Food Price Spikes and Strategic Interactions between the Public and Private Sectors: Market Failures or Policy Failures?

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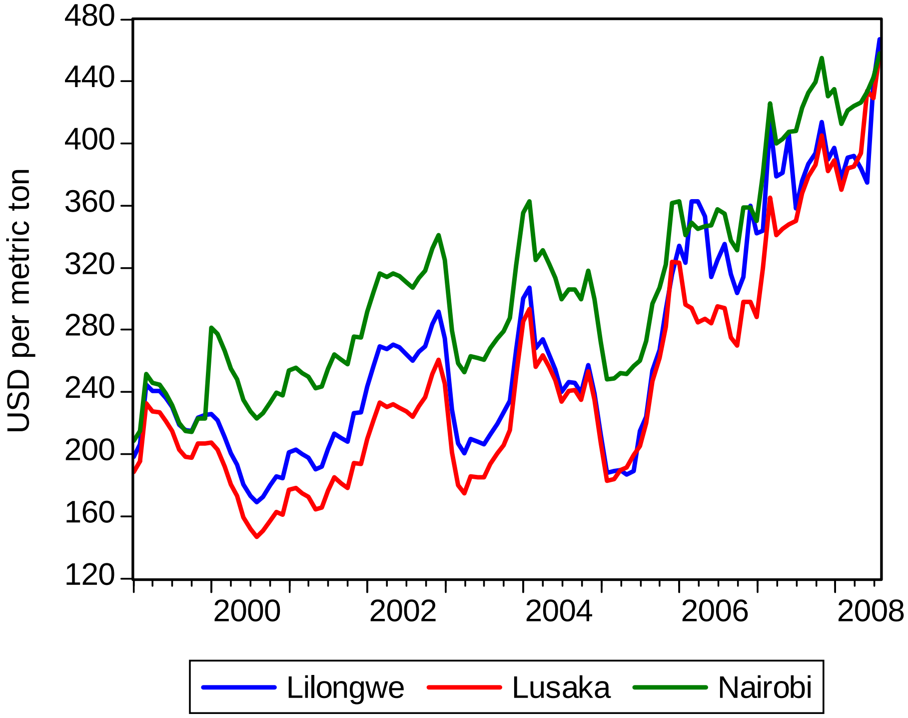
Presented at the expert meeting on “Institutions and Policies to Manage Global
Market Risks and Price Spikes
in Basic Food Commodities,”
FAO Headquarters, Rome, Italy, 27-28 October 2009

Cif import prices, ending August 2008



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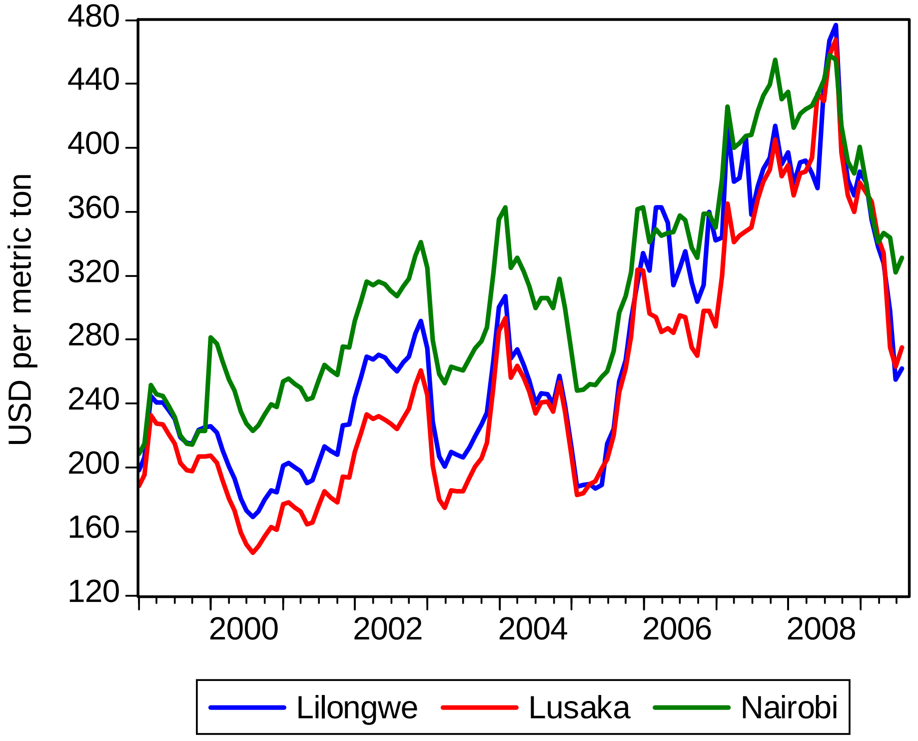
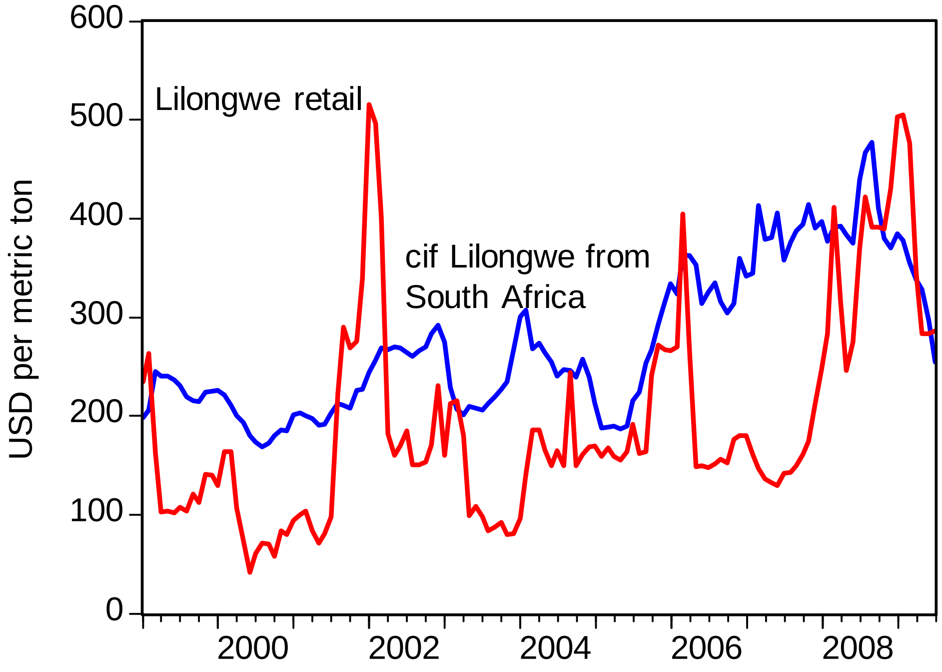
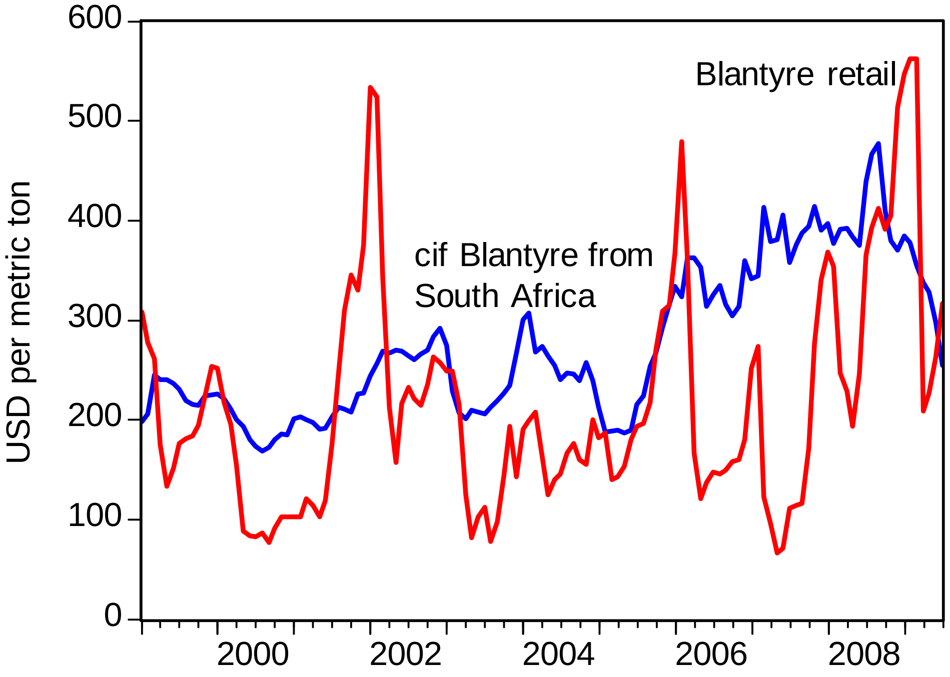


