

# ***POLICY SYNTHESIS***

## ***FOOD SECURITY RESEARCH PROJECT – ZAMBIA***

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### **MARKETS NEED PREDICTABLE GOVERNMENT ACTIONS TO FUNCTION EFFECTIVELY: THE CASE OF IMPORTING MAIZE IN TIMES OF DEFICIT**

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**Background:** Food relief for vulnerable groups is important in times of deficit. For the remainder of the population, well functioning grain markets can save lives during times of food shortfalls. This note illustrates how predictable Government behavior in the market can improve markets' ability to meet the needs of consumers.

If grain markets in Zambia functioned efficiently, the wholesale price of maize would not exceed the cost of importing maize from South Africa for any sustained period of time. If local prices rose above the cost of imports, then traders could make profits by importing grain from South Africa (or other neighboring countries with surplus maize). However, when maize grain wholesale prices in Lusaka are compared with estimated South Africa maize import prices, in both the 1998/99 and 2001/02 marketing seasons, domestic prices rose well above the cost of imported maize for several months. Consumers paid higher prices for their staple maize meal than would have occurred if markets performed efficiently. This would only occur if the commodity was in short supply. Why didn't traders import maize during these periods?

**Causes of import marketing problems, the example of the 2001/2002 marketing season:** In July 2001, the national crop forecast and food balance sheet suggested a commercial import requirement of 200,000 tonnes of maize. In August 2001, Government announced its intention to arrange the importation of maize to be sold at a subsidized price, and initiated a tender process to select importers. It made arrangements with 16 Zambian maize millers (as buyers) and a number of commodity trading firms (as sellers) to import 200,000 tonnes of white maize over the period October 2001 through April 2002. However, starting in November, shortages were evidenced by many people queuing outside shops to buy mealie meal and local maize prices rose well above the cost of importing from South Africa.

**Government behavior affects private trader behavior:** While import arrangements were announced in August 2001, maize imports of substantial volume did

not commence until December 2001 and January 2002. Between August and December 2001, marketing actors had information that Government and millers were working out financing arrangements and other modalities to import maize to be sold at below-market prices in Zambia. During this period, most private companies refrained from importing commercial supplies, based on the knowledge that subsidized supplies were coming into the country under the Government import program to be sold at below market prices, and that commercial imports would be unable to find buyers in this situation.

However, because of financing problems, imports under the Government program were delayed. By the end of May 2002, only 130,000 tonnes had been imported under these arrangements, not the intended 200,000 tonnes. Late and insufficient imports under the Government program had two major effects:

(1) Fewer private market participants: Because Government arranged to supply selected milling firms with imported maize at a landed cost of \$160/tonne<sup>1</sup>, this ensured that these millers would have a major advantage in selling their products compared to other millers and traders who faced commercial import costs in the range of \$220-260/tonne. The risk to firms not awarded preferential import subsidies were great as the firms selected to receive the subsidy could undercut the rest of the market by selling at roughly US\$70-100/tonne less. This situation effectively froze out of the market all traders except those chosen under the Government program.

(2) A temporary import market paralysis causing maize grain (and mealie meal) shortages and high prices: During the 3-4 months between the tender announcement in August 2001 and the arrival of the first substantial imported volumes in December 2001, local supplies dwindled and maize prices rose sharply, reflecting scarcity of the commodity caused by an import gap, and the expectations that subsidized

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<sup>1</sup> For contracts signed after January 2002, the subsidy was reduced and the into-mill price became US\$200/tonne.

Government imports were imminent. Despite the fact that there was a widely recognized shortage of maize and mealie meal, the anticipated Government-led importation seemed to have effectively paralyzed the market: it discouraged private traders who were not selected to import, and the selected firms themselves were waiting for supplies to arrive and did not arrange any complementary imports.

**Direct or indirect subsidies on maize imports discourages commercial imports:** Subsidies have been in two different forms. First, direct subsidies on imported maize were provided to millers during the 2001/02 season. Second, indirect subsidies were provided during the 1998/99 marketing season through exchange rate depreciation: the Food Reserve Agency imported maize for sale to millers and kept its Kwacha selling price constant during the remainder of the season. However, as the Kwacha depreciated, the dollar value of the maize sold to millers decreased and was never adjusted. Hence, FRA provided an indirect subsidy equal to the Kwacha/US Dollar exchange loss. In both scenarios, maize was sold at less than commercial prices. As a result, in both scenarios Government gave selective advantages to buyers that were given access to its subsidized maize supplies, effectively pushing all other millers and traders out of the market.

**Import subsidies on imported maize grain provided to large millers may not benefit the consumer:** The 2001/02 maize shortage resulted in rationing of maize meal and the subsidy that Government conferred on maize importation was not passed through to consumers. Despite the subsidy on maize and subsequent price reductions of maize grain, breakfast meal prices remained at high levels throughout 2002. While maize grain market prices dropped from US\$350/t in January 2002 to US\$160/t in May 2002 (a decrease of more than 75%), breakfast meal prices in Lusaka declined by only 15% during the same period. This would indicate that much of the subsidy was conferred to millers or retail traders who bid up the price in response to the local scarcity of mealie meal that persisted, indicating that the imported volumes were insufficient to meet the entire shortfall.

**If maize import arrangements are to benefit low-income urban and rural consumers, alternative market channels should be explored:** The observed high mealie meal prices during a maize deficit season, coupled with the non-availability of maize grain in the public markets, would strengthen the argument for making Government-imported maize grain directly available to consumers and small retailers, not exclusively to large millers. As presented in FSRP Policy Synthesis No. 5 (October 2002), low-income

consumers stand to benefit a great deal from having access to maize grain for grinding at the hammer mill, rather than having no choice but to purchase expensive industrially milled mealie meal.

**Implications for the current 2002/03 maize shortage:** Maize meal prices in late 2002 are substantially higher than normal because of the regional Southern African crisis. In Lusaka, real maize grain retail prices in October 2002 were double their levels 12 months earlier. This implies that maize grain and mealie meal are becoming scarce and that low-income consumers are already becoming dependent on more expensive industrial mealie meal. How should Government respond?

#### **Options for Consideration:**

*(1) Import arrangements, either in the form of subsidies for selected market participants or in the form of direct Government/FRA imports, should only be announced if and when the necessary resources are in place to cover the entire announced import requirement.* Uncertainty over Government's actions in the market will compound the risks that private traders face in importing supplies. A key goal of Government is to add stability and clarity to the market, so that traders can respond to opportunities. Clear statements about Government intentions backed up by timely action will help in this regard.

*(2) If Government is uncertain that the required resources will be available to meet its intended import target, it is in the country's interest to encourage private sector imports by clearly announcing the sale of any maize imported by Government at full commercial US Dollar-based price, covering all import costs.* The private sector is unlikely to arrange commercial maize imports to supplement Government efforts unless there is a guarantee that Government will not sell below commercial market prices. The sale of Government imports can be through a series of open tenders with full import cost as the reserve price. The cost to consumers could actually be lower under this approach than if Government attempts, and fails, to import and sell sufficient quantities at subsidized rates.

*(3) If maize import arrangements (subsidized or not) are to benefit consumers, maize grain should not be available exclusively to large mills, but also to small scale traders, hammer mills and consumers.*

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