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AFRICA AGRICULTURAL MARKETS PROGRAM (AAMP) POLICY BRIEFING

“Variation in Staple Food Prices in Eastern and Southern Africa: Causes, Consequences and Policy Options”

Maputo, Mozambique, January, 2010

This brief summarizes the policy implications of three thematic papers and seven country background papers prepared for the COMESA-ACTESA policy seminar on “Variations in staple food prices: Causes, consequences, and policy implications.” There is little controversy about the need for governments to support staple food markets with infrastructure, market information, agricultural research, and other public goods. However, many of the most costly agricultural programs in eastern and southern Africa involve raising food prices to protect farmers, lowering food prices to protect consumers, and reducing volatility in food prices through a variety of mechanisms including tariffs, export restrictions, public trading in staple foods, and subsidized distribution. A review of the experience with these policies is particularly relevant in the wake of the global food crisis, which has led to an expansion in trade restrictions and stabilization efforts.

What are the policies and investments that will reduce agricultural marketing margins between locations? Based on a review of recent research on food markets in Africa, we offer the following recommendations:

- Continue the process of agricultural market liberalization. Five of the seven recent studies found that agricultural market liberalization had reduced marketing margins and improved efficiency.
- Streamline administrative border procedures, which may be a greater obstacle to regional trade than poor roads. One such step would be to explore the feasibility of regional uniform truck registration.
- Promote competition in the transport industries by reducing barriers to entry into the transport industry and eliminating protection for local trucking companies.
- Improve market information using information and communication technology. Strong

evidence from Niger and other countries suggests that mobile phones can lower price spreads between markets and improve market efficiency.

- Improve transportation infrastructure. This becomes more important as administrative and policy barriers to trade are relaxed.

These measures would reduce transport costs and trader profits, shrinking the gap between the price farmers receive for staple crops and the price consumers pay.

How can African countries reduce vulnerability to fluctuations in world food prices? The global food crisis in 2007-08 has sparked renewed interest in food self-sufficiency. Self-sufficiency in maize is feasible in many African countries that already produce 90-95% of their requirements. For rice and wheat, however, achieving self-sufficiency would be either a major challenge or almost impossible.

One approach, which is politically appealing because of its quick results, is to restrict imports. If enforceable, import restrictions can increase the rate of self-sufficiency quickly, but they raise the price of staple foods significantly. Avoiding vulnerability to a spike in world grain prices like the one in 2007-08 could require keeping grain prices permanently at or above the peak levels during the crisis. This would have serious adverse effects on food security, particularly among the urban poor.

A better approach to pursuing self-sufficiency is to boost domestic production by investing in agricultural research, extension, disease control, and storage methods. Based on numerous studies, this would be a good long-term investment regardless of its success in achieving self-sufficiency. However, staple food self-sufficiency would not eliminate food price volatility; rather it would replace volatility due to international markets with volatility due to domestic supply shocks. The evidence suggests that price volatility due to domestic supply

shocks is at least as large as volatility due to international markets. For example, import parity prices of maize are generally more stable than domestic maize prices in Africa. Furthermore, the price of rice (a largely tradable grain) is less seasonal and more stable than the price of maize (a largely non-tradable grain) because regular imports stabilize the former.

As food-importers, sub-Saharan African countries have a strong interest in restraining major exporters from imposing export restrictions, which were responsible for exacerbating the price increases during the global food crisis. This could be done by lobbying the World Trade Organization to limit food export restrictions as part of multi-lateral trade agreements.

Similarly, the effects of another spike in world food prices could be ameliorated if African countries themselves restrained from banning grain exports. Although these bans are understandable from the perspective of an individual country, the combined effect of many countries doing this is to exacerbate the price spike, particularly for landlocked countries. Efforts to limit food export bans would have to be carried out at the regional level rather than at the national level.

In the longer term, African governments can promote resilience to volatility in international grain prices by diversifying the staple foods diet of consumers. During the global food crisis, the domestic prices of cassava, sweet potatoes, and other non-tradable staple foods rose much less than the prices of rice, wheat, and maize.

Do trade restrictions and government interventions to buy, sell, and trade staple food crops reduce price volatility? A comparison of the experiences in eastern and southern Africa found that these policies have not helped Malawi, Zambia, Kenya, and Tanzania stabilize maize prices. After controlling for seasonal patterns and size of harvest, maize price volatility was lower in Uganda and Mozambique, where the government rarely restricts international grain trade and does not maintain buffer stocks. Thus, trade barriers and public grain reserves tend to worsen price instability.

Trade restrictions widen the band between import and export parity prices within which domestic prices can fluctuate. The experience of Ethiopia, Malawi, Kenya, and Madagascar indicates that grain prices occasionally exceed the import parity price because of 1) the rationing of foreign exchange to prevent depreciation of the currency, 2) the inability of traders to obtain food import

permits, and 3) uncertainty regarding the government's intentions regarding food imports. These spikes can be avoided by maintaining open borders and a realistic exchange rate.

Grain reserves used for stabilization introduce uncertainty because purchase and sale operations are large and unpredictable. Traders are hesitant to compete against a subsidized public enterprise and may withdraw from seasonal storage and grain trading. Thus, public grain reserves tend to displace private traders, depriving the market of the stabilizing effect of their arbitrage activities.

Policy and institutional changes can facilitate grain price stabilization by promoting regional trade with an open borders policy. In addition, they can encourage private storage by using public grain reserves for emergency relief only. If a more activist trade and grain reserve policy is deemed necessary, it should be made as predictable and rules-based as possible, with clear criteria for when tariff rates will be adjusted and when public grain stocks will be bought and sold.

This does not mean that governments have no role to play in staple food markets. As mentioned above, they have an important role in addressing market imperfections and promoting equity. For example, the government needs to play an active role in:

- providing public goods such as agricultural research and extension, agricultural statistics, crop forecasts, market information services, and transportation infrastructure;
- addressing externalities in agricultural markets by controlling plant and animal disease and regulating agricultural chemicals;
- promoting competition in agricultural trade and processing; and
- implementing emergency relief and other well-targeted poverty-reduction programs.

While some price variation is inevitable, the policies described here will contribute to a stable and predictable policy environment and competitive staple food markets, in which price margins between markets and volatility over time are minimized.