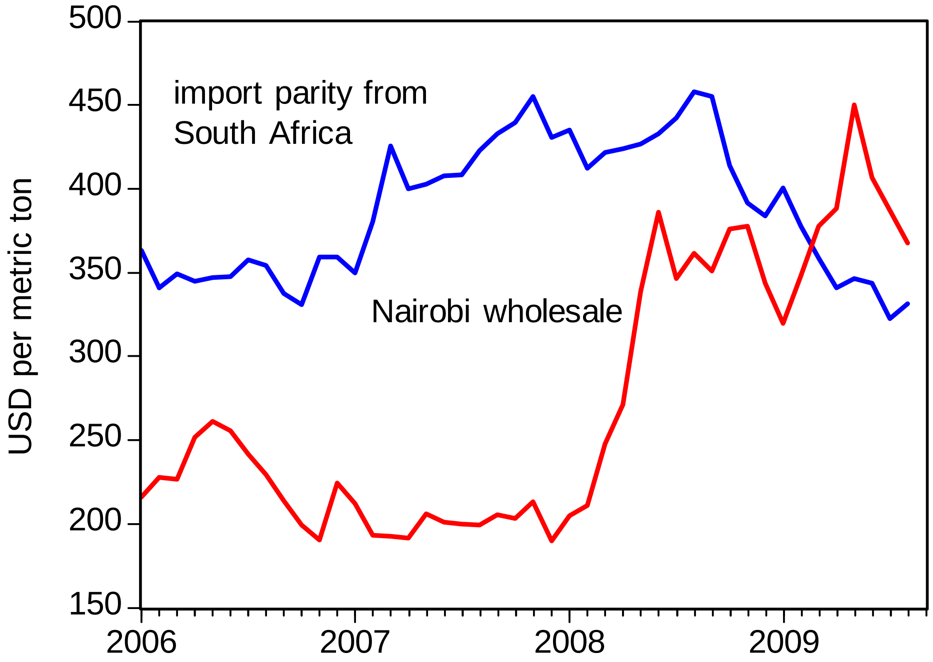
Maize prices vs import parity, Lilongwe, Malawi



Maize prices vs. import parity, Blantyre, Malawi



Maize prices vs. import parity, Nairobi, Kenya



Motivation

Many African countries are continuing to experience "food crises" well after world food prices tumbled in late 2008. *Why?*

Issues explored in this paper:

- ☐ Why do food prices surge over import parity with surprising frequency in E/S Africa?
- ☐ Can policy analysis provide insights to reduce the frequency and severity with which it occurs?

Two salient problems in this environment

1. **Credible commitment** (North)**:**
   - inability of parties to make commitments that the other party regards as credible → precludes course of action that could improve outcomes for both
2. **Reliability and accuracy of public market information**
   - Can official food production estimates be relied upon?

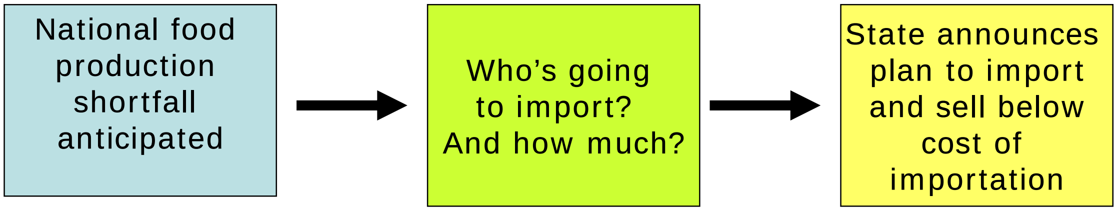
Strategic interactions between public and private sector in food markets

- 3 recurrent processes

Process # 1:

National food production shortfall anticipated

National food production shortfall anticipated → Who's going to import? And how much?



National food production shortfall anticipated

Who's going to import? And how much?

State announces plan to import and sell below cost of importation

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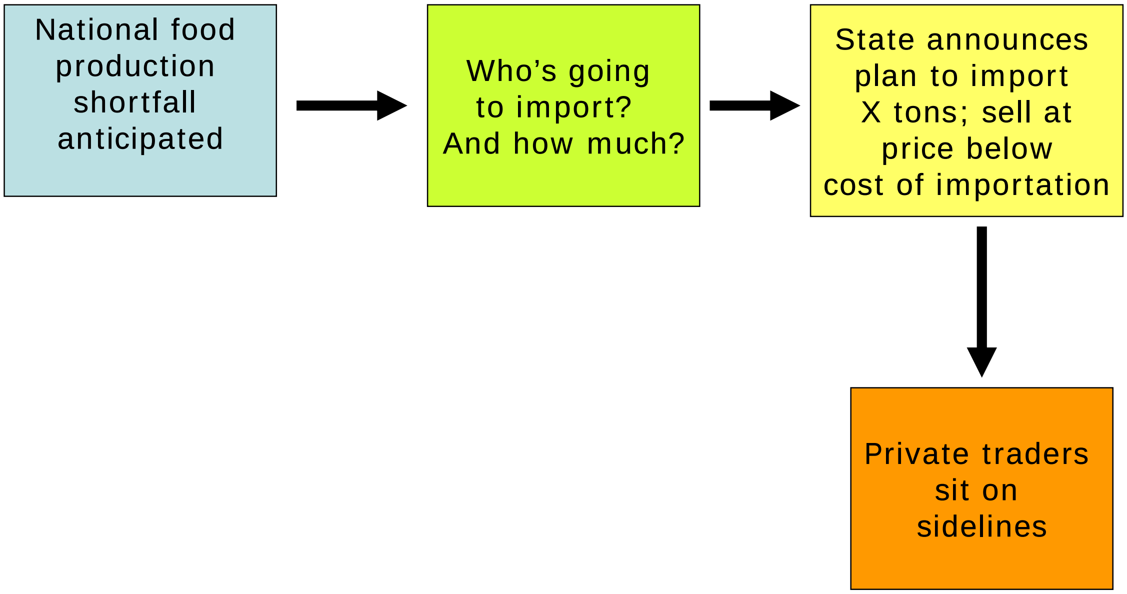
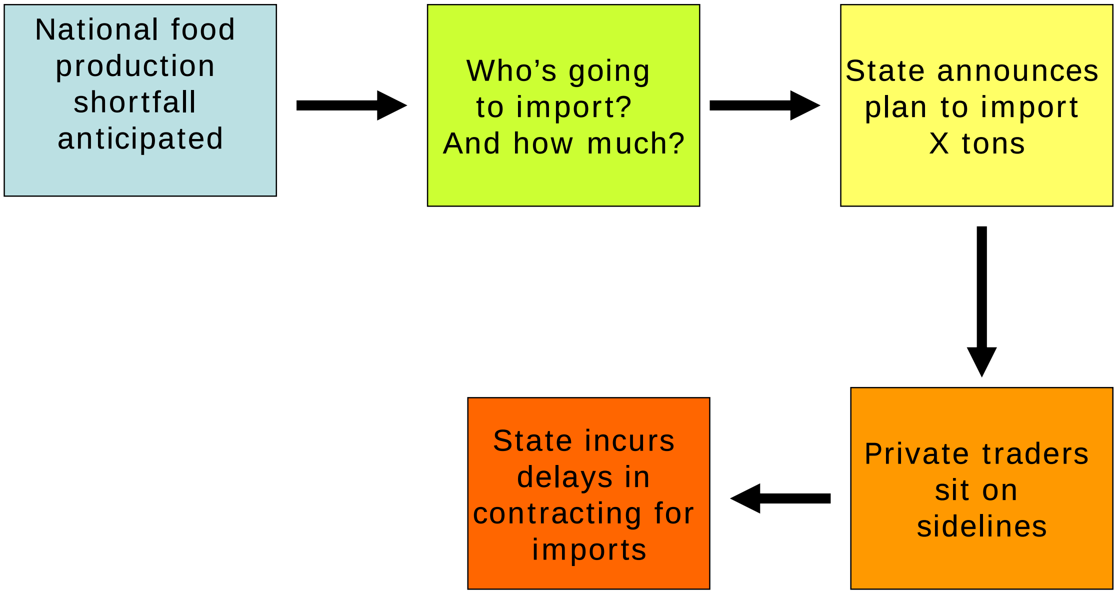


National food production shortfall anticipated

Who's going to import? And how much?

