

The Challenges of FRA Maize Pricing

Times of market volatility

Zambia has recently emerged from a period of very high maize prices in the 2008/09 season, which has caused great hardship for consumers. Ironically, world maize prices tumbled in late 2008. SAFEX maize prices have hovered near \$170 per tonne since November 2008. Yet Zambian maize prices remained over \$300 per tonne until the 2009 harvest that has recently hit the market. The extremely high Zambian prices in the 2008/09 season were caused by a combination of high world prices, a lack of transparency about available supplies in the country, late timing of decisions to imports, and poor coordination among the various actors involved in the maize sector.

It is important to learn from the 2008/09 experience in order to not repeat past mistakes in the 2009/2010 marketing season and beyond. Currently the GRZ faces especially important decisions about the optimal role of the Food Reserve Agency to assist in helping the country ensure food security and promote the interests of farmers and consumers in the country.

Maize outlook vis-à-vis maize pricing

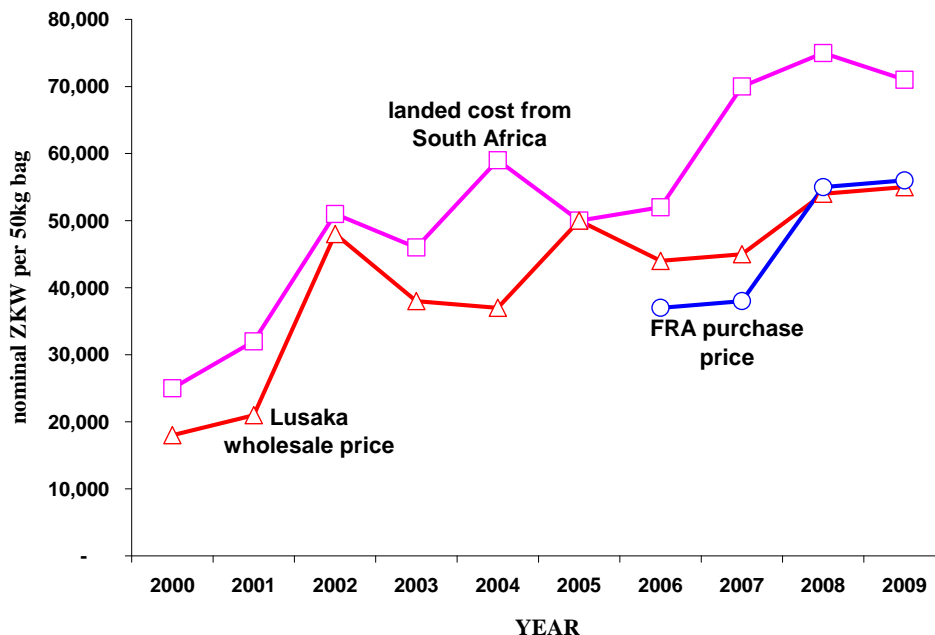
Some stakeholders have criticized the FRA maize buying price of 65,000 kwacha per 50kg bag (roughly US\$260 per metric tonne, paid at remote rural satellite depots) as being too low and have proposed that the FRA raise its into-depot maize purchase price as high as 85,000 kwacha per bag (roughly US\$349 per tonne).

The rationale for offering a price at 85,000 kwacha per bag reflects an effort to provide incentives to farmers to produce more maize and ensure adequate maize supplies in the country. Generally, governments can most effectively achieve their objectives by setting grain purchase and sale prices based on information about the likely marketing season supply-demand conditions. Based on crop forecasts for Zambia, the 2009 maize harvest is anticipated to be 1.9 million tons – the highest maize harvest recorded in the past 15 years, resulting in an exportable maize surplus. According to the Regional Agricultural Trade/East Africa Grain Council Bulletin of February 2009, good harvests were also achieved in South Africa, Malawi, and Mozambique. It is forecasted that South Africa will get a bumper harvest of roughly 12 million tonnes. The maize harvest in Mozambique and Malawi are also projected to rise sharply over last year's production. Therefore, the regional maize supply situation appears to be favourable.

After a volatile world grain price situation in 2008, world grain prices appear to be headed for a more stable period in 2009. June to December 2009 maize price futures on SAFEX range from US\$142 to US\$157 per tonne. International US Gulf maize export prices have returned to the range of US\$140 to US\$150 since late 2008 and are projected to stay roughly in this range in 2009.

Figure 1 shows the evolution of nominal wholesale maize prices at Lusaka, the cost of importing white maize from South Africa to Lusaka, and the purchase price by the Food Reserve Agency. Prices shown are the average of May-October prices in each year because this is the prime maize marketing period in which most smallholders sell their maize. The comparison of market prices, import prices, and FRA prices can tell us something about the relationship one would expect to find between these prices.

Figure 1. May-October Average Maize Prices, Nominal Zambia Kwacha per 50kg Bag



Note: 2009 landed import cost from South Africa determined as the average of May to December 2009 SAFEX futures prices plus \$120 per ton for transport to Lusaka. Source: AMIC, SAFEX, FRA.

The FRA purchase price has normally been below the Lusaka wholesale price. The FRA must incur transport, handling and storage losses associated with moving grain from the outlying production areas to urban areas. As long as the FRA selling price to millers reflects these marketing costs, its selling price will be higher than its buying price. Hence it is unsurprising that the FRA purchase price should be set below the price in urban markets (otherwise its selling price to millers and other buyers would be uncompetitive compared to grain sourced by private traders, e.g., the Lusaka wholesale price in Figure 1 above).

