



October, 2009

Original: **ENGLISH**

**COMMON MARKET FOR EASTERN
AND SOUTHERN AFRICA**

Twenty Fourth Meeting of the Trade and Customs Committee

Nairobi, Kenya
2-4 November, 2009

**Staple Food Trade in the COMESA Region: The Need for a Regional
Approach to Stimulate Agricultural Growth and Enhance Food Security**

09 (rmm)

Staple Food Trade in the COMESA Region: The Need for a Regional Approach to Stimulate Agricultural Growth and Enhance Food Security

Introduction

1. Poverty reduction in the COMESA region can only be achieved by bringing about agricultural sector growth. The first Millennium Development Goal, halving hunger and poverty by 2015, gave the impetus for the AU and NEPAD to launch the Comprehensive African Agricultural Development Programme (CAADP), which is currently being designed and implemented in many of the COMESA member states as well as at the regional level. The CAADP framework recognizes that reduction of poverty and food insecurity requires, among other things, a favourable investment climate, national and regional market access, and supportive public policies.

2. This policy brief has been prepared by ACTESA and the COMESA Secretariat to highlight opportunities and constraints in regional trade in food staples, which currently stands at 27% of total intra-COMESA trade (2008). Trade in food staples not only brings about agricultural growth, it is also a powerful instrument in stabilizing food supply and food prices in the region. For example, inter-seasonal fluctuations of maize production in southern Africa are substantial, ranging from -65% in 1992/93 to +15% in 2005/06 relative to the 1990-2005 mean production (Jayne and Tschirley, forthcoming). These production fluctuations cause substantial price volatility, especially in countries that are distant from import and export markets. Managing national food surpluses and deficits requires a well functioning regional trading sector, operating within a trade-friendly policy environment. However, in many parts of the COMESA region trade in food staples is far from free, notwithstanding the COMESA Free Trade Area. Food security concerns often prompt national governments to control imports and exports, often becoming market actors, thus creating an unpredictable and often a commercially unviable trading environment.

3. Thus, the task at hand is to explore how regional trade in food staples could be facilitated while addressing national food security concerns. This policy brief highlights some of the issues and challenges and suggests an initial course of action for the COMESA Trade and Customs Technical Committee to consider.

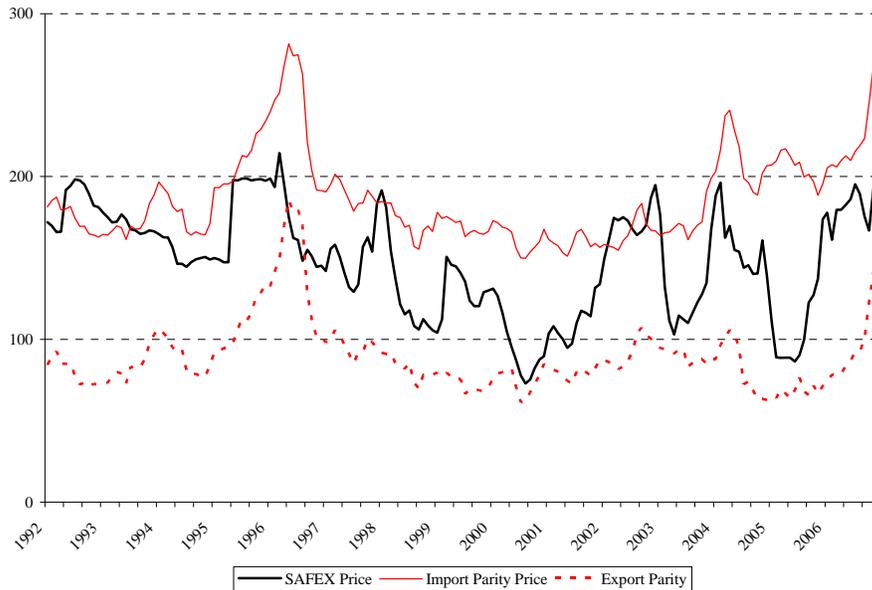
1. The role of trade in preventing and mitigating food insecurity and stimulating agricultural growth

a. Production and price instability

4. Food price fluctuations in the region are a result of domestic, regional and international production and market conditions. The level of price volatility should theoretically be confined to export parity price levels at the lower end and import

parity price levels at the upper end of the price band, reflecting supply and demand conditions during surplus and deficit marketing seasons respectively (Figure 1).