State announces plan to import X tons; sell at price below cost of importation

Private traders sit on sidelines



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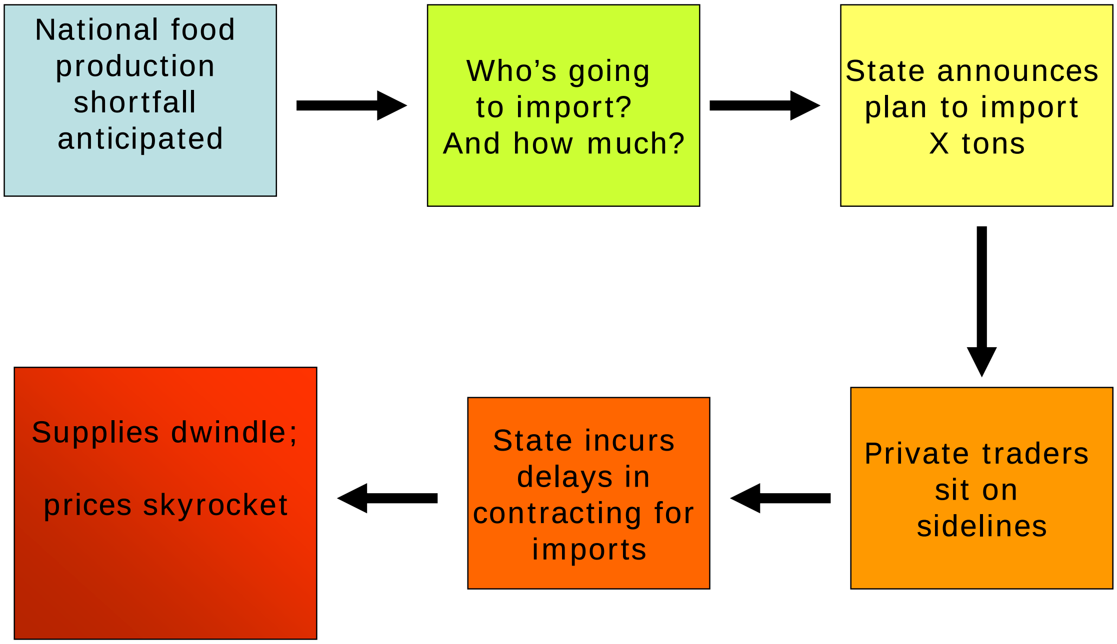
State incurs delays in contracting for imports



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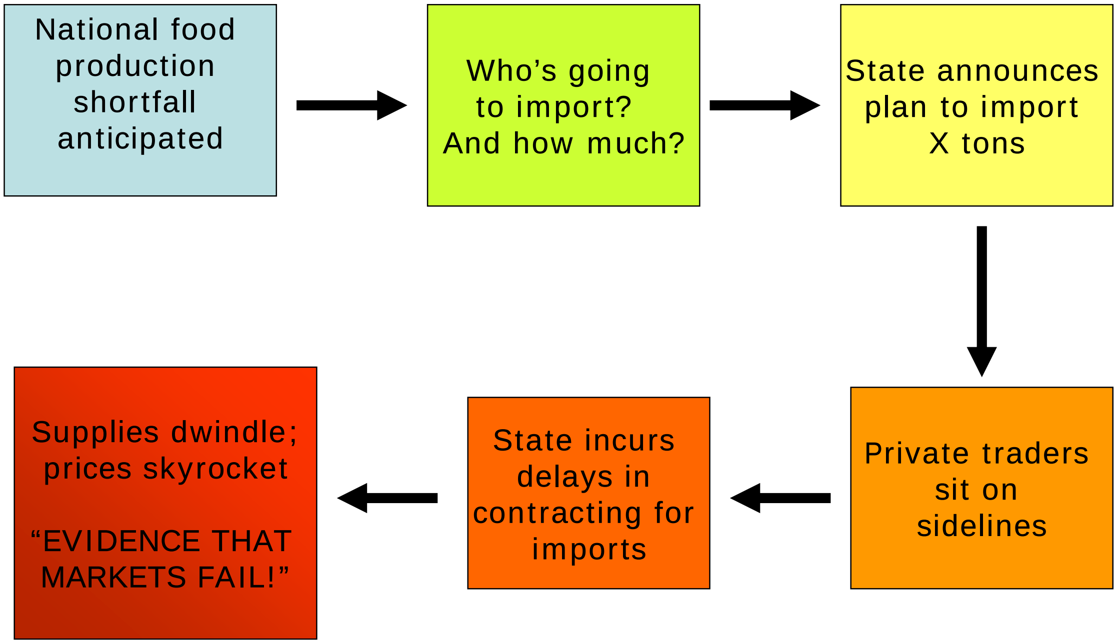
Supplies dwindle;

prices skyrocket



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"EVIDENCE THAT MARKETS FAIL!"

Process #1 roughly describes

1. Zambia: 2001/02, 2002/03
2. Malawi: 2001/02, 2005/06

Process #2:

National food production shortfall anticipated

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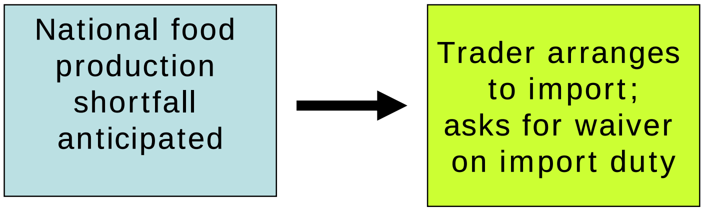

National food production shortfall anticipated

Trader arranges to import; asks for waiver on import duty

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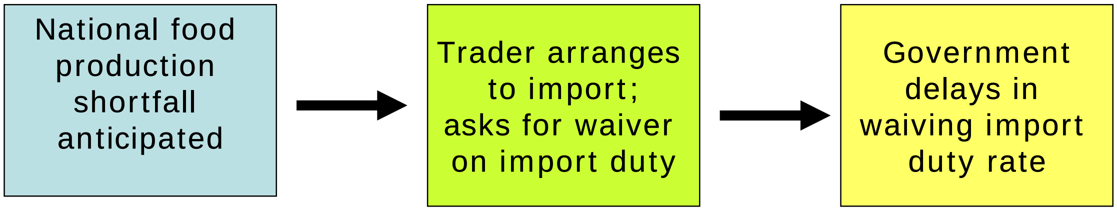

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Government delays in waiving import duty rate

