Do no harm?
How well-intentioned (but misguided) Government actions exacerbate food insecurity: Two case studies from Malawi[1]

Case 1: The food crisis of 2001-2002

During a six-month period from late 2001 to early 2002, Malawi experienced a food crisis. Much has been written on the causes of this crisis. While early media reports stressed "drought conditions," poor weather was a minor factor. Neither was the "sell-off" of the Strategic Grain Reserve much of a factor. Rather the 2001-2002 food crisis in Malawi was the result of two interrelated events: (a) long-term decline in purchasing power of the poor coupled with (b) a sudden spike in consumer maize prices in late 2001. The structural causes of the long-term decline in purchasing power have been described elsewhere (e.g. Frankenberger et. al, 2003; Rubey 2004). This brief concerns the second contributing factor: the sudden, unexpected spike in consumer maize prices in late 2001 that, coupled with the long-term deterioration in rural incomes, triggered the crisis.

Malawi's maize markets were "liberalized" in the mid-1990s, permitting private traders to freely buy and sell maize at market prices. However, to this day, the Government of Malawi continues to play a role in maize markets alongside private sector traders, mostly by selling maize through ADMARC, the agricultural marketing government parastatal. During the 2001-2002 period, ADMARC attempted to subsidize maize, ostensibly to help consumers gain access to low-priced maize. However, in 2001-2002, these attempts by ADMARC to stabilize maize prices for the poor had the unfortunate effect of making maize prices more volatile. In fact, there is evidence that continued Government attempts to subsidize maize prices actually exacerbated the crisis.

In September 2001, ADMARC established a fixed price of 17 MK per kg for maize sold through ADMARC depots. This price remained unaltered for the next 18 months. But, in comparison to prevailing market prices in 2001, this ADMARC price was "too low." That is, the ADMARC price was below the prevailing market price in both Malawi and neighboring countries. Private sector traders, including those that engage in cross border trade, saw no opportunities to sell at a profitable price in Malawi. In fact, there were clear incentives to export Malawian maize to other countries in the region where consumer prices were not being kept artificially low by government actions.

As a result, as Malawi entered the 2001-2002 "hungry season," few private traders saw profit opportunities and few made plans to import maize into Malawi. But as the hungry season progressed, ADMARC was not able to keep up with demand and many ADMARC depots ran out of maize. With no subsidized ADMARC maize, consumers had to turn to private markets. But given limited private sector supply, maize was scarce and prices for maize in local markets skyrocketed, quadrupling in some cases in just a few months.

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[1] By Lawrence Rubey. December 2004. Please send comments to lrubey@usaid.gov. The views expressed in this brief do not reflect the official position of USAID or the U.S. Government.

By contrast, the food security situation a year later during the 2002-2003 period was very different. While observers feared a repeat of the 2001-2002 crisis, it never materialized. Clearly, widespread distribution of food aid played a role. But imports by the private sector also contributed to price stability in markets. For much of the 2002-2003 marketing season, the ADMARC price of 17 MK was "too high." That is, private sector traders found that it was profitable to import maize into Malawi and sell it at prices ranging from 10 to 16 MK per kg, undercutting the ADMARC price of 17 MK per kg. In addition, government and donor intentions on maize imports were made very clear. As a result, private sector imports were significant and ADMARC sold very little maize and had large carry-over stocks. Most importantly, prices remained relatively stable throughout the hungry season, in stark contrast to the previous year (see attached graphic illustration).

