

East African governments' responses to high cereal prices



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This study analyses the responses of governments in four East African countries (Kenya, Tanzania, Uganda and Ethiopia) with respect to price formation and price transmission in the cereal sector. All four countries were confronted with high cereal prices in 2008. Government policies applied largely pursued consumer price reduction, but such short-term price policies did not encourage farmers to respond with increasing production, the more so because farmers were facing very high fertiliser prices. The report concludes by discussing policy options to help improve market functioning which supports agricultural productivity growth.

In dit onderzoek worden de reacties van de regeringen van vier Oost-Afrikaanse landen (Kenia, Tanzania, Uganda en Ethiopië) met betrekking tot prijsvorming en prijsstransmissie in de graansector geanalyseerd. In 2008 kregen alle vier de landen te maken met hoge graanprijzen. Het gevoerde overheidsbeleid was voornamelijk gericht op een verlaging van de consumentenprijs, maar met een dergelijk prijsbeleid voor de korte termijn werden landbouwbedrijven niet gestimuleerd om meer te produceren, temeer omdat ze te maken hadden met zeer hoge kunstmestprijzen. Ten slotte wordt besproken welke beleidsopties er zijn om het functioneren van de markt te verbeteren en zo een groei van de landbouwproductiviteit te bevorderen.

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Preface

In 2008 international food prices raised to record levels. The Netherlands' policy memorandum *Agriculture, rural entrepreneurship and food security* mentions that these price increases have contributed to a 'change in thinking'. The high food prices and resulting unrest in some countries by protesting consumers has made it clear how important a well-functioning agricultural sector is. The renewed attention for the agricultural sector does not limit itself to increasing productivity, although that still remains an important goal, but it also encompasses creating an enabling environment which is conducive for the private sector, improved value chains and a better functioning of local and regional markets.

This study focuses on government interventions in cereal markets in four East African countries (Ethiopia, Kenya, Tanzania and Uganda) in the context of the high international food prices in 2008, which remained high in 2009 in these countries while international prices decreased. This has caused the following dilemma for governments: how to choose the optimal extent of intervention in agricultural input and output markets, balancing the needs and interests of the poor urban population and the net food buyers in rural areas on the one hand and the interests of farmers on the other hand. The first group benefits from government intervention to keep domestic cereal prices low, while farmers would be more encouraged to increase production and productivity by high prices, especially because prices of seeds and fertilisers also have increased in the past two years.

This report aims to contribute's insights from the Ministry of Agriculture, Nature and Food Quality (LNV) into and the policy debate on how to contribute to the reduction of rural poverty and improve food security in developing countries. The research has benefitted from seminars held in Nairobi (Kenya) and Kampala (Uganda). The authors of the study are grateful to all, mainly local participants who shared their expertise with the Dutch team. LNV staff (Desiree Hagedaars, Co Neeteson, and Roeland Bosch in The Hague and Agricultural Counsellor Pim Bruinsma in Nairobi) is much appreciated for their feedback and assistance throughout the duration of the study.

A handwritten signature in black ink, appearing to read 'R.B.M. Huirne', written in a cursive style.

Prof Dr R.B.M. Huirne
Director General LEI Wageningen UR

Summary

Focus of the study

The aim of this study is to give insight into the different responses of governments in developing countries with respect to agricultural market developments. The study focuses on the role of the government in four East African countries (Kenya, Tanzania, Uganda and Ethiopia) with respect to price formation and price transmission in the cereal sector. All four countries were confronted with high cereal prices in 2008, but their governments reacted in very different ways. Based on literature review and local market reports the analysis and comparison of government responses shows how governments did intervene in the cereal markets, how domestic supply and demand responded and which local and regional factors influence cereal prices in these countries.

Trade policies and agricultural taxation

History shows that governments in East Africa have always intervened in agricultural markets, mostly via trade policies, but also through domestic policies such as taxes and subsidies on outputs and inputs. During the 1960s and 1970s - the phase of import-substitution industrialisation - government policy was very much biased against agriculture. This bias has been decreased by the reforms of the 1980s and 1990s, especially by reducing the taxation of exports. Nowadays, agriculture in Kenya and to a lesser extent Uganda is supported, but anti-agricultural (macro-economic) policies still exist in Ethiopia and Tanzania. Most cash crops in Sub-Saharan Africa (such as cocoa, tea and coffee) have always been and still are heavily taxed. For cereals the picture is mixed: some crops (e.g. sorghum) are subsidised, but others (such as rice, maize and millet) face net taxation.

The food crisis and its impact on East Africa

In 2007 and 2008 the world faced a dramatic increase in food prices. Although prices have come down since then, mid-2009 food prices were still relatively high in East Africa. Recent price hikes and fluctuations are caused by several factors. On the one hand they reflect underlying trends in supply and demand for agricultural commodities that began more than a decade ago (e.g. reduced productivity growth, increasing food demand in emerging economies, especially in Asia) and on the other hand there are a number of more recent developments

which all occurred at the same time, thus causing the peak in prices (e.g. lower harvests, higher input prices and a strong increase of demand of bio-fuels).

Interestingly, cereal prices in East Africa often show a different pattern than world prices. First, prices in the four East African countries continued to increase in the summer of 2008 while world prices started to decrease again. Second, domestic prices in East Africa fluctuate more than the world price. And third, domestic prices in the four countries correlate more with each other than with world prices and the influence of world price developments is relatively small compared to regional developments.

The high food prices caused a food crisis in the four East African countries. Some countries had already been plagued by droughts, natural disasters and political unrests, while the instability in global markets and the major increase in global food prices made importing food very costly, thus making an already tight situation even worse. In East Africa the share of household income spent on food is generally high, while most people, including cereal producers, are net food buyers. Therefore only a small group of net sellers of food was able to profit from the high prices. Ethiopia, Kenya and Tanzania are generally not self-sufficient in maize and therefore frequently depend on imports. Uganda, in contrast, produces a surplus in maize and therefore this country suffered less than the other three.

The food security situation as well as the factors leading to the crisis differed between the four East African countries. As shown below this caused governments of the four countries to pursue different policies with a different focus (short-term versus long-term).

Government responses in Kenya

In Kenya violence as a result of contested national election results combined with poor rains led to failed cereal harvests at the beginning of 2008. In addition higher fertiliser prices led to a nearly 30% increase in the costs of production. As a result the total Kenyan maize production in 2008 was 29% lower than in 2007 and 22% lower than in 2006. In January 2009 the government declared the food shortage a national disaster, which threatened the lives of about 10m people. Kenya is a net importer of maize and in the period when domestic maize prices peaked, the country relied heavily on imports from South Africa, the US as well as Tanzania and Uganda. On average maize prices in Kenya rose with 69% in 2008, but there were strong regional price differences, which shows that domestic markets were not functioning well. The Kenyan government reacted not by tackling the root causes of reduced maize supply, but with direct market intervention measures (e.g. reduced taxes, export bans and price con-

trols). Producers and traders have criticised these measures for being too interventionist and not stimulating the private sector to invest in the maize supply chain. Moreover, international donors have pointed out that corruption in the intervention buying National Cereals and Produce Board has worsened the problems in Kenya.

Government responses in Tanzania

The food security situation in Tanzania has not been as dire as in Kenya, partly because Tanzanian grain reserves were better supplied, although also in Tanzania a large part of the country suffered from moderate food insecurity. Poor harvests and natural disasters - such as a volcano eruption and a fire disaster - were the main causes. The maize price development in Tanzania shows a different pattern than in the other countries: prices started rising relatively early in mid-2007 and peaked in January 2008, after which they decreased again until mid-2008, mostly due to good harvests. Since then prices are on the rise again and they continued to be high in 2009. In order to stabilise the maize market, the Tanzanian government enforced an export ban in January 2008, while import duties were also removed. When prices remained high, the government authorised the imports of large quantities of duty-free maize several times and extended the export ban to all agricultural commodities. However, exports to Kenya and Sudan - countries with much higher price levels - continued, which further decreased the domestic maize reserves. The strict export policy of the Tanzanian government may have exacerbated the food insecurity situation in neighbouring countries, pushing up prices even more, while Tanzanian farmers and traders were not able to profit from higher prices.

Government responses in Uganda

In Uganda, both excessive rains, causing floods, and severe droughts caused food shortages in the north-eastern part of the country. Besides these climatic factors, decades of civil war have afflicted the same area. However, although maize prices are higher than the five-year average, food prices are still relatively stable and consistent with normal seasonal patterns. Unlike in the other three countries, maize is not a major staple crop in Uganda. The price of a major staple crop, matoke (cooking banana), was 33% lower in 2008 than in 2007. A main reason for higher food prices in Uganda may be import of food by neighbouring countries (e.g. Kenya, Tanzania and Rwanda). However, the government did not impose any bans, quotas or other restrictions to exports. In contrast, the government has seen the high prices as an opportunity to boost production and improve the food marketing system by reducing transaction and transport

costs. The government continued to pursue agricultural extension, innovation stimulating and agricultural credit provision policies. Furthermore, the food-insecure Karamoja District, which had been hit hard by several consecutive droughts, as well as some other parts of the country, has been provided with high-yielding seeds and tractors to address the 2008 food crisis. But overall the government of Uganda has not taken any short-term direct intervention measures.

Government responses in Ethiopia

Mainly severe droughts caused a deteriorating food security situation in Ethiopia in mid-2008. The government then estimated it needed about 600,000 tonnes of cereals to meet emergency food assistance needs of about 4.6m people. However, the government and the World Food Programme were not able to meet all demands, which caused prices to increase further. In the first half of 2009 the situation remained critical and even worsened in some areas. The hike in food prices in Ethiopia reflects relatively high inflation in Ethiopia (up to 40% in 2009). There is also quite some regional differentiation: the local Ethiopian maize markets are not well integrated in the world market and interregional trade is restricted by inadequate infrastructure and high transaction costs. In the period March-October 2008, Ethiopian maize prices almost tripled from USD300 to 900 per tonne. The government reacted in several ways: with export bans on cereals in the beginning of 2008, measures to deal with illegal practices of traders, large food imports for the urban poor and elimination of fuel subsidies to save money for food consumption subsidies. All these efforts to bring down prices have been very costly and the government has been forced to implement measures to decrease its budget deficit.

Conclusions

The effects of high cereals prices on the food security situation in East Africa have been shaped by two main factors: the climatic conditions in each country and the diverse government responses to the high cereal prices. Although there are several regional trade agreements in the region, which, in principle, stimulate regional trade, there are still various obstacles to inter-regional trade and markets in the four countries are little connected. This explains the large differences between the domestic maize prices in the four countries. In reaction to the food crisis most East African countries, except Uganda, pursued short-term policies to reduce food prices for consumers (i.e. price-oriented policies). Only in Uganda long-term policies focusing on extension and innovation in order to encourage productivity growth were implemented in reaction to the high prices.

In most cases farmers were hurt by the short-term price policies (such as price controls and the purchase of maize for reserves against set prices below market prices), which resulted in lower profits compared to a non-interventionist situation. They were also disadvantaged by very high fertiliser prices and as a consequence, many farmers reduced their maize cultivation, which again aggravated the food situation. Farmers who are net food buyers were helped by government price policies (although the effect was smaller than for urban households).

Food security will remain an important issue in the future: prices and price variability will remain relatively high in East Africa. The divergence of prices between and within countries points at high transport and transaction costs. Trade can improve regional food insecurity. To facilitate this, governments should help to reduce transaction risks and costs through investments in input and output markets and infrastructure and through reducing the costs of (regional) trade. This will benefit both farmers and consumers.

Currently, many farmers do not specialise in cash crops but diversify and reserve part of their land for food crops, which is rational in the light of fluctuating harvests and prices. This strategy reduces their risk but hampers productivity growth. If farmers would specialise more, investments in terms of inputs (such as seeds and fertiliser) would become more economic. Market-based instruments can reduce price and income risks of farmers, thus facilitating specialisation and a shift to a more professional agriculture that can achieve a higher productivity. Such instruments can include warehouse receipts systems, forward contracts, credit facilities linked to harvests and other marketing instruments that reduce price or income risks. Government policies may initiate and support local private initiatives. International donors with their financial means and expertise can play an important role in reducing transaction risks and encourage productivity growth, not only by proposing a set of technical solutions to improve markets, but also by engaging in honest debates with policy-makers (e.g. on the positive role of traders) and/or by supporting informal institutional arrangements.

Samenvatting

Reacties van Oost-Afrikaanse regeringen op hoge graanprijzen

Doel van de studie

Het doel van deze studie is om inzicht te geven over de verschillende reacties van overheden in ontwikkelingslanden op ontwikkelingen in de agrarische markten. De studie handelt over de rol van de overheid in vier Oost-Afrikaanse landen (Kenia, Tanzania, Oeganda en Ethiopië) bij de prijsvorming en prijstransmissie in de graansector. Al deze landen werden geconfronteerd met hoge graanprijzen in 2008, maar hun overheden reageerden verschillend. De analyse is gebaseerd op literatuuronderzoek en lokale marktrapporten en geeft aan hoe overheden intervenieerden in de markt, hoe binnenlandse vraag en aanbod daarop reageerden en welke lokale en regionale factoren daarbij een rol speelden.

Handelsbeleid en landbouwbelasting

De geschiedenis toont aan dat overheden in Oost-Afrika een lange traditie hebben van interventies in de landbouwmarkten, meestal via handelsbeleid, maar ook door binnenlands beleid zoals belastingen en subsidies op producten en inputs. In de jaren zestig en zeventig werd de landbouwsector belast ten gunste van de opbouw van de industrie (industrialisatie via imports substitutie). Dit veranderde in de jaren tachtig en negentig, vooral door belastingen op export te verminderen. Op dit moment wordt de landbouw in Kenia, en in mindere mate ook in Oeganda, ondersteund maar het macro-economische beleid in Ethiopië en Tanzania is nog steeds nadelig voor de landbouw. De meeste gewassen in Sub-Sahara Afrika (zoals cacao, thee en koffie) worden (nog steeds) belast. De situatie is verschillend per graansoort: de productie van sorghum wordt gesubsidieerd, maar rijst, mais en millet worden belast.

De voedselcrisis en de gevolgen voor Oost-Afrika

In 2007 en 2008 stegen wereldwijd de voedselprijzen drastisch. Hoewel ze sindsdien zijn gedaald, waren de prijzen in de zomer van 2009 nog steeds hoog in Oost-Afrika. De recente prijsspieken en fluctuaties worden veroorzaakt door diverse factoren. Aan de ene kant zijn zij het gevolg van trends in het aanbod en de vraag naar landbouwproducten die al meer dan tien jaar geleden begonnen (zoals dalende productiviteitsgroei, toename van de vraag in sterk groeiende economieën, vooral in Azië) en aan de andere kant trad tegelijkertijd een aantal gebeurtenissen op (waaronder tegenvallende oogsten, sterk stijgende inputprijzen en een forse toename van de vraag naar biobrandstoffen) die de prijzen omhoogstuwden.

Opmerkelijk is dat de ontwikkeling van de graanprijzen in Oost-Afrika een patroon volgt dat op een aantal punten afwijkt van die van de wereldmarktprijs.

1. Prijzen in Oost-Afrika bleven stijgen terwijl de piek op de wereldmarkt in de loop van 2008 al geweest was.
2. De prijzen in Oost-Afrika schommelen veel meer dan op de wereldmarkt.
3. De binnenlandse prijzen van Oost-Afrikaanse landen correleren meer met elkaar dan met de wereldmarktprijzen, wat aanduidt dat regionale marktontwikkelingen de prijsvorming meer bepaalt dan ontwikkelingen op de internationale markt.

De hoge voedselprijzen veroorzaakten een voedselcrisis in de vier Oost-Afrikaanse landen. Sommige landen werden al geplaagd door droogte, natuurrampen en politieke onrust, terwijl oplopende internationale prijzen de import van voedsel snel duurder maakten. In Oost-Afrika wordt een groot deel van het inkomen aan voedsel besteed en een groot deel van de bevolking (ook veel boeren) voedsel moet aankopen. Als gevolg daarvan heeft slechts een klein deel van de bevolking (de nettoverkoopers van voedselproducten) kunnen profiteren van hoge prijzen. Ethiopië, Kenia en Tanzania zijn doorgaans niet zelfvoorzienend in mais en dus regelmatig afhankelijk van import. Oeganda, daarentegen, produceert wel een overschot aan mais.

De voedselsituatie en de oorzaken die hebben geleid tot de crisis verschillen tussen de vier landen. Zoals hierna wordt beschreven, heeft dit tot gevolg gehad dat de overheden in de vier landen kozen voor verschillende beleidsopties.

Beleidreacties van de overheid in Kenia

In Kenia leidde geweld als gevolg van betwiste resultaten van de nationale verkiezingen gecombineerd met geringe regenval tot het mislukken van de graanoogsten in het begin van 2008. Daar kwam bij dat door hogere kunstmestprijzen de productiekosten fors toenamen. Het gevolg was dat de Keniaanse maisproductie in 2008 bijna 30% lager was dan in 2007 en ruim 20% lager dan in 2006. In januari 2009 verklaarde de overheid het voedseltekort tot een nationale ramp die het leven van circa 10 mln. mensen bedreigde. Kenia is een netto-importeur van mais en, terwijl binnenlandse prijzen een piek bereikten, moest het land mais importeren uit Zuid-Afrika, de VS en ook uit Tanzania en Oeganda. Gemiddeld namen de prijzen voor mais met 70% toe in 2008 maar er waren grote regionale verschillen, wat aanduidt dat de binnenlandse markt niet goed functioneerde. De Keniaanse regering reageerde met directe marktinterventies, waaronder het opkopen van graan, belastingverlaging voor consumenten, een exportverbod en prijsbevrozing. Producenten en handelaren bekritiseerden deze maatregelen heftig omdat het de private sector niet zou aanzetten tot meer investeringen in de maisketen. Bovendien wezen internationale donoren op corruptie die zich zou voordoen bij een semi-overheidsinstantie die de aan- en verkoop van graan verzorgt.

Beleidsreacties van de overheid in Tanzania

De voedselsituatie in Tanzania was niet zo nijpend als in Kenia, deels omdat de graanreserves in Tanzania groter waren. Toch werd de voedselzekerheid in delen van het land bedreigd, vooral door slechte oogsten en natuurrampen (vulkanuitbarsting en bosbranden). De prijsontwikkeling van mais heeft in Tanzania een ander patroon dan in de andere drie landen: prijzen stegen relatief vroeg in 2007 en piekten in januari 2008, waarna ze weer daalden tot halverwege 2008 als gevolg van goede oogsten. Sindsdien zijn de prijzen echter weer gestegen en ze zijn hoog gebleven in 2009. Met het doel de markt te stabiliseren kondigde de Tanzaniaanse regering een exportverbod voor mais af in januari 2008 en werden importtarieven opgeheven. Toen prijzen hoog bleven, stond de regering enkele malen grote hoeveelheden heffingsvrije import van mais toe en werd het exportverbod tot alle landbouwproducten uitgebreid. Toch bleef uitvoer van mais naar Kenia en Soedan (waar prijzen hoger waren) plaatsvinden, waardoor binnenlandse reserves verder afnamen. Het strikte exportbeleid van de Tanzaniaanse regering kan de situatie van voedselschaarste in omringende landen verergerd hebben, door de prijzen op te stuwen terwijl boeren in het land niet konden profiteren van die hogere prijzen.

Beleidsreacties van de overheid in Oeganda

In het noordoosten van Oeganda veroorzaakten zowel uitzonderlijk zware regen als droogte voedseltekorten. Daarnaast woedde in deze regio jarenlang een burgeroorlog. Toch zijn de voedselprijzen er relatief stabiel en volgen ze het normale seizoenspatroon, hoewel de recente maisprijzen wel hoger zijn dan het 5-jaarlijkse gemiddelde. Anders dan in de andere drie landen van deze studie is mais niet het belangrijkste voedselgewas in Oeganda; dat is matoke (cooking banana), waarvan de prijs in 2008 een derde lager was dan in 2007. Een reden voor de hogere prijzen voor mais is de vraag van importerende buurlanden (Kenia, Tanzania en Rwanda). De regering stelde geen verbod of quotum in om de export te beperken. Integendeel, de regering zag de hogere prijzen als een kans om de productie en verkoop te stimuleren, onder meer door transactie- en transportkosten te verminderen. De Oegandese overheid zette het beleid van landbouwvoorlichting, investeringssteun aan innovaties en landbouwkrediet voort. Bovendien stelde de regering zaden en tractoren beschikbaar in onder meer het Karamoja District, waar voedselschaarste heerst in verband met voortdurende droogte. De regering nam geen kortetermijnmaatregelen die gevolgen zouden hebben voor consumenten- dan wel producentenprijzen.

Beleidsreacties van de overheid in Ethiopië

Vooraf door droogte is halverwege 2008 de voedselsituatie in Ethiopië sterk verslechterd. De overheid schatte in dat er ongeveer 600.000 ton graan nodig zou zijn als noodhulp om aan de behoeften van 4,6 mln. mensen te kunnen voldoen. Echter, de overheid en het Wereld Voedselprogramma waren niet in staat om aan deze vraag te voldoen, waardoor prijzen verder stegen. In de eerste helft van 2009 bleef de situatie kritiek en deze verslechterde in sommige regio's nog verder. De stijging van de voedselprijzen in Ethiopië reflecteert ook de buitengewoon hoge algemene inflatie in het land (tot wel 40% in 2009). Er zijn ook sterke regionale verschillen: de lokale maismarkt is niet zo goed geïntegreerd met de internationale markt en interregionale handel wordt belemmerd door onvoldoende infrastructuur en hoge transportkosten. In de periode maart tot oktober 2008 steeg de prijs van Ethiopische mais van 300 naar USD 900 per ton. De regering reageerde met diverse maatregelen: een exportverbod op graan begin 2008, optreden tegen illegale praktijken van handelaren, grote voedselimporten (ten behoeve van de stedelijke armen) en het afschaffen van brandstofsubsidies om geld uit te sparen voor voedselsubsidies voor de consumenten. Deze pogingen om de prijzen voor consumenten te drukken, heeft veel geld gekost en de regering staat nu onder druk om maatregelen te nemen om de overheidstekorten te verminderen.

Conclusies

De gevolgen van hoge graanprijzen op voedselzekerheid in Oost-Afrika worden door twee factoren bepaald: klimatologische (weers)omstandigheden en de diverse beleidsreacties op de hoge graanprijzen. Hoewel er verschillende regionale handelsakkoorden zijn die in principe de onderlinge handel faciliteren, zijn er nog diverse obstakels en zijn de markten van de vier landen slecht met elkaar verbonden. Dit verklaart de grote verschillen tussen de binnenlandse prijzen voor mais in de vier landen. In reactie op de voedselcrisis hebben de Oost-Afrikaanse landen, met uitzondering van Oeganda, kortetermijnmaatregelen uitgevaardigd om de prijzen voor consumenten te verlagen (op prijs gerichte interventies). Alleen in Oeganda richtte het overheidsbeleid zich als reactie op de hoge prijzen op voorlichting en innovatie om productiviteitsgroei aan te moedigen. In veel gevallen werden de boeren benadeeld door de kortetermijnprijspolitiek (waaronder prijsbevrozing en de aankoop van mais voor voorraadvorming tegen prijzen die beneden de marktprijs lagen), waardoor ze lagere opbrengsten behaalden dan het geval zou zijn geweest zonder ingrijpen van de overheid. Boeren werden ook geconfronteerd met hogere kunstmestprijzen waardoor ze minder mais produceerden en de voedselsituatie verder verslechterde. Boeren die nettokoper van voedsel zijn, werden door het overheidsbeleid gesteund maar in mindere mate dan de stedelijke consumenten.

Voedselzekerheid blijft een belangrijk onderwerp: voedselprijzen zullen hoog en prijschommelingen groot blijven in Oost-Afrika. Het verschil in prijzen tussen en binnen landen duidt op hoge transport- en transactiekosten. Handel kan bijdragen aan het verhogen van de regionale voedselzekerheid. Om dit te bereiken kan de overheid transactierisico's en -kosten helpen verlagen door te investeren in verbeterde toegang tot markten voor inputs en outputs, en in infrastructuur, en door de (administratieve) kosten van regionale handel te helpen verminderen. Deze maatregelen zullen zowel producenten als consumenten ten voordeel zijn.

Veel boeren specialiseren zich niet in marktgewassen maar spreiden hun aandacht en risico's en reserveren ten minste een deel van hun land voor voedselgewassen, wat rationeel gedrag is in het licht van schommelende oogsten en prijzen. Deze strategie vermindert hun risico maar beperkt ook de productiviteitsgroei. Als boeren zich meer specialiseren, worden investeringen in het gebruik van productiemiddelen sneller rendabel. Marktinstrumenten kunnen prijs- en inkomensrisico's van boeren verminderen en dus specialisatie mogelijk maken, wat een professionelere landbouw tot gevolg zal hebben met een hogere productiviteit. Deze instrumenten kunnen bijvoorbeeld zijn: opslagbewijzen (warehouse receipts), termijncontracten, kredietfaciliteiten verbonden aan de oogst- en andere verkoopinstrumenten waarmee prijs- en inkomensrisico's kun-

nen worden verminderd. Overheidsbeleid kan lokale private initiatieven helpen opzetten en ondersteunen. Ook internationale donoren kunnen met financiële middelen en expertise een belangrijke rol spelen in het verminderen van transactierisico's voor boeren en handelaren en in het stimuleren van productiviteitsgroei. Dat kunnen zij doen door zich, naast technische oplossingen voor verbeterde marktwerking aan te dragen, (meer) in het debat met beleidsmakers te begeven (bijvoorbeeld over de positieve rol die handelaren kunnen spelen bij het verbeteren van marktwerking) en/of door ondersteuning van informele institutionele verbintenissen.