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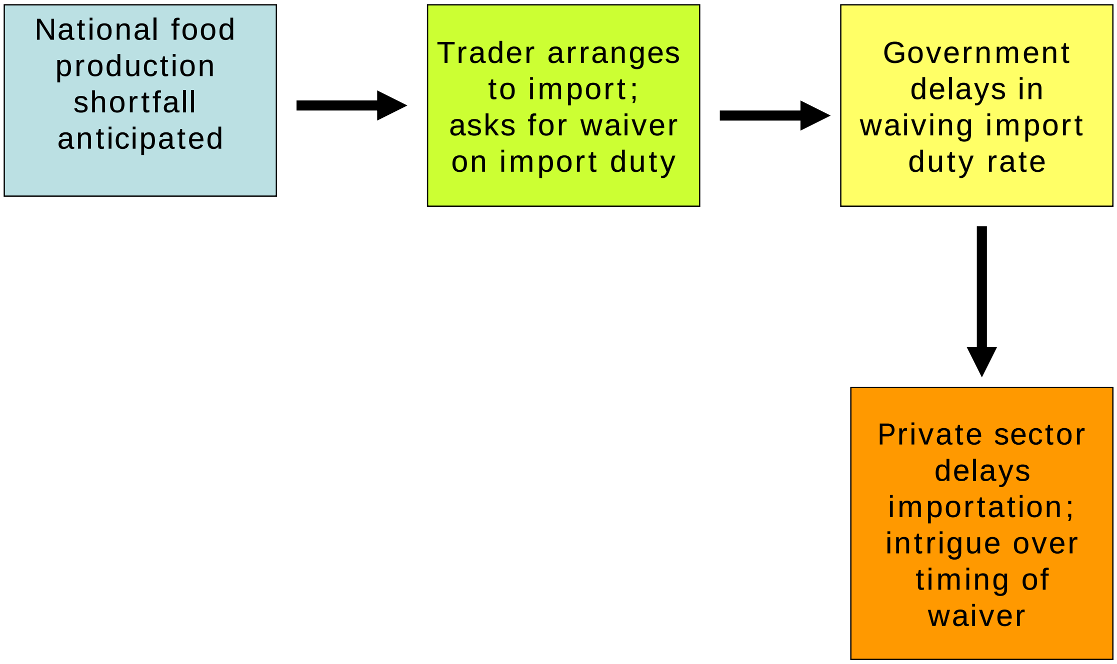

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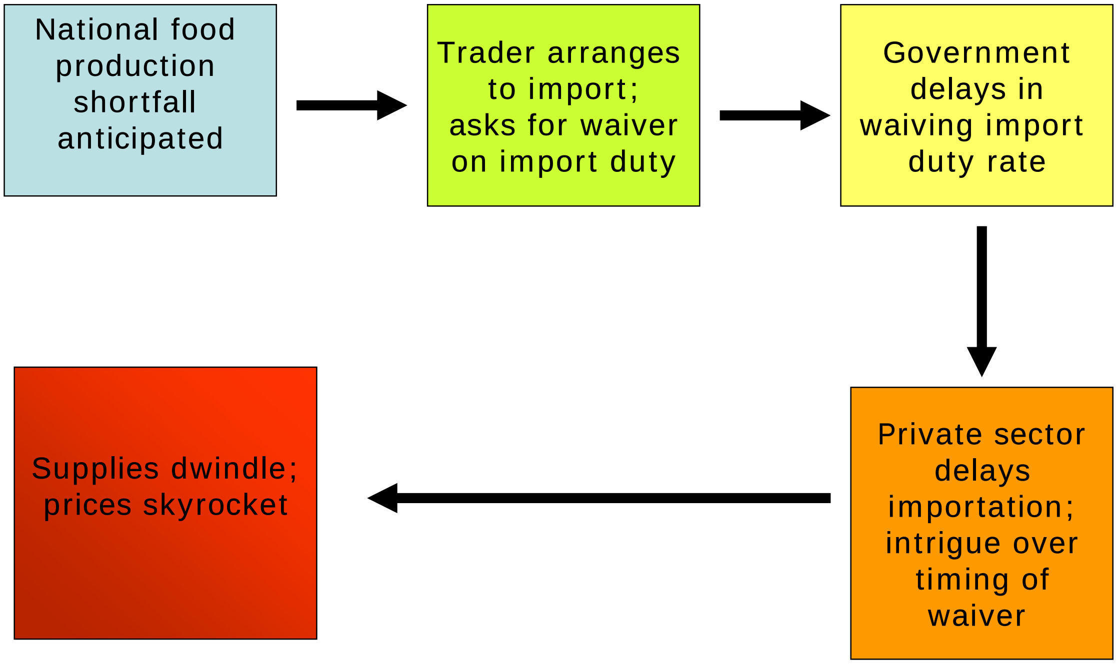

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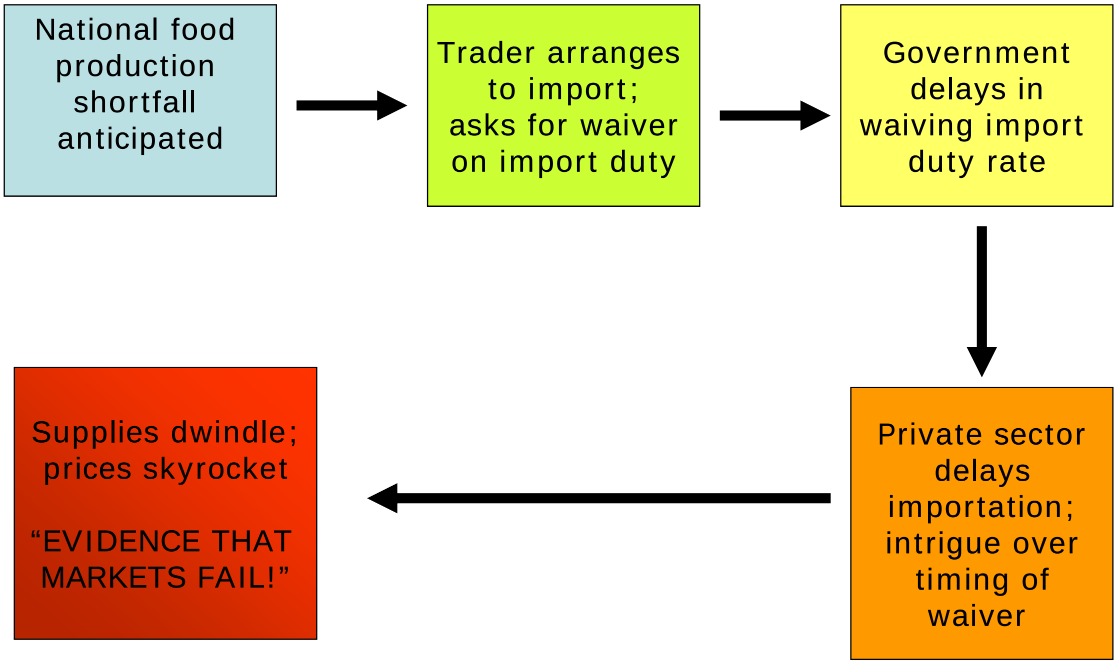

