self-sufficiency rate for dairy products dropped from 81% in 2019 to 75% in 2023, the lowest recorded level since data became available in 2014. Additionally, the seasonality of milk production in Georgia, with declines during the autumn-winter period, further amplified the reliance on imports during this period.

Georgia has even higher self-sufficiency within egg production (93-98%). From 2019 to 2023, the local output slightly decreased (by 1.2%), yet imports surged by 93.75% in 2023 compared to 2019, with an

average yearly increase of 33.36% to meet this growing consumption. Consequently, the self-sufficiency ratio for eggs fell from 96% in 2019 to 93% in 2023, another recorded minimum. As the rise in demand grew faster than local production, it caused increased dependence on international markets. Therefore, despite the country's notable domestic production, global shocks in food price have significantly impacted the price of milk, cheese, and eggs in Georgia.

Graph 5. Annual inflation rate for milk, cheese, and eggs, percentage



Source: Geostat

Bread and cereals. Within this category, bread and wheat flour are the most essential products. Notably, Georgia's self-sufficiency ratio for wheat reached 22% in 2023, thus indicating a heavy reliance on imported wheat. An analysis of the food balance data reveals the following dynamic: while wheat imports fell significantly (a 10% decrease in 2023 compared to 2019) and consumption decreased starting from 2021 (an 11% decline in 2023 compared to 2019), local production correspondingly increased by 46% in 2023 compared to 2019. Consequently, the self-sufficiency ratio for wheat increased from 15% in 2019 to a stable 22% in the following years.

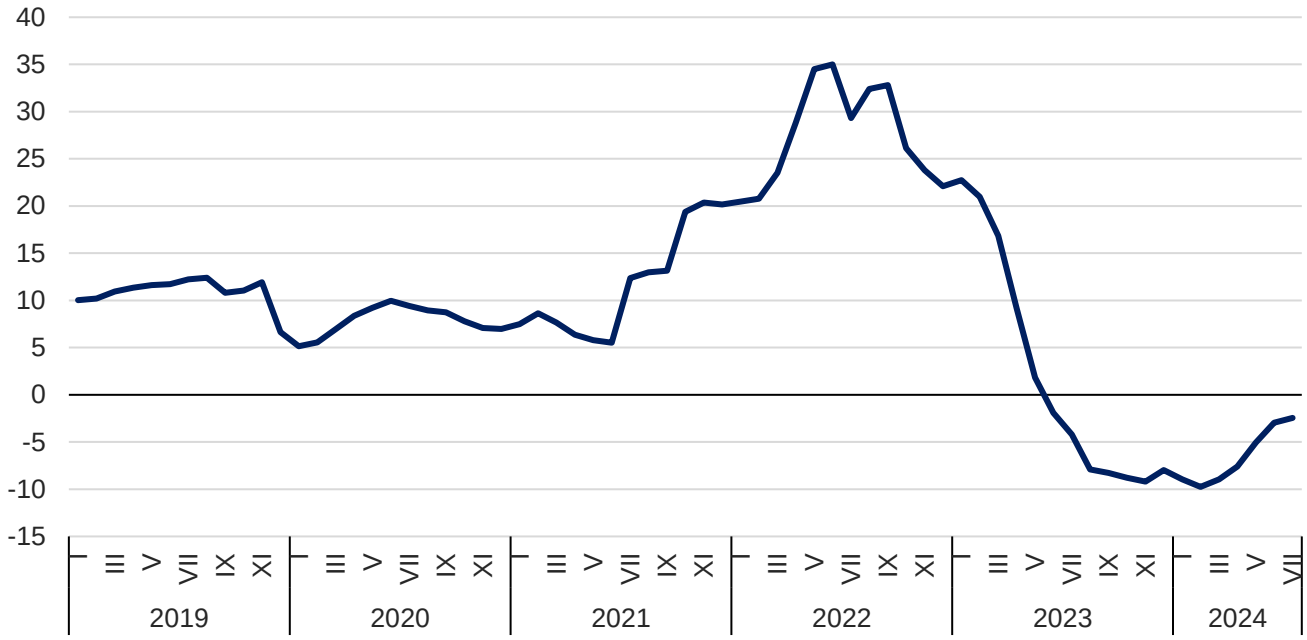
This trend is distinct from the other categories, as wheat consumption significantly declined despite increased migration into the country. A key factor in this shift was the Russian introduction of a floating tariff on wheat in June 2021. Since Georgia is heavily reliant on Russian imports, the floating tariff made importing wheat flour more affordable than importing wheat itself. Before the tariff, Georgia imported minimal quantities of wheat flour. However, following its introduction, wheat flour imports surged by more than nine times, rising from 1,651 tons in May 2021 to 15,086 tons in May 2023 – peaking at 23,651 tons in August of 2022. Concurrently, wheat imports decreased by nearly 54%, falling from 26,212 tons in May 2021 to 12,133 tons in May 2023, with a low of 2,743 tons in May 2022.