Figure 1. White maize spot prices (SAFEX, Randfontein (Johannesburg), USD/tonne)

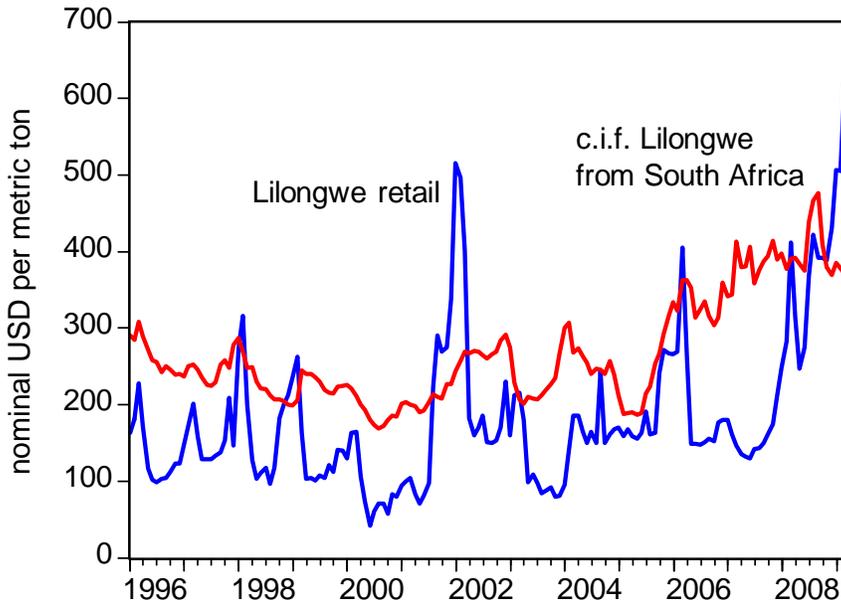


Source: Haggblade

5. A greater gap between these export and import parity prices will reflect high marketing costs, often representing high transport costs to and from distant export and import locations. Regional infrastructure investment programs would have great potential to significantly reduce the cost of transport. For producers this would result in increased profitability and competitiveness due to lower input and marketing costs, while consumers would benefit from lower prices due to reduced import costs of food.

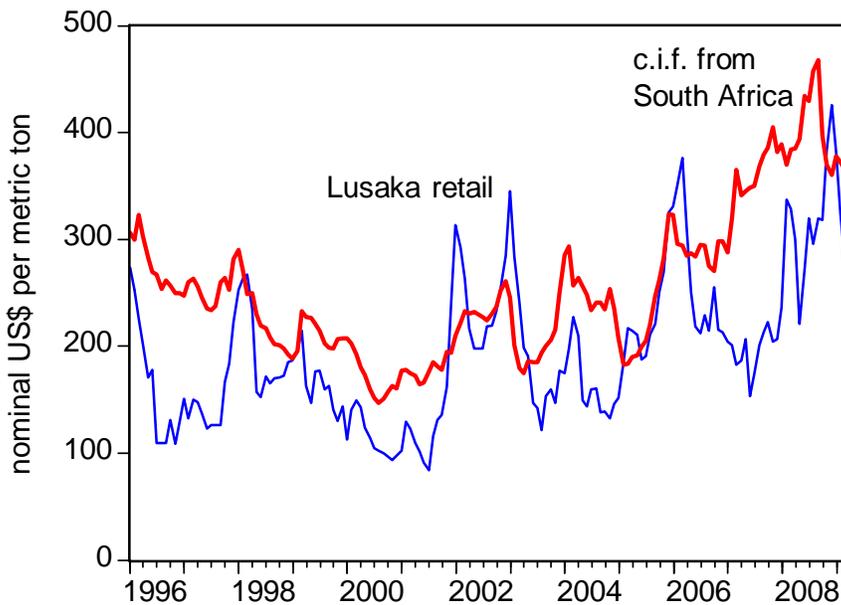
6. However, although in theory food prices should not exceed the cost of importing food, in practice they often do. For example, retail prices of maize grain in Malawi and Zambia frequently exceed the retail value of maize grain imported from South Africa, the nearest and most competitive source of maize imports.