1 Introduction

1.1 Background and focus

In several ways, 2008 was an exceptional year with food prices rising to record levels. The Netherlands policy memorandum *Agriculture, rural entrepreneurship and food security* states that these price increases on international agricultural markets have contributed to a 'change in thinking' (DGIS/LNV, 2008). The high food prices and resulting unrest in some countries by protesting consumers has made it clear how important a well-functioning agricultural sector is. The renewed attention for the agricultural sector does not limit itself to increasing productivity, although that still remains an important goal, but it also encompasses creating an enabling environment which is conducive for the private sector, improved value chains and a better functioning of local and regional markets.

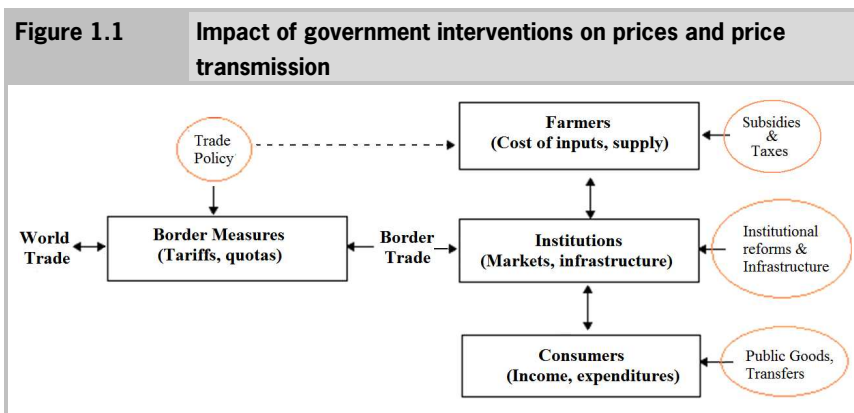
In this report, we focus on the role of government in promoting agricultural market development, with an emphasis on prices and local and national markets. The aim is to analyse the policy and intervention options in these areas, within the ongoing discussion concerning the optimal extent of government policy intervention in agricultural input and output markets in Africa. To focus this analysis, we have taken the unprecedented rise in cereal prices as a case because it compelled many governments into action. We analysed what has happened in four East African countries (Kenya, Tanzania, Uganda en Ethiopia) that were all confronted with high international food prices, but whose governments have acted in very different ways. The analysis and comparison between countries show how the governments in the selected countries became involved in the functioning of cereal markets and what position they took with respect to the private sector. It also gives an insight into how the domestic markets of these East African countries function, and how local and regional factors have influenced cereal prices in these countries.

1.2 Conceptual framework

Our study focuses on the role of governments in the cereal sector, with an emphasis on price formation and transmission in agricultural markets in (east) Africa. Figure 1.1 explains how prices are transmitted to consumers. Prices

function to balance the quantity demanded by consumers, and the quantity supplied by producers, resulting in an economic equilibrium of price and quantity traded. High prices thus signal a high demand relative to a mainly low supply and vice versa. Domestic prices are influenced by not only domestic demand and supply but also demand and supply in neighbouring countries and on the world market. However, most markets are not completely free but are influenced by (sometimes substantial) government influence. Prices are therefore also affected to a great extent by governments.

World prices are affected by trade policies - subsidies, tariffs, quotas, standards, market access - of developing and developed countries. World prices are transmitted to domestic prices through border measures, such as tariffs and quotas. Domestic prices are influenced by institutional structures, level of development of markets and the level of infrastructure. These factors usually lead to differences in prices in different local markets (i.e. geographical dispersion). However, domestic prices are also influenced by local supply factors (represented by the box 'Farmers') and local demand factors (represented by the box 'Consumers'). If markets function perfectly, then geographically dispersed supply will meet geographically dispersed demand and there will be one equilibrium price in different locations. However, in developing countries markets and their underlying institutions (the box 'Institutions') do not function perfectly. Factors such as transaction risk, transaction and transport costs lead to inefficiencies, a mismatch between demand and supply¹ and locally dispersed prices.



¹ This means that in some local areas there may be high supply (and low prices) while in another area there remains a shortage of supply (and low prices). This explains why, in a certain country, there may be a surplus in one area and food insecurity in another.

Figure 1.1 distinguishes four major areas in which the government influences prices and price transmission. First, in trade policy through border measures (tariffs, quotas, et cetera). They play a major role in many African countries, as these measures often generate income for the government, but often also inhibit free flow of goods between neighbouring countries.¹ Second, subsidies and taxes geared towards the farming community affect prices that farmers obtain for their produce or pay for inputs. Inputs such as fertilisers or water might be subsidised to decrease costs of farming while output might be taxed (e.g. when it is brought to the market). However, produce can also be indirectly taxed through border measures (especially when produce is for export; this is indicated by the dashed line). Third, governments have influence over many institutions, including market institutions, and infrastructure that facilitates the functioning of markets (see below for more). Finally, governments can support consumers' incomes and expenditures through public goods and transfers (e.g. food subsidies, food for work programmes).

Benson et al. (2008) have specified government policies that tackle high food prices into three categories, which can be distinguished by the time horizon with which they can be implemented (short, medium or long term see Table 1.1). The first two categories fall into the 'Consumers' box of Figure 1.1 while the last one falls into the 'Farmers' category. This specification will be used to classify and evaluate the government responses to the price developments in the four East African countries.

¹ Non-tariff measures (NTMs), which are all trade measures that are not tariffs, are becoming more important in international trade. NTMs increasingly impede trade from African countries to western markets, but they probably do not affect trade between African countries and imports of food crops into Africa.

Table 1.1		Potential policy responses to food crises		
Type of intervention	Time frame			
	short term (<1 year)	medium term (1-3 years)	long term (>3 years)	
Reduce food prices for consumers (price-oriented policies)	<ul style="list-style-type: none"> - Reduce tariffs/taxes on food - Adopt food price controls/take action against profiteers - Adopt consumer subsidies - Adopt food export bans or taxes - Pursue government food imports - Release food reserve stocks 	<p><i>Same options as short term plus:</i></p> <ul style="list-style-type: none"> - Establish food reserves and release policy - Establish variable tariffs or variable export subsidies/taxes - Pursue options to increase domestic food production (see below) 	<p><i>Same options as medium term plus:</i></p> <ul style="list-style-type: none"> - Invest in marketing infrastructure, institutions, and information - Invest in increased food production capacity (see below) 	
Increase food availability for (or income of) target groups (income-oriented policies)	<ul style="list-style-type: none"> - Increase support through existing social protection programs - Increase public sector wages - Increase food aid programs 	<p><i>Same options as short term plus:</i></p> <ul style="list-style-type: none"> - Establish new social protection programs or expand/improve existing ones 	<p><i>Same options as medium term and those for increasing food production plus:</i></p> <ul style="list-style-type: none"> - Invest in other development and anti-poverty programs (e.g. education, promote rural non-farm enterprises) 	

Table 1.1		Potential policy responses to food crises (continued)		
Type of intervention	Time frame			
	short term (< 1 year)	medium term (1-3 years)	long term (> 3 years)	
Increase food production (supply-oriented policies)	<i>Limited short-term options</i>	<ul style="list-style-type: none"> - Adopt input subsidies - Adopt producer price supports and subsidies - Expand agricultural credit - Strengthen agricultural extension 	<i>Same options as medium term plus:</i> <ul style="list-style-type: none"> - Pursue agricultural R&D - Invest in productive infrastructure and assets (e.g. irrigation, mechanisation) - Improve natural resource management - Improve property rights and resource tenure systems 	

Source: Benson et al. (2008).

Figure 1.1 shows that institutions play a central role in the way prices are transmitted and as discussed, whether prices converge or remain dispersed over different geographical locations. We identify institutional arrangements and institutional environment (see Eaton et al., 2008). The *institutional environment* consists of the broader socio-economic framework within which different institutional arrangements take place. In considering the institutional environment, a distinction is often made between formal and informal institutions. Formal institutions are 'embodied in constitutions, laws, the structure of state decision (the number of veto players and their mode of selection) and regulations enforced by judges, courts, police, bureaucracy, and the like' whereas informal institutions are 'norms of conduct, perhaps historical traditions or religious precepts' enforced by custom or habit (Keefer and Shirley, 2000). We can distinguish various components making up the formal institutional environment, in terms of applicable scope and specificity. For example, legal frameworks, especially property and contract laws and their supporting institutions, have a fundamental and broad significance for the cost and uncertainty associated with exchanging goods and services in general. On the other hand, government macroeconomic policy, which may involve regulations concerning taxation, government spending, monetary policy and exchange policy, may change frequently and can be

seen as influencing relative market prices in the economy. The institutional environment is the product of its history: powerful groups and individuals shape fundamental institutions to maintain their power. These institutions persist not just because powerful elites enforce them, but also because they become part of society's shared beliefs about how the world works, or should work, beliefs about how others will behave, or should behave. Such institutions thus become internalised norms and can be difficult to change (Shirley, 2008; North, 2005).

North et al. (2009) characterise most developing countries as 'natural states',¹ which manage the problem of violence by forming a dominant coalition that limits access to valuable resources - land, labour, and capital - or access to and control of valuable activities - such as trade - to elite groups. The state uses limited economic entry to generate economic rents which are used to create credible commitments among elites to support the current regime and provide order. In this sense, it is important to note that the state contains much more than the formal structure of government and also includes (other) powerful actors with power that are not identified with the formal government. North et al. (ibid) make several points about the functioning of natural states that are important to our analysis.

1. In a natural state, politics and economics are linked: the operation of markets and democratic institutions are not independent and all but economic organisations are also political ones. Therefore, North et al. (ibid) emphasise that economic and political systems are deeply intertwined.
2. Although natural states may have some of the features and institutions of economic and political competition that developed countries or 'open access states' have, these do not work the same way as in an open access state. Markets in natural states have far less access and are subject to far more explicit privilege and rent-creation, and are therefore significantly less competitive. Prices frequently do not reflect marginal costs. Also, in open access states, impartial, rule-of-law courts impose penalties on the executive branch of government when it fails to implement the laws according to the provisions specified in the law. However, this rarely happens in natural states where (often corrupt) courts do not constrain the executive branch.²
3. The personalistic, rent-creation basis of natural states makes it difficult for them to produce many of the common public goods and services associated with markets and economic growth. Natural states are also more subject to

¹ They label these states natural because, for most of the last ten thousand years, it has been virtually the only form of society that has been capable of securing physical order and managing violence.

² This is often described in terms of weak or no institutions, but this terminology is a bit misleading because as North et al. describe, there are (strong) institutions.

populism and policies that create macroeconomic imbalances and budgetary crises. The institutional environment, particularly in terms of legal frameworks, leads to difficulties in enforcing impersonal contracts, and rent-seeking behaviour by politicians, bureaucrats, criminals and the private sector.

All these factors use resources and restrain economic and technological development, which reduces access to markets and market development. Low levels of economic activity lead to thin markets,¹ high transaction risks and costs, and high unit costs for infrastructural development. This is one way of describing the 'low level equilibrium traps' afflicting the poor in many rural areas within low-income economies (Dorward et al., 2004; North et al., 2009).

When the institutional environment is weak, transactions are often governed through informal *institutional arrangements*, which is the case for much of East African grain trade. Institutional arrangements² refer to a set of rules or agreements governing the activities of a specific group of people pursuing a certain objective. Different types of examples include a contract - often verbal - (such as simply to exchange goods, or a sharecropping agreement between landlord and tenant farmer. Another example is a producers' organisation - an agreement among farmers perhaps to jointly purchase inputs or deliver produce to clients - and so on. Institutional arrangements thus involve agreements to exchange or coordinate goods or services (such as labour). Concluding and enforcing such agreements entails the expenditure of resources, referred to as transaction costs.

A weak institutional environment also leads to relatively high transaction risks. To protect oneself against risks or perceived risks of transaction failure, market participants incur costs (i.e. transaction costs). A large share of transaction costs consists of the expenditure of time on the part of buyers or sellers (search and information costs, bargaining and decision costs, monitoring and enforcement costs). Governments have a role in reducing transaction risks, costs and making markets more efficient and more equitable. We see three broad areas in which the government can do this (Keefer and Shirley, 2000):

¹ Thin markets are markets with few market participants and low levels of trade.

² North et al. (2009) identify institutions and organisations. Organisations consist of specific groups of individuals pursuing a mix of common and individual goals through partially coordinated behaviour. Organisations coordinate their members' actions, so an organisation's actions are more than the sum of the actions of the individuals. Organisations have their own internal institutional structure: the rules, norms, and shared beliefs that influence the way people behave within the organisation. This definition overlaps that of an institutional arrangement, but we view institutional arrangements to be a somewhat broader and looser concept: the participants of an institutional arrangement are not set.

1. Improving property and contract laws and their supporting institutions, which have a fundamental and broad significance for the cost and uncertainty associated with exchanging goods and services in general;
2. Government macroeconomic policy, which may involve regulations concerning taxation, government spending, monetary policy and exchange policy. Changes to these can be frequent and seen as influencing relative market prices in the economy;¹
3. Establishing or facilitating infrastructure and organisations that will reduce transaction risks and have a public goods nature: market information systems; roads; physical markets that include weighing equipment, storage; commodity exchanges; labelling and certification organisations, et cetera.

In the past, in many African countries, governments have often sought to replace markets by government bodies (such as marketing parastatals). However, it is currently generally acknowledged that governments should play a facilitating rather than a direct role in markets. Appropriate interventions are thus indirect in nature. Stiglitz (1989:202) has stated that:

'Market failures are particularly pervasive in LDCs [low development countries]. Good policy requires identifying them, asking which can be directly attacked by making markets work more effectively (and in particular, reducing government imposed barriers to the effective working of markets), and which cannot. We need to identify which market failures can be ameliorated through non-market institutions (with perhaps the government taking an instrumental role in establishing these nonmarket institutions). We need to recognise both the limits and the strengths of markets, as well as the strengths, and limits, of government interventions aimed at correcting market failures.'

This quote shows how complicated it is to balance government intervention on the one hand and leaving markets (with possible market failures) alone on the other hand. Generally, transaction risks are high in developing countries, which call for government intervention to reduce these risks and resulting costs directly or through the amelioration of market failures. However, given the func-

¹ Keefer and Shirley put forward that the security of property rights and the credibility of contracting is relatively more important for economic performance than the more common economic policy instruments: 'countries with high levels of institutional quality and poor macroeconomic policies grew twice as fast as countries with the reverse combination' (Keefer and Shirley, 2000).

tioning of a natural state, and the internal logic behind it, it remains to be seen whether governments in developing countries will take up these functions.

1.3 Overview of chapters

In this report, we will give an overview of past and current state of government involvement in agricultural development through trade policies, and through agricultural and macro-economic policies (e.g. agricultural subsidies, taxation and exchange rate policy). In between, important institutional aspects other than government interventions and policies will be mentioned but are not dealt with explicitly and in detail.

Chapter 2 starts with a historical overview of the government trade interventions in the four East African countries. This chapter covers the left half of Figure 1.1. (trade policy). Chapter 3 then discusses agricultural and macro-economic policies and how these policies have influenced (indirect) agricultural taxation at the farmers' level. Chapter 3 therefore broadly covers the right half of Figure 1.1 (subsidies, taxes, public goods and transfers). Chapter 4 reviews major causes and the effects of the food crisis in a general sense. Chapter 5.8 presents in more detail an analysis of the effects of government policies on cereal markets, farmers and consumers in each of the four countries (Kenya, Tanzania, Uganda and Ethiopia), which is being summarised and synthesised in chapter 9. Conclusions are presented in chapter 10.

2 Trade policies

2.1 Three phases

Seen in a historical context, Africa's agricultural and trade policy has gone through three distinct phases:

1. the phase during which colonial powers determined agricultural policy;
2. the phase which came after independence (around the 1960s for most African countries);
3. the phase during which Structural Adjustment Programmes (SAPs) were implemented, liberalising economies and reducing the role of the government, which happened in the 1980s.

Prior to the early 1960s, when many African countries gained independence, African trade policy was defined by the colonial powers. Primary commodities were exported from Africa and manufactured products were imported. The trade structure of African countries during this period was driven by the interests of the colonial powers.

After independence, the trade policies of many countries in Africa were inspired by the principle of import-substitution industrialisation (including Ethiopia and Tanzania). This strategy advocated the protection of the domestic market from foreign competition in order to promote domestic industrial production. Import-substitution industrialisation was widely accepted in the 1960s and 1970s as a viable policy to help developing countries achieve structural transformation and lessen their dependence on primary production.

Trade policies in most African countries during 1960-1980/1990 were characterised by extensive government involvement in the economy, both in production and in marketing. Additionally, the domestic market in these countries was shielded from foreign competition through a number of policy measures. Nontariff measures (NTMs) such as quantitative import restrictions and government licences were used profusely to restrict imports. Tariff structures were often highly complex, with a large number of tariff rates, and tariffs were high. Exports were often restricted by a number of export taxes and strict rules and regulations. The exchange rates of many countries were often overvalued and access to foreign exchange was rationed. The import-substitution industrialisation did not work as intended. Instead, many countries in Africa found themselves facing difficult global conditions with economies that lacked com-

petitiveness due to excessive state intervention in the economy and mismanagement.

In the 1980s and 1990s, the international financial institutions advocated a policy package of market-oriented reforms or 'Structural Adjustment Programmes' (SAPs) to tackle policy inadequacies such as overvalued exchange rates, restrictive trade regulations as well as excessive taxation of agricultural exports through marketing boards. Substantial currency devaluation and trade liberalisation, along with the dismantling of industrial protection measures were advocated. By the second half of the 1980s, about 60% of African countries were undergoing or had gone through a structural adjustment programme designed in collaboration with the World Bank and the International Monetary Fund (IMF). By the mid-1990s, most African countries had undertaken such programmes (UNCTAD, 2008a).

2.2 Impact of trade liberalisation

Two main trade liberalisation policies were expected to have a direct positive impact on the agricultural sector and exports. One was to cut high taxation on the sector by aligning producer prices with world prices. The second was to promote the development of private input and output markets ('getting prices right'). As part of this process, agricultural marketing boards were dismantled and subsidies on a range of inputs, such as fertilisers or insecticides, were cut. The sector was also expected to benefit from macroeconomic policies such as reducing the overvaluation of the exchange rate and providing a more stable macroeconomic environment. Such policies were supposed to enable agricultural exporters to capture a higher proportion of the world market price for their products, which would then give them a greater incentive to produce and export more.

After trade liberalisation, the trade balance in Africa worsened. In other developing countries, the increase in imports was compensated by a sharp rise in exports (Table 2.1). In Africa, the more limited export response was responsible for increased trade deficits. It must be pointed out that there is no direct cause and effect relationship between trade liberalisation and trade deficits. UNCTAD (2008a) finds that the main factors that have constrained the African export response to liberalisation relative to other developing countries have been export momentum and the real effective exchange rate. The concept of export momentum refers to a country's capacity to maintain its level of exports over time, and African countries have not been able to achieve this.

		Before	After	% change
All developing countries	Imports	28.1	37	32
	Exports	22.4	29.5	32
	Trade balance	-4.3	-5.9	-37
Africa	Imports	31	34	10
	Exports	23.2	25.7	11
	Trade balance	-6.6	-7.7	-17
Non-African Developing countries	Imports	23	38.9	62
	Exports	21.1	31.6	50
	Trade balance	-2.7	-4.9	-81

Source: UNCTAD (2008a).

The trade structure of African countries did not change much following trade liberalisation. Most countries in the region remain essentially primary product exporters, with only a few countries drawing a significant part of their export revenue from manufactured products. This leaves the majority of African countries dependent on volatile global commodity prices. In comparative terms, sub-Saharan Africa is the region of the developing world with the highest dependence on primary product exports (Table 2.2).

Exports			
Ethiopia	Kenya	Tanzania	Uganda
- coffee	- tea	- gold	- coffee
- qat	- horticultural products	- coffee	- fish and fish products
- gold	- coffee	- cashew nuts	- tea
Imports			
- food and live animals	- machinery and transportation equipment	- consumer goods	- capital equipment
- petroleum and petroleum products	- petroleum products	- machinery and transportation equipment	- vehicles
- chemicals	- motor vehicles	- industrial raw materials,	- petroleum

Source: CIA, The World Factbook.

The contribution of agriculture to total output in sub-Saharan Africa has generally remained at similar levels since 1980. In 2006 the sector's contribution to GDP was about 19%. In contrast, the proportion of agriculture in East and South-East Asian economies fell significantly over the same period, owing to the increasing share of manufactures. Thus, sub-Saharan Africa has become the region in the developing world with the highest ratio of agriculture to GDP since 2000, which reflects the lack of structural transformation (UNCTAD, 2008b)

The value of sub-Saharan African agricultural production remained stable between 1995 and 2000, while the nominal value of its agricultural exports declined slightly from about USD16.6bn to USD14.7bn between 1995 and 2000, before rising to USD25.3bn in 2006 (UNCTAD, 2008b). However, as compared with the significant increases in the value of agricultural exports from Latin America and from East and South-East Asia, the increase in the value of sub-Saharan African agricultural exports following liberalisation appears rather modest.

Two factors underpin this modest increase in value of sub-Saharan African agricultural exports. First, the recovery in agricultural production since 2000 does not appear to have been widespread. Although there has been some expansion in agricultural exports from sub-Saharan Africa, the region's share of global exports has remained fairly small, with agricultural exports becoming concentrated in a small number of countries. Over the period 2002-2005, just three countries accounted for about 56% of total sub-Saharan African agricultural exports, the largest exporter being South Africa, followed by Côte d'Ivoire and Ghana. Second, sub-Saharan Africa continues to depend on traditional non-fuel primary commodity exports such as coffee, cotton, cocoa, tobacco, tea and sugar. Traditional commodities were the top exports of the region in value terms in 2000: this situation had not changed in 2005, although there were some changes in the rankings - only cotton was in the top three in both years - and, more importantly, in 2005 fewer countries exported the top four products.

This continuing dependence on traditional commodity exports also reflects the region's inability to tap fully into the international trade in 'market-dynamic' (non-traditional) commodities, such as horticulture and processed foods. In the period 2000-2005, no African country featured among the world's 20 leading exporters of processed food. However, Africa has made some progress in diversifying its international agricultural trade, although progress has been slow. A few (East African) countries have made inroads into the international trade in horticultural products. Kenya, for instance, exports considerable amounts of horticultural products, although less than 1% of the global market (OECD, 2008), and also Ethiopia and Uganda have increased their exports of these

products, although these volumes are even smaller than those of Kenya. Finally, Africa's share in world agricultural imports decreased steadily from 5.4% in 1985 to 3.2% in 2006 (2008a). Whether this is a positive trend (Africa is less dependent on imports) or negative (African consumers have less variety; depend more on domestic production) is not clear.

What is interesting, is that trade liberalisation has had little effect on intra-African trade. Though there was a marked increase in the share of intra-African trade in the 1980s and early 1990s, it has remained essentially stable afterwards. Official intraregional trade accounted for only 8% of total African exports in 2006 - a much lower figure than in other regions.¹ This can be partly explained by tariff cuts, which reduce the preference margins given to other African countries and therefore reduce the incentives for intraregional trade. However, there are also other reasons. First, the products that African countries export tend to be similar in nature, thereby limiting the complementarity of exports. Second, the infrastructure for intra-African trade is often poor, which leads to high transaction costs. And third, despite the many regional agreements in place, these are generally slow to be implemented and there is little private sector involvement in them as compared with their equivalents in Europe, Latin America or Asia.

UNCTAD (2008a) states that trade liberalisation was expected to lead to increased production of tradables, that is, increased exports and changes in the composition of such exports. Given the relative importance of agriculture in African countries, one would therefore expect an increase in agricultural exports as well as some diversification into new agricultural exports. Trade liberalisation has created a price incentive structure which has contributed to some of the positive developments noted above. However, UNCTAD (*ibid*) concludes that the more successful agricultural exporters show that the main factors that underlie their performance, with the possible exception of the devaluation of the CFA franc, go beyond trade liberalisation and are the result of deliberate efforts by governments to develop the agricultural sector. It also concludes that contrary to the expectations of advocates of trade liberalisation who believed that agricultural exports were constrained by misguided policies, such as the high taxation of agriculture, to promote import substitution industrialisation, African countries are more hampered by structural problems that afflict the agricultural sector in Africa. Trade liberalisation policies that reduced barriers to trade were not integrated with sectoral policies that could have addressed supply-side response issues, thus preventing the region from attaining its full potential in agri-

¹ In reality, intra-regional trade may be much higher due to informal trade and smuggling.

cultural exports even within the context of improved macroeconomic fundamentals.

