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## Rationalise agricultural policy strategies

Minimum price and the role of the State in regulating agricultural markets in Sub-Saharan Africa.

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**THIS NOTE AIMS TO REMIND US OF AN ECONOMIC OBSERVATION THAT MANY GOVERNMENTS, INTERNATIONAL INSTITUTIONS AND TECHNICAL ASSISTANCE AGENCIES SEEM TO HAVE FORGOTTEN. IN A CONTEXT OF HIGH VOLATILITY OF AGRICULTURAL COMMODITIES PRICES, PURELY COERCIVE APPROACHES HAVE PROVEN TO BE COUNTERPRODUCTIVE. THIS NOTE PROPOSES A REVIEW OF ALTERNATIVES THAT TAKE INTO CONSIDERATION THE FUNCTIONING OF AGRICULTURAL MARKETS IN ORDER TO REGULATE THEM.**

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International agricultural commodity prices are inherently volatile. Some contemporary factors even tend to increase their natural volatility [1]. Since the 1990s and the liberalisation of agricultural markets, a majority of sub-Saharan African countries have implemented "compulsory minimum price" policies to deal with this volatility. Generally, these policies focus on cash crops involving a large number of smallholder farms, such as cocoa, cashew nuts, sesame, groundnuts, cotton, coffee and, more recently, shea and soybeans.

These interventions are characterised by two different approaches:

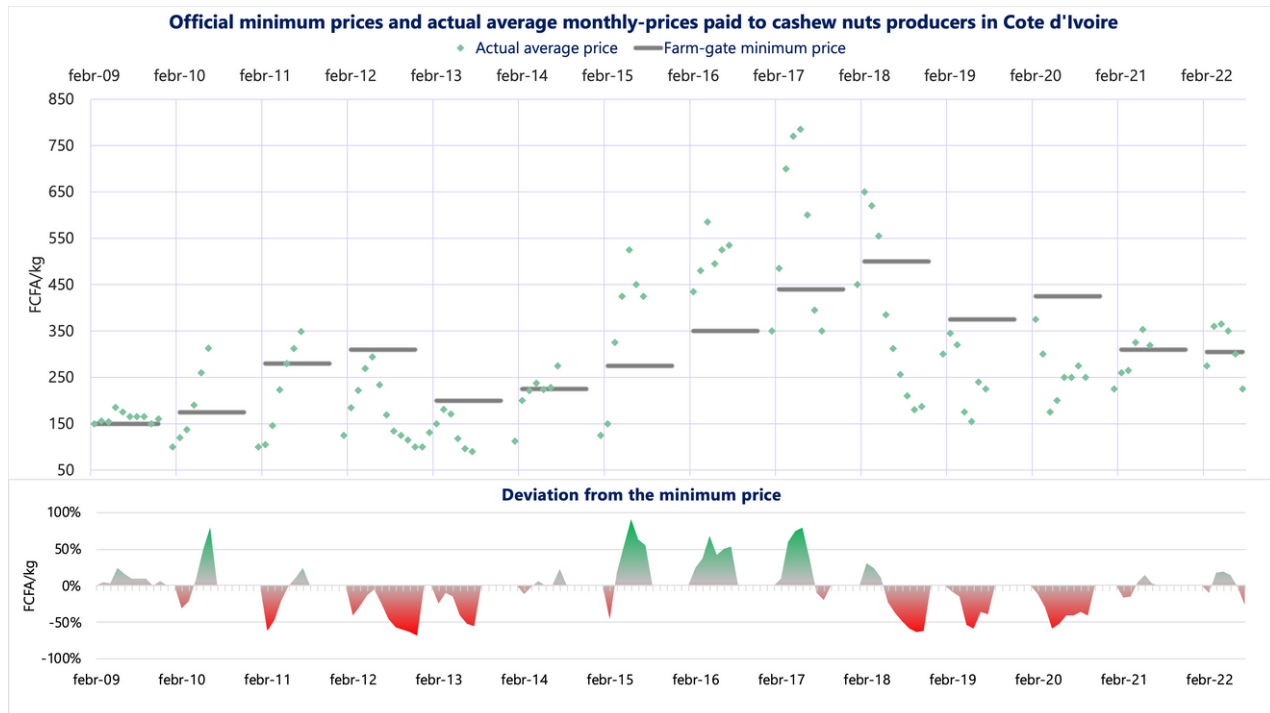
- Either they are based on market regulation mechanisms such as forwards and futures contracts, purchase price subsidies, buffer funds or weekly or monthly revision of prices according to the evolution of international prices (e.g. the cotton sector).
- Or they are based solely on the financial penalisation of actors in the national value chain through fines, stock seizures or licence withdrawals (e.g. cashew sectors).