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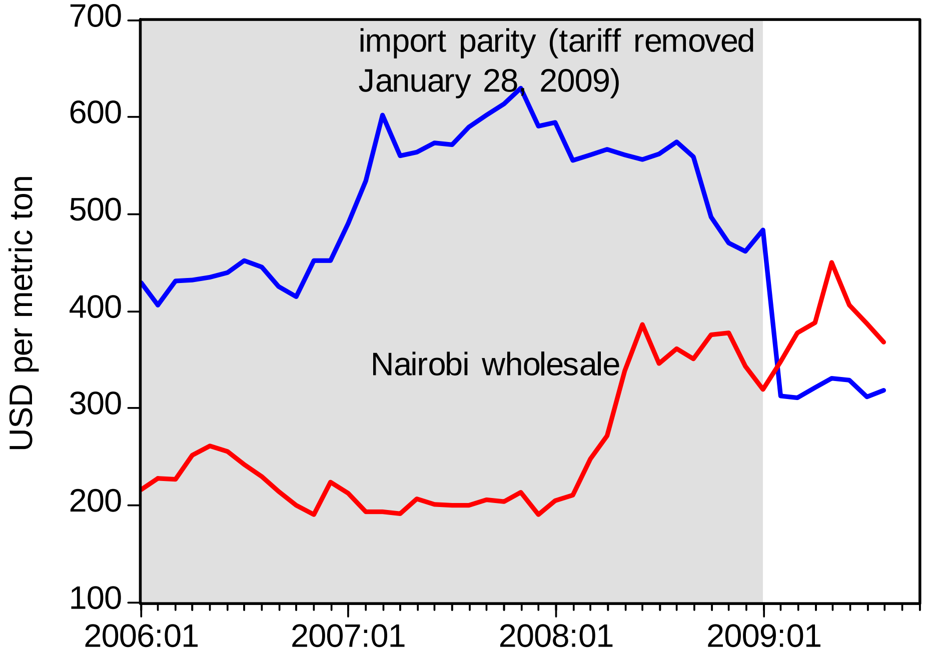
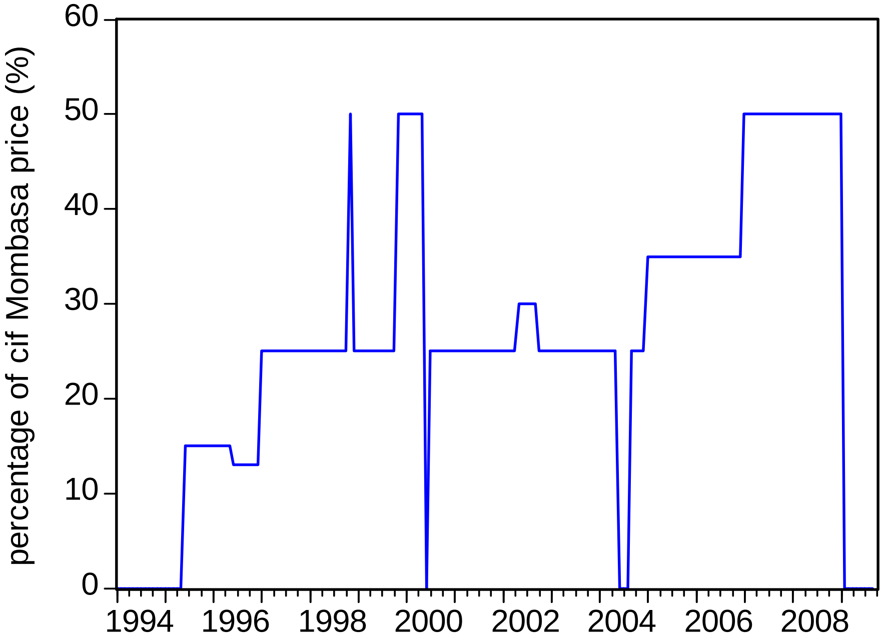
2. Kenya: 2003/04, 2008/09

Maize prices vs import parity, Nairobi, Kenya



Variable import tariff rate, Kenya



Process #3

National food production / balance sheets indicate adequate harvest

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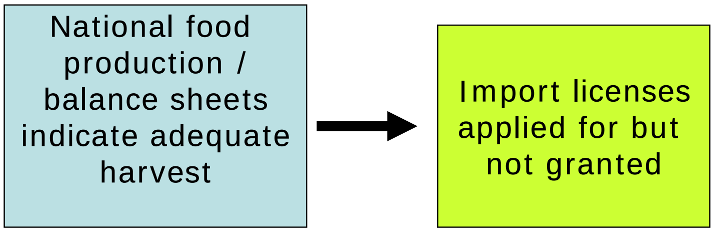

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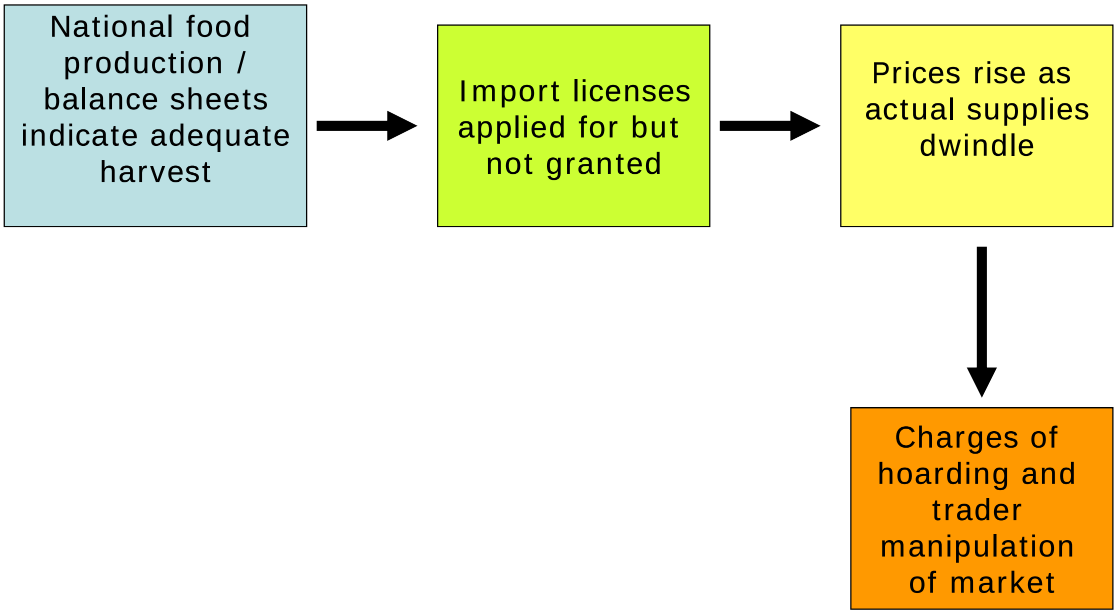

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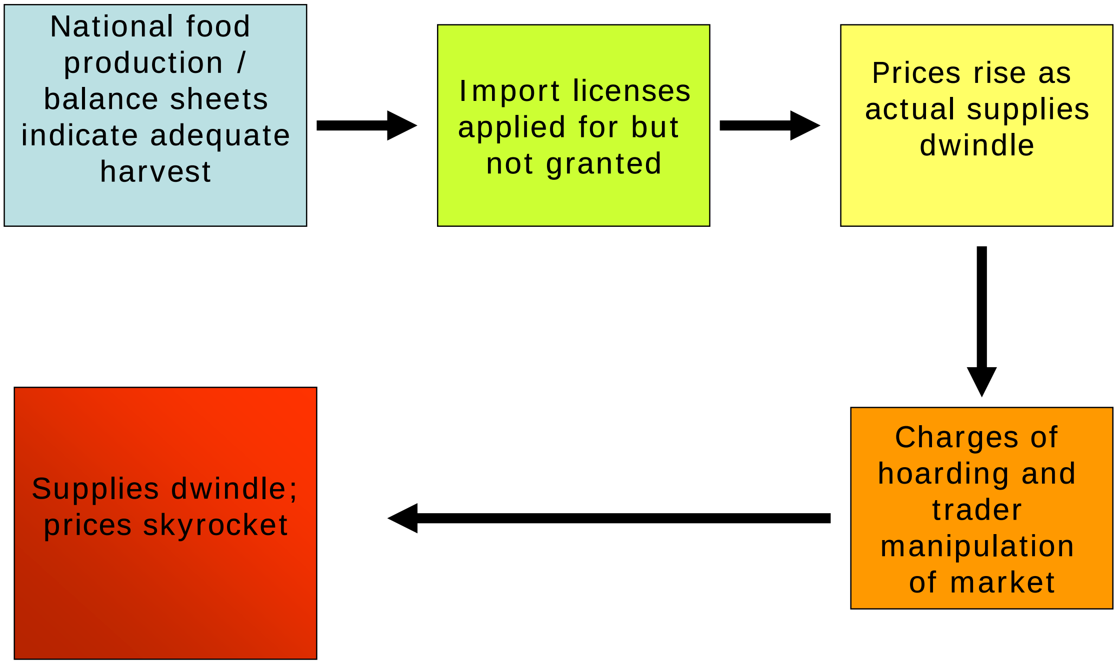