2.3 Regional trade agreements

There are several regional trade agreements that Ethiopia, Kenya, Tanzania and Uganda have joined. The *East African Community* (EAC) is an intergovernmental organisation comprising Burundi, Kenya, Rwanda, Tanzania, and Uganda. The East African Community was revived on 30 November 1999, when the Treaty for its re-establishment was signed. It came into force on 7 July 2000. The Launch of the EAC Customs Union on 31 December 2004, marked the introduction of Common External tariffs and Internal Tariffs for Extra regional imports and intra-regional trade, respectively. The main goals of the East African Community Customs Union are:

- Liberalising intra-regional trade in goods on the basis of mutually beneficial trade arrangements among the Partner States;
- Promoting efficiency in production;
- Enhancing domestic, cross border trade and foreign investment;
- Promoting economic development and diversification as well as industrialisation.

The *Common Market for Eastern and Southern Africa* (COMESA) is a preferential trading area with nineteen member states. COMESA was established in December 1994, replacing a Preferential Trade Area which had existed since 1981. Kenya, Uganda and Ethiopia are members; Tanzania left in 2000 and is no longer a member.

The *Africa Free Trade Zone* (AFTZ) is a free trade zone announced at the EAC-SADC-COMESA Summit on Wednesday 22 October 2008 by the heads of Southern African Development Community (SADC), COMESA and EAC. The African Free Trade Zone is also referred to as the African Free Trade Area.

These regional trade agreements aim to promote regional trade by developing an enabling environment for trade. For instance, in 2004, The Ministers of Agriculture at the meeting held in Nairobi in October 2004, issued the Nairobi Declaration on 'Expanding Opportunities for Agricultural Production, Enhanced Regional Food Security, Increased Regional Trade and Expanded Agro-Exports through Research, Value Addition and Trade Facilitation.'

They 'committed themselves and therefore the region, to moving away from a national to a regional approach to dealing with regional food security through the establishment of a regional food reserve and early warning system and removing all barriers to regional agricultural trade so that food crops and other agricultural commodities can move unimpeded across the region from surplus to deficit areas to meet the food needs of our people taking due cognisance of the need to harmonise procedures while taking measures to guard against the spread of pests and diseases. [...] The COMESA Trade and Customs Committee and subsequently, the Council of Ministers, fully endorsed the strategy of 'Maize without Borders' whose key features are to remove barriers and facilitate cross-border movement of maize across the region. This is in recognition of the fact that maize is a key and strategic food crop whose availability equates to food security in most COMESA countries' (Miti, 2004).

However, Nyoro et al. (2007) describes how governments within the COMESA have since applied measures that have been in violation of the policies signed within these regional trade agreements. Such measures have involved export bans, import duties, purchases by government financed marketing boards and imposition of various non tariff barriers. Non-tariff barriers in the form of restrictive trade regulations and policies (described in Nyoro et al. *ibid*) have deterred regional trade. As a result, informal cross border trade has increased, which has resulted in higher transaction costs. Non-tariff barriers also have discouraged the private sector from investing in the maize value chain. According to Nyoro et al. (*ibid*), food security in the region could be improved when countries would move away from a national perspective and adhere to the principles of the regional trade agreements. However, political economy issues such as national sovereignty explain why countries are hesitant to implement these principles. For instance, Kenya does not feel politically safe when relying on food supply entirely from other countries in the region. Considering that these other countries have often pursued policies such as export bans for cereals, the sentiment of Kenya (and other countries) may be appropriate.

3 Implicit agricultural taxation: distortions to agricultural incentives

Governments have always intervened in food and other agricultural markets, particularly via trade policies. Governments establish various border and domestic measures which have an immediate effect on consumer choices, producer resource allocation, and net farm incomes. Most commonly these are import or export taxes, subsidies and quantitative restrictions for farm and non-farm products, supplemented by direct domestic taxes or subsidies for farm outputs or inputs and food consumer subsidies or taxes (Anderson et al., 2008). The incentives faced by farmers are affected not only by direct protection or taxation of primary agricultural industries but also indirectly via policies assisting non-agricultural industries, since the latter can have an offsetting effect by drawing resources away from farming. It is relative prices and hence relative rates of government assistance that affect producers' incentives. While those non-agricultural measures may be of only minor importance in most developed countries today, they have been important in developing countries over the past decades.

Progress has been made over the past two or three decades by numerous countries in reducing those and associated anti-trade policy biases. However, many price distortions remain intersectorally as well as within the agricultural sector of low- and middle-income countries. Some governments provide explicit subsidies to selected food consumers, but often they are offset by implicit distortions to consumer prices via border measures such as taxes or quantitative restrictions on imports. In addition to the impact of own-country policies, farm earnings in developing countries are depressed by agricultural protection measures in other (especially high-income) countries which lower real prices of food, feed and fiber in international markets. This issue has escalated in recent years because of the Doha Development Agenda of the World Trade Organisation (WTO): agricultural exporting countries are demanding large cuts to farm subsidies and barriers to food imports in protective countries, as well as the removal of non-reciprocal preferential market access arrangements for former colonies under the Cotonou Agreement. (Anderson, 2009)

In this section, we will review the effects of these trade policies on the incentives (income) of farmers. This will be based on the work done by the World Bank. The World Bank has done a large survey on (implicit) agricultural taxation

(World Bank, 2008a).¹ This work has highlighted the fact that especially in developing countries, non-agricultural macro-economic policies indirectly impact agricultural and food markets. It examined both agricultural and non-agricultural policy measures including import and export taxes, subsidies and quantitative restrictions, plus domestic taxes or subsidies on farm outputs or inputs and consumer subsidies for food staples.

Agricultural price, trade and exchange rate policies have reduced the earnings of African farmers. Macroeconomic policies historically taxed agriculture more than agricultural policies did, but both were important in poorer countries. In a study involving 21 African countries, Anderson and Masters (2008) find that African governments have removed many of their earlier anti-farm and anti-trade policy biases. Government policy bias against agriculture had worsened in the late 1960s and 1970s, primarily through increased taxation of exportable products. Reforms of the 1980s and 1990s reversed that trend, and average rates of agricultural taxation are now back to or below the levels of the early 1960s. Most of this gain has come from reduced taxation of farm exports. In figure 3.1 the nominal rates of assistance for Kenya, Uganda, Ethiopia and Tanzania are shown. Anti-agricultural (macro-economic) policies decreased, but still exist in Ethiopia and Tanzania. The nominal rate of assistance (NRA) to agriculture is the percentage by which government policies have raised gross returns to farmers above what they would be without the government's intervention.

Anderson and Masters (*ibid*) estimate that for 21 surveyed countries in Africa, for 2000-2004, the burden of taxation averaged USD6bn per year or USD41 per person working in agriculture. Although this figure is much lower than its peak in late 1970s when it was USD10bn per year or USD134 per farm worker, it is still significantly larger than public investment or foreign aid into the sector. The continuing taxation in Africa contrasts with both Asia and Latin America, where the average agricultural NRAs reached zero by the early 21st century (although like Africa, those regions still have a wide dispersion of NRAs across products and countries).

¹ See www.worldbank.org/agdistortions.

Figure 3.1 Nominal rate of assistance to agriculture in Kenya, Uganda, Ethiopia and Tanzania 1975-79 and 2000-2004

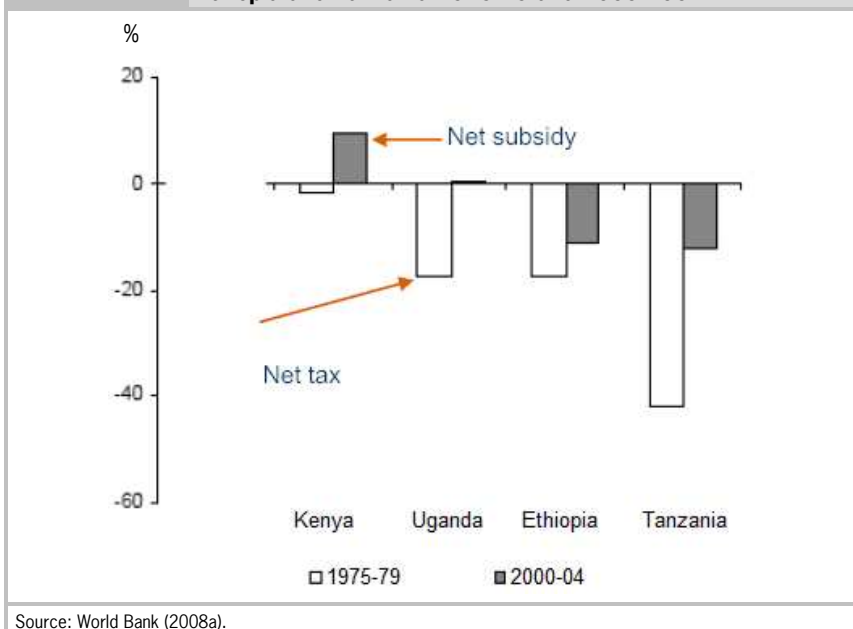
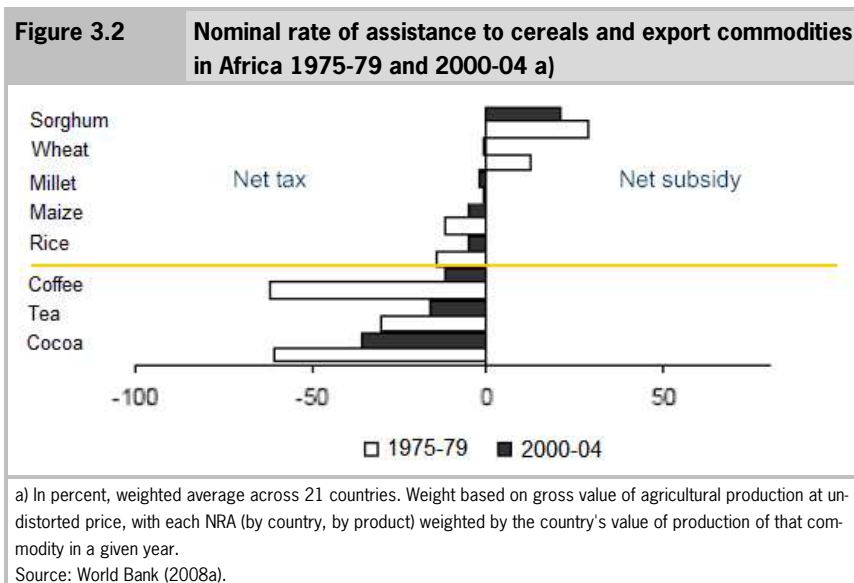


Figure 3.2 shows that for some cereals (e.g. sorghum and wheat) the NRAs have been historically high denoting an implicit subsidy in Sub-Saharan Africa. For other cereals (e.g. maize and rice) there has been an implicit taxation in the late 1970s. In 2000-2004 these have been reduced. However, for export crops such as tea, coffee and cocoa - important crops in Kenya, Uganda, Ethiopia and Tanzania - the implicit taxation was much more severe and is still high. Anderson and Master (ibid) therefore signal that African farmers have become less taxed in part because of the changing trade orientation of African agriculture. Reduced taxation of farmers has occurred in part because of a decline in the share of output that is exportable, and a corresponding rise in the share that is import-competing. The rate of protection from imports for these products has fluctuated but remains positive. This helps only the few farmers who are net sellers of the protected products, however, and does so in a way that is less efficient and less equitable than many other possible interventions. Anderson and Master conclude that trade restrictions continue to be Africa's most important instruments of agricultural intervention. Domestic taxes and subsidies on farm inputs

and outputs, and non-product specific assistance, are a small share of total distortions to farmer incentives in Africa.



It is interesting to point out the differences between Kenya, Uganda, Ethiopia and Tanzania. The general anti-farm bias still exists in Ethiopia and especially in Tanzania. In *Tanzania* benefits in terms of less negative NRA measures have been achieved for coffee, cashew nuts, cotton and beans among major exports, and for food crops, but many the NRA measures for other export crops (such as tea and tobacco) appeared unchanged and still negative. This implies that for many cash crops, other distortions, due to high transport costs, marketing inefficiencies and the prices paid to farmers, became worse. There is evidence that high transport costs are still a major distortion for export crops in the 2000s (Morrissey and Leyaro, 2007).

In *Ethiopia*, as in many other developing countries, exchange rate controls, prohibitive trade taxes, and agricultural price policies have historically been the main sources of distortions to agricultural incentives. All of these have changed significantly since the early 1990s. However, Rashid et al. (2007) suggest that three forms of distortions still persist: control over input markets, ad hoc government interventions in output (mainly cereal) markets, and disincentives through depressed prices due to the continued inflow of food aid.

In *Kenya* the anti-farm and anti-trade biases have fluctuated considerably since the 1960s but has been mostly negative. Only recently it has improved. There are three periods during which tradable agriculture and the sector in general had distinctly negative rates of assistance (the early 1970s, 1980s and 1990s). In each of these periods the cause of the taxation on agriculture is an overvaluation of the Kenya Shilling. The severe drop in the NRA on output in the early 1990s reflects the additional effect of unusually high world prices for maize and tea that were not matched with increases in farm gate prices. Excessive charges by parastatal marketing boards also contributed to negative NRAs in the 1980s and early 1990s (Winter-Nelson and Argwings-Kodhek, 2007).

The anti-farm bias in *Uganda* has been reduced to almost zero since the 1980s. This is due to the predominance of largely non-traded food crops in Ugandas agricultural production, and the relatively small share of these crops which were marketed, with most production being for own consumption during this period. While the overall magnitude of the distortions remained low throughout the period, the strong bias against export crops undoubtedly held back the development of the sector (Mathews et al., 2007).

Anderson (2009:3) poses the question:

'If distortions to agricultural markets are so pervasive, and the reform of farm protection measures so elusive, there must be strong political economy reasons for such widespread interventional by governments.'

In seeking to explain public policy choices, Anderson assumes vested interest groups are the units of analysis that compete by spending time, energy, and money on the production of pressure to influence both the design and the tactical implementation of policies. Thus both public and private sector agents are involved. Masters and Garcia (2010) have analysed the data of the World Bank (Agricultural Distortions project) and show that governments:

1. tax agriculture in poorer countries and subsidise it in richer ones;
2. tax both imports and exports more than non-tradable farm products;
3. tax more/subsidise less where there is more land per capita.

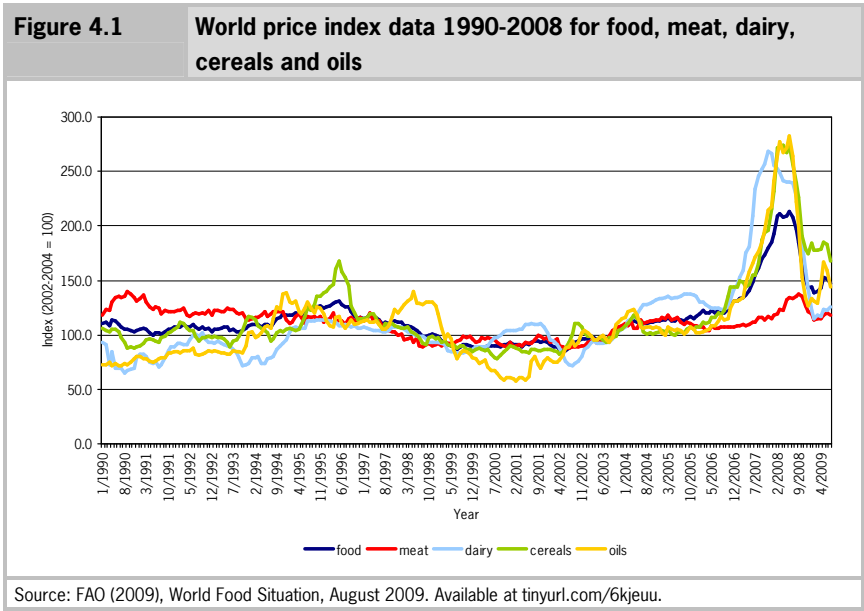
However, they show that there are differences across continents in these tendencies.

The reasons behind these distortions can be found in political economy motives. Master and Garcia (2010) confirm the vested interest groups hypothesis by finding that larger groups obtain more favourable policies. They find rent-seeking motives for trade policy. Countries with more checks and balances on the exercise of political power have fewer distortions. Governments with a small

nonfarm tax base (e.g. most African developing countries) may have a stronger motive to tax agricultural imports and exports, or conversely governments with a larger tax base may be less constrained by fiscal concerns and hence freer to pursue other political goals. In fact, they find that import taxes are associated with revenue motives - so they are smaller when other revenues are available - but export taxes are not. They conclude that governments in lower-income countries actually destabilise domestic prices, relative to what those prices would be with freer trade, over the full time period of the data. A given policy may achieve short-term stability, but on average these policies are not (or perhaps cannot be) sustained, leading to large price jumps when policies change.

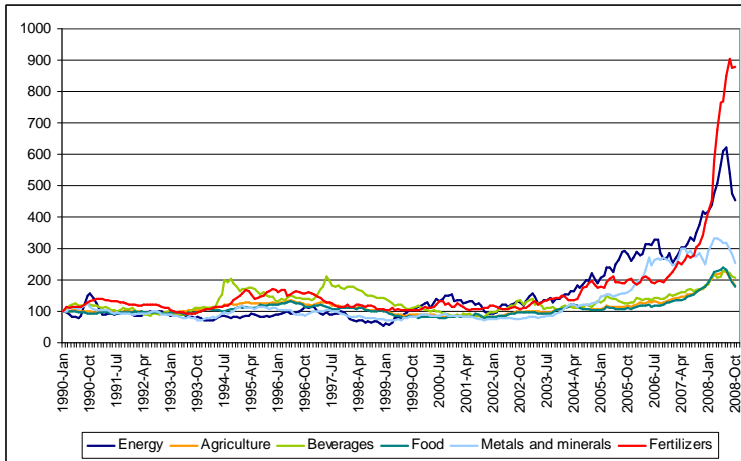
4 The food crisis

A dramatic increase in food prices was seen in 2007-2008 although prices have come down since (Figure 4.1).



These high food prices need to be put into perspective: prices for other commodities such as energy, metals and minerals and especially fertilisers, rose even more during the same period (Figure 4.2).

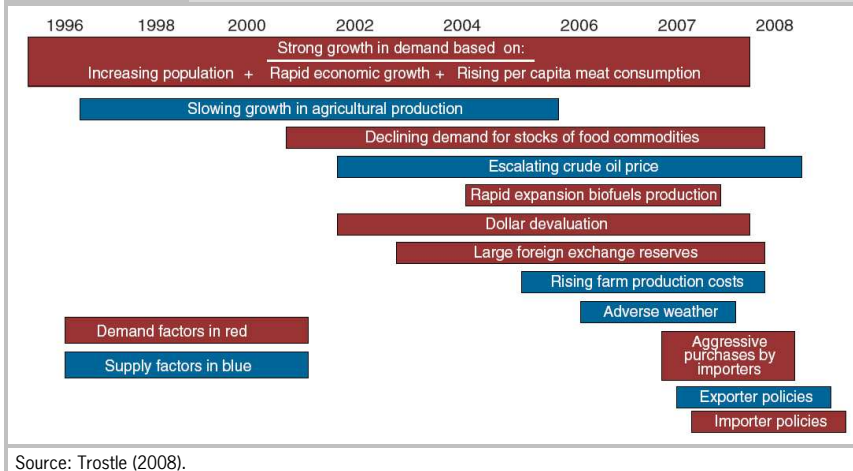
Figure 4.2 Price index of oil, food and other commodities 1990-2008 a)



a) Index 1990 = 100.
Source: World Bank (2008a).

It is important to note that several factors have caused the recent price fluctuations. They reflect underlying trends in supply and demand for agricultural commodities that began more than a decade ago on the one hand and other developments that have occurred more recently on the other hand (Figure 4.3).

Figure 4.3 Factors that caused price increase 1996-2008



Source: Trostle (2008).

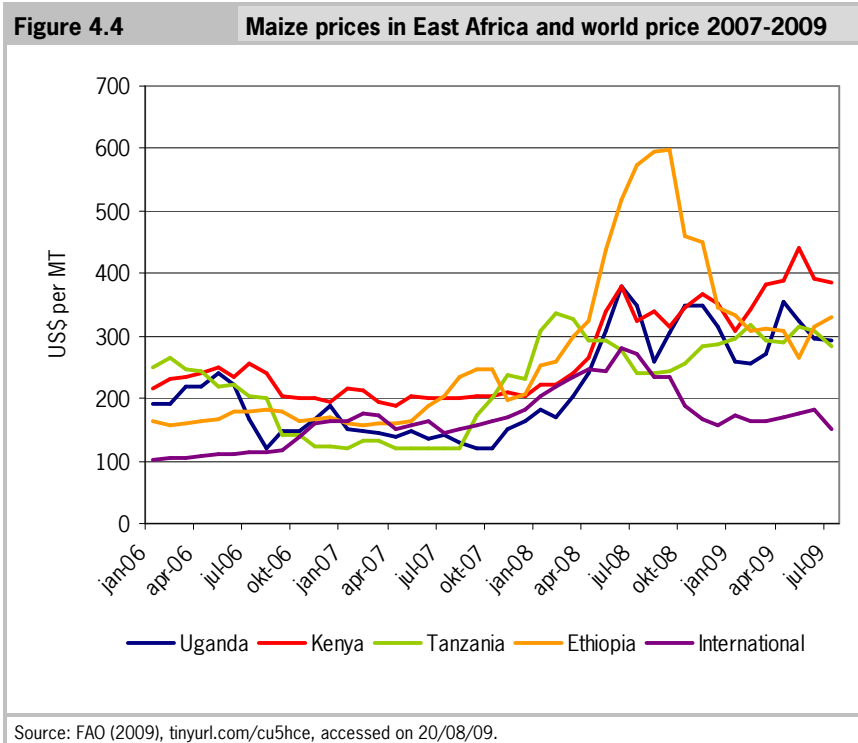
Banse et al. (2008) point out that the high prices reflect a 'perfect storm' in which different factors have come together almost simultaneously, resulting in a peak in prices. In the course of 2008 prices started to decrease again. The decrease in prices partly reflected the recovery in supplies. Also the economic downturn and the crisis in global financial markets in October 2008, leading to the US dollar's renewed strength and declining energy prices were reflected in steep price falls in all grains. These developments led to a collapse of ocean freight rates to only a fraction of their mid-year peaks, further reducing grain import costs.

What is interesting to note, however, is that domestic prices in (east) African countries show a different pattern than world prices. Figure 2.7 shows the maize prices in East Africa and the world market price. Two observations come up. First, the world market price for maize has increased until mid-2008 but then decreased with almost 45% since its peak in June and 23% in total. The prices in the East African countries, by contrast, continued to increase (21% in Tanzania, 72% in Kenya, 69% in Uganda and 91% in Ethiopia). Second, domestic prices in East Africa fluctuated more than the world market price. When the prices are tested for correlation, the prices of Nairobi and Uganda are highly correlated¹ (0.923). The prices of Tanzania are also correlated with those of Kenya and Uganda but a bit less (0.623 and 0.621 respectively). The world prices are also correlated with domestic prices (0.626, 0.501 and 0.586 for Kenya, Uganda and Tanzania respectively) but less than the prices of neighbouring countries. The conclusion is that domestic prices in the four East African countries correlate more with each other than with world prices.

Domestic prices are only partly influenced by world market prices and are highly influenced by domestic supply (during bimodal harvest seasons) and regional trade. A study by Dembélé et al. (2008) shows that cereal prices in several West African markets seemed to be isolated from world prices: the domestic situation in terms of production and those of neighbouring markets explain much of the price fluctuations in these countries. Two FARM publications (Daviron et al., 2008; Diarra, 2008) investigated how (fluctuating) international prices were transmitted to (West) African markets. The studies find that between 1994 and 2007, import of cereals had a 'stabilising effect' on the domestic cereal prices: without imports, domestic prices fluctuate much more. The sharp increase of cereal prices in 2007/2008 was transmitted mostly to consumer prices, but in a diminished manner (a sharp increase in cereal prices

¹ Correlations are all significant at the 0.01 level.

did not lead to a similar sharp increase in consumer prices, but a more moderated increase).



At the beginning of 2009, the Red Cross¹ warned of an 'exceptional food crisis' in East Africa. Several regions were worn down by successive droughts, years of poverty and conflict, but the situation in 2009 was even more complex than usual because of an increased vulnerability brought about by the instability in global markets and the major increase in cost of food cereals. Countries in East Africa usually import cereals to meet the needs of the population, but the high cost of food internationally exacerbated an already extreme situation. Therefore, the humanitarian crisis that had its roots in 2007-08 continued into 2009. In East Africa, the share of household income spent on food is generally high (Table 4.1), from 35.8% in urban areas in Kenya to 67% in rural areas in Tanzania.

¹ ReliefWeb: available at tinyurl.com/ce3w2b, accessed on 16/03/09.

		National	Rural	Urban
Ethiopia	2004	50.84	54.26	38.4
Kenya	2006	45.8	58.2	35.8
Tanzania	2000	65.4	67	60.2
Uganda	2002	44	49	32

Source: FAO (2009), Food Security Statistics available at tinyurl.com/dmzqlq, accessed on 10/04/09.