Figure 2. Lilongwe maize retail prices vs. import parity from South Africa



Source: Jayne et al.

Figure 3. Lusaka maize retail prices vs. import parity from South Africa



Source: Jayne et al.

7. Such price spikes exceeding import parity levels in most cases reflect an absence of regional trading activity. Various obstacles have either discouraged private imports, or impeded trading capacity by government institutions, or a combination of both, resulting in a supply vacuum during critical periods of extremely low local food supplies.

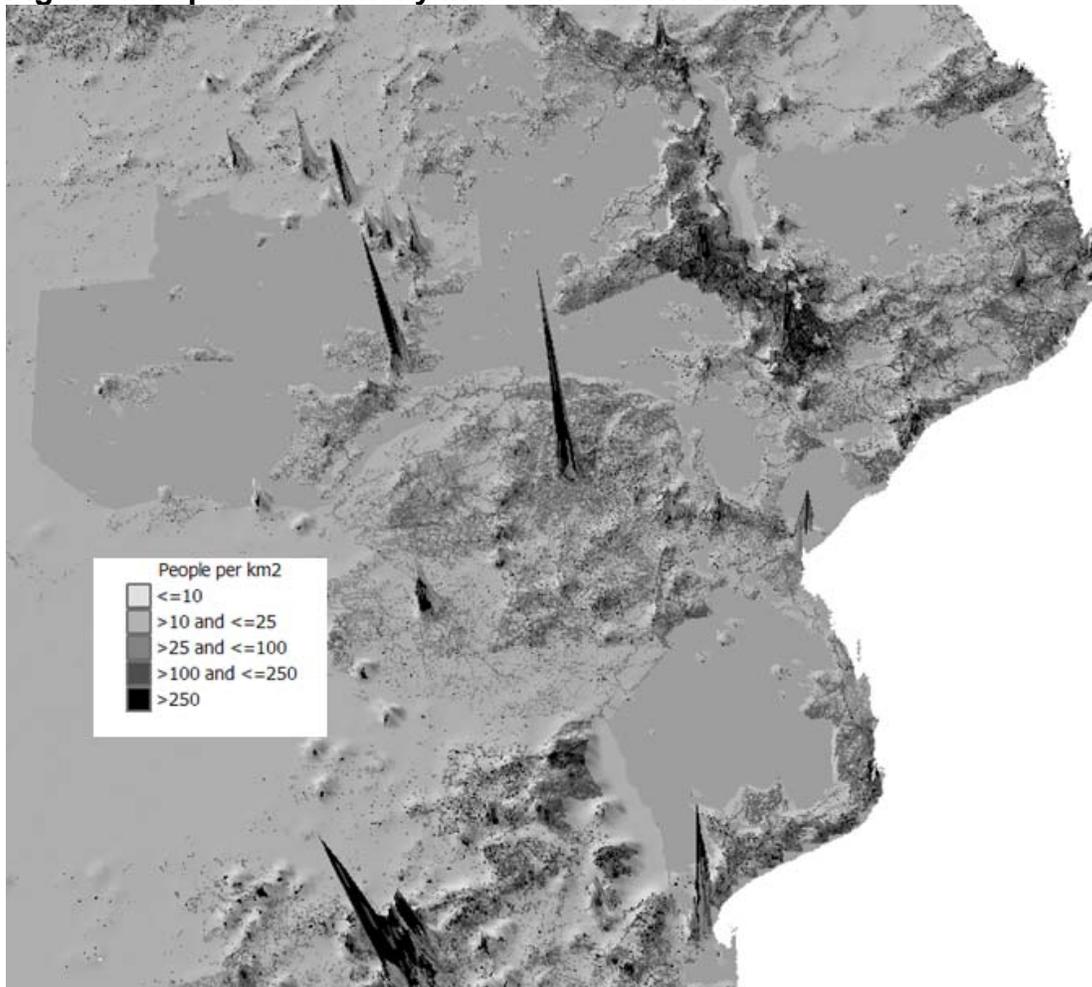
8. The same way trade impediments can cause domestic prices to exceed import parity during a period of food deficits, domestic market prices can fall below export parity prices during a period of surplus. Although poorly documented, there have been cases of export trade barriers causing domestic surpluses and deteriorating market prices.