In response to these shifts, the Georgian government introduced a temporary import duty on wheat flour in June 2023, which slightly reversed the trend: wheat imports increased but did not return to the 2021 levels, while wheat flour imports declined but remained higher than the pre-tariff levels. This

indicates a transition in the Georgian market, moving from predominantly wheat imports to a balance between wheat and wheat flour imports.

The floating tariff also led to increased prices for wheat flour and bread in 2021-2022. Wheat flour prices peaked in September 2022 with a 41% year-on-year increase. Moreover, bread prices surged by 36% in June 2022, driven by record-high wheat prices, which reached a five-year peak. However, prices started to fall in the second half of 2023, and this has continued into 2024.

Graph 6. Annual inflation rate for bread and cereals, percentage

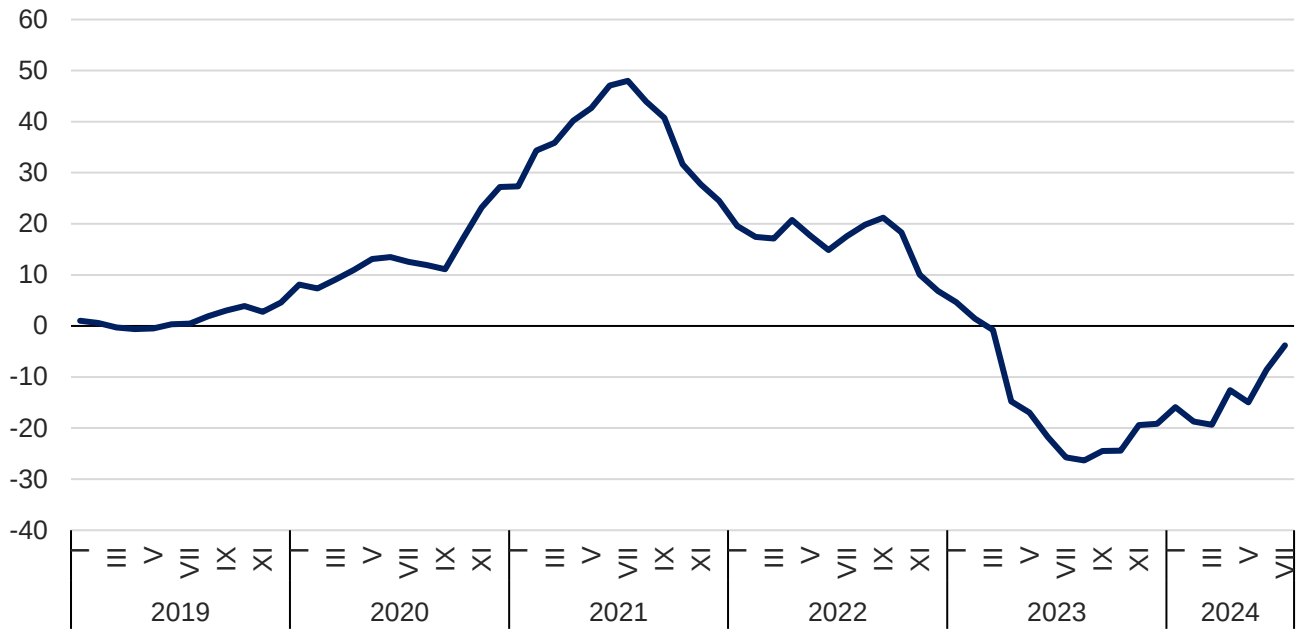


Source: Geostat

Oils and fats. In April 2021, the price of sunflower oil reached its highest level since 2008. The increase in prices, which began in September 2020, was driven by a poor sunflower harvest in the major producing regions of Russia and Ukraine. By April of 2021, the international price of sunflower oil stood at 1,653 USD per ton, which was $465 or 39% higher than the price in September 2020. Due to dry weather conditions in 2020, the Ukrainian sunflower harvest decreased from 16.5 million tons in 2019 to 12 million tons in 2020. In Russia, the harvest volume also, fell from 15.4 million tons in 2019 to 13 million tons in 2020.

During this period (2020-2021), there were also significant increases in the price of other vegetable oils. For example, the price of palm oil rose by 46% year-on-year, to $1,086 per ton, while the price of soybean oil grew by 41% year-on-year, reaching $1,136 per ton (FAO, 2021).