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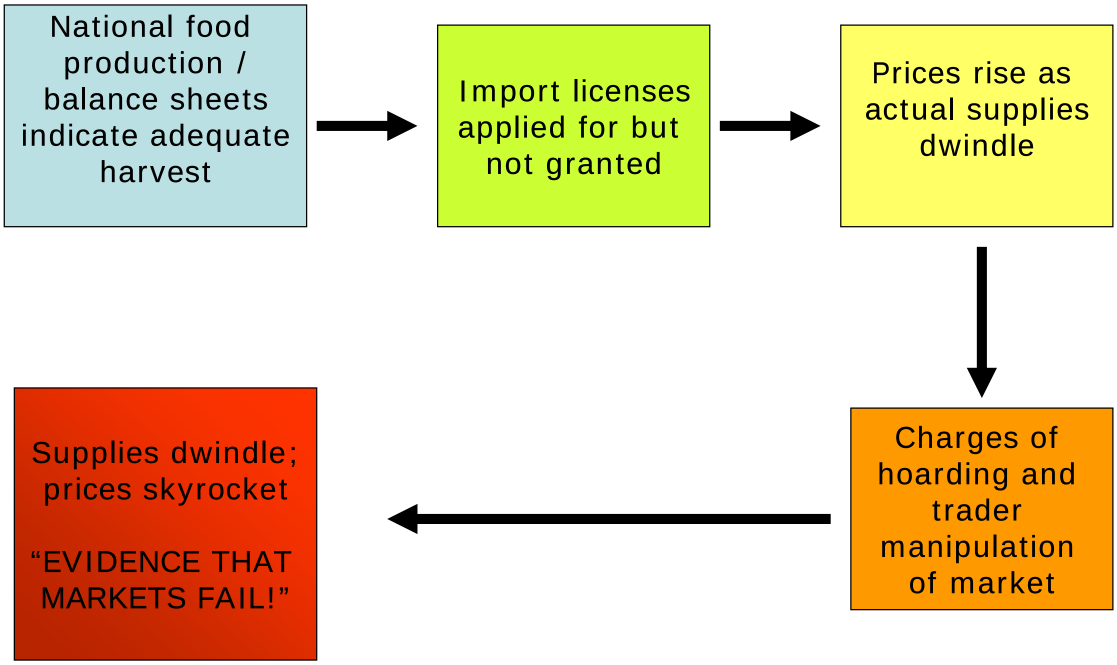

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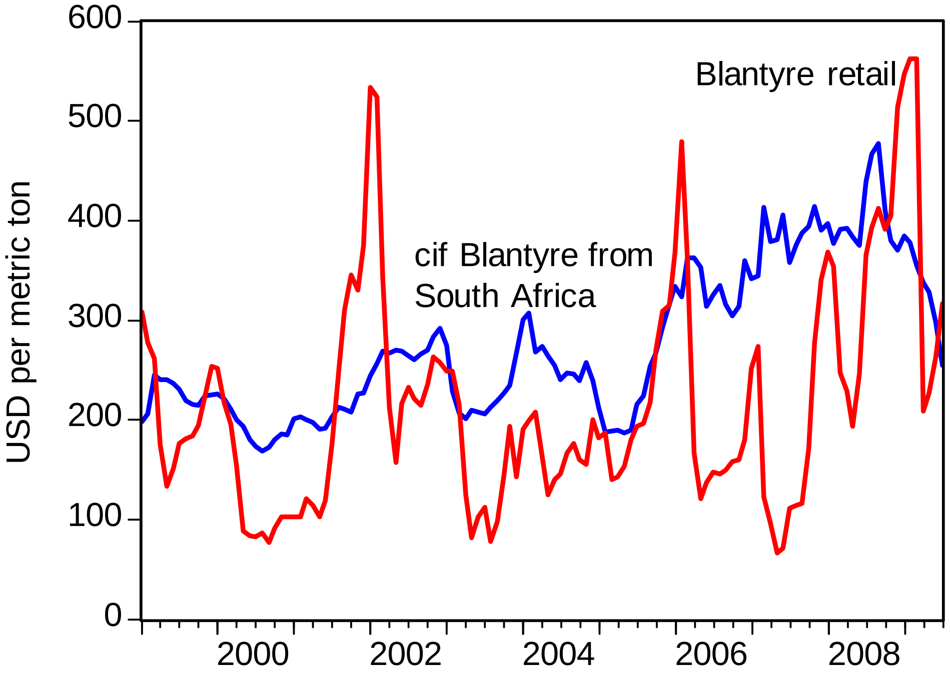
Process #3 roughly describes

1. Malawi: 2008/09
2. Zambia: 2008/09

Maize prices vs. import parity, Blantyre, Malawi



Common theme in all 3 processes:

- Government efforts to manage upside food price risk through discretionary trade policy instruments *can/have* exacerbated food crises
- Credible commitment at the heart of most of these crises

Competing models of roles of state and private sector in food markets:

Model 1

Rely on markets state role limited to:

- Public goods investment
- Regulatory framework
- Strengthening of institutions / defense of property rights
- Policies supportive of private sector entry and competition

Model 2

Primary reliance on markets

- but role for *rules-based* state operations

- e.g., buffer stock release to defend stated ceiling price
- Marketing board purchases at stated floor price announced in advance
- Transparent rules for initiating state imports

Model 3

Role for markets and *discretionary* state intervention

- Based on premise that private sector cannot ensure adequate food supplies in response to production shortfalls
- Justification for unconstrained role for state interventions in markets to correct for market failures

What is the right strategy?

- Poulton et al (2006) note that there is no credible government commitment to Model 1 (**full liberalization**), hence Model 2 (**markets with rule-based state operations**) is preferred
- However, questionable whether Model 2 could be perceived as credible either
  - Many countries believe that when it comes to food security only government can ensure this – and cannot be restricted by rules-based approaches to achieve national food security
- With low level of trust and commitment problems, Model 3 (**ad-hoc interventionism**) is likely to become the long-run equilibrium
- Model 3 has in fact become the dominant model among the main maize-producing countries in the region

What to do? (1)

1. Work with governments to show that it is in their long-term interests to increasingly adopt Model 1 or 2 in order to view the private sector as an ally in achieving national food security, not an enemy
   - Formal govt-private sector consultations
   - Work out the details of a rules-based approach to government involvement in markets – periodic stakeholder fora

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What to do? (2)

2. De-politicize national crop production forecasting

   – national food security requires accurate and unbiased crop forecasts

What to do? (3)

3. Reconsider impacts of:
   - ❑ Restricting licensing of private importation
   - ❑ Maintaining import tariffs after production estimates indicate a national shortfall
     - -- especially in light of prevailing world food price projections
     - -- eliminating import tariff at last minute concentrates the timing of imports and increases the risks of capacity constraints

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Getting Markets Right:

What does this mean?

- Not getting government out of markets
- Changing the *role* of government from direct intervention to supportive investments to make markets work
  - – Public goods investment
  - – Policy predictability: Clear, rule-based public operations in markets
  - – Credible commitment will enable more sophisticated risk management tools to come on line (e.g. warehouse receipt systems)
  - – Greater transparency and consultation needed between private and public sectors

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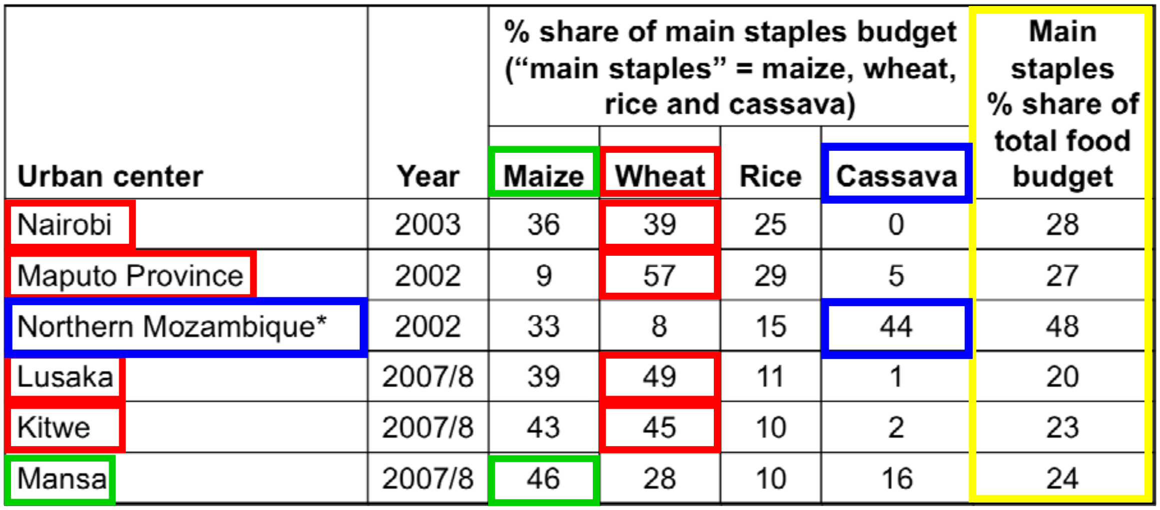
thank you