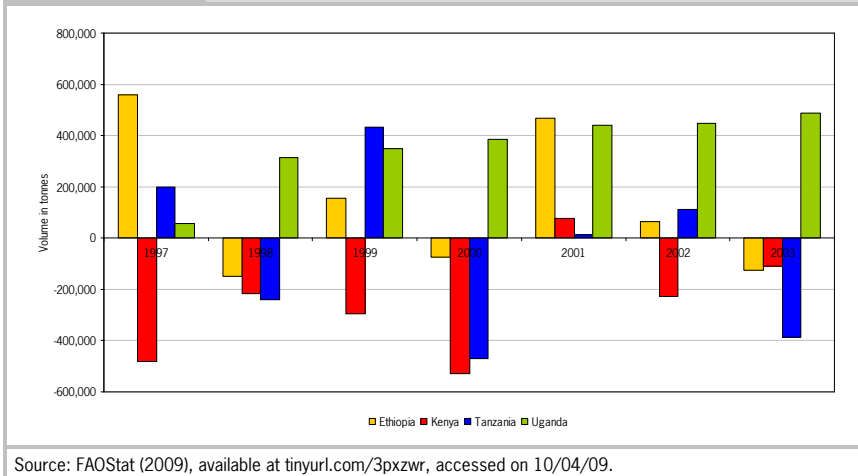
Table 4.1 makes clear that food prices are a sensitive issue in these countries: rising food prices will affect households immediately. Maize is the key staple food crop in the East Africa and its availability in most countries is equated to food security. Even cereal producers in these areas are usually net buyers. Only a relatively small share is net seller and will profit from high prices (Table 4.2).

Country	Year	Crop	% net sellers	Source
Ethiopia	2000	Maize	23	Jayne et al. (2006)
Kenya	2001	Maize	32	Jayne et al. (2001)
Tanzania	2003	Food	33	Sarris et al. (2006)

a) Data for Uganda not found.

The regions' maize demand and supply is characterised by an annual variation of deficits and surpluses (Figure 4.5). Kenya and Tanzania, especially, but also Ethiopia, are not self-sufficient in maize every year and hence frequently depend on imports. In contrast, Uganda mostly produces a surplus in maize and can therefore export part of it.

Figure 4.5 Maize production net of consumption (food) 1997-2003

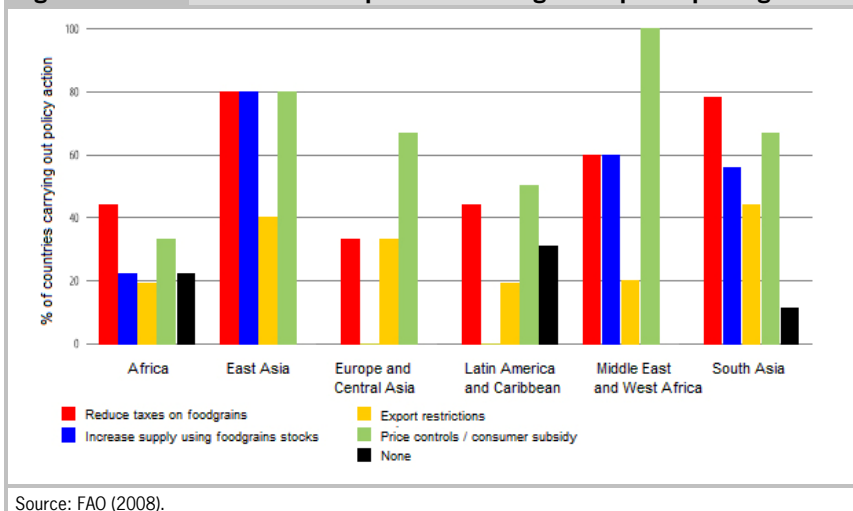


Source: FAOStat (2009), available at tinyurl.com/3pxzwr, accessed on 10/04/09.

Figure 4.5 already indicates that countries such as Kenya and Tanzania, which occasionally need to import maize to fulfil domestic consumption, are more vulnerable to high international prices than for instance Uganda, which generally can fulfil its domestic maize consumption by domestic production.

Figure 4.6 gives an overview of the steps that governments in the world have taken to reduce high food prices. In general, national policy responses to soaring food prices have varied in nature and effectiveness, but the focus has been on guaranteeing an adequate and affordable food supply for the majority of consumers, providing safety nets for the most food insecure and vulnerable and, to a much lesser degree, fostering agricultural supply response (FAO, 2008).

Figure 4.6 Government responses to the high food prices per region



Source: FAO (2008).

Some policies can have adverse effects (Von Braun, 2008; FAO, 2008). First, policy responses such as export bans or high export tariffs may reduce risks of food shortages in the short term for the relevant country, but they are likely to backfire by making the international market smaller and more volatile. Export restrictions can have harmful effects on import-dependent trading partners - the 'beggar thy neighbour' effect.¹ While such barriers sometimes help to contain pressures on domestic prices, they can also signal problems and lead to panic buying on domestic markets. On the other hand, in some countries where the barriers have been put into place, farmers reduced planting of cereals in the face of low domestic prices for their products coupled with high prices for inputs such as fuel, seeds and fertilisers. Second, price controls can fail by reducing farmers' incentives to produce more food and diverting resources away from those who need them most. Third, by reducing import barriers - in principle a welcome move toward more open trade - countries have put upward pressure on prices by expanding global food demand.

¹ Beggar-thy-neighbour policies are those that seek benefits for one country at the expense of others. Such policies attempt to remedy the economic problems in one country by means which tend to worsen the problems of other countries.

5 Kenya: government responses to high cereal prices

5.1 Background: conflict leading to failed harvests

At the beginning of 2008, violence broke out as a result of contested national election results in Kenya, especially in Western and Nyanza provinces in South-west Kenya. The FAO reported in February 2008¹ that the political unrest displaced about 600,000 and killed nearly a thousand people. The crisis disrupted markets, destroyed businesses and has been a blow to the tourism sector. Additionally, rains were poor in October to December 2007, which led to the failure of the secondary season cereal harvest in January 2008 in the southeast, and to increased food insecurity in northern and southern pastoral areas. The Southeast is one of Kenya's main growing areas. FEWSNET² indicated that national maize production in the 2008 long rains season was expected to be about 12% less than in 2007 due to crop losses of 60% in the central highlands and marginal agricultural areas. In addition, high fertiliser prices led to a nearly 30% increase in the costs of production and subsequent lower applications of fertilisers and a 10% decline in the area planted to maize. However, the rise in food prices after the post-election crisis did lead to an expansion in maize planting in Nyanza Province, which was expected to offset some of the expected production declines.

As a result, the total maize production in 2008 was 29% lower than 2006 and 22% lower than 2007 (RATIN, 2009).³ Beginning of 2009, the situation did not yet improve much. An estimated 2.34m MT national maize output for the 2008/2009 production season was anticipated, which is about 15% lower than the short-term average and could be even lower, once the extent of the 2008/2009 short-rains crop failure is fully evaluated (FEWSNET, 2009).⁴ By January 2009, the President of Kenya declared the food shortage which threatened the lives of approximately 10m people a national disaster (RATIN, 2009; Figure 5.1).

¹ FAO Special Alert No. 324 - 14 Feb 2008. tinyurl.com/cw83ut, accessed on 13-03-09.

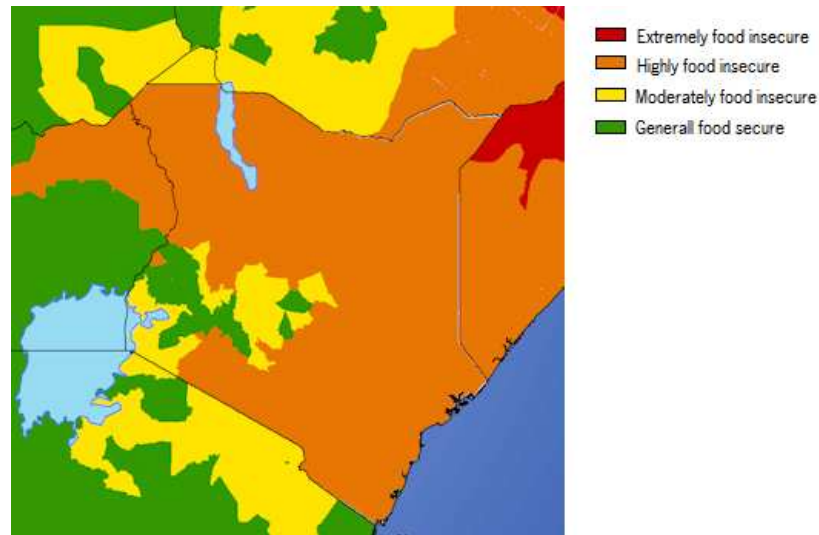
² FEWSNET Kenya Food Security Update July 2008. tinyurl.com/d86tce, accessed on 13-03-09.

³ www.ratin.net, accessed on 13-03-09.

⁴ FEWSNET, 2009 February update. tinyurl.com/de7gyn, accessed on 13-03-09.

Figure 5.1

**Projected, most likely food security conditions in Kenya,
2nd Quarter 2009 (April-June)**



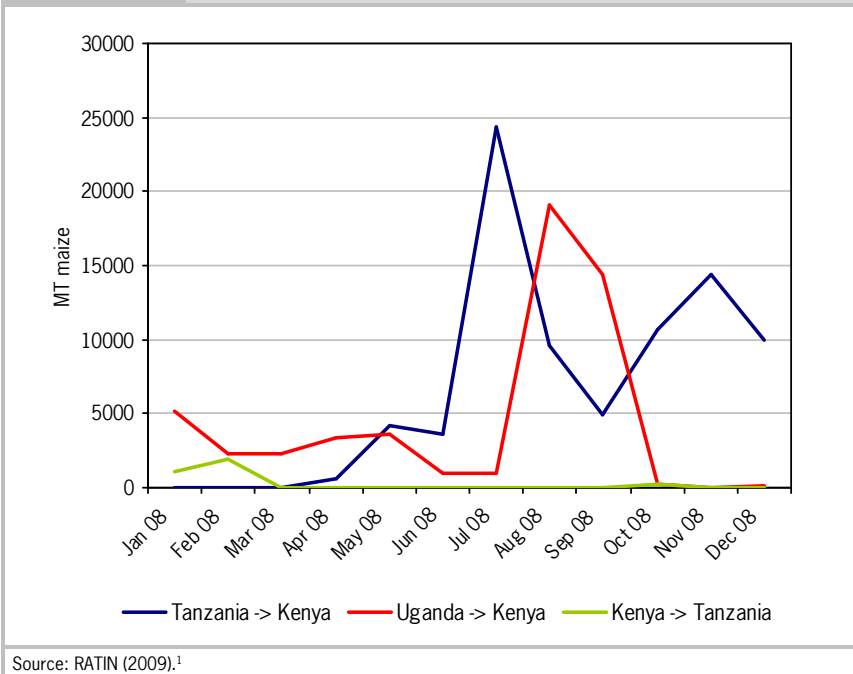
Source: FEWSNET (2009), accessed 16-07-09, FEWSNET Kenya Food Security Update July 2008. tinyurl.com/d86tce, accessed on 16-07-09. tinyurl.com/dxgyul, accessed on 06-04-09.

5.2 Cross-border trade

Cross-border trade for maize has been an important source of supply for the domestic market of Kenya (Figure 5.2). In the period in which maize prices rose in Kenya, imports from neighbouring countries Tanzania and Uganda peaked. However, Kenya has also relied heavily on imported maize from South Africa and the United States of America. The main sources of wheat have been the US, Australia, Russia and Europe, while the main source of maize has been South Africa with some additional from the US (RATIN, 2009).¹

¹ tinyurl.com/dxgyul, accessed on 06-04-09.

Figure 5.2 Cross-border trade between Tanzania, Kenya and Uganda 2008



This figure however does not include Sudan, which has been a major importer of cereals as well during the same period, due to its humanitarian crisis.

5.3 Prices

5.3.1 General

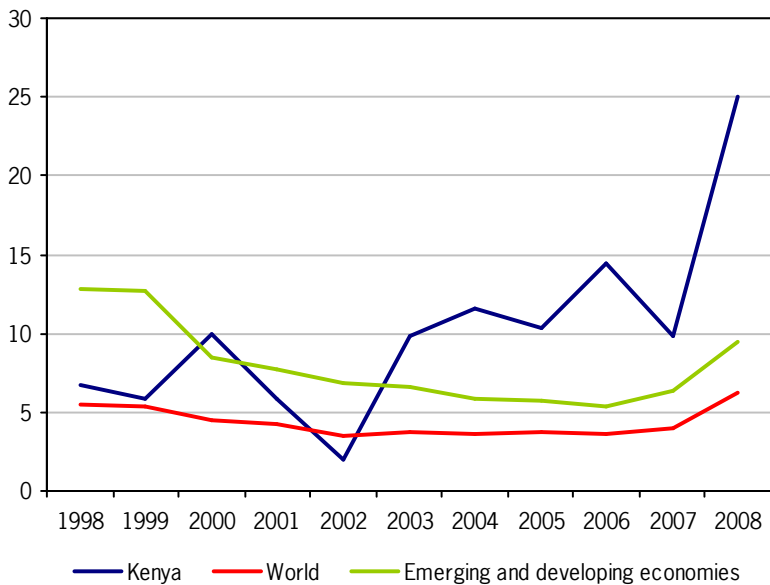
According to the IMF (2008a:4), growth in Kenya rebounded strongly over the five-year period preceding the election crisis that erupted at the end of 2007.

¹ tinyurl.com/ddqg86, accessed on 15-01-09.

However:

'Political instability took a toll on economic activity and exacerbated inflationary pressures in early 2008. First quarter GDP contracted by 1.3% (year-on-year), with tourist arrivals down by over 50% and most sectors hampered by disruptions to supply chains and displacement of productive resources. The resulting shortages compounded inflation pressures arising from an earlier accommodative monetary policy as well as from rising international fuel and food prices. Inflation for the official headline consumer price index (CPI) was 26.5% in July [2008] (year-on-year); and even if the index appears to overstate inflation.'

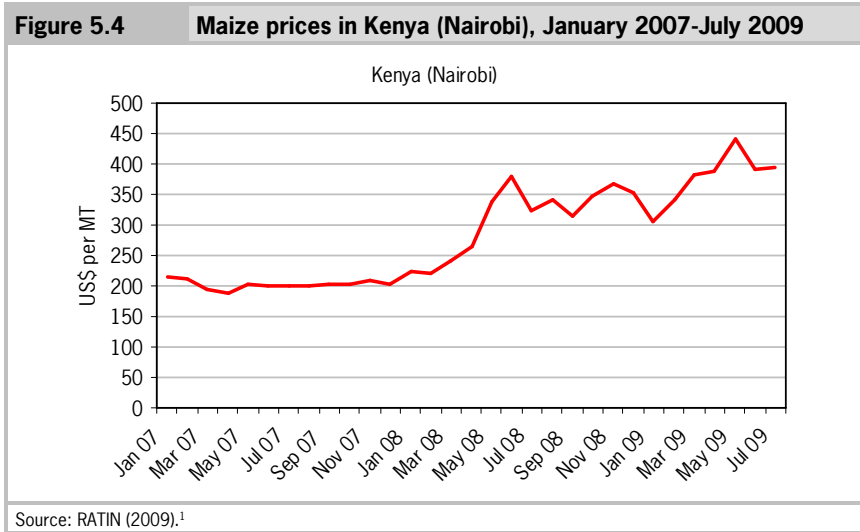
Figure 5.3 Inflation Kenya (average consumer prices, annual percent change 1998-2009)



Source: IMF (2008).

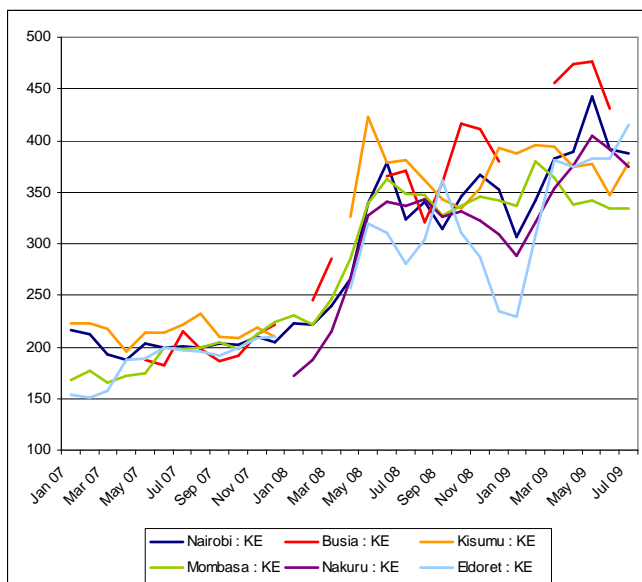
5.3.2 Cereal prices

Maize prices rose with 69% in 2008 (Figure 5.4). As was discussed in the previous chapter, the high prices were caused by a combination of factors, amongst which a shortfall in domestic supply and high input prices. The shortfall in domestic supply was caused by unreliable rainfall, reduced acreage and low yields due to the political unrests.



¹ RATIN Prices at www.ratin.com, accessed on 16-07-09.

Figure 5.5 Regional maize prices in Kenya, January 2007-February 2009

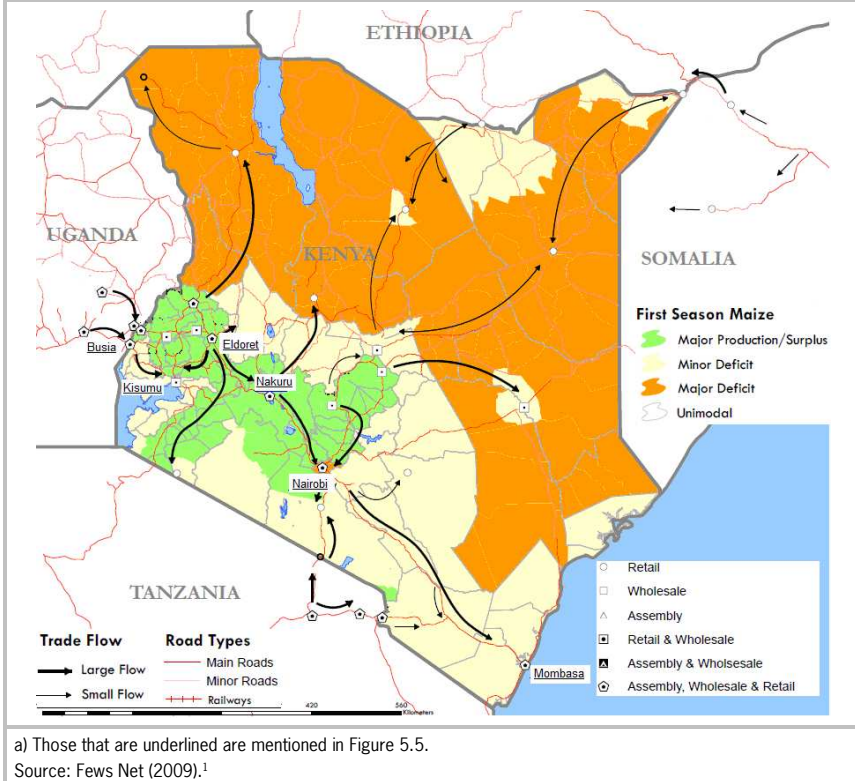


Source: Regional Agricultural Trade Intelligence Network (RATIN) (2009).¹

Figure 5.5 shows that when prices started increasing, the differences between regional prices also started diverging. Prices differ with 70% in some instances (e.g. December 2008). This is an indication that markets were functioning less efficiently. When high prices are a result of relative shortages, and low prices of relative surpluses, one would expect trade between the two regions and subsequently converging prices. Figure 5.6 shows the marketplaces that are mentioned in Figure 5.5 (underlined). It is expected that the price differences will be greater for places that are more remote (e.g. in North Kenya).

¹ Ratin Prices at www.ratin.com, accessed on 16-07-09

Figure 5.6 Trade routes and places in Kenya (first season maize) a)



5.4 Government policies

In 2008, Kenya had a maize shortfall of approximately 270,000 tonnes, which the Government tried to cover by supplying millers with maize stocks held by the National Cereals and Produce Board (NCPB) purchased from the previous seasons. In addition, the Government imported about 140,000 tonnes to increase the strategic grain reserve. Even with this arrangement, the maize supply was still not adequate with many maize processors struggling to procure maize for daily milling (RATIN, 2008).²

¹ tinyurl.com/c8na4o.

² RATIN East Africa Food and Trade Bulletin, Sept '08 (No. 50) at tinyurl.com/mogzvq, accessed on March 2009.

In June 2008, the government removed sales tax on rice and bread and reduced import tax on wheat to reduce consumer prices. However, prices continued to rise and the government felt compelled to take further measures. While in December 2008 a 2-kg bag of maize was selling at KES120, the government made an agreement with millers to lower the price of a bag to KES65-72. However, there were dissenting voices in the governing coalition party warning that these price reductions were not enough (BBC, 2 December 2008).¹

Confusion about the official government policies also ensued. In December 2008, the Agriculture Minister William Ruto stated that the Treasury had released KES1bn on 9 December 2008 for the NCPB to buy maize from farmers and to resell this to millers at a subsidised price. According to the directive issued by Ruto and Prime Minister Raila Odinga, the NCPB would buy maize from farmers at KES1,950 per 90-kg bag (KES43.3 per 2-kg bag) and then sell it to millers at KES1,750 (KES38.9 per 2-kg bag). Low income earners could then buy a 2-kg bag of maize at a reduced price of KES52 in areas such as Kibera and Kangemi while flour would be sold at KES72 per 2-kg bag for the middle-income people. The acting Finance Minister John Michuki however, declared that he did not know where the money for the subsidy would come from (Nairobi Star, 10 December 2008).²

The Kenya government announced two different prices for maize: one for the poor, the other for the middle class. The government would sell 'government-branded maize meal' to the poor using a chain of government regulated retail outlets at KES52 per 2-kg bag. However, the opposition party Orange Democratic Movement (Jakoyo Midiwo) claimed that consumers could only afford to pay KES40, thus pressuring the government to take even more action. Much criticism was also directed at the price system, because there was no guarantee that only the poor would buy the cheap, 'government-branded' maize. Entrepreneurs could obtain the cheap maize at KES52 per 2-kg bag and then supply it to upper-income retail outlets at KES72, thereby making a huge profit (BBC 2 December 2008; Nairobi Chronicle, 2 December 2008).³ The government tried to avoid this by introducing prices of KES72 in urban areas and KES52 in rural areas.

Confusion also marked the distribution of the subsidised maize flour. Millers across the country said they had little information about how the flour was to be distributed. They said their contract with the Government entailed milling the

¹ tinyurl.com/c5sc5c, accessed on January 2009.

² tinyurl.com/cgay5u.

³ tinyurl.com/c5sc5c and tinyurl.com/dftwc5.

new brand and handing it over to the cereals board. Supermarkets too were not sure whether they would be asked to sell the flour. Prime Minister Raila Odinga had indicated that the flour would be sold in low-income areas, but that consumers from other areas were also free to buy it. Agricultural Minister Ruto said the maize flour would be distributed by the cereals board. When key Government officials met millers for talks on how to reduce maize flour prices, they agreed that the new brand would be distributed to areas such as slums where the majority of poor Kenyans live. However, Mr Ruto said that the flour would also be available in supermarkets (*Daily Nation*, 9 December 2008).¹

The government decided to implement further price controls by forcing farmers to sell to the National Cereals and Produce Board (NCPB) at KES1,950 for a 90-kg bag (or KES43.3 for a 2-kg bag) and banning maize millers from buying the commodity directly from farmers. As would be expected, the Kenya National Federation of Agricultural Producers (Kenfap) and the Cereals Growers Association (CGA) opposed this move, blaming the Government for distorting the market by imposing price controls on maize. Kenfap Chairman Nduati Kariuki said maize trade was liberalised almost a decade ago and the Government should respect that policy decision. Farmers demanded to receive at least KES2,360 per 90-kg bag (or KES52.4 per 2-kg bag) (*The Standard*, 8 December 2008)² which is much higher than consumers were reported to be able to pay. It was also reported that the government imported maize at KES3,000 per 90-kg bag (*Capital News*, 8 December 2008).³ There were reports that some farmers or companies knew ahead of time about changes in government policy and sold maize in neighbouring countries ahead of the November ban on maize and maize product exports (*Associate Press*, 16 January 2009).⁴ Therefore the government policy may have contributed to a further shortage of maize supply on Kenyas market.

At the same time the price controls were introduced, rumours of corruption emerged. Investigations by newspaper the *Daily Nation* indicated that the politicians have been buying maize from the NCPB and selling it to millers at exorbitant prices. In November 2008 there were accusations that letters from the Ministry of Agriculture were being used by a cartel consisting of involving senior politicians and businessmen to authorise the purchase of maize from the NCPB. Reportedly, the cartel later resold the maize to millers at a higher price (*Daily*

¹ tinyurl.com/m7nwj2.

² tinyurl.com/czzqze.

³ tinyurl.com/cj8nyb.

⁴ tinyurl.com/d83y4d.