b. The relationship between agricultural growth and trade in sustainable development and food security.

9. The production of food staples – for growing urban markets and food-deficit rural areas – represents the largest growth opportunity available to African farmers. Currently, the market value of Africa's food staples amounts to \$50 billion per year, or nearly three-fourths of the value of all agricultural production. This figure is estimated to almost double by 2015 (Diao and Hazel, 2004). Given population growth and growing urbanization, Africa's market demand for food staples will grow dramatically in coming decades. Facilitating expansion of these markets will, therefore, be critical for efforts aimed at stimulating agricultural production, broad-based income growth and poverty reduction and for ensuring food security of vulnerable populations in deficit zones.

10. Throughout the region, rural food surplus production zones supply major deficit urban consumption centres as their natural markets. These spatially linked clusters of production and consumption zones are referred to as foodsheds. When mapping food production and population clusters in southern Africa, it becomes clear that large breadbaskets exist that have the potential to supply deficit urban and rural areas (see Figure 4), even in years of drought in some parts of the region (Haggblade, forthcoming).

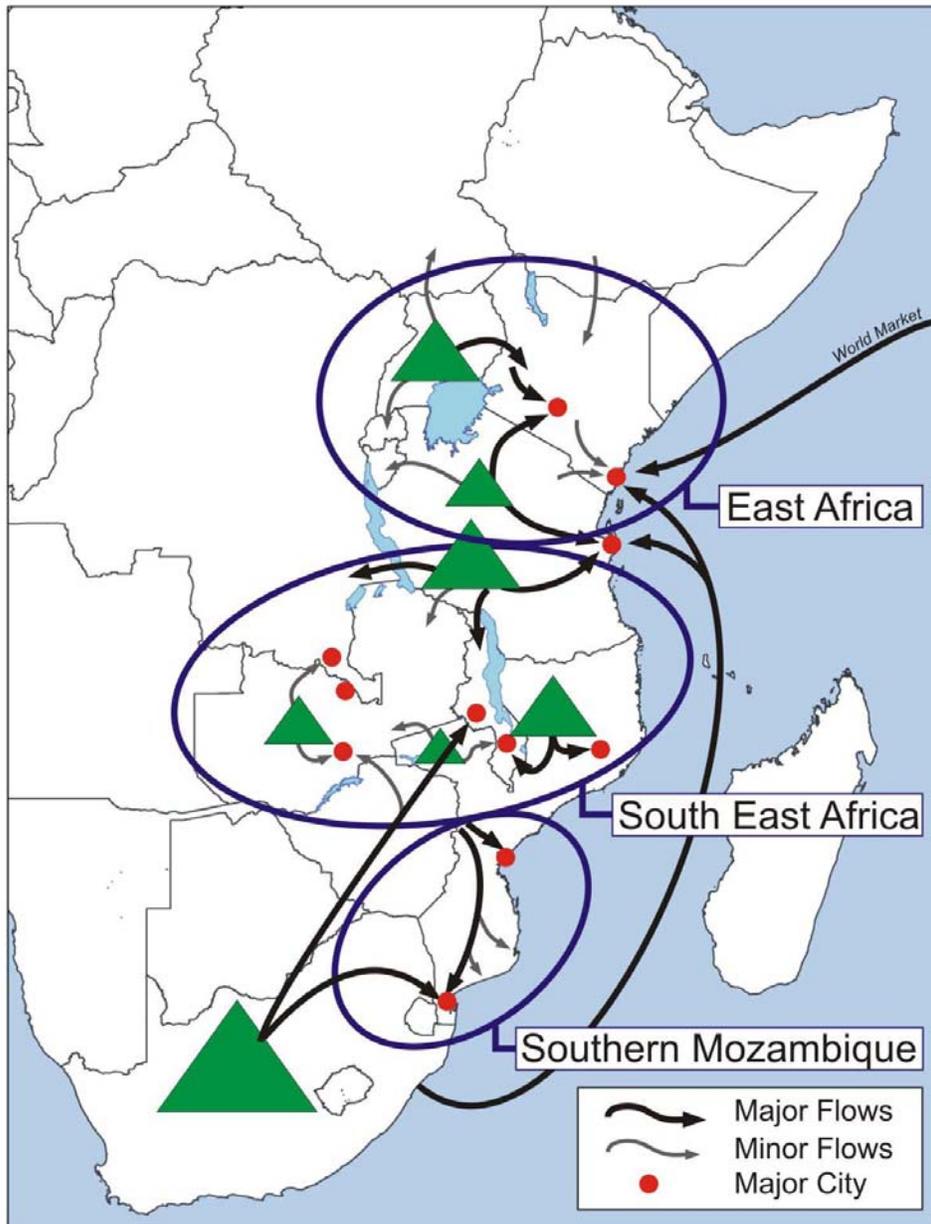
Figure 4. Population density in south-eastern Africa