Malawi's experience during 2001-2002 and 2002-2003 provides a stark example of how actions by the private sector can contribute to maize price stability. And it offers a cautionary tale of how government good intentions can backfire and actually harm consumers. While consumer maize subsidies are seen as "beneficial" to consumers, the "benefit" can be short-lived. The experience 2001-2002 suggests that when ADMARC subsidized maize stocks ran out, maize prices shot up much more than they otherwise would have. This is because the ADMARC maize subsidy created a disincentive for private sector imports, imports that help have a moderating impact on prices. Thus, when ADMARC ran out of maize, there was less supply of private sector maize. In essence, sale of subsidized maize through ADMARC contributed to, rather than reduced, the price volatility faced by consumers in 2001-2002.[2]

What lessons are there for the future? Consumers are much more likely to be able to cope with gradual, predictable increases in consumer prices that reflect the normal seasonal pattern in Malawi (e.g. the gradual increases) rather than the extreme volatility of a tripling of consumer maize prices. And high levels of poverty in Malawi mean that a portion of consumers may not be able to afford maize at market prices. But ADMARC subsidies that are available to all consumers are a costly and disruptive way of trying to help vulnerable consumers. Rather, it would be much more cost-effective, as well as less disruptive to the market, to target subsidies to vulnerable groups.

Also, the Government of Malawi should sell government-owned maize only through an open tender process, instead of the prevailing practice of selling at fixed prices that do not respond to changing market conditions. This policy change would reduce market disruptions, create opportunities for the private sector, and lessen the chance of future crises. Since the Government of Malawi could also raise much more revenue by selling maize locally in an open tender process, the introduction of local open tender sales would have the complementary effect of easing the Government's fiscal problems. Lastly, the Government of Malawi needs to make a clear and unequivocal statement about its maize sales and purchase strategy well in advance each marketing year. Only then will private traders have a clear picture of what the Government is planning to do.

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[2] Interestingly, this conclusion is at odds with research findings commissioned by NGOs in Malawi that blamed the Malawi food crisis of 2001-2003 on the removal of maize price controls in the mid-1990s and *lack* of Government intervention in maize markets (Devereaux, 2002; Drimie, 2004).

2001/2

Lots of price volatility. Why?

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Spotty supply situation in market

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Little private sector role

2002/3

Little price volatility. Why?

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Relatively good supply situation in markets

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Significant private sector role

WHY THE DIFFERENCE?

2001/2

ADMARC price of MK17 is "too low"

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Little private interest/profit opportunity

↓

High demand for "cheap" ADMARC Maize. ADMARC stocks run out

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But little private sector imports...

↓

RESULTS: PRICES SKYROCKET

2002/3

ADMARC price of MK 17 is "too high"

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ADMARC is irrelevant –but lots of private sector interest

↓

Few sales by ADMARC

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But private sector meets demand...

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RESULTS: PRICES STABLE

Without such a statement, private traders are likely to be plagued by uncertainty and the end result will be inaction by the private sector.

Case 2: The fertilizer shortage of 2004

During the 2004 maize planting season, Malawi experienced a fertilizer shortage. As the planting season began in November, almost two-thirds of fertilizer imports had not arrived in Malawi. Fingers were quickly pointed, and private sector fertilizer importers suffered much of the blame. Yet, there is persuasive evidence that the fertilizer shortage was the result of ill-timed and incorrect pronouncements by the Government of Malawi. These ill-timed pronouncements had a ripple effect on markets and restricted the ability of fertilizer dealers to import planned levels of fertilizer in a timely manner.

On June 24th 2004, the Principal Secretary for the Ministry of Agriculture was widely quoted in the national media as advising farmers to wait and not buy fertilizer until the Government established a new, lower subsidized price for fertilizer. In the following days, Government officials revealed plans for a new fertilizer subsidy scheme that would bring down the price of fertilizer and continued to advise farmers to hold off in buying fertilizer. While July is typically a slow month for fertilizer sales, fertilizer dealers usually see sales pick up in August, increase further in September and October, reaching their peak November.

But in 2004, fertilizer sales were flat during this August to October period. Farmers apparently listened to Government recommendations and waited for the planned subsidy to be put in place. Slow sales during August to October meant less cash flow for fertilizer importers. Since most importers order fertilizer in multiple orders, using the proceeds of the first orders to fund later orders, less cash flow had a chilling effect on follow-up orders. Fertilizer stocks were not moving and there was no reason for importers to order more stocks (all inorganic fertilizer in Malawi is imported).