Nation, 24 November 2008).¹ There were also accusations that the Ministry of Agriculture had provided 400,000 bags of maize to a cartel of millers without charge. In November 2008, four millers had been contracted to mill the maize on the government's behalf and return this for distribution. Critics said that selection of the millers had been done without any competitive bidding. Agriculture permanent secretary Dr Romano Kiome confirmed that the government was yet to conclude a list of stockists to sell the low-cost flour. He defended the selection saying that those chosen had 'voluntarily' agreed to make available 30% of their milling capacity to the project. He said the government was still registering more millers for the service (*Daily Nation*, 13 December 2008).²

Furthermore, some million bags of maize seemed to be missing from the NCPB stores, fuelling suspicions that the grain may have been stolen from these stores and sold. Data from the NCPB showed that the Board had in store 2.6m bags of maize in June 2008. However, Mr Ruto had informed the House of Parliament that the maize in the stores at the time was 1.6m bags (*Daily Nation*, 5 February 2009).³ On 26 January, Agriculture Minister William Ruto dissolved the entire of NCPB board and sacked 12 top managers, as he sought to improve efficiency at the board (*Capital News*, 29 January 2009).⁴ The Grain Bulk Handlers limited (GBHL) also came under fire, being accused of inefficiency by delaying deliveries of maize (*KBC*, 20 January 2009).⁵

The Kenyan media also carried reports about corruption with respect to exports to neighbouring southern Sudan of maize imported by Kenya. Maize purchased from the NCPB by millers and middlemen at a price of KES1,750 per 90-kg bag, was sold to Sudan at about KES6,000 by middlemen. On top of this, the Justice and Constitutional Affairs Minister Martha Karua accused agriculture ministry officials for illegally buying large quantities of imported maize and reselling it on the Kenyan market for a commission.

Although Kenyas Minister for Agriculture William Ruto denied all charges, Kenyas anti-corruption authority opened an investigation into the suspected embezzling of large quantities of maize in January 2009. (AFP, 13 January 2009; Muigwithania 2.0, 13 January 2009).⁶ In July 2009 twenty-four politicians were cleared of charges of corruption in the maize scandal. A Kenya Anti-Corruption Commission report stated that 21 MPs and three ministers (including Ruto) who

¹ tinyurl.com/d7agk8.

² tinyurl.com/cv9c46.

³ tinyurl.com/nkvhex.

⁴ tinyurl.com/d4mevm.

⁵ tinyurl.com/dzvkvv.

⁶ tinyurl.com/c7b94v and tinyurl.com/cpdkx4.

were accused of writing notes to the management of the national cereals stores for maize allocation had not committed any crime (*Daily Nation*, 13 July 2009).¹

At the end of January 2009, the government agreed to buy maize from farmers at KES2,300 up from KES1,950 per bag. The decision made after a consultation meeting between the government and representatives of the Cereals Growers Association. The arrangement would be effective in February and March once it is approved by parliament (*KBC*, 28 January 2009).² This came after reports that farmers in the North Rift region are holding on to their maize stocks in anticipation of better prices as most supermarkets in Mombasa run out of maize flour stocks. Farmers hope that the government through the National Cereals and Produce Board will review their prices upwards from the current KES1,950. It is also claimed that some millers are hoarding their stocks in anticipation of a price increase. Where it is available a 2-kg packet of maize flour is being sold at KES112 and limited to two packets per shopper at a time (*KBC*, 27 January 2009).³

The government also waived import duties. Finance Minister Uhuru Kenyatta said maize imported between 16 January and 16 July will be cleared through customs without payment. The move, he said, is aimed at ending the artificial shortage created by the alleged mismanagement of maize stocks by the board and politicians (*Afrol News*, 27 January 2008).⁴

In March 2009, the government of Kenya said it would subsidise fertiliser prices. DAP fertiliser will be sold at a reduced price of KES2,500 while CAN fertiliser will retail at KES1,650 per 50-kg bag from a high of KES6,000. President Kibaki stated that

'It is for this reason that the Government has taken over procurement of 40% of the national fertiliser requirement. This will cost KES6.2bn, excluding the Tea fertiliser being bought by KTDA for KES1.6bn. The total amount of fertiliser to be procured by the Government and the KTDA will be 163,000 tons' (Government of Kenya, March 11, 2009).⁵

The measures taken by the government have failed to bring down maize prices (Figure 5.4), but might have stabilised them. By mid-2009, the Cereal Millers Association (CSA) stated that prices stabilised at around KES80 per 2-kg

¹ tinyurl.com/krxxyyp.

² tinyurl.com/cz2oku.

³ tinyurl.com/c8xrsv.

⁴ tinyurl.com/dl8vje.

⁵ Available at ReliefWeb, tinyurl.com/csxo37, accessed on 16-03-09.

packet of maize flour as a result of availability and adequate supplies of maize through importation. The CSA also indicated that prices would only decrease as a result of good harvests (*Daily Nation*, 15 July 2009).¹ The government, in the meantime, was making plans to fix the prices of fuel and several basic food commodities, including maize and maize flour. The business community warned that these price controls could lead to shortages:

'Unless the state wants to start trading, no miller will import maize or wheat at a higher price and sell flour at a loss,' he said. Already wheat farmers were demanding KES3,500 per bag, way above the price set by the cereals board.' (*Daily Nation*, 23 June 2009).²

5.5 Conclusions

Maize prices started to rise in Kenya mid-2008 and have remained high since. The main reason for this is reduced supply, which had several causes. Because maize is an important food crop, the reduced supply and subsequent high prices have led to a situation of food insecurity problems in large parts of the country. Three reasons underlie the high prices. First, a lack of rains or late rains has led to failed or reduced harvests in several harvest seasons in parts of the country. Second, the food situation was severely affected by the contested election results at the end of 2007 which led to riots, violence and displacement of people, notably in one of the main maize producing areas of Kenya. Third, because international prices were high in 2008, the Kenyan government faced high maize import costs.

These three underlying problems, however, were compounded by the government activities. The government that was dealing with high prices, mounting food insecurity and increasing protests over these, was the outcome of long negotiations between two contesting parties.³ The *National Accord and Reconciliation Act 2008* provided a possibility for power-sharing, with Kibaki remaining President and Raila Odinga taking a newly re-created post of Prime Minister. However, as news reports show, the members of the two parties that now form a government still do not trust each other. There were several accusations of corruption (which may be in fact founded, as Kenya is becoming increasingly

¹ tinyurl.com/ktnxje.

² tinyurl.com/lokh9e.

³ Namely the Party for National Unity led by Mwai Kibaki and the Orange Democratic Movement (ODM) led by Mr Raila Odinga.

corrupt)¹ and ethnic lineage, which played a major role in and after the elections remain an important factor.² Thus, a divided government has been in power in Kenya which has not been able to tackle the problem of high maize prices in a unified and consistent manner.

The government also has been too directly involved trying to curb prices, instead of tackling the root causes of reduced maize supply. The East African Grains Council (EAGC, 2009) has criticised the Kenyan government for too many direct interventions into the maize markets and has advocated more support to the private sector. The policy measures that the government takes need to be temporary and backed up by measures to stimulate the sector. According to the EAGC, the willingness of the private sector to invest in the maize value chain (supply of inputs, production, post-harvest handling infrastructure, processing and logistics) is linked to free market policies.

A consultative meeting held by EAGC for its Kenyan members made the following recommendations for sustainable structured maize trade (EAGC, 2009). These recommendations include that the Ministry of Agriculture (MoA) should establish a Public/Private sector grain consultative forum to be able to quickly determine the available stocks and shortfalls and to ensure grain forecasting and preparation of a national balance sheet. They also include that all traders, millers and the NCPB should be able to purchase maize from the farmers at market prices and that the 'City Council Cess' (tax) on maize which is currently KES40 per bag should be removed as this cost is passed on to consumers. The EAGC advocated that the government should uphold free market principles and focus on faster availability of market information and a price discovery mechanism so that information on price, quality, quantity, location of where maize is available. The government should further work on *regional* mechanisms (e.g. accurate capture of available regional maize stock - regional maize balance sheet; regional crop forecasting system, harmonisation of COMESA and EAC maize standards).

The list of the EAGC makes clear that there is much more that the Kenyan government could do to support the private sector. Several of these recommendations are related to in reducing transaction costs and risks, such as mar-

¹ A study released by Transparency International July 2009 shows corruption index rising in virtually all the institutions, including the parliament (Press Release TI Kenya, 02 July 2009. Available at tinyurl.com/m4y734).

² The fact, for instance, that the minister accused of corruption (Ruto) was from the Kalenjin ethnic group was an important factor in the media discussing his position. See for instance The Standard, 13 July 2009 available at tinyurl.com/nlo7jb. Ruto, a member of the ODM, was also accused of delivering hate speeches in the run-up to the 2007 elections (*Time*, 30 January 2008 at tinyurl.com/mmejq2).

ket information and price discovery mechanisms, establishing of a regional crop forecasting system. The Cereal Millers Association, for instance, blames the government for not responding adequately early by importing sufficient amounts of grain (World Grain, 2009).

Some international donors have pointed out that corruption has aggravated the problems in Kenya. The German ambassador, echoing the concerns of other diplomats said in January 2009 that Kenya should pursue reports of corruption. The U.S. Ambassador has said Kenyan government policies such as requiring farmers to only sell their produce to the government and targeted price controls

'have indirectly contributed to shortages and in addition have inadvertently perhaps contributed to reports of corruption' (The Standard 27 January 2009).¹

When taking a political economy perspective, the actions of the government can be understood. As Holmén (2005) explains, the priorities made by the government and market actors are usually not primarily determined by the needs of farmers but rather by how governmental and market actors perceive their own situations and survival options. This applies especially to the Kenyan government, which is composed by two opposing factions. Political reasons, winning votes by showing that one of the two political factions is doing a better job in tackling the food crisis in the short term than the other are powerful motivations.

¹ tinyurl.com/nspmlz.

6 Tanzania: government responses to high cereal prices

6.1 Background: normal harvests and food security

The food security situation in Tanzania was not as dire as in Kenya (Figure 6.1) but also in Tanzania a large part of the country was moderately food insecure. This had its roots in several poor harvests. The harvesting of the 2007/2008 short rainfall (*vuli*) season crops, which accounts for some 30% of annual food supplies was below average, due to poor rains. However, the food supply situation remained generally satisfactory throughout the country with the exception of some areas in the region of Arusha and Iringa where food shortages were reported, mainly due to a volcano eruption on Mount Oldongai and fire disaster (*FAO Crop Prospects and Food Situation*, No 2, April 2008).¹

There were normal rains in mid-2008 leading to good harvests of main coarse grain crops (mostly maize). Tanzania's 2008/2009 short rainfall (*vuli*) season was poor again and affected several regions (Mwana, Shinyanga, Kilimanjaro, Dodoma, Singida, and the northern coast (Figure 6.1). However, the food security impacts in these areas were expected to be much less severe than in Kenya because Tanzanian grain reserves were better supplied and because households in these areas are much less dependent on the *vuli* rains harvest than the farmers in Kenya. By the end of 2008, an estimated 240,544 people were reported to be food insecure (FEWSNET, 2009).²

The food security situation as in Figure 6.1 remained largely unchanged by July 2009 (FEWSNET, 2009).³ However, prospects for 2009 were not encouraging. The north-east regions of Tanzania continued to receive below-average rainfall for the duration of the main (*masika*) season (March-June). Average rainfall in unimodal regions from April to May improved production prospects. However, limited input utilisation, due to the high fertiliser costs, were likely to lead to lower yields. Furthermore, in the south-east, poor localised rains in Lindi and Mtwara districts were expected to reduce the cereal harvest (FAO, 2009).⁴

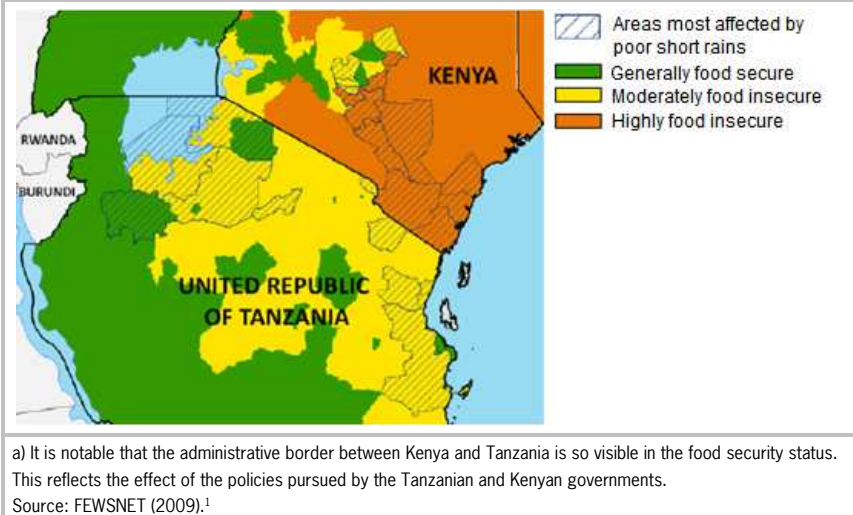
¹ tinyurl.com/dyrvzw, accessed on 19/03/09.

² Executive Overview of Food Security January 28 at tinyurl.com/chqan2, accessed on 20/03/09.

³ tinyurl.com/dkdgn5.

⁴ FAO Crop Prospects and Food Situation, no 3, July 2009. tinyurl.com/kwj27p, accessed on 17-07-09.

Figure 6.1 Food security status Tanzania January 2009 a)



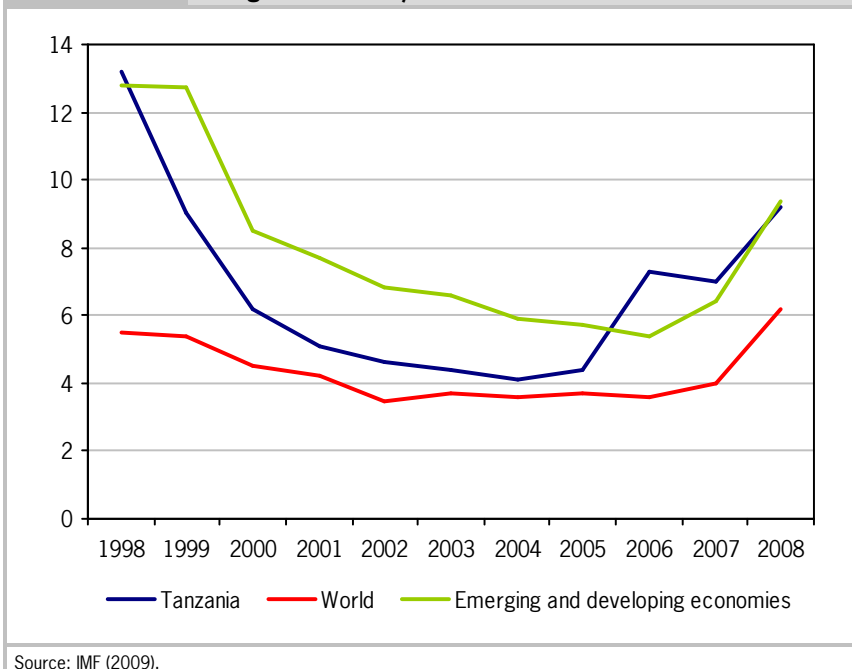
6.2 Prices

6.2.1 General

Inflation in Tanzania decreased from 1998 until 2004, after which it increased quite sharply. However, inflation figures were much higher before 1998 (from 1990-1997 the average inflation was 24%). The Tanzanian economy continued to perform well and economic growth exceeded 7% in 2007/08 (July-June). Inflation has risen to 11.8% by October 2008, which mainly reflected the surge in global food and fuel prices. Beyond the lagged impact of the sharp rise in global food and fuel prices, a rapid expansion in liquidity driven by a surge in government spending added to inflation pressures (IMF 2009a).

¹ Executive Overview of Food Security Special Focus: Kenya and Tanzania January 28. tinyurl.com/chqan2, accessed on 20/03/09.

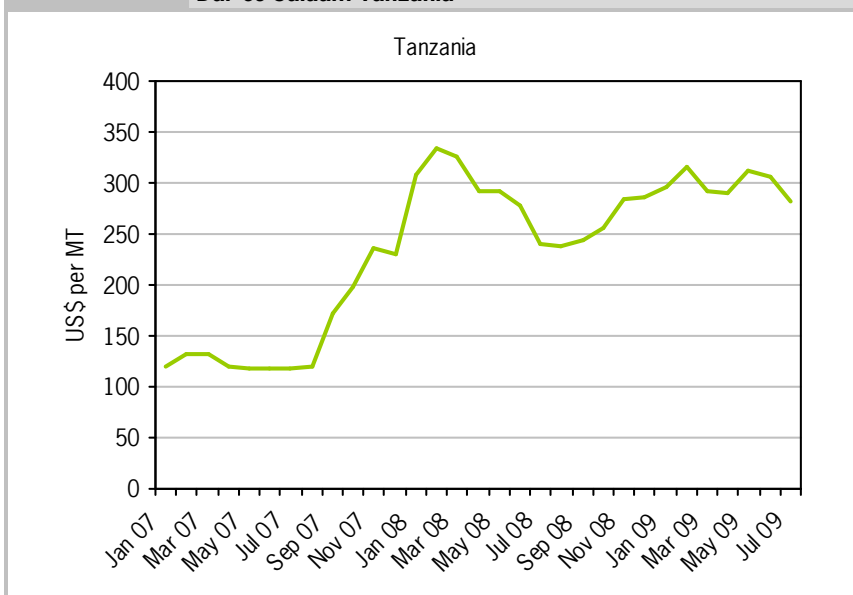
Figure 6.2 Inflation Tanzania (average consumer prices annual percent change 1998-2009)



6.2.2 Cereal prices

Maize prices in Tanzania started rising relatively early in mid-2007 and peaked in January 2008, after which they came down again until mid-2008, after which they rose again (Figure 6.3). Prices in 2008 were on a significantly higher level than those in 2007 and remained high in 2009.

Figure 6.3 Maize prices (in USD per tonne) 2007-mid-2009
Dar es Salaam Tanzania



Source: RATIN (2009).

The first half of 2007 was characterised by favourable food security condition. Wholesale maize prices increased moderately between June and July on some markets, but this increase was seasonal and reflected normal flows of grain from surplus to deficit areas. During the second half of 2007 prices began to increase very rapidly. This was attributed to a number of factors, including:

- High fuel costs that have resulted in increased transport costs;
- Campaigns to standardise the weights of bags sold by farmers;
- Excessive crop sales during the harvest, which depletes stocks in the areas;
- The upcoming cashew season that increases the purchasing power of the residents, causing traders to take advantage of the situation and increase prices.

Source: FEWSNET (2007).¹

In 2008, prices of staple commodities (including maize) declined in response to good unimodal harvests, as well the export ban that the government imposed to provide some relief from high prices for poor urban populations. However,

¹ Tanzania Food Security Update August at tinyurl.com/dy8nqj, accessed on 20/03/09.

the prices remained significantly above those of 2007 and those of the five-year average, particularly in urban markets like Dar es Salaam and Arusha (FEWSNET, 2008).¹ This suggests that a supply response by Tanzanian farmers to high and increasing food prices was insufficient to counteract all of the factors that pushed prices up. These factors were attributed to high fuel and transportation costs as well as speculation (although this is difficult to prove). The continuation of high levels also suggests that the market interventions imposed by the government such as export restrictions and import subsidies reduced market prices only marginally (FEWSNET, 2008).²

By mid-2008, grain stocks were also running low, which made prices seem more volatile than normal and which was another factor contributing to the increase in prices. By January 2009, prices in Tanzania had reached another peak. Because the October-December 2008 harvest in Kenya was low, it meant that adjacent areas in Tanzania, which usually import maize from Kenya, could not do so in January 2009, further tightening supplies. The other factors that have kept an upward pressure on prices in Tanzania during 2008 included as fuel prices, transport costs, and costs of other inputs, which continue to persist. As a result of this tightening of supplies and rising prices, up to 250,000 people in about 20 districts were considered food insecure (FEWSNET, 2009).³

Despite the export ban, sources suspect that the little maize grain reserves could also be vacuuming to Southern Sudan via Kenya, where a bag of maize retails at higher prices than in Tanzania. Kenyan and Tanzanian traders were reported to be buying large consignments of maize from Tanzania farmers, taking the consignment via *Panya-routes*⁴ to Kenya where they get transported to Sudan where maize is the new 'gold'.

6.3 Government policies

In order to stabilise cereal availability and prices, the government of Tanzania enforced a cereal export ban in January 2008. Maize imports became exempt from import duties in March 2008 to increase cereal availability. However, unofficial exports continued and nominal prices remained about 80% above the

¹ East Africa Regional Food Security Update June. tinyurl.com/d6rwsq, accessed on 19/03/09.

² East Africa Regional Food Security Update: Staple food prices July. tinyurl.com/cvfgc4, accessed on 20/03/09.

³ East Africa Regional Food Security Update: Focus: Regional markets and food prices January. tinyurl.com/dedcpd.

⁴ Panya is Kiswahili for mouse. Panya routes are smuggling routes.

2003-07 average in May 2008 (FEWSNET, 2008).¹ In a further effort to limit the price increases, and to mitigate the effects of the localised food shortages, the government authorised the imports of around 300,000 tonnes of maize duty-free and imposed an export ban on all agricultural commodities (FAO, 2008).² By the end of 2008, the Government announced that it would make maize flour available at a subsidised price (*Arusha Times*, 31 January 2009).³

Tanzania's Strategic Grain Reserve (SGR) was decreased significantly mainly due to sales of maize and sorghum to the World Food Programme, the Prime Minister's Office and other public institutions as well as private traders to alleviate food shortages in some areas. By the end of July 2008, the SGR had only 75,438 tonnes left, which is 41.7% lower than July 2007 (*The Citizen*, 13 October 2008).⁴ By January 2009, the grain stocks were again 121,769 tonnes which were projected to last for six months when the next harvest season starts. The Government is required to have a stock of 150,000 tonnes of cereals annually (*Arusha Times*, 31 January 2009).⁵

In January 2009, the government stopped issuing food export permits to avoid a food shortage and said more than 240,000 people needed food aid in the country (*Daily Monitor*, 19 February 2009).⁶ The spokesperson for the Ministry of Agriculture, Food Security and Cooperatives, Mr Richard Kasuga, said that Tanzania did not have enough food for its own citizens' consumption and could, therefore,

'not bail out its equally needy neighbours. [...] We have strengthened security at all the border posts. We have also stopped issuing permits for the sale of food out of the country until the situation normalises.'

He added that Tanzania had not received any requests from neighbouring countries intending to buy food from Tanzania:

'However, even if such an appeal is sent now, there is no way Tanzania can sell food. We are taking all the necessary steps to ensure that even individuals do not export any food.' (*The Citizen*, 29 January 2009).⁷

¹ East Africa Regional report on market prices, April/May tinyurl.com/cyjq2u.

² Crop Prospects and Food Situation No 2 April tinyurl.com/dyrvzw.

³ tinyurl.com/dmfc7l, accessed on 20/03/09.

⁴ tinyurl.com/crsfeg, accessed on 20/03/09.

⁵ tinyurl.com/dmfc7l, accessed on 20/03/09.

⁶ tinyurl.com/cc644k, accessed on 20/03/09.

⁷ tinyurl.com/d626vx, accessed on 20/03/09.

Also in January 2009, the government approved the import of 900,000 tonnes (10m 90-kg bags) of grain duty free. It planned that the government would import 7m bags for its strategic grain reserves while millers and traders could import the rest (*Arusha Times*, 31 January 2009).¹ In March 2009, Tanzania removed import duties on grain until May 2009 to enable the import of 300,000 tonnes of grain by the private sector. Tanzanian President Kikwete directed on 2 March that the private sector was allowed to import the amount without taxation. This meant that any grain imported into the country in that period would be cleared through customs without payment of duty. The president also indicated that there would be more funds for agriculture in the 2009/10 budget (*The Citizen*, 4 March 2009).²

Mid-2009, the food security outlook was rather bleak. An evaluation of the food situation conducted between May and June 2009 revealed that at least 61 districts would face food shortage in 2009-10. The Tanzanian government (through the National Food Reserve Authority-NFRA) planned to buy 165,000 tonnes of food including 160,000 tonnes of maize and 5,000 tonnes of sorghum. The deputy Minister for Agriculture and Cooperatives, Dr Mathayo said the government would try to control inflation on food prices by letting the NFRA sell part of its food reserve in order to flood the market in areas where food prices are expected to rise (*The Citizen*, 11 July 2009).³

6.4 Conclusions

Tanzania's maize prices were one of the first in the East African region to increase (mid-2007) due to a combination of factors, in which poor harvests played a role, but also high fuel prices. Because harvests in 2008 were relatively good, prices decreased in Tanzania, while prices in neighbouring countries increased. The demand for maize from neighbouring countries put pressure on the prices in Tanzania, even though the government imposed an export ban but could not prevent informal trade. At the end of 2008, harvests were disappointing and by this time, cereal stocks had also decreased, pushing up prices. The government responded more aggressively this time, announcing it would increase the security on borders to prevent export, even though the food insecurity situation in neighbouring Kenya was still more severe than in Tanzania.

¹ tinyurl.com/dmfc7l, accessed on 20/03/09.

² tinyurl.com/daosvg, accessed on 20/03/09.

³ tinyurl.com/kjmf05, accessed on 17-07-09.

The direct market interventions by the Tanzanian government may exacerbate the food insecurity situation in neighbouring countries, pushing up prices even more in those countries, while producers in Tanzania are not benefiting from these high prices. When farmers in Tanzania sell their maize, prices are likely to drop temporarily as there is an increase in supply. If they were allowed to sell to neighbouring markets, where supply is low and prices high, this price effect would be dampened. However, the government is dissuading this: the spokesperson for the Ministry of Agriculture, Food Security and Cooperatives (Mr Richard Kasuga) appealed to farmers to reserve enough food for their own use and avoid being lured by middlemen 'who will come to you with promises to buy the cereals at much higher prices' (*The Citizen*, 29 January 2009).¹ In reality there is much informal trade with Kenya, see also section 5.2.

