

# Markets, trade and sustainable rural development

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## The art of balancing

### High cereal prices and government responses in East Africa

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In several ways, 2008 was an exceptional year with food prices rising to record levels. The Netherlands policy note "Agriculture, rural economic development and food security" states that these price increases on international agricultural markets have contributed to a "change in thinking" (LNV DGIS, 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. Many governments felt compelled to take action, but had a difficult balancing act: to support consumers by lowering prices on the one hand, or to accept high prices because they benefit producers? In this policy brief we present the findings of our study of the role of the government in 2008 with respect to high maize prices in East Africa, and offer some conclusions on what role governments can take to achieve win-win situations.

#### 2008: a year of high food prices

In 2007 prices of fats and oils as well as grains started to increase to reach their peak mid-2008 (250% and over 300% compared to 1990 levels resp.). After this, prices plunged again to stabilize in early 2009. In East Africa, cereal (maize) prices also started to rise in 2007, but instead of falling again mid-2008, they continued to rise and volatility has continued to be high. This situation is depicted for maize prices in figure 1.

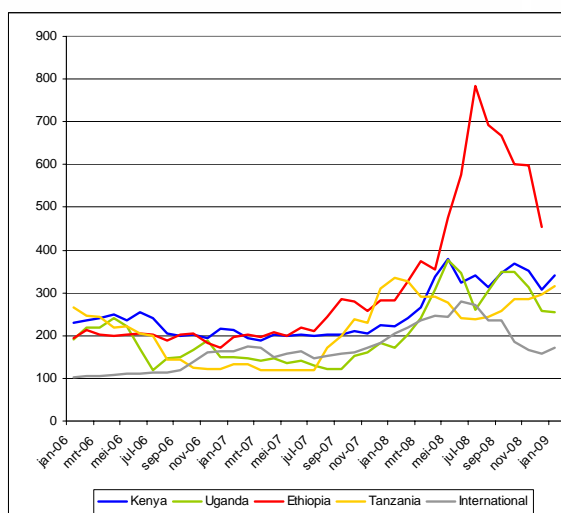


Figure 1: Maize prices in East Africa 2006-2009

The high maize prices are a reflection of the relative lack of supply and increasing food insecurity, especially in Kenya and Ethiopia. There are several reasons that explain the high prices and relative scarcity of maize. The high international prices only partly explain the rise in prices. As figure 1 shows, prices in East Africa correlate more with each other than with international prices. High international prices have made it more expensive for East African countries to import maize to ease the lack of supply. A second reason is political unrest. In Uganda the "Lord's resistance army" has been terrorizing the North (where the food situation is moderately insecure, see figure 2). In Kenya early 2008, the political unrest following the

contested election results has led to a decrease in agricultural output (most of the violence was in the maize growing region in the south-west). Besides political unrest there have been natural disasters (e.g. a volcano eruption in Tanzania, floods in Uganda) that led to a disruption in agricultural output. Combined with occasional regional and temporal droughts and failing harvests, a characteristic of traditional African agriculture, these events led to a sharp increase in food prices and food insecurity.

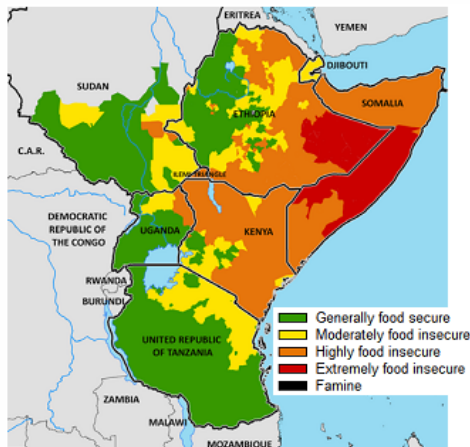


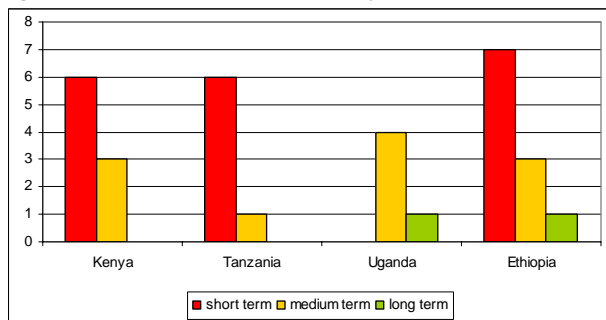
Figure 2: Food security situation in East Africa, April 2009 (Fewsnet, 2009)

- Pursue government food imports
- Release food reserve stocks
- Increase support through existing social protection programs
- Medium term (1-3 years)**
- Establish food reserves and release/distribution policy
- Establish variable tariffs or variable export subsidies/taxes
- Establish new social protection programs or expand/improve existing ones
- Long term (> 3 years)**
- Invest in marketing infrastructure, institutions and information systems

### Government responses

The governments of East African countries have pursued different policies with a different focus (short-term versus long-term). As figure 3 shows, most policies have been short-term to mitigate negative effects of high food prices for (urban) consumers. Uganda stands out by not having pursued any short-term policies. In fact, president Museveni stated that high prices were good news for the farmers in Uganda<sup>1</sup>.

Figure 3: Number of measures taken by East African countries



Some short-term policies such as export restrictions have worsened the situation in neighboring countries: “beggar-thy-neighbor” policies.

#### Box 1: Government policies in Ethiopia

##### Short term (< 1 year)

- Reduce tariffs/taxes on food
- Adopt food price controls/take action against speculation
- Adopt consumer subsidies
- Adopt food export bans or taxes

<sup>1</sup> This reflected the fact that Uganda did not suffer as much from droughts as the other countries, as well as the fact that Uganda does not depend on maize as a food crop.

### Effect on farmers

Farmers were hurt by several short-term price policies (such as price controls, 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 fertilizer prices and as a consequence, many farmers reduced their maize cultivation. Farmers who are net food buyers were helped by government price policies (although the effect was smaller than for urban households).

### Conclusions

Food security will remain an important issue in the future: prices and price variability will remain relatively high in East Africa. Internationally, high prices and export bans have led to land lease constructions (“land grabbing”) where food-importing countries are trying to secure food security by leasing land in Africa. The divergence of prices between and within countries points at high transport costs and high 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 (win-win situation).

The fact that well-functioning (domestic) markets are crucial in achieving food security, besides increased investments in technology, has not received sufficient attention. Donors have an important role to play in this.

Currently, many farmers do not specialize in (cash) crops but diversify and reserve part of their land for food crops. This reduces risk but hampers productivity growth. If farmers would specialize more, investments in terms of inputs (seeds, fertilizer) would become more economic. Market-based instruments can reduce price and income risks of farmers, thus facilitating specialization 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.

#### Information: