D. THE SETTING OF MAIZE PRICES.

1. Findings

As in a number of countries, the preferred staple food-crop, in Malawi's case, maize, is a major object of Government concern. There is a long history of official control and political intervention in maize markets, with prices typically fixed at levels that are commercially unsustainable, and that typically generate severe budgetary problems.

Unfortunately, maize yields, besides being highly dependent on the varieties planted and on the level of inputs used, are extremely dependent on the weather. Unlike some of the traditional legumes, and certainly unlike cassava, the crop has little ability to withstand periods of drought.

As a consequence of these characteristics, in a bad rainfall year, harvests are subject to very large declines, with rapidly escalating implications for prices. In addition, traditional storage systems are subject to severe problems with insect infestation and mold, and successful maize storage requires sophisticated and expensive facilities, out of the reach of most local producers or intermediaries.

As a result of the above, local market variations in the availability and the price of maize, can be severe. These variations are typically aggravated by the probability that weather patterns may affect the entire region, implying that regional trade may not be a reliable mechanism for stabilizing local prices. Overseas price movements have their own patterns and determinants. They are strongly influenced by the panoply of politicized subsidies, interventions, and surpluses in a number of the richer European, Asian, and North American countries.

2. Conclusions

Fixed official prices fly in the face of functional markets. They deny or remove the ability of the market to respond to the complete range of information to which markets and prices typically adjust. In addition, such fixed prices may be very difficult and expensive to defend, characteristically leading to dual prices and the strong tendency to engender corruption, favoritism and rent seeking. It must be recognized that politicians, officials, or economists, regardless of the information and analysis available to them, are rarely capable of selecting or advising on appropriate fixed prices over the long-term.

It should be noted that the export parity price (net of transport costs) provides the natural floor price to domestic markets. In situations of chronic surplus, (not a current problem for Malawi), this floor price can be defended by exporting. The CP related to maize prices makes sense in implying that the domestic price should never sink below the export parity price, but market prices in an importing country such as is the case with Malawi at present, would normally be expected to rise significantly above the export parity level.

In the event of a good year, and surplus supplies across the region, the export parity price in Malawi is so low that it sends the signal to farmers and to their suppliers that the price of additional output will not cover its production costs - therefore plantings to produce for the market should be cut back or not undertaken. In a situation of recurrent maize deficits in Malawi, the market price can be expected to rise above the export parity price and, depending on the judgments of intermediaries, and the response of local producers --it will move up toward the import parity price. This latter price then provides a ceiling to local prices, in that imports can be expected at that price.

The problem with the use of these prices in place of market prices is that the export parity prices are typically so low that production deficits result, necessitating imports. Conversely, import parity prices are normally so high that supplies exceed domestic requirements, necessitating exports. In either case, not only are the budgetary implications severe, but also the crucial adjusting and balancing role of functioning markets is completely undermined.

The basic conclusion is that export possibilities serve to defend the export parity prices in the event of domestic surpluses. In the case of chronic deficits, domestic prices can be expected to rise as high as import parity levels, but no higher. With good information right through the commercial community of producers and traders, including transport and storage agents, market consensus prices typically emerge, and constantly adjust, as new information becomes available.

3. Recommendations

Recommendation 1

USAID/M should make clear to the GOM that maize prices should be determined by the consensus of an open, well-functioning market. Ensuring that such a market exists, and identifying and removing impediments and distortions that impair its performance, is a legitimate task of government. Fixing artificial prices for such a commodity is not the task of government. Nevertheless, in times of severe shortages, subsidized maize prices, which essentially establish a price floor, can be an effective tool.

Recommendation 2

In addition to ensuring adequate food aid in the event of a crisis, it can be extremely helpful for donors to enter into a countrywide dialogue relating to food shortages and as to the reasons for these. This dialogue should include proposals for specific interventions, targeted to support the incomes, welfare, and nutrition of the country's very poorest people. It must be recognized, however, that the longer run recovery issues must focus on increasing farm productivity, and that this is unlikely to be successfully addressed, without credible market incentives to producers, and to the multiple agents that provide crucial supply and marketing services to them, thereby allowing them to maintain and increase their productivity.

Recommendation 3

Providing adequate food aid without destroying the incentives for the recovery of production, is a familiar dilemma. Its resolution certainly includes potentially massive short-term food assistance in the event of food emergencies. It also must be seen to include a credible strategy, mentioned above, to re-establish commercially sustainable increases in production.

4. *Lessons Learned*

- Given its dependence on unpredictable factors such as the weather and regional and international variations in prices and supplies, there is a basic error in setting, or in recommending a particular price for a commodity such as maize. That error is that no such correct price exists.

- Open and competitive markets typically determine prices, which normally vary quite widely between locations and seasons, depending on familiar market factors. The essential task in these circumstances is to ensure the functioning of such a market, and also that structural or regulatory problems do not distort the price signals emerging from it. This is a very different approach from trying to adjust or correct a fixed price to be imposed on such markets.

- Well-functioning, well informed markets, by instigating multiple adjustments among the full range of market participants, as described above, will tend to minimize the domestic deficits and surpluses that require entry onto external markets. Ironically, fixing domestic prices in a fashion that deters those adjustments is more likely to result in chronically continuing domestic crises, and the recurrent necessity to rely on those external markets.