¹ tinyurl.com/d626vx, accessed on 20/03/09.

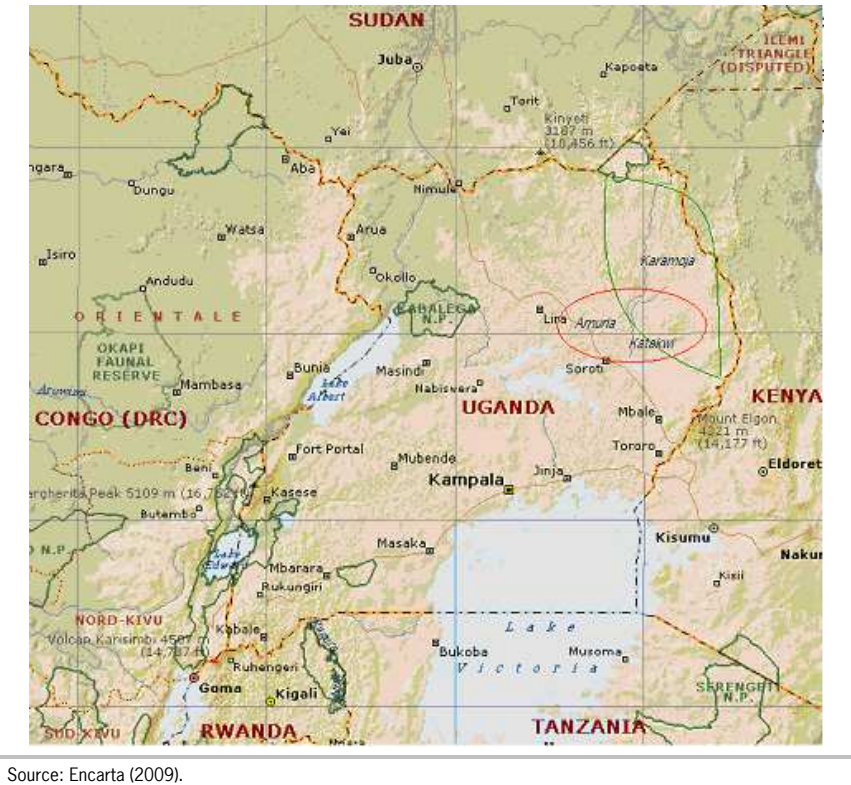
7 Uganda: government responses to high cereal prices

7.1 Background: drought and food assistance

In the period July-September 2007 excessive rains caused extensive flooding in Amuria and Katakwi Districts (see map - red outline) where crop losses, both pre and post-harvest, were very high. An FAO/WFP mission assessing the food security conditions found that there was an unfolding food crisis in the affected districts and in parts of neighbouring ones. At the same time, food prices in some rural markets were rising fast in 2008 and were double their levels a year ago (FAO WFP, 2008b).

In the North-East (Karamoja District - see map, green outline) there were three consecutive years of drought. The first season's harvest of 2008 was poor because of a long dry spell, while heavy rains, pests and diseases destroyed crops for the second season. In 2008, 70% of the population in Karamoja District received food assistance (OCHA, 2008).

Figure 7.1 HF-crisis locations in Uganda



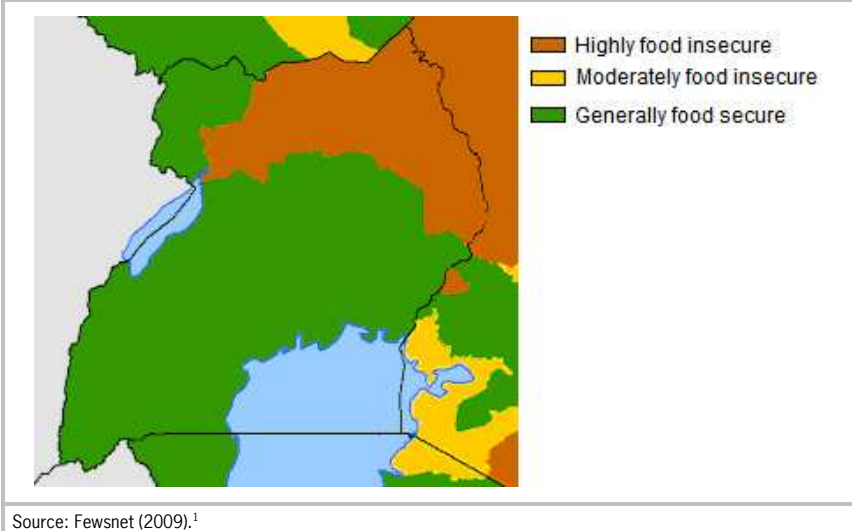
Source: Encarta (2009).

Not only did the north-east of Uganda suffer floods and drought, it has also been afflicted with two decades of conflict.¹ These combined factors have led to a food crisis: in 2008 over a million people were at risk of starvation and over 40,000 children were suffering acute to moderate malnutrition (IRIN, 30 July 2008; 19 August 2008).² See figure 7.2 for the food security situation in Uganda for the first quarter of 2009.

¹ The 'Lord's Resistance Army' (LRA), which seeks to overthrow the Ugandan Government, has murdered and kidnapped civilians in the north and east since 1986. Although the LRA does not threaten the stability of the government, LRA violence at one time displaced up to 1.7m people, creating a humanitarian catastrophe.

² Available at tinyurl.com/cx55fd. and tinyurl.com/dexlgz, accessed on 12 March 2009.

Figure 7.2 Estimated food security conditions, 1st Quarter 2009
(January-March)



7.2 Prices

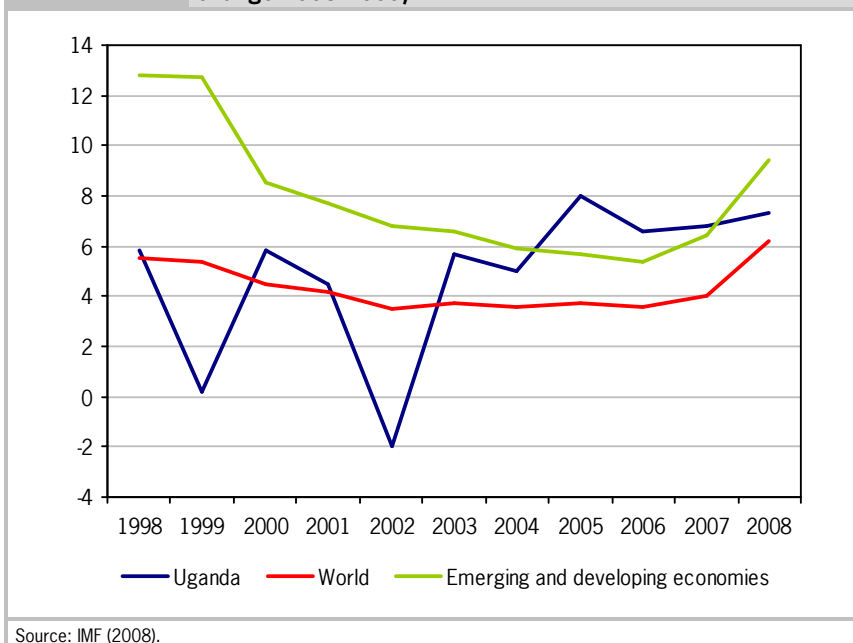
7.2.1 General

According to the IMF (2009b),

'Uganda's economy has been among the fastest-growing in Sub-Saharan Africa. Building on a foundation of two decades of sound policies, Uganda achieved an impressive economic performance, with high growth, low inflation, and steady poverty reduction [...]. In 2008 Uganda has been buffeted by two major shocks. First, the global surge in food and fuel prices has caused domestic inflation to rise above 15%; well beyond traditional comfort levels [Figure 7.3]. Global economic downturn is likely to affect both the demand for Ugandas exports and, more significantly, the availability of financing for critical investment projects.'

¹ Available at tinyurl.com/b3m2by, accessed on 12/03/09.

Figure 7.3 Inflation in Uganda (average consumer prices, annual percent change 1998-2009)



A large part of the inflation was caused by food commodities (IMF, 2009b; Based on Ugandan authorities and IMF Staff estimates).

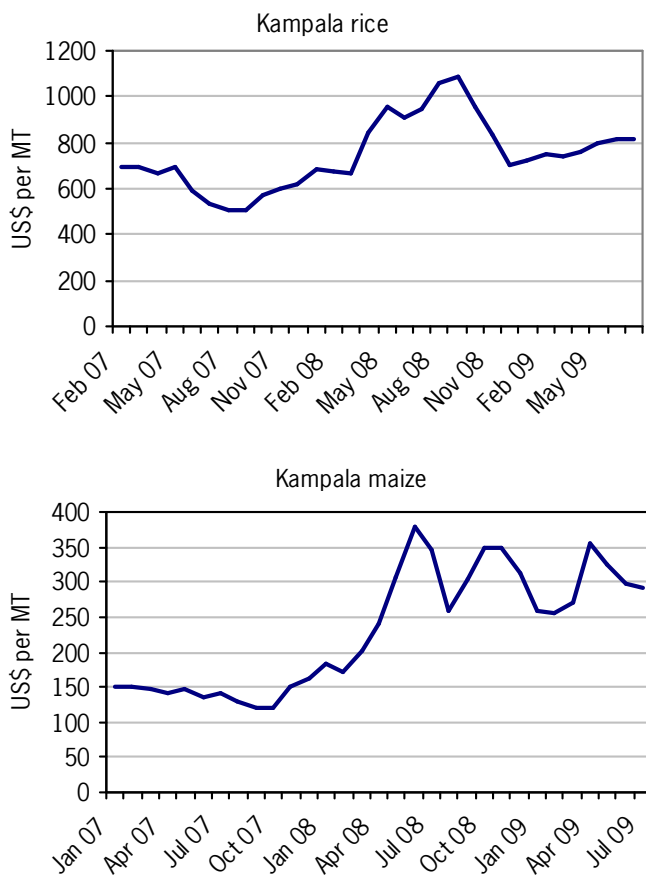
7.2.2 Cereal prices

In Uganda, although maize prices are higher than the five-year average, food prices in general are relatively stable and consistent with normal seasonal patterns. The price of matoke (cooking banana) in Kampala in 2008 was 33% lower than in 2007. Maize is not a major staple in Uganda, but is largely sold as a commercial crop. Therefore, the rise in regional and international maize prices had a positive rather than a negative impact on food security in the country. (FEWSNET, 2009).¹ Rice is another major (cash) crop in Uganda, and therefore we include it in this section. Maize and rice prices increased substantially end of 2007, beginning 2008 (Figure 7.4). Maize prices fell mid-2008, as did rice

¹ FEWSNET, April/May 2008 EAST AFRICA Regional report on market prices. tinyurl.com/cyj2u, accessed on 19/03/09.

prices, but maize prices have increased again, fluctuating at a high level. The increase in price of maize in April was assigned to large scale purchases for schools, relief aid and institutional requirements. Prices have since decreased again (FAO, 2009).¹

Figure 7.4 Maize and rice prices in Kampala, Uganda 2007-2009



Source: RATIN (2009).²

¹ Crop Prospects and Food Situation n. 3 July 2009. tinyurl.com/kwj27p. accessed on 10-07-09.

² tinyurl.com/bjjo72, accessed on 27/02/09.

A study on food prices in Uganda has examined to what extent domestic prices were influenced by international commodity prices. It concludes that it does not see

'rising global food prices in themselves and, beyond oil price increases, the factors that are generally accepted as causing the rise in global food prices as being important direct causes of rising general food prices in Uganda. Certainly higher global prices for wheat and rice do result in higher prices for those foods in Ugandan markets, since a significant portion of Ugandas consumption of these foods comes from the international market. However, Uganda is generally insulated from many of the other factors causing the rise in global food prices because high transaction costs (particularly transport) make its participation in the global markets problematic' (IFPRI, 2008).

However, the report does point out that there may be secondary effects of high global food prices, especially when it is coupled with regional effects, such as the 'uncharacteristically high demand from Kenya' which resulted from the political turmoil (see section 5.4). When Ugandan food prices enable food traders from neighbouring countries (e.g. Kenya, Tanzania, Rwanda) to profitably import food from Uganda (or Ugandan traders to profitably export), local markets will see an increase in demand and the prices Ugandan consumers face will rise. The IFPRI study includes a survey of traders to examine whether they have been able to benefit from higher demand and prices. It showed that only 10% of the traders indicated that they traded larger volumes than a year ago. The reason for this is that because demand increased, so did also the number of traders, especially part-time non-professional traders.¹ The IFPRI study also noted that equally important, capital and credit constraints that established traders face were exacerbated by the higher prices, which means higher costs to acquire stocks, increased transport costs due to rising fuel prices, and the longer distances traders need to travel to acquire the stocks required. The result has been an overall reduction in the quantities that most traders have handled in 2008.

¹ This was confirmed during the workshop that was held in Kampala and Nairobi in December 2008. These traders are called 'brief-case traders' and consist of people who have a job, such as in the civil service, but will use their own money to engage in short-term trading and to make a profit.

7.3 Government policies

In a speech made during Ugandas 46th Independence Day Celebration, president Museveni explained why, according to him, prices were so high:

'The major causes of high food prices is the high demand for our farm produce and the high transport costs as a result of high fuel prices and not well-maintained roads. Regarding the high regional demand for food, I urge Ugandans to take advantage of this and produce more for the market. However, Ugandans must be careful not to sell everything they have and remain with not enough food for their families; and also keep some for planting, particularly cereals. Our economy has been affected by high prices in other countries such as Kenya, from which we import some of our household goods. Since we import some of our consumer items, the high prices in the countries from which we import are also reflected in higher prices of our domestic goods.' Uganda Media Centre, 9 October 2008)¹ (

The Ugandan government did not impose any bans, quotas, or other restrictions on trade in food commodities (IFPRI, 2008). In fact, the president of Uganda Yoweri Museveni told Commonwealth heads of government in June 2008 that he was 'very happy' about the food crisis.

'Why? Because we produce a lot of food. We are stuck with food. [...] Our problem has been marketing ...'

The president hoped the food crisis would prompt the removal of trade barriers, allowing countries like Uganda to profit from food surpluses (BBC, 11 June 2008).²

The Ugandan government mobilised KES3bn (USD1.8m) to address the 2008 food crisis in Karamoja (Figure 7.1) as well as in flood-affected neighbouring districts and other parts of the country. It also stated that it would distribute high yielding sorghum seeds that could mature in 30 days and that it would provide tractors (IRIN, 22 May 2008).³ New Vision reported in June 2009 that the FAO had provided over 700 tonnes of seed, while the Government provided

¹ tinyurl.com/bk72ax, accessed on 27/02/09.

² tinyurl.com/cgwk4u, accessed on 27/02/09.

³ tinyurl.com/dnzk2x, accessed on 27/02/09.

12 tractors and rehabilitated Nabiny Agricultural Farm Institute in Karamoja District, which has been hard hit by the food crisis (World Vision, 23 June 2009).¹ At the same time, the World Food Programme (WFP) pledged to double the amount of food it buys in Uganda to about USD100m (UGX170bn) worth annually. The WFP is already the single largest buyer of food in Uganda. In 2007, the agency bought food worth nearly USD55m (UGX93.5bn); while in 2006 purchases totalled USD48m (UGX6bn) (*Daily Monitor*, 6 February 2008).²

The approach taken by the government has been to improve agricultural production by increasing the efficiency and effectiveness of the agricultural extension service through the National Agricultural Advisory Services (NAADS) programme. NAADS aims to develop a demand driven, farmer-led agricultural service delivery system targeting poor subsistence farmers, with special emphasis on women, youth and people with disabilities. The budget allocation to NAADS increased by 62%, bringing the total allocation to UGX97bn (USD59m). Ugandas finance minister Suruma proposed exempting income arising out of new agro-processing investments from income tax starting in July. To mitigate the effect of soaring transportation cost on food prices, there would also be tax exemption for trucks with a loading capacity of at least 3.5 tonnes (afrol News/IRIN, 13 June 2008).³

However, in a meeting with farmers and UNFFE (Uganda National Farmers' Federation), the government policy to boost agricultural production was criticised. Data from UNFFE shows that the agricultural sector grew with only 1.9% growth over 2006-2007 which was a 0.6% drop over the 2004 and 2005 figure. During a national public hearing on agricultural policy issues facing small-holder farmers, farmers said that

'this is because of the unarticulated policies and institutional frameworks that are leading to a decline in agricultural production.'

According to the farmers, there was a lack of participation in policy implementation, especially in programmes like the National Agricultural Advisory Services (NAADS), the Plan for Modernisation of Agriculture and the Poverty Eradication Plan. Further, NAADS failed to provide services to farmers. (East African, 20 September 2008)⁴

¹ tinyurl.com/law4fn, accessed on 17/07/09.

² tinyurl.com/beo2eh, accessed on 27/02/09.

³ tinyurl.com/cfzlgw, accessed on 27/02/09.

⁴ tinyurl.com/ck3852, accessed on 27/02/09.

7.4 Conclusions

The cereal prices in Uganda seem to be influenced more by regional dynamics (several failed harvests in the Northeast and large demand from both Sudan and Kenya in 2008) than by international prices.

The approach taken by the Ugandan government is quite different from that of many other governments in East Africa. The government of Uganda seemed to be relatively untroubled by the high prices and imposed no measures that would bring down food prices for consumers. Instead, it chose to focus completely on stimulating the production side (seed, extension, tax exemptions), although its efforts have been criticised by farmers as not being effective. It has to be noted that maize is not the most important food crop in Uganda and thus high maize prices would benefit farmers while not hurting consumers.

8 Ethiopia: government responses to high cereal prices

8.1 Background: drought and food assistance

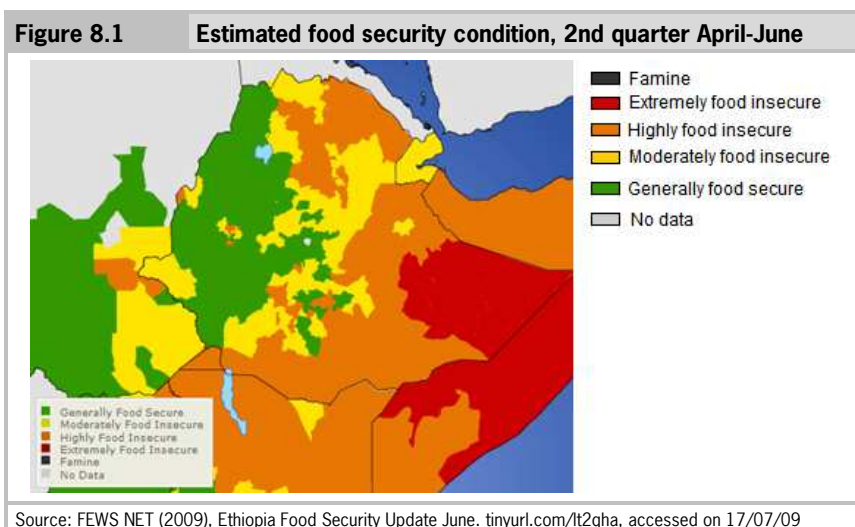
In July 2008, several parts of Ethiopia were confronted with drought conditions. By October the situation had deteriorated. Poor secondary season (*'belg'*) rains led to delayed plantings and partial crop failure (FAO GIEWS 2009).¹ In southern and south-eastern Ethiopia, including the southern zones of Somali Region, pastoral and agro-pastoral populations remain highly food insecure due to successive seasons of below-average rains, flooding in riverine areas, livestock disease, an armyworm infestation, conflict, inadequate humanitarian assistance, and extremely high prices of food (Figure 8.2). Parts of the Ethiopian state SNNPR became extremely food insecure after minimal rains led to a failed sweet potato harvest in the beginning of 2008 and a near failure of the 2008 belg harvest. By August 2008 belg producing parts of Tigray and Amhara regions, as well as parts of Oromia region, were also facing high to extreme food insecurity (FEWSNET, 18 August 2008).

Mid-2008, the Ethiopian Government and humanitarian partners estimated that some 510,000 tonnes of cereals were needed to meet emergency food assistance needs for 4.6m people until November 2008. This estimate of the number of people in need represents an increase of 2.6m people compared to the April 2008 estimate. However, at the time the Ethiopian government made the estimate of a total requirement of 598,000 tonnes, only about 130,000 tonnes, or 30%, was available (or had been pledged). The World Food Program announced that, due to funding shortfalls, it had been forced to reduce food assistance to tens of thousands beneficiaries in drought-affected areas and that the Program, without new contributions, may not be able to fully respond to the increasing food aid requirements resulting from the drought. The inability of WFP to meet all demands put additional pressure on prices.

By early 2009, the situation in large parts of Ethiopia was still critical and remained so in the second quarter of 2009 (Figure 8.1), although there were good 'meher' rains in Western Ethiopia. The number of Ethiopians requiring humanitarian assistance in the first months of 2009 dropped due to good food

¹ In Ethiopia there are two cropping seasons: the belg season are the short rains while the meher season are the long rains.

harvests in western regions of Ethiopia (IRIN, 30 January 2009).¹ However, the situation progressively became worse in 2009 as Ethiopia faced high levels of food insecurity. A total of 7.5m chronically food insecure people received assistance through employment in public works under the Productive Safety-Net Program (PSNP). An additional 4.9m people required emergency food assistance through June 2009. In addition, about 200,000 people were displaced in the southern parts of the country due to clan conflict and are receiving humanitarian assistance. It was projected that there would be insufficient relief food in due to a combination of resource shortfalls and a shortage of trucks to transport food from the Djibouti port (FEWSNET, 2009).²



¹ tinyurl.com/b5sq6g, accessed on 27/02/09.

² Ethiopia Food Security Update June. tinyurl.com/lt2qha, accessed on 17/07/09.

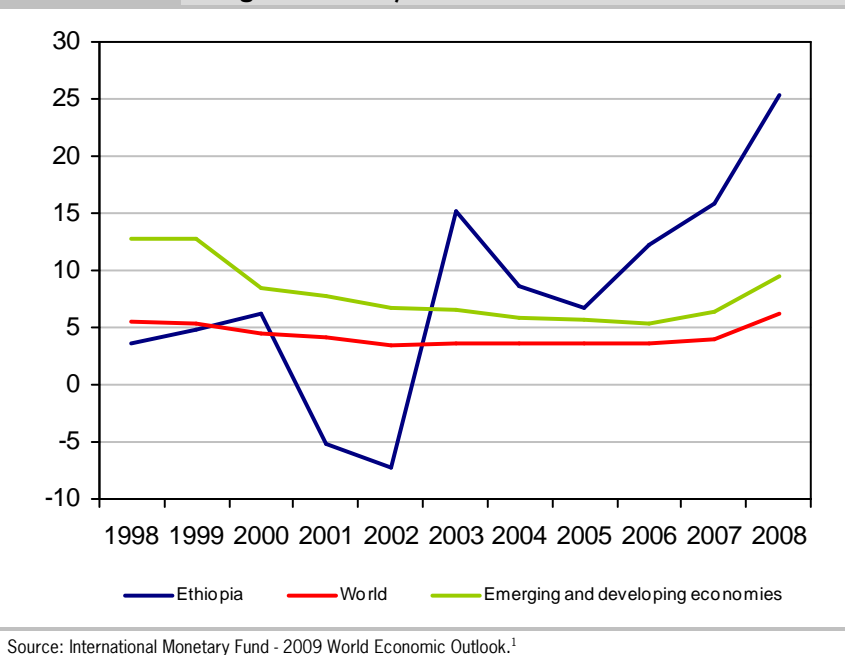
8.2 Prices

8.2.1 General

The Ethiopian economy has been growing rapidly from 2004-2008. Favourable weather conditions and pro-growth policies have helped sustain recovery from a sharp drought-related contraction in 2002/03. However, inflation has been high (Figure 8.2). The food price index reflects general inflation in Ethiopia: from 2002, general inflation in Ethiopia has risen to 20%. The reasons for this high inflation rate are unclear. In a study on Ethiopian food prices, Ulimwengu et al. (2009) suggest that significant local factors have caused the food price surge in Ethiopia, especially the severe drought shock of 2002-2003. Loening et al. (2008) have reviewed several studies that have analysed the causes of inflation in Ethiopia (by EDRI, NBE, World Bank and IMF). They conclude that there was a lack of consensus on what are the factors mechanisms causing the inflation. We will not go into all the arguments here, because our study focuses on cereal prices. In Loening et al. (ibid), the authors conclude that the international food/non-food prices influence domestic prices in Ethiopia in the long-run but that there are large deviations from equilibrium due to agricultural supply shocks (e.g. due to drought).¹

¹ The add inflationary expectation, which carry over 28-44% of inflation into the next period according to their calculations. However, this would also induce farmers to grow more produce, increasing supply and reducing prices.