The importance of import prices

It is also expected that the FRA purchase price should be lower than the cost of importing grain from South Africa. This has indeed been the case for each year that the FRA has set a purchase price since 2005. As long as the Government of Zambia tries to keep maize prices in the country below import parity levels, the FRA’s buying price will be below the landed cost of imports.

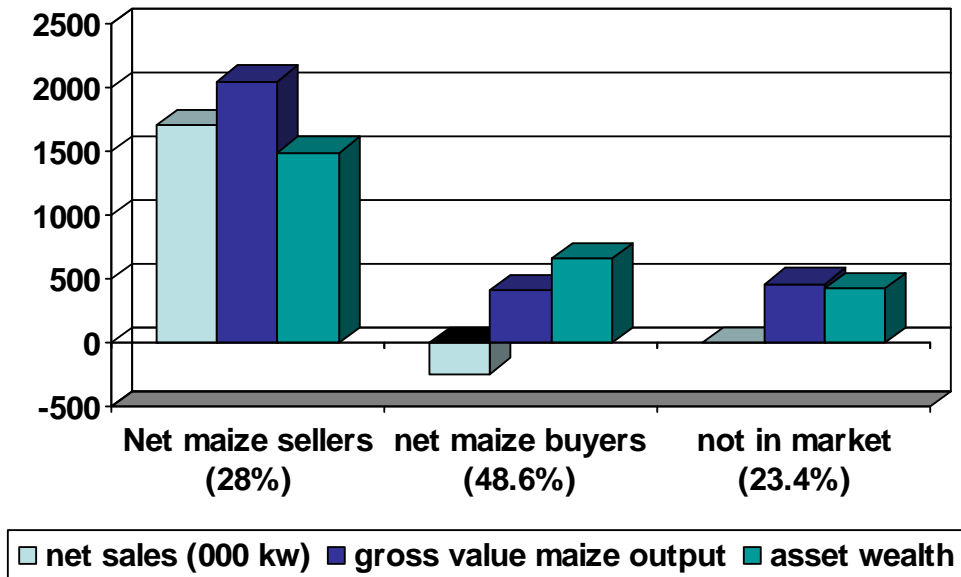
Reference to Figure 1 indicates that, given projected import prices in 2009, if the FRA were to accept some stakeholder recommendations, and set a purchase price of ZK 85,000 per bag, this will most likely exceed by a significant margin the expected full cost of importing maize from South Africa. Assuming that the FRA sells maize above its purchase price, the FRA selling price would be even further above the cost of importing maize. At ZK 85,000, the FRA would be paying farmers more for the crop than the cost of importing it.

High maize prices disadvantage many poor rural households

A buying price of ZK 85,000 would likely push up the price surface in Zambia back to levels experienced recently in the 2008/09 crisis year, but this time not because of scarcity and high world prices but as a deliberate policy decision. Research results indicate that, unfortunately, the majority

of households in Zambia, both rural and urban, are not sellers but buyers of maize (see Figure 2). Moreover, the rural poor in Zambia tend to be buyers of maize. Hence, a rise in the maize price surface to ZK 85,000 per bag would have adverse income distributional effects by transferring income from the majority of the population in Zambia who are relatively poor net maize buyers to large commercial farmers and to about 25% of the nation's smallholder households who sell relatively small amounts of maize.

Figure 2. Net maize sales, gross value of maize output and asset wealth (in '000 kwacha per household) of smallholder farm households that are net maize sellers (28% of national total), net maize buyers (48.6% of total) and who neither buy nor sell maize (23.4%)



Maize exports and the need for Zambian farmers to be competitive

Market prices paid for maize over and above the purchases that FRA has announced will be determined by commercial supply and demand. Zambia is likely to have a significant exportable surplus during the 2009/10 marketing season. By the time that maize exports are taking place by private traders (FRA will not export maize as it will not sell its 09/10 purchases this season), local market prices will begin to reflect market prices in those importing countries (the DRC and Zimbabwe in Zambia's case), adjusted for transport and other marketing costs. Therefore, in surplus years, there is a need for Zambia's maize to be competitively priced. If not, other countries, in particular South Africa, will capture those export markets. As a comparison, South African farmers' maize will be exported at ex-silo prices equivalent to ZK 40,000 (in the Johannesburg area). If Zambian maize were priced at ZK 85,000 in outlying production regions, it would be considerably cheaper for Zimbabwean and DRC buyers to source maize from South Africa rather than Zambia. This kind of regional competition highlights the importance of focusing on reducing production and marketing costs in Zambia rather than raising prices to sustainably promote the competitiveness and long-term viability of Zambian maize production.

Government debt to maize traders may affect market liquidity

It has been reported that FRA still owes grain traders a significant amount of money for the grain it purchased from traders in the 2008/09 season. As a result, some traders have not been able to pay back commercial loans from the last season. Many banks will not provide traders with new loans to buy maize again this year until the outstanding loans are repaid. A possible consequence is significantly reduced working capital, negatively affecting traders' ability to buy the current crop. The late entry of key private maize buyers because of lack of working capital has led to weak market activity, resulting in depressed maize prices.

Conclusions

Determining an FRA purchase price is a complex matter as it affects a multiplicity of factors that influence the performance of Zambia's agricultural sector. The sustainability of a maize farmer, however, depends on that farmer's price competitiveness, both locally and on the regional export market. Issues of adoption of new agricultural technologies and public goods investments that will reduce costs – such as feeder roads, improved agronomic practices, more productive seed varieties, meaningful extension messages, and ensuring the availability of fertilizer at the appropriate time -- are critical for the future competitiveness and viability of Zambia's farm sector.

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