Source: Haggblade

11. As depicted in Figure 5 below, trade flows within a number of foodsheds involve border crossings. For example, surplus maize produced in Nampula province in Mozambique has reliably supplied dense population centres in Malawi, especially during seasons when Malawi was experiencing the effects of a drought. Likewise, other opportunities exist for intra-regional trade to supply maize to food deficits areas during partial drought in the southern Africa region (Tschirley et al., 2006). In eastern Africa, maize produced in Uganda has been supplying the Kenyan market, and various other cross-border trade flows occur in that region.

Figure 5. Foodsheds (maize) in eastern and southern Africa



Source: Haggblade

12. Regional trade has the potential to not only reduce price volatility and food insecurity (Haggblade, 2008); it also has the potential to stimulate agricultural growth in production zones. However, trade barriers of various kinds, often imposed in an unpredictable manner, currently create a less than favourable investment climate for farmers and agribusinesses. Predictable trade policies that ensure cross-border market access are required to stimulate agricultural growth. In addition, public investments in production and marketing infrastructure, and agricultural support services are required in order to attract the private

investments that are needed to commercialize food production and trade, and enhance productivity and competitiveness.

2. Challenges in the staple food trade in the COMESA region

a. The COMESA Free Trade Area

13. When the merger of SADC, EAC, and COMESA becomes a reality, the largest free trade area in Africa will be created. It will include South Africa, a major player in African and world commodity markets.

14. However, at the present time, the principles of the COMESA Free Trade Area do not seem to apply to the staple food trading sector considering the trade barriers that exist. Unless a member state notifies COMESA about the invocation of import or export bans for goods of national importance, the actual imposition of such restrictions is illegal under the Free Trade Area, as defined in Article 50 of the COMESA Treaty. Few, if any, member states have registered any exceptions with COMESA.

15. However, rather than becoming a policing mechanism, the Free Trade Area should be used to the advantage of member states. The development of trade-based solutions to address food security challenges should be the focus, creating economic opportunities while preparing for and dealing with food security threats.

b. The roles of governments and the private sector

16. Following the (partial) liberalization of food markets in Africa, the private sector has started to engage and invest in commodity trading and processing. Yet, many government marketing parastatals still exist and operate in the market alongside the private sector. Most parastatals no longer have the financial nor operational capacity to meet a country's entire crop marketing, storage and processing requirements, and rely on the private sector to perform all or some of these functions. Although the private sector and national governments depend on one another, there exists a low level of trust between them.