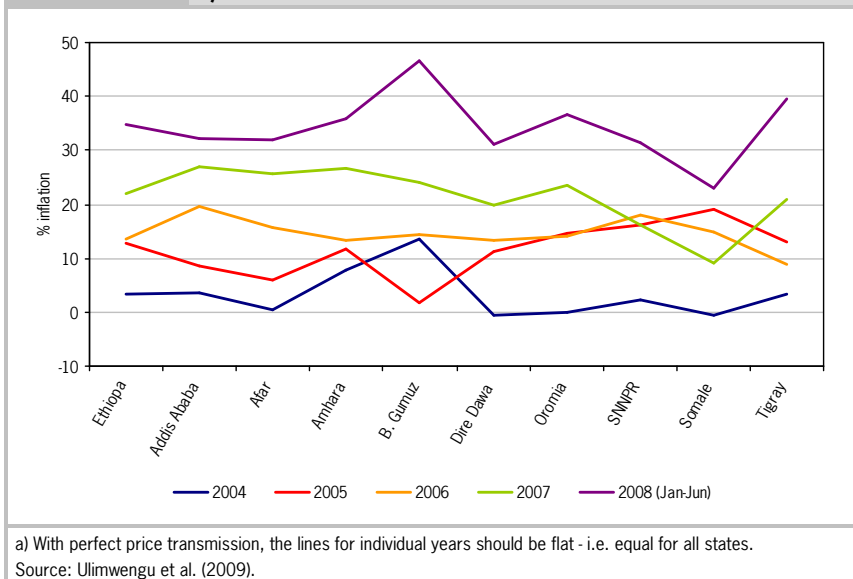
Figure 8.2 Inflation Ethiopia (average consumer prices, annual percent change 1998-2008)



Ulimwengu et al. (2009) note that between states, food price inflation differs considerably (Figure 8.3), which can be explained by the fact that local demand and supply factors play a significant role on the one hand, and limited price transmission on the other (i.e. shortages in one area are not easily replenished with surpluses from other regions thus equilibrating prices).

¹ Available at tinyurl.com/2kjk6.

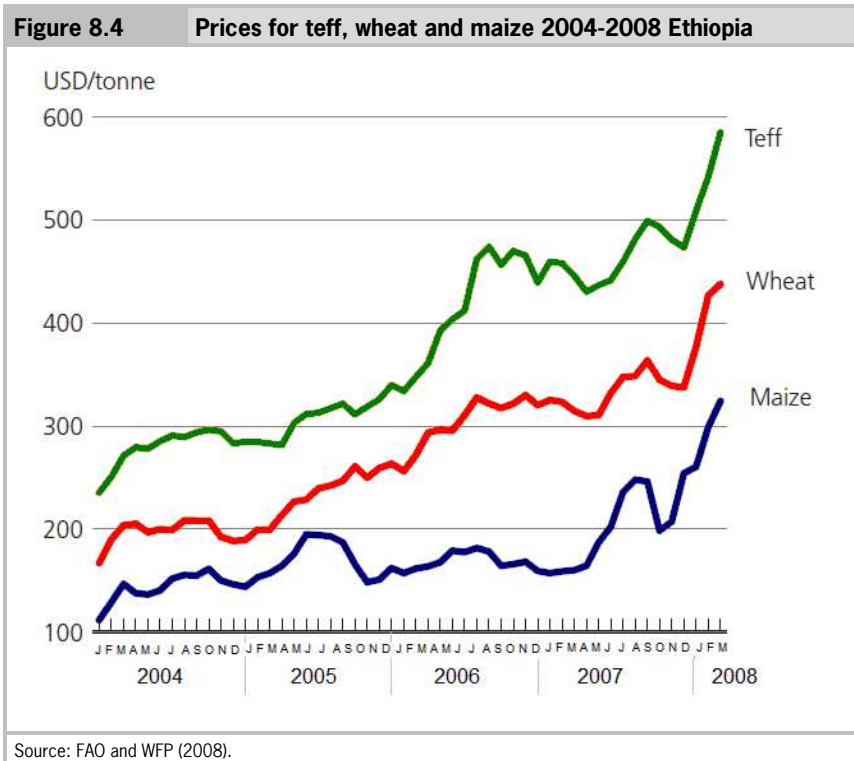
Figure 8.3 Food inflation in regions of Ethiopia, end-of-period rates (%)
a)



On the demand side, influx of refugees may explain sudden price hikes, such as in Benishangul-Gumuz. On the supply side, weather conditions lead to differences in the performance of the agricultural sector across regions, explaining some of the price heterogeneity observed across regions. The differences should disappear when markets function. However, inadequate infrastructure and food markets with high transaction costs in Ethiopia restrict trade between surplus and deficit grain-producing regions could explain regional heterogeneity in prices. In fact, Ulimwengu et al. (ibid) found that none of the Ethiopian local maize markets were integrated to the world maize market. In other words, these markets do not share a common long-run trend in their respective price with the world maize market. In addition, they could not find evidence of market integration among Ethiopian regional maize markets. This reflects very high transaction costs of food markets.

8.2.2 Cereal prices

In general, the prices of the three main cereals (teff, wheat and maize) have been increasing since 2004 in Ethiopia (Figure 8.4). In the first half of 2008, the increase was strongest. It is also interesting to note that the price movements of these three cereals seem to be highly correlated.



However, mid-2008, prices for maize in Ethiopia started to decrease again, although staying at high levels (Figure 8.5).

Figure 8.5 Maize prices (in USD per tonne) Ethiopia 2007-2009

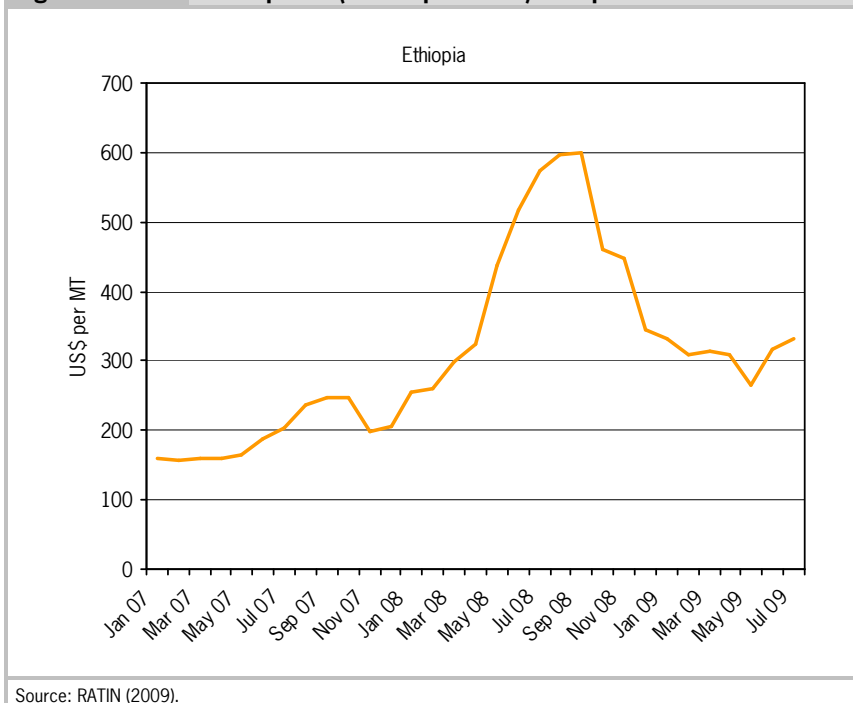
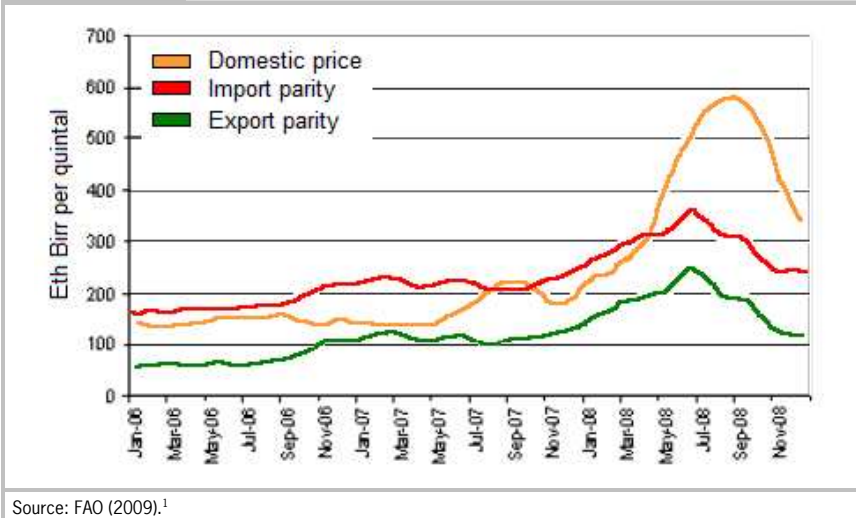


Figure 8.6 shows that the domestic prices for wheat and maize were higher than import parity and export parity.¹ This means that it was much cheaper to import maize or wheat than buy it locally. It also means that Ethiopia was not competitive on the world market - its domestic prices were much higher than world market prices.

¹ Import parity price is the price that a purchaser pays or can expect to pay for an imported good, thus the c.i.f. import price plus tariff plus all other costs (e.g. marketing, handling, transport and taxes) incurred in getting the imports to the point of sale. Export parity price is the world price multiplied by the exchange rate, minus all other costs (e.g. marketing, handling, transport and taxes) incurred in getting the exports to the foreign customer, and minus the tariff in that market.

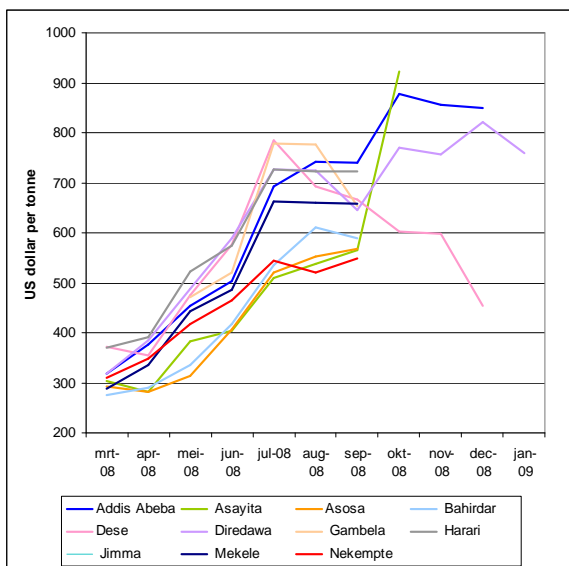
Figure 8.6 Domestic maize prices and import and export parity Ethiopia 2006-2008



Source: FAO (2009).¹

¹ tinyurl.com/bcesz9.

Figure 8.7 Regional prices for maize (in USD per tonne)
March-December 2008

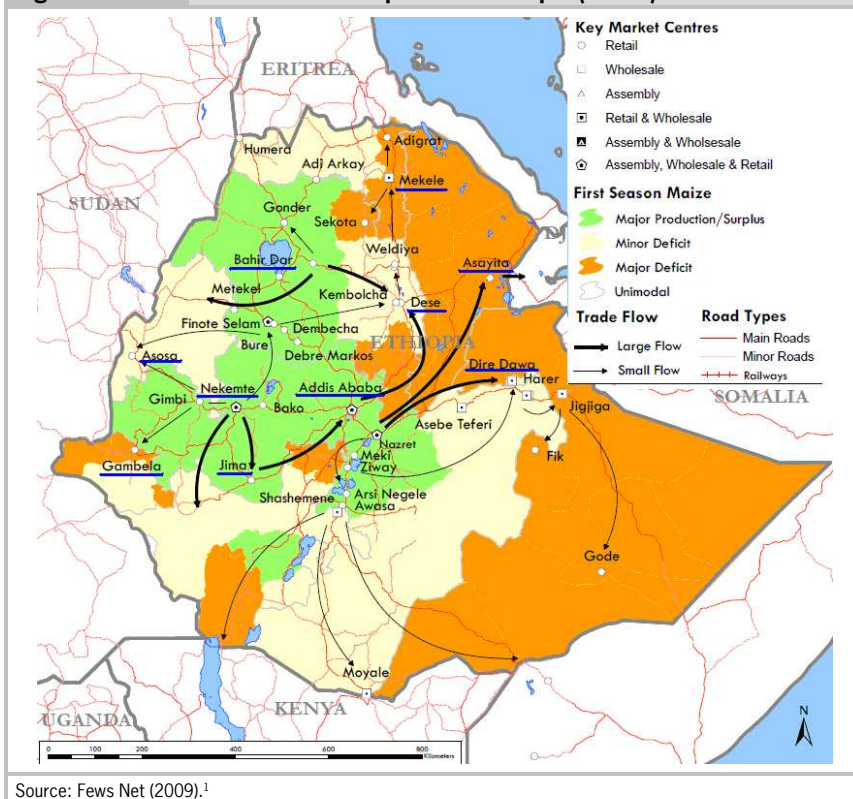


Source: Central Statistical Agency Ethiopia (2009).¹

Figure 8.7 shows that, as in Kenya, prices diverged more in the period in which they were relatively high (in June the difference was almost 50%). In some cases (e.g. Asayita market and Gambela market) the prices even have opposite trends (decreasing and increasing respectively). As in Kenya, this indicates that markets are not functioning efficiently, and that relative deficits and surpluses are not equalised through trade. In Figure 8.8 the markets mentioned in Figure 8.7 are depicted.

¹ Available at tinyurl.com/cu5hce.

Figure 8.8 Trade routes and places in Ethiopia (maize)



This reflects the high transaction and transport costs in Ethiopia. As Figure 8.8 shows, cereals (e.g. maize) must be transported over large distances, from surplus areas to deficit areas. In Ethiopia, transaction costs are high (Gabre-Madhin, 2007) and infrastructure is often inadequate.

8.3 Government policies

The government of Ethiopia reacted in several ways to high food prices, beginning in 2007, when Ethiopia introduced a ban on exports of main cereals, which was maintained in the first months of 2008 (FT, 4 April 2008).²

¹ tinyurl.com/c7qtof.

² tinyurl.com/cf75h4.

In April 2007, the Ethiopian government created a grain stabilisation programme to curb the developing crisis in the grain markets of the main cities. The scheme initially covered just the capital Addis Ababa but was extended to 12 other cities. The Ethiopian Grain Trade Enterprise, which runs the programme, estimated in April 2008 that the programme benefits 4m people in urban areas (*FT*, 4 April 2008).

In January 2008, Ethiopia increased the cash wage rate for the labour intensive public works portion of its Productive Safety Net Programme (PSNP)¹ by a third, raising the annual transfer to food-insecure households in rural areas to an average of USD120 per year to restore its purchasing power to the originally designed levels (World Bank, 2008?). The daily wage rate which is used to calculate cash transfers for public works in the framework of the PSNP, has been increased from ETB6 to ETB10 (starting from January 2009) (FAO and WFP, 2008).

In February 2008, the Ethiopian government stockpiled grain (IRIN, 2008).² It also announced a temporary freeze on the World Food Programme's (WFP) local purchases of food for emergency interventions. The government banned exports of the main cereals and grain stockpiling, and it imposed a temporary 10% surtax on luxury imports to help fund wheat subsidies for the poor. The WFP began buying food in Ethiopia in the mid-1990s on the invitation of the government, to help firm up prices,

'which tended to fall drastically at harvest time, resulting in farmers often receiving prices which were incredibly low, as farmers were under pressure to dispose of their commodities to meet urgent cash requirements' (IRIN, 2008).³

In March 2008, Prime Minister Meles Zenawi announced the creation of a special task force to monitor and prosecute 'greedy' traders. Mr Meles had accused businessmen of profiting from and exploiting the situation (BBC News, March 2008). In a speech to parliament he said that

¹ The PSNP aims to mobilise labour for public works activities (infrastructure and assets to promote agricultural productivity and access to markets such as feeder roads, soil and water conservation, micro-dams for irrigation), while smoothing food consumption, protecting household assets or preventing impoverishment. The government targets those who face food insecurity and offers employment for five days a month in return for transfers of either 15 kg of cereals or cash equivalent of USD4.00 per month for each household member. Households with no labour and no other means of support are eligible for direct support worth the same amount (Demeke et al., 2009).

² tinyurl.com/dd4czzw, accessed on 26/2/08.

³ tinyurl.com/az39kw, accessed on 26/2/08.

'Such greedy and illegal business persons will only respond when each has been identified and punished. As a result, the government has decided to completely change its approach toward those committing economic crimes. A task force comprising members of the Ministry of Trade and Industry, the federal police and the National Security and Intelligence service has been set up to permanently monitor illicit activities and take prompt legal measures as necessary.' (VoA 18 March 2008)¹

The perception that the private sector was unduly profiting from high prices seemed to be shared by many others in Ethiopia. The *Daily Monitor* (30 March 2008)² cited a source who claimed that

'Government business enterprises have played and are still playing an undesired role fuelling the current inflation. [...] As government business companies, these enterprises are basically expected to play a positive role in stabilizing the market to offset acts of greedy and a get-rich-quick traders and speculators.'

The claim that the private sector was fuelling high prices was refuted by a FAO and WFP report which put forward that the price increase in Ethiopia had different causes:

'Ethiopia has experienced unprecedented economic growth since 2002 and gross domestic product has risen by 48% in real terms as a result of substantial public spending and investment as well as private investment drawing upon domestic funds, increasing amounts of remittances from abroad and domestic credit. As a result, the general consumer price index has risen steadily. Food prices have risen faster than non-food prices in the last few years and the available evidence indicates that this is due to a 'classic' price inflation phenomenon and to changes in the behaviour of surplus farmers and consumers rather than to rent-seeking strategies and practices by traders.' (FAO/WFP, 2008a:5)

In May 2008, the government imported 150,000 tonnes of wheat which was distributed to urban poor at subsidized prices (and later in the year it imported another 150,000 tonnes). The Government further decided to cancel the value-

¹ tinyurl.com/cjeoen, accessed on 17/03/09.

² tinyurl.com/aeb9d3, accessed on 26/2/08.

added tax, turnover surtaxes on food grains and flour - which constitute more than half of the country's food consumption - as well as all types of tax imposed on cooking oil, and surtax on soap. It established measures which include provision of direct and indirect subsidies, and has spent ETB372 (USD38m) to subsidise wheat and ETB3.52bn (USD366m) to subsidise fuel. The monthly distribution of 25 kg of wheat for low-income urban dwellers, which was introduced in March 2007, continued as well as distribution of edible oil and other products (FAO and WFP, 2008a).

However, the government again blamed traders for the fact that food grain price stability was not achieved in some communities 'due to illegal practices by traders operating outside the law'. Prime Minister Meles Zenawi stated the government will take action against black market operators. It was reported that 45 traders were arrested (Reuters, 21 May 2008).¹

In August/September the Ethiopian Government sold about 190,000 tonnes of wheat from its grain reserve to about 800,000 urban poor and imported 150,000 tonnes of wheat to meet demand in urban areas, while WFP and NGOs provided about 197,629² tonnes of food to the increasing number of people requiring food assistance (Demeke, 2009).³

In September 2008, the Federal Government placed an order to buy 300,000 tonnes of wheat estimated to cost USD77m, on behalf of the Ethiopian Grain Trade Enterprise (EGTE), a federal agency responsible for the stabilisation of the domestic grain market. This was the fourth import of wheat by the enterprise since September 2007, although it was the first time for Prime Minister Meles Zenawi's administration to procure such a high volume. The government subsidized retail prices to cover transport cost from the place of purchase to the central stock in Addis Abeba (Addis Fortune, 15 March 2009).⁴ The Ministry of Trade and Industry announced that the government would distribute wheat to flour factories at a lower price (ETB5.5 per kg). The wheat was distributed to the factories at ETB3.5 per kg. However, several factories and related businesses still sold flour at a higher price (ETB8.5 per kg) (Ethioforum, 2008).⁵ Subsidised wheat targeted at the poorest Ethiopians is sold at ETB3.5 per kg.

¹ tinyurl.com/adru66, accessed on 27/02/09.

² OCHA, Ethiopia, Weekly Situation Report, Drought/Food Crisis in Ethiopia, 23 September 2008. tinyurl.com/aqarb8, accessed on 27/02/09.

³ The government has recently announced a revision of the estimated number of people in need of humanitarian assistance from 4.6m to 6.4m, and the revision of the figures will necessitate additional resources. OCHA, Situation Report: Drought/Food Crisis in Ethiopia, 23rd September 2008. tinyurl.com/aqarb8, accessed on 27/02/09.

⁴ tinyurl.com/d6jgkf, accessed on 09/04/09.

⁵ tinyurl.com/d7cpmd, accessed on 27/02/09.

Again, it was reported that much of this subsidised wheat is resold at much higher prices (ETB7-8 per kg) (BBC 21 March and 16 October 2008).¹

In early October 2008, the Government eliminated fuel subsidies by fully adjusting the domestic price to import parity level. This measure was expected to save about USD200-250m per year and to be used to subsidize food consumption (through additional food imports) whose benefits are considered to be less regressive than fuel subsidies. The overall balance of Government finance in 2007/08 (including external grants) showed a budget deficit of 2.9% of GDP, the lowest in last four years (FAO WFP, 2008).

In February 2009, the IMF reported that Ethiopia would receive USD50m.

'to mitigate the impact of exogenous shocks on the balance of payments, address domestic economic imbalances, and protect Ethiopias most vulnerable people.'

The Ethiopian government will implement various policies (Honda, 2009):

- Eliminate domestic fuel subsidies. The fuel subsidy was abolished in October 2008 by adjusting regulated domestic prices to import parity. The authorities will review domestic fuel prices monthly, adjusting them as needed but keeping a margin above world prices in order to repay the debt of the Oil Stabilisation Fund.
- In late 2008 the government imported wheat equal to more than 3% of domestic crop production and distributed it to low-income families and flour mills at import cost - well below domestic prices. It is prepared to do so again if necessary to mitigate the impact of high food prices.
- Significantly tighten fiscal policy and eliminate domestic borrowing. In the revised 2008/09 budget, general government domestic borrowing is targeted at zero - down from 2.7% of GDP in 2007/08 - by containing expenditures and enhancing revenue mobilisation through administrative measures.
- Reduce domestic borrowing by public enterprises. Such borrowing will be kept to ETB4-8bn, 1.1-2.2% of GDP, in 2008/09, down from 4.4% in 2007/08, by limiting investment activities and also by repaying the debt of the Oil Stabilisation Fund. The authorities have established an inter-agency committee to monitor key public enterprises and public institutions.
- Tighten monetary policy. The National Bank of Ethiopia plans to reduce broad money growth to less than 20% in 2008/09 from about 23% at the

¹ tinyurl.com/bcunpn and tinyurl.com/bjwmpf, accessed on 27/02/09.

end of the previous fiscal year. It also intends to closely monitor and control money creation arising from its net lending to the government.

- Increase exchange rate flexibility. Reflecting this commitment, the official exchange rate against the U.S. dollar depreciated by 5% on January 15, 2009. This, together with a similar-size depreciation on January 2, brings the cumulative depreciation since end-2008 to over 10%.

8.4 Conclusions

Ethiopia has been confronted with unfavourable weather conditions in various parts of the country, leading to high food insecurity in several states. Combined with already high food prices, this fuelled prices even more and led to high costs of addressing food insecurity problems. Despite efforts of the Ethiopian government to increase the supply of cereals (especially wheat) in the domestic market through imports, prices kept spiralling upwards and were at some point much higher than import as well as export parity prices.

Many in Ethiopia, including notably the government and its president Meles Zenawi, believed that the high prices were caused by a 'greedy' private sector and a number of traders were even arrested. However, the FAO refuted this in its report on the food crisis. This does point out the hostility of the Ethiopian government towards the private sector (and traders in particular).

One reason why domestic cereal prices in Ethiopia increased is a shortage of supply (due to reduced harvests in some parts of the country) and high world market prices (for tradable cereals such as wheat). However, it is not clear why prices continued to rise even when world prices started to decline and why domestic prices were so much higher than world market prices. One explanation is that economic growth and increased demand fuelled inflation. Another is that the expectations that prices would continue to rise also played a role. The measures taken by the government against traders might therefore be counter-productive.

Another notable feature of the Ethiopian food crisis is that food (in)security is highly regionalised and that food prices differ per state. This highlights the fact that markets are not functioning smoothly - balancing supply and demand within the country and equilibrating prices. High transaction costs (see 2.1) and transport costs are the reason behind this. The government therefore could invest more in measures reducing these transaction and transport costs. It must be pointed out that the Ethiopian government did invest in infrastructure and a Commodity Exchange has been established in April 2008, which will not only

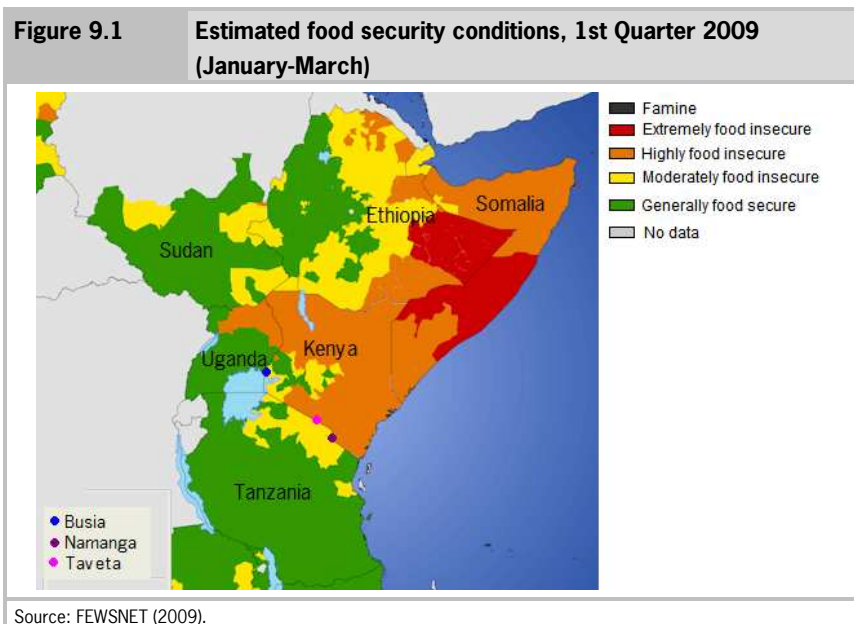
function as a central auction but also will disseminate price information throughout the country.