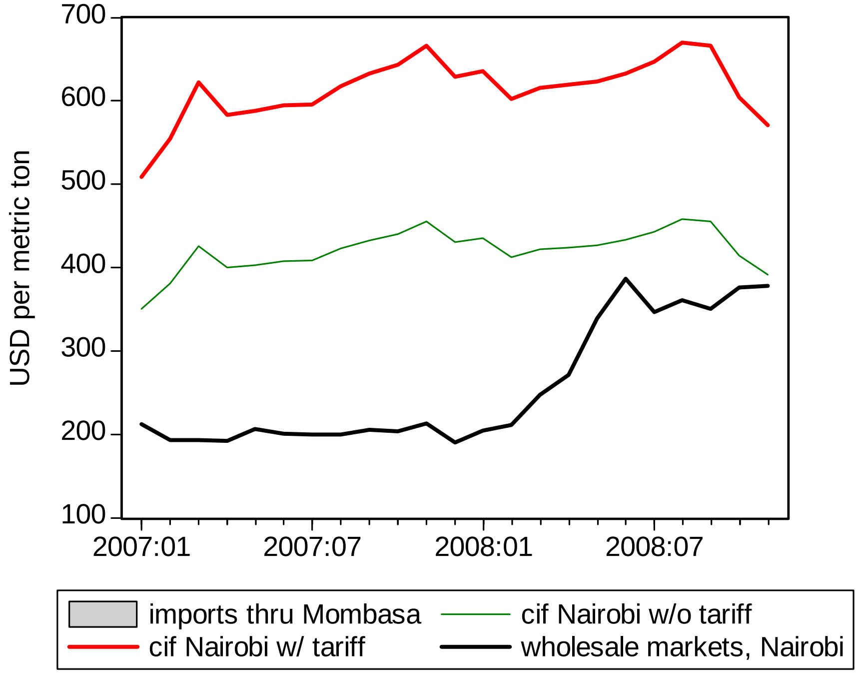
Diversification of consumption patterns due to increasing wheat imports



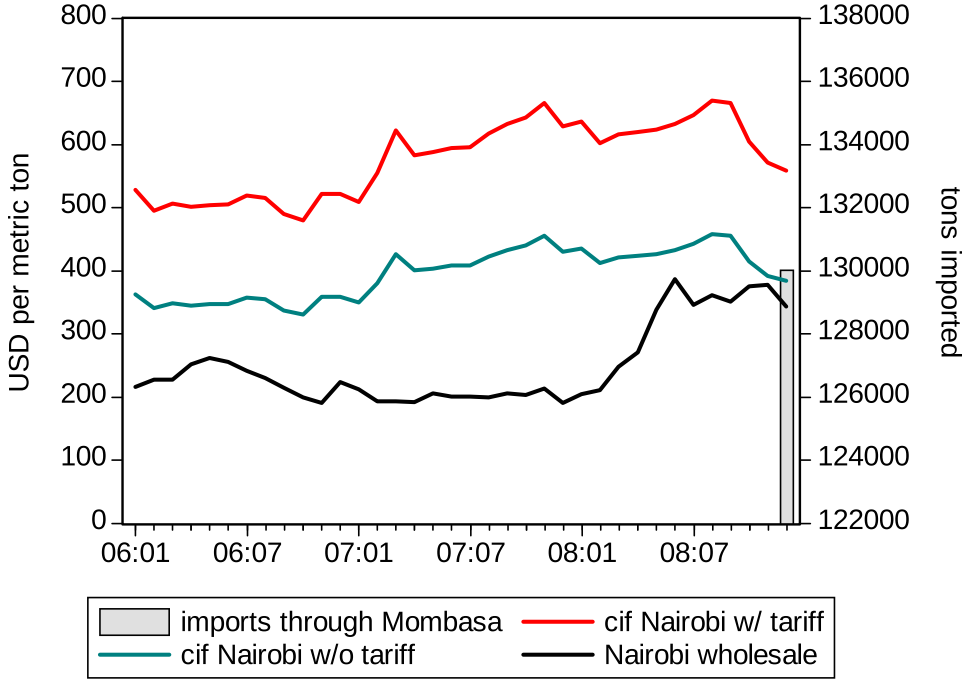
Urban center	Year	% share of main staples budget (“main staples” = maize, wheat, rice and cassava)				Main staples % share of total food budget
		Maize	Wheat	Rice	Cassava	
Nairobi	2003	36	39	25	0	28
Maputo Province	2002	9	57	29	5	27
Northern Mozambique*	2002	33	8	15	44	48
Lusaka	2007/8	39	49	11	1	20
Kitwe	2007/8	43	45	10	2	23
Mansa	2007/8	46	28	10	16	24