17. Governments remain engaged in food commodity markets to provide services such as social safety nets, crop marketing as buyer of last resort, food buffer stocks, and price controls that benefit producers and consumers. Governments also impose trade rules that may have the objective of protecting consumers from a stock-out, or from high prices. All of these interventions have an impact on the market, especially when prices are artificially set and are inconsistent with prevailing market prices. The result is an unpredictable market environment with risks that can not be tolerated by many firms, severely diminishing their market making capacity, and ultimately causing their temporary or permanent withdrawal from the market.

c. Import and export trade barriers

18. During times of deficit, governments become concerned about their country's food security situation and often adopt an approach of protectionism, tightly controlling trade flows. Food exports are typically banned, and imports from within the region or from the world market experience various other complications, for example due to uncertainty surrounding the application of import duties or import subsidies.

19. In 2008, Kenya's projected maize deficit called for the importation of over 600,000 tonnes of maize, much of which could have been satisfied with imports from Uganda and Tanzania. However, Tanzania had an export ban in place, while Kenya maintained a 50% import duty. As a result, market shortages occurred and prices increased sharply. Despite the official export ban, 120,000 tonnes of maize was imported from Tanzania (Jayne et al., 2009).

20. Export bans rarely achieve their objectives. Large truck loads are converted to smaller loads on pick-up trucks, wheelbarrows, bicycles, or human backs, in order to circumnavigate official border posts. Transaction costs increase due to the inefficiencies of extra handling and low capacity transportation, and the end result is increased food prices.

21. Another example of an import trade barrier occurred in Zambia, where a projected maize shortfall for 2002 was anticipated in 2001. Government entered into discussions with millers and traders on how to import the projected deficit. A maize import subsidy program was developed between selected millers, the Zambian government, and selected suppliers in South Africa. A substantial subsidy was intended to keep consumer prices under control. The subsidy was paid directly to the suppliers in South Africa, in addition to the importers' payments. Due to liquidity problems, the subsidy payment was made very late in the season, causing maize imports to be significantly delayed. Maize and mealie meal shortages occurred in the meantime, local market prices exceeded import parity (see Figure 3), and Zambian traders and millers who were not selected to benefit from the subsidy refrained from commercially importing maize for fear of being uncompetitive in the market once the subsidized maize reached the Zambian market. Hence, the lack of implementation capacity of a well-intentioned import program paralyzed commercial market activity and actually resulted in market shortages (Nijhoff et al., 2002).

22. There are many other examples of trade barriers, involving the imposition of ad hoc export or import bans, uncertainty surrounding the removal or introduction of import or export duties, or a lack of transparency about the modalities of government market interventions. The trade barriers themselves, especially their unpredictability, contribute to a policy environment that will stifle trade and commercialization of agriculture.

3. How can food security concerns be addressed while maintaining open borders?

a. Analysis, consultations and planning to identify regional trade opportunities

23. Monitoring global, regional, and national food supply and demand projections in conjunction with increasingly accurate early warning information will allow timely planning for commercial and non-commercial food supplies. Governments, regional economic communities, and the private sector can collaborate in identifying import and export opportunities among member states and within existing foodsheds, thus allowing natural commodity flows to meet market demand in deficit areas. The planning of food aid and other non-commercial food supplies will require close coordination with the planning of commercial transactions. A consultative process is required, allowing governments and the private sector to reach consensus on mutually agreeable and workable policies and programmes.

24. To enable governments to consider and plan a market response to food crises, information needs include improved food balance sheets, accurate market price information, household budget shares and price elasticities of demand among staples (Tschirley et al., 2006).

b. Identify food security guarantee instruments for governments under a free trade scenario

25. Governments require a certain “comfort level” before opening up their food markets and allow unrestricted imports and exports during a season potential food deficits. This need for comfort should be appreciated and taken into account when making recommendations on trade-based solutions to maintaining national food security.