Graph 7. Annual inflation rate for oils and fats, percentage



Source: Geostat

WHAT'S DRIVING UP PRICES?

Limited local production. Limitations within local supply chains are a common contributor to food and beverage shortages on the domestic market, thus leading to rising prices. Furthermore, Georgian agriculture remains highly vulnerable to weather conditions, and adverse shocks can significantly impact various food products by reducing quality or even rendering them inedible. Decreased local production might also lead to a rise in imports, often leading to higher costs from import-related expenses and higher vulnerability by transmitting the volatility of international prices to the domestic market.

Trends in international markets. Given Georgia's small, import-dependent economy, the country is particularly vulnerable to fluctuations in international prices. These global price changes often transmit to the domestic market after a certain period, which varies between sectors, affecting the cost of goods for consumers. Harvest conditions in exporting countries equally play a significant role, as they influence the availability and affordability of imported products. Political tensions and war, followed by trade restrictions, can also exacerbate the situation and further limit access to essential goods. Developments in recent years, namely the COVID-19 pandemic and Russia's war in Ukraine, have placed significant upward pressure to food prices. Moreover, transportation costs impact final prices substantially, making logistics an important contributor to market prices.

Increased demand. Another significant factor contributing to the rise in food prices, or resistance to subsequent decrease, is the robust demand from the market. In the food and beverages category, most products are characterized with an inelastic demand as they are essential goods for consumption. Furthermore, alongside disruptions to food supply chains, Russia's war in Ukraine has played a notable

role in this dynamic. The conflict not only disrupted agricultural production and export routes but also triggered a substantial increase in the flow of migrants from both Russia and Ukraine. This surge in migration has further intensified domestic demand for food and beverages, thereby exerting additional upward pressure on prices. The compounded effect of supply chain disruptions and heightened demand has thus made it challenging for food prices either to stabilize or to decrease.

Exchange rate dynamics. Another contributor to the rise in local prices is the exchange rate. Given that Georgia is an import-dependent economy, fluctuations in the exchange rate have a direct and often rapid impact on local price levels. When the value of the Georgian lari depreciates against major foreign currencies, the cost of imported goods increases, leading to higher prices for consumers. Conversely, even when global prices stabilize, a weak exchange rate can continue to drive local prices upward, making it difficult for the economy to benefit from international price reductions.

Graph 8. GEL/USD average monthly exchange rate

Source: National Bank of Georgia

Beyond the mentioned factors, additional conditions may also influence prices, such as technological advancements in the sector, new government regulations, etc. Together, these factors create a complex environment where both global and domestic challenges directly impact the stability of Georgia's food and beverage markets. The reliance on external sources further intensifies price pressures in the domestic market.

THE WAY FORWARD

The notable import dependency, due to limited local production that is characterized by a high degree of seasonality, is one of the most significant contributors to high food prices in Georgia. While over the last decade the Georgian government has significantly increased public spending on agriculture, from 0.4% of total government spending in 2010 (30.6 mln. GEL) to 3.8% (760.4 mln. GEL) in 2022, the agricultural sector still suffers from small-scale subsistence farming, which results in limited, rather seasonal, local production and high food prices (ISET Policy Institute, 2023).

In order to design public policies that efficiently address the issue of high food prices, it is essential to research food price formation and transmission on agri-food markets in Georgia. An in-depth study of the following drivers behind food prices is consequently recommended:

1. **Price pass-through –** the extent to which changes in agricultural commodity prices are transmitted to retail food prices. This involves analyzing the speed and magnitude of price adjustments along the supply chain.

2. **Market integration –** the degree of integration between domestic and international markets. Assessing to what extent and how quickly changes in global commodity prices, exchange rates, and trade policies affect domestic food prices.

3. **Transmission channels –** the various channels through which price changes are transmitted within the food supply chain. This includes analyzing factors such as transportation costs, processing and packaging costs, marketing margins, and retailer behavior.

4. **Market structure and competition –** the role of market structure and competition in food price transmission and formation. Assessing how market concentration, the presence of dominant players, and the behavior of retailers or food processors influence the efficiency and speed of price transmission.

5. **Policy impacts –** taxes, subsidies, and trade restrictions related to the food industry. Investigating how policy interventions may distort or affect the transmission of price signals along the supply chain.

6. **Price volatility –** examining how shocks or fluctuations in commodity prices propagate into retail food prices, while also assessing the implications for food affordability and consumer welfare.

In-depth research into each of these areas could therefore contribute to developing appropriate policies and interventions that promote fair pricing, market stability, and consumer welfare.

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