The efforts of the Ethiopian government to bring down prices by importing wheat have been very costly. The government is now forced to implement measures to decrease its budget deficit. It remains to be seen how the financial crisis will affect the economy in 2009.

9 Comparison of East African countries' government responses to high cereal prices

9.1 Prices

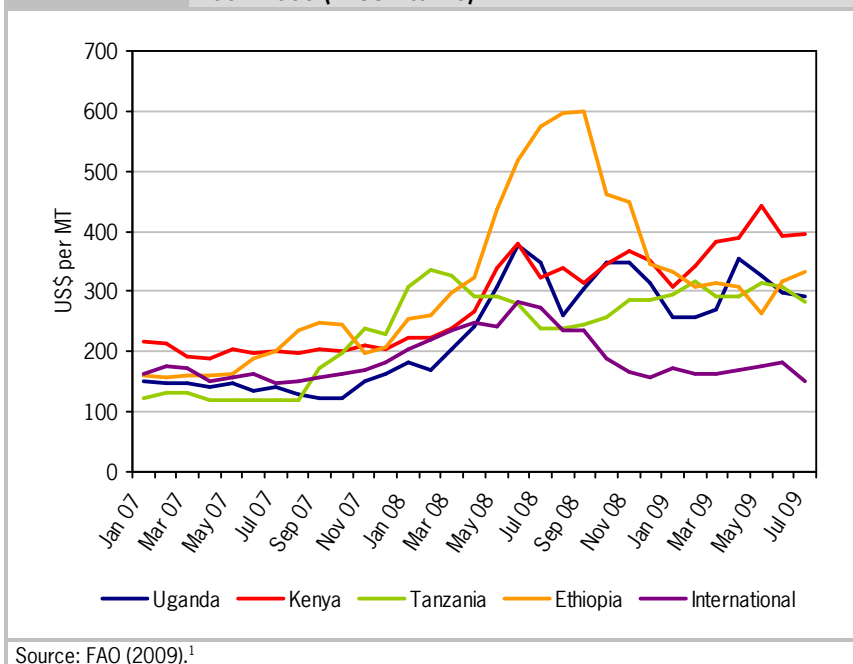
Two major factors shaped the food security situation in East Africa. First, the climatic conditions have differed per region in the past years. When one region experienced drought, another region may have experienced good rains. Second, the policy responses to cereal price increases have differed per country, and this is actually visible in a map depicting food security conditions in East Africa (Figure 9.1). For instance, the border of Kenya with Tanzania is clearly visible. This also indicates at the fact that regional trade is not very efficient. If it was, it would lead to fewer differences between regions, balancing surpluses and deficits.



However, cereal trade does play a crucial role in East Africa. According to the Regional Agricultural Trade Intelligence Network (RATIN, 2009), cross border trade has grown rapidly in the East African Community (EAC) since December 2008, following the second season harvest in both Uganda and Tanzania. Tanzania and Uganda have been the main source of maize, while Kenya was the main recipient. Uganda supplies Kenya, Sudan, Rwanda and Democratic Republic of Congo (DRC) and Tanzania has been supplying mainly Kenya. Busia border (border between Kenya and Uganda, Figure 9.1) has been very busy, so have Taveta and Namanga borders (Borders between Tanzania and Kenya). There was increased trading activity at Busia due to the high demand from Kenya. RATIN expected the maize inflow into Kenya from Uganda to continue till end of March 2009 after which it is expected to reduce as stocks diminish. In Tanzania harvesting started slightly earlier and the production was not that good. Therefore surplus stock for exports are already low and Tanzanian traders and farmers are storing maize for food security as they monitor the current season. Based on RATIN's historical border statistics, availability of stocks, demand and price differentials determine the direction of flow. Despite the fact that the Tanzania government put an export ban on agricultural commodities last year, significant volumes of maize have been exported into Kenya. This is mainly because of high prices in Kenya.

Prices of maize differ considerably in the four countries (Figure 9.2). The minimum price difference is 15% while the maximum price difference is 228%. Again, this is a symptom that markets in East Africa are not very efficient and/or connected - apparently traders cannot make use of these price differences by making a profit. Compared to international prices, the East African prices are relatively high, especially in Ethiopia in 2008.

Figure 9.2 Maize prices Kenya, Uganda, Ethiopia and Tanzania, 2007-2009 (in USD tonne)



Source: FAO (2009).¹

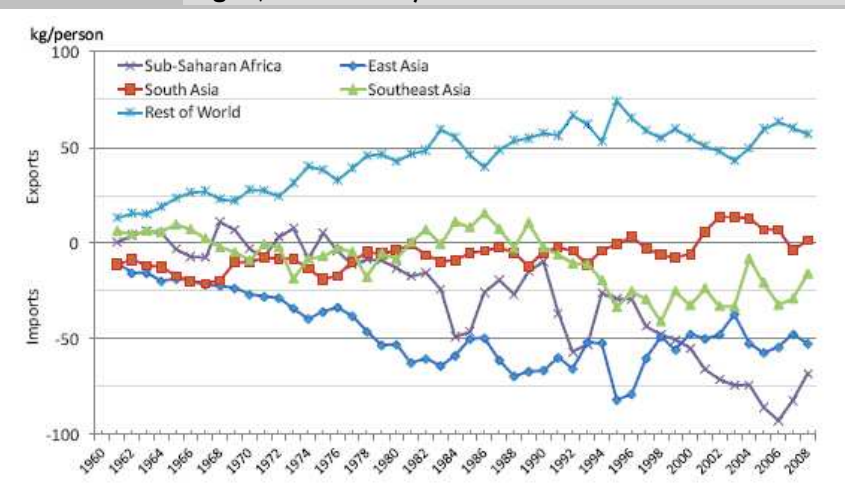
Domestic price instability tends to be highest in Africa, especially in land-locked countries where the wedge between export and import parity is high because of high transport costs and poor market infrastructure (Byerlee et al., 2006).

9.2 Trade

The high prices have hit the countries hard through their per capita cereal-grain imports, which are the highest in the world (see Figure 9.3). High cereal prices have meant very high costs to African countries.

¹ tinyurl.com/cu5hce, accessed on 6 April 2009.

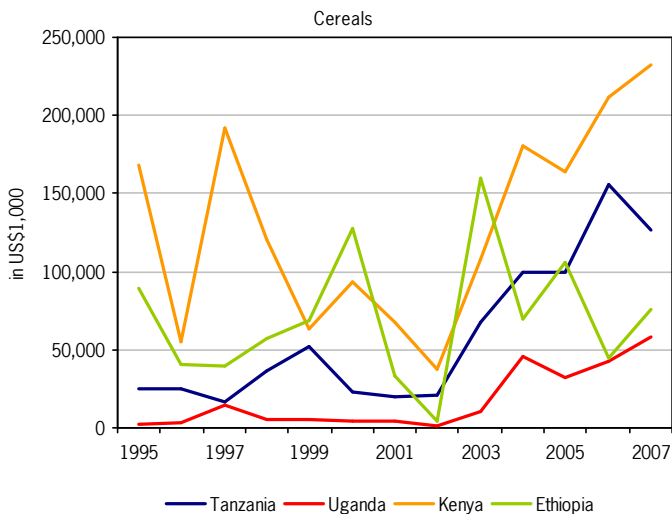
Figure 9.3 USDA estimates of cereal grain net trade per capita, by region, 1961-2008 a)



a) Data are for standard trade years over a 12-month season ending in the year shown, from USDA PS&D database (www.fas.usda.gov/psdonline), matched with mid-year population estimates from US Census Bureau, International database (www.census.gov/lpc/www/ldb).
Source: Masters (2008).

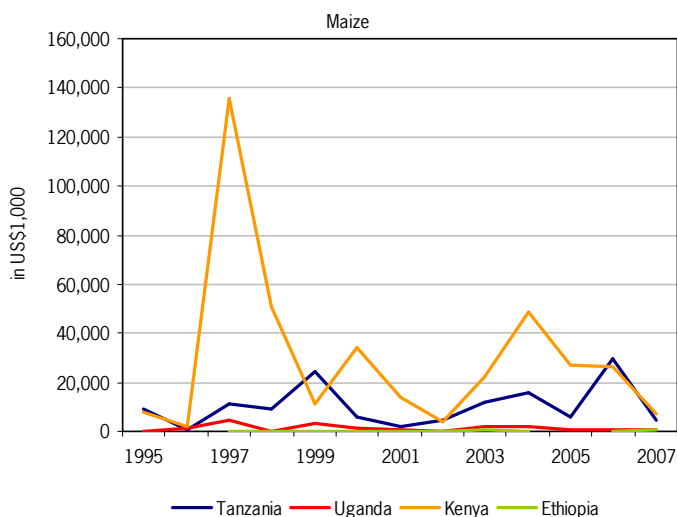
Especially Kenya has spent much on importing cereals, followed by Tanzania, Ethiopia and Uganda. Figure 9.4 shows the countries' total cereal imports since 1995 (of which most is wheat) while Figure 9.5 presents their maize imports.

Figure 9.4 Cereal imports (in USD1,000) 1995-2007 in Tanzania, Uganda, Kenya and Ethiopia



Source: UN Comtrade database.

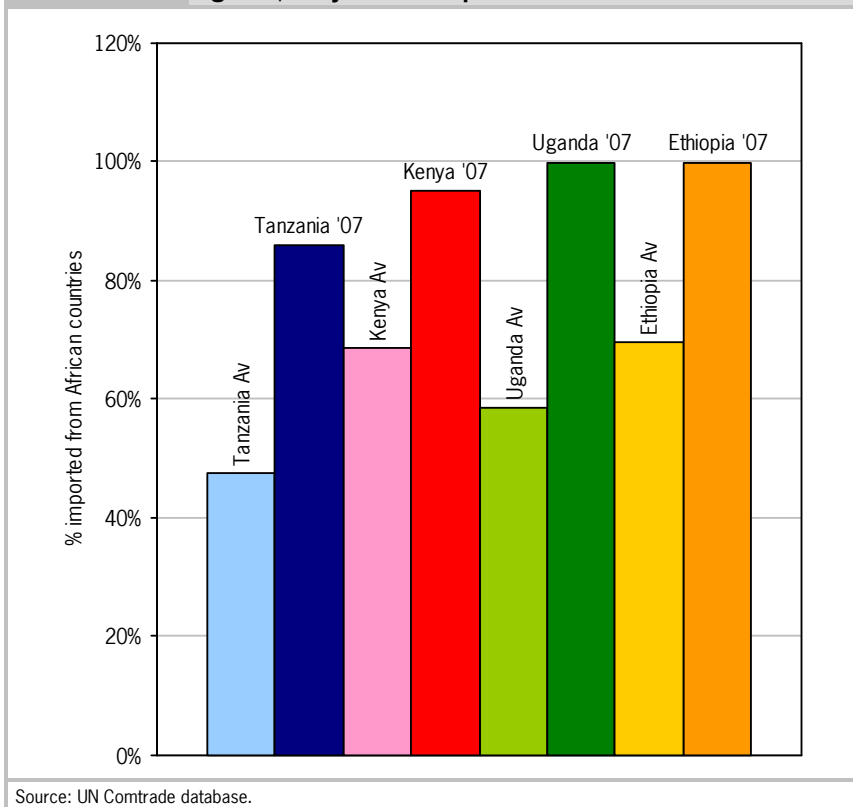
Figure 9.5 Maize imports (in USD1,000) 1995-2007 in Tanzania, Uganda, Kenya and Ethiopia



Source: UN Comtrade database.

The four East African countries in our study have imported maize mostly from other African countries, especially in recent years (Figure 9.6). Wheat, by contrast, is mostly imported from non-African countries. This means that regional trade is extremely important for food security in East Africa.

Figure 9.6 Maize imports from African countries as a share of total maize imports (average 1995-2007 and 2007) in Tanzania, Uganda, Kenya and Ethiopia



9.3 Government responses

Table 9.1 gives an overview of the policies that were implemented by the governments of Ethiopia, Kenya, Tanzania and Uganda *specifically in response to the rising food prices*. Of course all countries invest in long-term interventions

such as marketing infrastructure, antipoverty programs, agricultural R&D, natural resource management but these were not noted in the table because except for Uganda these were not mentioned in relation to the high prices. Most countries pursued short-term policies to reduce food prices for consumers (price-oriented policies), except Uganda. Especially Kenya and Ethiopia, which have experienced high (cereal) price increases have imposed for the most part only price-oriented policies, followed by Tanzania. Ethiopia has also increased support through social protection programs (increased existing food for work programs).

Table 9.1		Policies implemented to respond to the rising food prices in Ethiopia, Kenya, Tanzania and Uganda			
Type of intervention	Short term (< 1 year)	Ethiopia	Kenya	Tanzania	Uganda
Reduce food prices for consumers (price-oriented policies)	- Reduce tariffs/taxes on food	✓	✓	✓	
	- Adopt food price controls/ take action against profiteers	✓	✓		
	- Adopt consumer subsidies	✓	✓	✓	
	- Adopt food export bans or taxes	✓	✓	✓	
	- Pursue government food imports	✓	✓	✓	
	- Release food reserve stocks	✓	✓	✓	
Increase food availability for (or income of) target groups (income-oriented policies)	- Increase support through existing social protection programs	✓			
	- Increase public sector wages				
	- Increase food aid programs				
Type of intervention	Medium term (1-3 years)	Ethiopia	Kenya	Tanzania	Uganda
Reduce food prices for consumers (price-oriented policies)	<i>Same options as short term plus:</i>				
	- Establish food reserves and release policy	✓	✓	✓	
	- Establish variable tariffs or variable export subsidies/taxes	✓	✓		

Table 9.1		Policies implemented to respond to the rising food prices in Ethiopia, Kenya, Tanzania and Uganda (continued)			
Type of intervention	Short term (< 1 year)	Ethiopia	Kenya	Tanzania	Uganda
	- Pursue options to increase domestic food production (see below)				✓
Increase food availability for (or income of) target groups (income-oriented policies)	<i>Same options as short term plus:</i> - Establish new social protection programs or expand/improve existing ones	✓			
Increase food production	- Adopt input subsidies		✓		✓
(supply-oriented policies)	- Adopt producer price supports and subsidies		? a)		
	- Expand agricultural credit				✓
	- Strengthen agricultural extension				✓
Type of intervention	Long term (> 3 years)	Ethiopia	Kenya	Tanzania	Uganda
Reduce food prices for consumers (price-oriented policies)	<i>Same options as medium term plus:</i>				
	- Invest in marketing infrastructure, institutions, and information	✓			
	- Invest in increased food production capacity (see below)				
Increase food availability for (or income of) target groups (income-oriented policies)	<i>Same options as medium term and those for increasing food production plus:</i>				
	- Invest in other development and antipoverty programs (e.g. education, promote rural non farm enterprises)	Public works			
a) It is unclear to what extent the policies imposed by the Kenyan Government actually <i>supported</i> Kenyan producers, which have protested against the low producer prices imposed by the government.					

Table 9.1		Policies implemented to respond to the rising food prices in Ethiopia, Kenya, Tanzania and Uganda (continued)			
Type of intervention	Short term (< 1 year)	Ethiopia	Kenya	Tanzania	Uganda
Increase food production (supply-oriented policies)	<i>Same options as medium term plus:</i>				
	- Pursue agricultural R&D				? b)
	- Invest in productive infrastructure and assets (e.g. irrigation, mechanisation)				
	- Improve natural resource management				
	- Improve property rights and resource tenure systems				

b) The NAADS program was mentioned by the Ugandan president in relation to high food prices, but was not established because of high food prices.

Table 9.1 does not, however, include the detrimental interventions that were implemented by the governments. For instance, the confusion that was created by the Kenyan government over the policies (with different ministries disagreeing over which policy was to be implemented), the less than transparent way certain policies were implemented in Kenya, which led to accusations of corruption, the price floors that were imposed and which were deemed to be unfair according to producers. In Ethiopia, the crackdown on traders, which were accused of hoarding and speculation when they were seen storing more than a certain amount of grains. In Tanzania, the accusations that 'greedy neighbours' were driving up prices. All these did not help markets to function by clearing demand and supply and establish equilibrium market prices. These detrimental interventions combined with policies in Table 9.1 especially hampered regional trade between the countries.

It is interesting to note that despite the various interventions to reduce consumer prices by the governments of Kenya and Ethiopia, prices have not (yet) come down substantially. Both countries are still facing very high prices, although the prices in Ethiopia have come down. It remains to be seen therefore, to what extent the policies pursued were successful, especially when taking into consideration the negative effects (corruptions, backlash against traders, beggar-thy-neighbour policies).

Uganda seems to be the exception because the government saw the high prices not as a problem but as an opportunity. Although Uganda has its regions with relatively high food insecurity (due to internal conflict and climate-related events such as flooding), on the whole, the country has been able to attain a relatively high productivity level and could therefore be more optimistic.

10 Discussion and conclusions

In this study we focused on government interventions in cereal markets in four East African countries (Ethiopia, Kenya, Tanzania and Uganda) in the context of high international food prices in 2008. These high prices of 2008 remained high in 2009 in East Africa (although there are some differences between the four countries), while international prices decreased. This has caused a dilemma for governments: how to choose the optimal extent of intervention in agricultural input and output markets, balancing the needs and interests of the poor urban population and the net food buyers in rural areas on the one hand and the interests of farmers on the other hand. The first group benefits from government intervention to keep domestic cereal prices low, while farmers prefer high prices, especially because prices of inputs (such as seeds and fertilisers) also have increased in the past two years.

There are four major areas where governments can influence prices and price transmission:

1. trade policy (border measures such as tariffs and quotas);
2. subsidies and taxes (focused on farmers);
3. institutional reforms and infrastructure (focuses on institutions);
4. public goods and transfers (focused on consumers).

Over the past decades, East African governments intervened in the agricultural sector especially in the first two areas, but often with a negative effect on the agricultural sector. During the 1960s and 1970s - the phase of import-substitution industrialisation - government policy was very much biased against agriculture. This bias has been decreased by the reforms of the 1980s and 1990s, especially by reducing the taxation of exports. Nowadays, agriculture in Kenya and to a lesser extent Uganda is supported, but anti-agricultural (macro-economic) policies still exist in Ethiopia and Tanzania. Most cash crops in Sub-Saharan Africa (such as cocoa, tea and coffee) have always been and still are heavily taxed. For cereals, the picture is mixed: some crops (e.g. sorghum) are subsidised, but other crops (such as rice, maize and millet) face net taxation.

Institutions (markets and infrastructure) and institutional reforms play a central role in the system of price transmission. Governments can influence the functioning of markets through the institutional environment that facilitates/governs these markets. In reality however, most (transactions in) cereal markets in East Africa are not governed by a well established institutional framework with

clear formal rules but rather by informal institutional arrangements between market participants. Because the East African countries in this study lack a strong institutional environment, transaction risks in food markets are high and market participants face high transaction costs (for contact, contract and control).

The governments in East Africa almost exclusively resorted to short-term price-oriented policies that reduced prices for consumers, with Uganda being the exception. In general, the policies had little effect with regard to stabilisation of prices and markets: overall, prices continued to fluctuate and rise. The policies also did little to improve the situation of farmers since governments did not pay much attention to supply-oriented policies. Farmers often did receive higher prices, but at the same time farmers suffered from extraordinarily high input prices. In addition, some governments (e.g. in Kenya) introduced price controls which have a short term positive effect on lowering consumer prices, but a long term detrimental effect on farm-gate prices. The policies can thus best be summarised as a treatment of symptoms (i.e. high prices) instead of focusing on root causes. Government policies did not tackle the fundamental problems of transaction risks and costs that market participants in East Africa usually face. Some government policies also triggered new transaction costs.

One short-term measure that was implemented by Tanzania, Kenya and Ethiopia was an export ban (combined with reduction of import barriers). At regional level these unilateral measures increased food insecurity ('beggar thy neighbour'). They prevented farmers from taking advantage of higher prices in neighbouring countries, while they also prevented surplus cereals to cross borders to deficit areas. These measures continue to exist, although there are several regional trade agreements in East Africa, such as EAC and COMESA that agree on reducing trade barriers. The problem is that trade (liberalisation) policies are not integrated/consistent with national sectoral policies that could address supply-side response issues. This has prevented the region from attaining its full potential in agricultural exports even within the context of improved macroeconomic fundamentals. Although there is (informal) cross-border trade between the East Africa countries, this type of informal trade is very costly and risky. Therefore, a reduction of transaction risks and costs at regional level and a strong commitment to the existing trade agreements are crucial to ease cross-border trade and to better regulate (regional) food surpluses and food shortages.

We can draw several conclusions with respect to the role of government in food markets. First, our study has highlighted the fact that governments often intervene directly in markets (as in Kenya, Tanzania and Ethiopia), with (unin-

tended) adverse consequences. Many economists have therefore argued that the role of the government is to improve the conditions (i.e. institutional environment) in which trade and markets are embedded, more than directly intervene in markets. However, Moore and Schmitz (2008) warn against 'legal formalism' and 'property rights fundamentalism' which put much focus and faith on the formal institutional environment. They argue that the institutional and political reforms needed to improve the formal institutional environment may not be achievable within a reasonable time span. Besides, the rule of law is not an end in itself but a means to provide investors with what they need: assurance that their property rights will not be violated. Legal formalism might be neither the only nor necessarily the best way for governments to provide investors with the assurances they need.

Thus, as our conceptual framework has outlined, informal institutional arrangements can be an alternative to a (badly functioning) institutional environment. Moore and Schmitz (*ibid*) make a similar argument and recommend that policy-makers (and donors) depend as far as possible on the many self-regulation systems (i.e. informal institutional arrangements) that exist - and not to take measures that might undermine these self-regulation mechanisms without putting something better in their place. There are several examples of how informal institutional arrangements can be supported. Currently, many farmers do not specialise in (cash) crops but diversify and reserve part of their land for food crops, which is rational in the light of fluctuating harvests and prices. This strategy reduces their risk but hampers productivity growth. If farmers would specialise more, investments in terms of inputs (seeds, fertiliser) would become more economic. Market-based instruments can reduce price and income risks of farmers, thus facilitating specialisation and a shift to a more professional agriculture that can achieve a higher productivity. Such instruments can include warehouse receipts systems, forward contracts, credit facilities linked to harvests and other marketing instruments that reduce price or income risks. Government policies to initiate and support local private initiatives, as well as international donors to help with finance and expertise can play an important role in reducing transaction risks and encourage productivity growth.

Second, although there is thus a role for government in improving food markets by supporting (informal) institutional arrangements that reduce transaction costs and risks, our study also highlighted that in general, the East Africa governments resorted to short-term, ad-hoc policy measures that at least showed the public they were doing something. These actions and also the agricultural distortions of net taxing agricultural production can be explained by a political economy approach which acknowledges that economic and political systems

are intertwined (see North et al., 2009; Rausser and Roland, 2010). This study makes clear that the policies and action of the governments were very much inspired by politics. Unsworth (2009) points out that this view has important consequences for donor policy. She signals that most donor-led development debates still focus on policy and practice instead of applying political economy analysis to specific aspects of development practice. She finds that donors have remarkably little interest in understanding the political processes involved in building more effective public authority and aligning incentives around productive use of resources. Because of a poor diagnosis of the real problems and processes,¹ donors have often come up with defective solutions.

In this light, the approach 'Framework for Strategic Governance and Corruption Analysis' (SGACA) that the Netherlands Ministry of Foreign Affairs has adopted is a step in the right direction. This approach can be very useful in understanding agricultural markets as well. The analysis includes a 'Power and Change Analysis' (PCA) which comprises an institutional analysis ('rules of the game') that should lead to more insight into how formal and informal institutions of the state, civil society and the private sector shape the way business (e.g. agricultural markets and trade) is conducted and how relationships are managed. It also includes an analysis of key actors' capacities and interests, the events and pressures (context) to which they are responding and a mapping of factors that fundamentally shape the state and political system.

Unsworth (2008) also suggests to donors that instead of seeing their role as experts bringing solutions, or as politically neutral 'partners', they should see themselves as convenors, facilitators and politically aware contributors to serious debate. They would find it easier to have an honest debate about a range of politically sensitive governance issues if these did not form part of the conditionality attached to large financial aid transfers. This is particularly true for issues concerning market institutions: there is no set of solutions ready to be applied to markets that will reduce transaction costs and risks immediately. Markets in developing countries form a complex interactive system that cannot be improved by quick-fix solutions but need more systemic transformations. A debate with national governments about the useful role of traders and middlemen, recognising the valuable functions they perform, finding ways to support them (or at least not obstruct and marginalise them) would already be helpful.

¹ Most of the debates that have shaped donor thinking and practice have been led by economists (such as Jeffrey Sachs, William Easterly, Paul Collier, Dani Rodrik). Although these economists have alluded to fundamentally political issues (why governments lack the capacity and incentives to tackle poverty) most did not investigate the underlying causes and processes at work.

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