Meanwhile, the planned fertilizer subsidy scheme hit some snags. When the ruling party won the July 2004 Presidential election, efforts to design the subsidy scheme began immediately. During late July and August 2004, several different subsidy scenarios were discussed by the Ministry of Finance, Ministry of Agriculture, and the private sector. But negotiations and discussions dragged on and no decisions were made. By September, rumors were circulating that the subsidy scheme would be dropped in favor of free farm input packs for 2 million households. But the subsidy scheme resurfaced later that month in a Presidential speech. Finally, in late October, the Government reached agreement with a key donor for the distribution of free farm inputs to 2 million households through the Targeted Input Program (TIP). The fertilizer subsidy scheme that had been announced in June 2004 was quietly forgotten.

The Government of Malawi then faced a new challenge: sourcing the needed fertilizer for the TIP scheme. Many fertilizer importers, who had been sitting on fertilizer stocks for months due to much slower than normal sales, quickly offered to sell stocks to the Government for the TIP program. With their cash flow situation improving, importers made new orders in October. But it was too late. By the end of October, only 36 percent of the expected fertilizer tonnage of 219,000 tons was in Malawi. Almost 22 percent was still in transit and a whopping 42 percent was ordered but not yet in transit. Thus, by the end of October, just over a third of the needed fertilizer was in-country due to the slow pace of orders that stemmed from the slow sales during the July-October period.

In November 2004, the main planting rains arrived. A large, but ultimately unknown percentage of farmers, planted maize and tobacco without initial fertilizer applications. Stories of farmers searching unsuccessfully for fertilizer for sale mushroomed. The Consumer Association of Malawi reported cases of fertilizer price gouging as scarcity of fertilizer became an issue of national concern. Given the importance of fertilizer in Malawi and the obvious link between national maize production and fertilizer application rates, there are now fears that Malawi will face a reduced harvest in 2005 because of the fertilizer debacle, triggering another hike in maize prices, and a possible food crisis in late 2005.

Nation, June 25, 2004

Fertilizer price to go down, says PS

by James Chimpweya

Government is working on modalities to reduce the price of fertilizer, *The Nation* has learnt.

Charles Matabwa, Secretary for Ministry of Agriculture, was speaking at the 8th annual general meeting by National Smallholder Farmers Association (Nasfam).

"Government is working on modalities to have the price of fertilizer reduced. We are sure fertilizer will go down before December and government will come up with a statement on the matter," said Matabwa.

He advised farmers to keep some money after selling their produce so that they can buy fertilizer at the reduced price next growing season. "I would advise farmers to wait until government announces the new price," he said.

He said government reduced hessian levy so that farmers make enough profit after selling their tobacco and he asked Nasfam board of directors to discuss the controversy surrounding the levy with Tobacco Association of Malawi (Tama) during its council meeting..

"Reduction of the levy meant farmers would go home with more money. I have read correspondence between Tama and Nasfam, saying Tama has no money because of the levy.

"So, I would advise that you discuss the issue during Tama council meeting and have a common understanding for the benefit of smallholder farmers in the country," he said.

Commenting on the AGM whose theme was: "Diversification— a key to sustainability," Matabwa said diversification was a tool and strategy towards long term sustainability.

In Malawi, diversification is usually tied to tobacco which is currently facing a lot of challenges like anti-smoking lobby that continue to influence people's opinions on tobacco worldwide. Surprisingly, tobacco remains a major foreign exchange earner for Malawi and is the most widely grown cash crop in the country, he said.

Matabwa asked Malawians to change their mind-set since tobacco prices continue to fall at auction floors and the crop contributes massively to deforestation.

"The threats will persist and resurface in different forms. We seriously need to embark on approaches to diversify our income generating base and maximise our production. We need to look for other crops that can replace tobacco, but this cannot be done overnight. It is a gradual process," he said.

Matabwa: Government working on modalities

He assured Nasfam that government will provide the enabling environment in meeting diversification challenges

Status of Fertilizer Supply in Malawi as of 31st October 2004 (2004-05 Cropping Season)