26. Some governments in the region see a need for food security stocks to act as a buffer in times of vulnerability to food insecurity. However, the operations and maintenance of such reserves are extremely costly and require substantial national resources. Their management record is mostly poor, and in southern Africa they played no role in responding to and mitigating the 2002/03 crisis (Tschirley et al., 2006).

27. Hence, a key challenge is to assist member states in designing instruments and mechanisms that, on the one hand, require only limited physical food stocks and, on the other hand, have the capacity to provide a guaranteed supply of sufficient food in the event that market mechanisms break down or non-market requirements are greater than expected. While it is not the purpose of this policy brief to present detailed recommendations, aspects of modern-day commodity trading practices and instruments are highlighted for reference.

28. The alternative to holding physical food security reserves is the acquisition of contracts that guarantee the supply of food commodities in the event that supplies are needed. The key requirements are, first, that it is a credible and guaranteed supply contract that can be executed as and when needed, while locking in a maximum price, and, second, that it provides the option not to execute the contract if it is not needed. The South African Futures Exchange (SAFEX) offers such contracts in the form of “call options” on futures contracts, purchased by paying a premium, executed when needed, or foregone or closed out when not needed, all without ever taking ownership of the commodity until the moment that the option is exercised. This can be compared to taking out an insurance against food insecurity, with a premium to be paid.

29. As early as 1997/98, a maize deficit season in much of the southern Africa region, two years after the establishment of the Agricultural Markets Division of SAFEX, the use of maize futures among Zambian traders and the Zambian Food Reserve Agency would not only have had the potential to reduce the total cost of imports, it would also have provided a guaranteed supply of physical commodity without the need to purchase the physical commodity until needed (Nijhoff, 1998). Actual price hedging and physical supply using SAFEX agricultural derivatives was accomplished in Malawi in recent years, saving the Malawian government some USD 60 per tonne compared to imports if they had been arranged using the international spot market at the time of importation. Alternatively, less sophisticated commodity exchanges, warehouse receipt systems and individually constructed contracts involving banks, warehouse managers, and private stock holders across the region can be used for the same purpose of securing options on physical stocks at predetermined prices, without the obligation of taking physical delivery.

30. To take advantage of the opportunities of securing food supplies along these lines requires a fund that allows the purchase of the commodity if and when required. The interest earned could cover the cost of option premiums and allow the fund to keep its value in real terms. Such a fund could operate regionally, or at the national level, and can be considered as a self-financing virtual food buffer stock. COMESA can play a key role in developing such an innovation whose main benefit will be for member states to feel comfortable allowing unrestricted trade in food staples.

4. The importance of policy consensus

31. Several challenges have been identified in this policy brief. First, concerning regional trade in food staples, in many countries the COMESA Free Trade Area is not adhered to. National governments continue to operate in food markets and control trade flows in the perceived best interest of the country. These interests are mostly related to short-term food security concerns. The various trade barriers that are put in place in a haphazard and unpredictable

manner discourage trade and hence frustrate agricultural growth. The long-term benefits of free trade in food staples to agricultural sector growth are rarely considered when dealing with short-term food security concerns.

32. Second, governments need the private sector to achieve food security objectives. In turn, the private sector needs government policies and support services that enable them to achieve commercially oriented objectives. When objectives and expectations are at variance, mutual trust can be compromised, which can result in a lack of credible commitments by both parties, and poor performance of food security policies and programs.

33. With the implementation of the COMESA Customs Union and the impending SADC-EAC-COMESA Free Trade Area it is now time to resolve the issues and challenges facing regional trade in staple food commodities. A regional approach to food security and agricultural growth is required, rather than an isolationist approach that stifles trade, investment, and progress. A consultative process is needed, allowing governments and the private sector to reach a consensus on a mutually agreeable and workable policy direction. Empirical policy analysis as part of the consultative process, and facilitation by regional economic communities, can make important contributions. While the content of policies is important, it is even more important for stakeholders to reach consensus, even if the policies are sub-optimal (Tschirley and Jayne, forthcoming).