Sometimes these approaches assume that it would be possible to impose a price on the international market: agricultural economic history has repeatedly disproved this idea [2]. Based on such an assumption, the Tanzanian government's initiative in November 2018 [3] to have the army buy the country's entire cashew production in order to impose a higher price on the international market has had catastrophic consequences for Tanzanian farmers, the national economy and public accounts.



## Minimum price policies which are not backed by risk management mechanisms are inefficient, destabilising and value-destroying

In the case of the cashew nut sector in Côte d'Ivoire, which is the main source of income for more than 600,000 rural households in the centre and north of the country, there is a total decorrelation between the minimum prices set by the State and the actual prices paid in the production areas. Thus, over a 12-year study period, the real prices (Pr) charged were roughly equal to the minimum prices (Pm) set for the season only 20% of the months observed. The rest of the time, the difference between the prices charged and the minimum prices was greater than 10%. Moreover, the distribution of these deviations does not follow a regular or predictable pattern.



This absence of correlation between official prices and prices actually paid can make producers vulnerable. Indeed, those who would like to use the minimum price as an indicator for their marketing strategies find themselves more disoriented than in the absence of information on agricultural markets. The example of the cashew sector in Côte d'Ivoire is not an isolated illustration. Other examples show that price-fixing policies, without the support of a market regulation mechanism, are ineffective, including in food crops (e.g. maize and soya in Malawi [4]).

### Minimum price policies

#### Backed by a regulatory/market adjustment mechanism

 <b>Cotton</b> Cote d'Ivoire, Burkina Faso, Mali, Togo, Benin	 <b>Cocoa</b> Côte d'Ivoire, Ghana	 <b>Rubber</b> Cote d'Ivoire	 <b>Palm Oil</b> Cote d'Ivoire
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#### Not backed by a regulatory/market adjustment mechanism

 <b>Cashew</b> Cote d'Ivoire, Burkina Faso, Mali, Togo, Benin, Ghana, Mozambique, Guinea-Bissau	 <b>Maize</b> Malawi, Rwanda, Zimbabwe, Zambia	 <b>Soy</b> Togo, Benin, Zimbabwe	 <b>Ground-nuts</b> Senegal, Gambia	 <b>Sesame</b> Burkina Faso, Mali	 <b>Shea</b> Benin
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Besides this disorienting impact, minimum prices have other perverse effects on agricultural sectors :

- The disconnection between the real market and the official price encourages informal trade, to the detriment of traceable and documented transactions. Indeed, buyers who keep a written record of a transaction below the "minimum price" expose themselves to a sanction. They therefore favour informal trade and double accounting to avoid any risk of sanctions.
- Farmer organisations, often unable to offer their members the official minimum price, see their relations with their members deteriorate. Most producers do not see the profitability of group sales. Thus, the minimum price policy is detrimental to initiatives to structure farmers into associations, cooperatives or economic interest groups.
- Official prices are often homogenous nationwide, which does not allow for price differentials to account for conditions of access (access/security/parafiscality), differences in quality, the diversity of available outlets or concentration (collection time to fill a truck).

In so doing, the single price disadvantages producers who invest in increasing their production, their quality or adding value by integrating pre-processing or processing stages. In other words, this policy favours downward standardisation.

Moreover, this policy undermines trust between the rural world and the urban public authorities. Minimum prices encourage arbitrariness (State officers can decide to pursue any farmer, trader or processor on the grounds that he or she has not respected the official price) and corruption (the pretext of not respecting the official price can be used to exert parafiscal pressure on the actors in the value chain).

Some policy makers may not even realise the inefficiency and damage caused by this type of policy, as the institutions or officials in charge of regulating the sector provide them with distorted data indicating that minimum prices were respected for most of the season.

However, examples of effective and innovative agricultural market regulation policies with a limited impact on public finances exist throughout the African continent. It is therefore urgent and strategic to capitalise on best practices to build effective regulations rather than disruptive policies.

## Regulatory policies adapted to the budget capacities of States are possible and effective

There are many examples of effective agricultural market regulation policies. Galtier [5] has carried out a wide analysis of private and public tools and policies for managing price instability. The relevance of each tool depends on the sector, the budgetary capacities of the States and the private actors involved.