*includes Nampula city

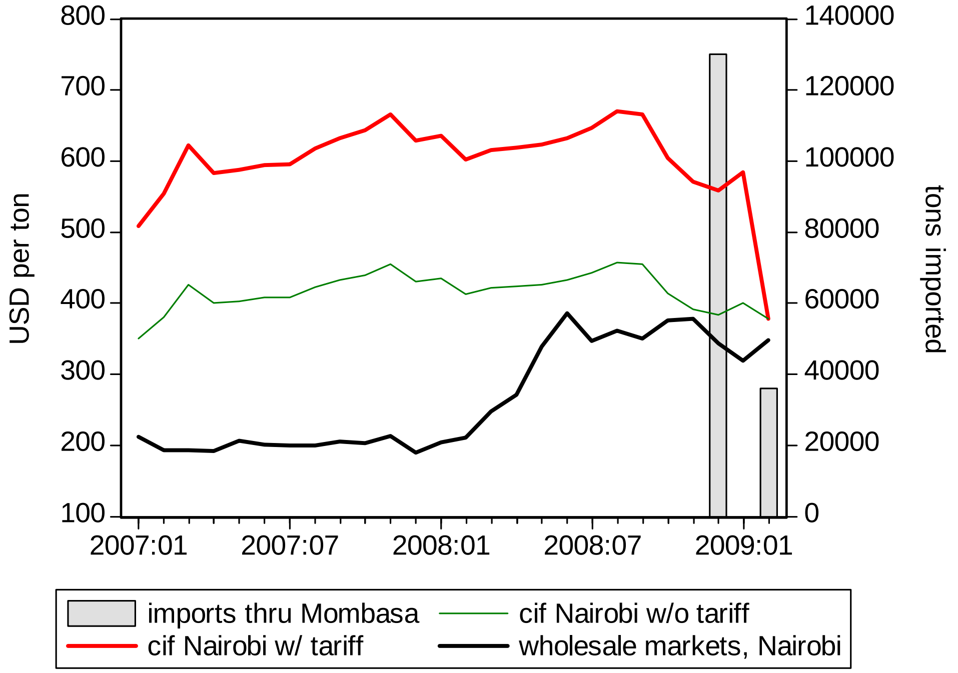
November 2008, Kenya



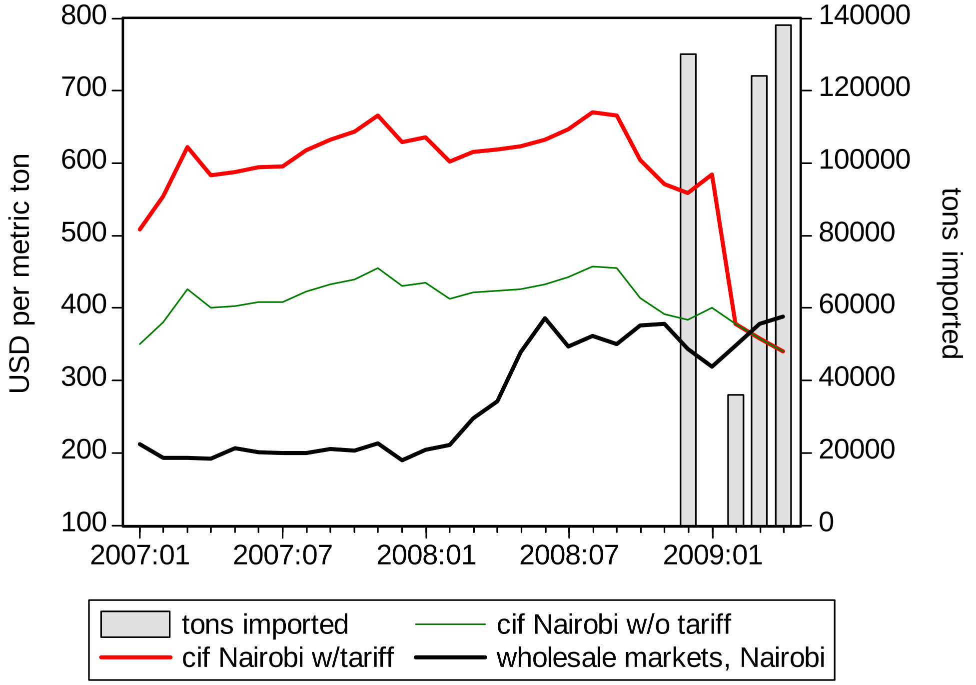
December 2008, Kenya



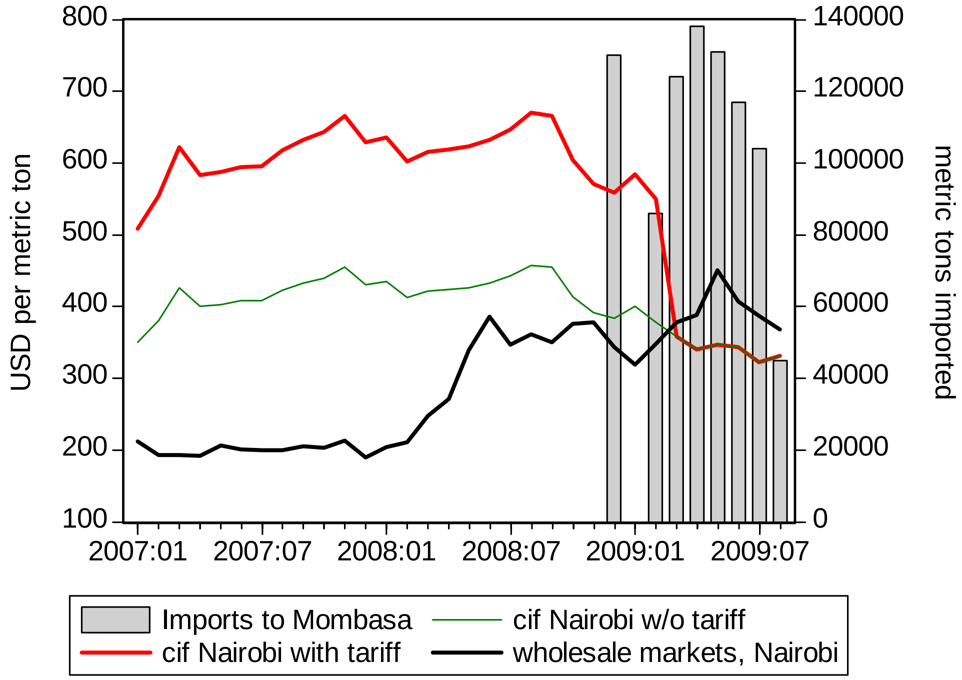
February 2009, Kenya – tariff removed



April 2009, Kenya



August 2009, Kenya



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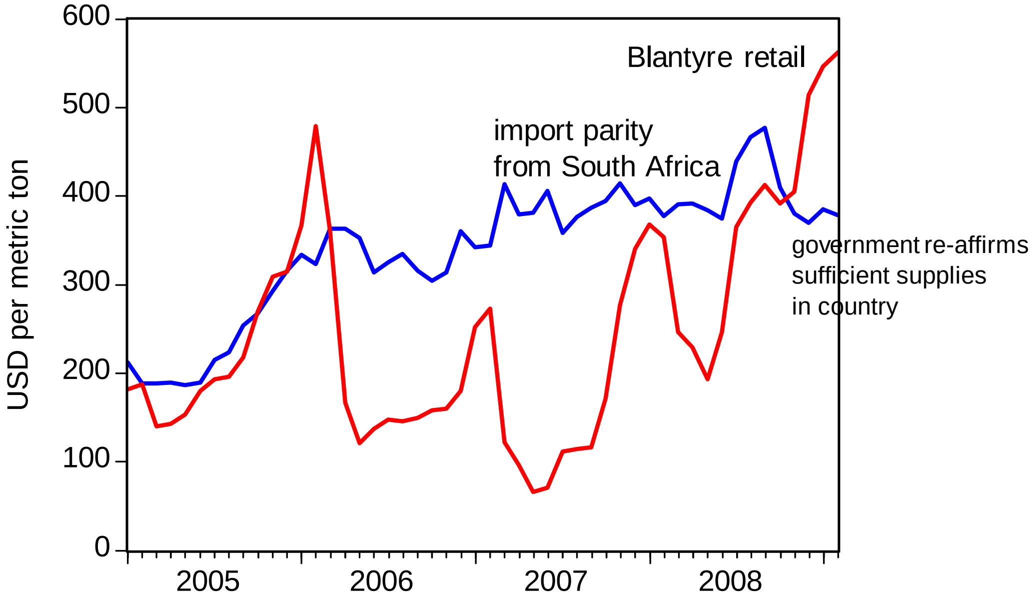
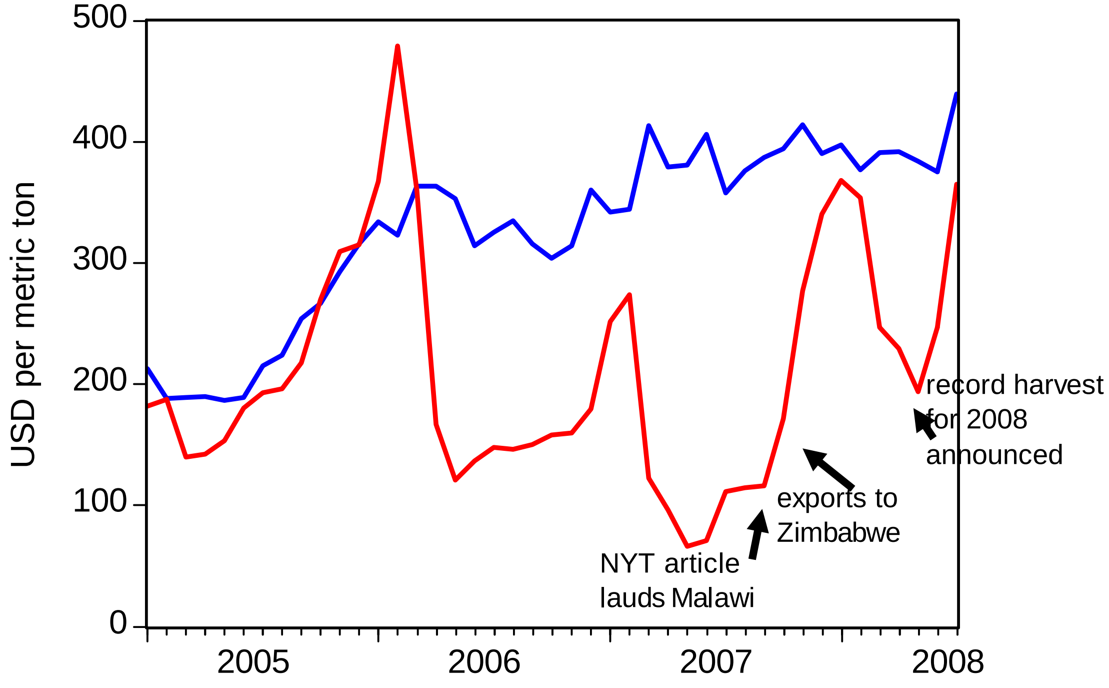


July 2008, Malawi



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