5. Recommendations

34. The following recommendation may be considered:

- a. Given that regional trade in food staples represents the single biggest opportunity for development and has the potential to significantly contribute to stabilizing food supply and food prices, it is recommended that the Technical Committee on Trade and Customs include staple food trade as a recurring item on its agenda. Prioritizing this issue is consistent with the priorities identified under the CAADP framework, under which Pillars 2 and 3 highlight the importance of trade infrastructure, market access, and cross-border trade to attain food security. A detailed work plan is to be developed and submitted to member states by December 31, 2009.

35. In anticipation of the work plan, the following recommendations may be considered at this stage:

- b. It is recommended that COMESA, ACTESA, and its partners continue to identify and document current constraints inhibiting regional staple food trade.

- c. In collaboration with member states and regional partners, it is recommended that, as per its mandate, ACTESA design a program that aims to improve national and regional supply and demand estimates, information on trade flows, market price information, and relevant household-level data. This data will feed into the proposed policy consensus building process (see below).
- d. A process of reaching policy consensus on how governments and the private sector can improve the performance of regional staple food markets is needed. This may require a high-level regional working group, led by ACTESA, in which intra-regional trade policy for staple food commodities can be developed and implemented, both for the short and the long-term.
- e. Given that national governments require a certain “comfort level” before allowing free trade in staple food commodities, and that the operation of physical food reserve stocks in Africa has been costly and otherwise challenging, it is recommended that alternative food security guarantee instruments are developed, in partnership with the private sector and cooperating partners.

References

- COMESA (2008), “Trade in Food Staples: Promoting Price Stability and Food Security through Intra-Regional Trade”. AAMP Proceedings Report, Training Workshop and Policy Seminar, Nairobi, Kenya, December 2008.
- Diao, Xinshen; Peter Hazel (2004), “Exploring Market Opportunities for African Smallholders”. 2020 Africa Conference Brief 6, International Food Policy Research Institute, Washington, DC.
- Haggblade, Steven; Steven Longabaugh; and David Tschirley (2009). “Spatial Patterns of Food Staple Production and Marketing in South East Africa: Implications for Trade Policy and Emergency Response”. Draft Working Paper, Michigan State University, East Lansing.
- Haggblade, Steven; Jones Govereh, Hunter Nielson, David Tschirley; and Paul Dorosh (2008). “Regional Trade In Food Staples: Prospects For Stimulating Agricultural Growth And Moderating Short-Term Food Security Crises In Eastern And Southern Africa”. Michigan State University, East Lansing. Presented to the AAMP Training Workshop and Policy Seminar, Nairobi, Kenya, December 2008.
- Jayne, T.S., Antony Chapoto, Isaac Minde, and Cynthia Donovan (2009). “The 2008/09 Food Price and Food Security Situation in Eastern and Southern

Africa: Implications for Immediate and Longer Run Responses”. International Development Working Paper #96. Michigan State University. East Lansing.

Nijhoff, J.J. (1998). “The Use of South African Maize Futures and Options in Zambia: A Brief Assessment of Hedging Opportunities for Zambian Maize Producers and Processors at the South African Futures Exchange”. Paper presented at the AFMESA/FAO Workshop on Grain Commodity Trading and Commodity Exchanges, Pretoria, South Africa, 1998

Nijhoff, J.J., T.S. Jayne, Billy Mwiinga, and Jim Shaffer (2002). “Markets Need Predictable Government Actions to Function Effectively: the Case of Importing Maize in Times of Deficit”. Policy Synthesis 6. Food Security Research Project, Lusaka.

Tschirley, David, Jan J. Nijhoff, Pedro Arlindo, Billy Mwinga, Michael T. Weber, and T.S. Jayne (2006). “Anticipating and Responding to Drought Emergencies in Southern Africa: Lessons from the 2002-2003 Experience”. International Development Working Paper #89. Michigan State University. East Lansing.