In sub-Saharan Africa, one of the main constraints on States is their low budgetary capacity. Thus, several examples of public regulation mechanisms with a small budgetary footprint are presented below. This list is neither exhaustive nor prescriptive. Regulatory mechanisms can and should be adapted to the specificity of each

country and each sector according to the relative weight in the world market, the level of liquidity (processing/concentration in the production areas or, on the contrary, export of the raw product), the perishability of the products and the level of organisation of farmers.

Five mechanisms summarised in the table below seem relevant to adapt and implement. They can be implemented independently or synchronously by combining several tools to reduce the effect of volatility on rural households and agricultural sectors. They are listed in the table below in order of simplicity and cost.



Mechanism	Cost	Feasability	Governance	Objectives
<b>Updated and indicative market information</b> (non-normative)	Low CAPEX Low OPEX	<b>Simple</b> Requires the production of truly independent and technical information which is difficult to operationalise if the implementation is handed over to a traditional public institution.	Market-based	<ul style="list-style-type: none"><li>• Reduce the impact of price volatility</li><li>• Reduce geographical and sociological information asymmetries</li></ul>
<b>Structuring the market around a physical commodity exchange</b>	High CAPEX Low OPEX	<b>Complexity moderate</b> Requires good geographical targeting of infrastructure and strong integration of private stakeholders during the design	Market-based	<ul style="list-style-type: none"><li>• Reduce the impact of volatility</li><li>• Improving the added value distributed to farmers</li></ul>
<b>Price band mechanism (import or export)</b>	Low CAPEX Variable OPEX Requires an exception to the principle of budget universality	<b>Complexity moderate</b> Requires countercyclical use of tax revenues and isolation of those revenues from the rest of public finances, i.e. an exception to the principle of budgetary universality of taxes	Public intervention	<ul style="list-style-type: none"><li>• Stabilise prices on the national market on an intra- and inter-seasonal scale</li></ul>
<b>Structured and coordinated use of price risk hedging tools</b>	Moderate CAPEX Moderate OPEX	<b>Complexity high</b> Requires a strong correlation between a commodity exchange/futures market and the local market, as well as limited cross-border flows or sub-regional coordination	Market-based	<ul style="list-style-type: none"><li>• Stabilising prices on the national market on an intra-seasonal scale</li></ul>
<b>Policy for regulating and driving supply</b> Grubbing-up, renovation, conversion and fallow premiums or production quotas	High CAPEX High OPEX	<b>Complexity high</b> Requires fine targeting of incentives to reduce production and a strong enforcement mechanism to be effective	Public Intervention	<ul style="list-style-type: none"><li>• Stabilise prices on the national and international market on an intra- and inter-seasonal scale</li></ul>



For each mechanism, there are success stories in Africa and elsewhere in the world:

- For updated and indicative market information, examples of success can be found in the rubber and palm sectors in Côte d'Ivoire or in the N'kalô Information Service on the scale of 14 countries [6].
- For the structuring of the market around a physical stock exchange, the examples of the Ethiopian Commodity Exchange (ECX) [7 and 8] and the Warehouse Receipt System (WRS) in Tanzania are interesting models [9].
- For price band mechanisms (on imports or exports): the Russian example on cereals and the Indonesian example on palm oil can inspire Sub-Saharan African countries [10].
- Concerning the use of international hedging tools to stabilise prices on an intra-seasonal scale, the example of Côte d'Ivoire's Programme de Vente Anticipé à la Moyenne (PVAM) for the cocoa sector is probably the best model to use. The smoothing funds and mechanisms using the advance sale of many cotton sectors in sub-Saharan Africa can also serve as a reference.
- Regarding policies for regulating and driving supply, history holds at least two inspiring examples: the rubber industry in Thailand[11, 12 and 13], with its renewal and conversion premium programme under the RAOT (Rubber Authority of Thailand) and the European wine sector, with its policy of grubbing-up premiums since the 1950s[14]. In markets where the continent dominates world supply (notably cocoa and cashew nuts), these examples could inspire coordinated policies between African producing countries. In other sectors (cotton, palm, rubber, macadamia, coffee), such policies could be implemented in coordination with other major producing countries outside the continent.

## Conclusion

Faced with the volatility of agricultural commodity prices, minimum price policies are often used as an easy remedy. However, when they are not backed by adequate regulating mechanism, they can have a harmful effect, as the example of the Ivorian cashew sector tends to show. Thus, in order to protect farmers and urban consumers with modest incomes, it is necessary to build, or rebuild, adequate and innovative regulations. These can be inspired by policies that have proved their effectiveness in Africa and elsewhere: information systems, physical exchanges, floating taxes, price risk hedging tools or supply monitoring policies.

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