CHAPTER 7

EFFICIENT EXCHANGE OF GOODS AND SERVICES – THE KEY TO GROWTH

Introduction

Without access to markets there is no economic or social progress. If we were required to provide for all our own needs and could not specialise and exchange goods and services, we would join the rest of the animal kingdom. Even primitive human societies specialise and exchange. The efficiency of that exchange system is critical to the success of the society. The key to that success is flexibility. The market, and the society, needs to be able to respond rapidly to changing circumstances. To be efficient a market must make as much information available as possible so that the exchange can be to the best advantage of all parties.

Good access to reasonably priced communications is a key component of rural development because without them marketing is too expensive. Until markets are secure and reasonably stable, poor farmers will continue to provide for their own basic needs and reduce their opportunities for development. Governments in Africa have often contributed to the insecurity of markets, despite the stated goal of stabilising markets through state marketing boards. In order to contribute to stabilising and making markets more secure, the government agency should be selling when commodities are in short supply and buying when they are abundant. In fact experience in Kenya, Tanzania, Zambia, Malawi and Zimbabwe has shown that historically, rural areas get no, or little, access to formal sector grain after droughts and are unable to sell their grain to government marketing agencies in times of surplus.

Given the poor record of centralised marketing agencies, it is important to develop other mechanisms for making markets more secure. Minimising costs and the time required to access transport, communication, processing and other equipment are important functions for governments. Governments need to minimise regulations restricting market entry and make it easy for new traders and processors to enter the market. This will encourage the increased supply of market options to farmers and reduce the transaction costs involved in exchange. Highly regulated markets lower economic activity and encourage political and economic rents.

The costs of a controlled economy in efficiency terms have been widely recognised and underlie the strong movement towards market liberalisation. The costs of centrally-controlled economies in equity terms are less widely recognised and need attention. Structural adjustment and IMF policies continue to be blamed for political instability and the escalating impoverishment in many African countries. However, the negative effects of structural adjustment programmes arise predominantly from the debt burden and the lack of effective strategies to assist the transformation of state workers into independent entrepreneurs or their effective absorption in the private sector. These negative impacts of adjusting the ship of state should not be confused with the impacts of market liberalisation.

In much of southern and eastern Africa, the opportunities created by market liberalisation have encouraged the informal sector. This has allowed the poor to absorb many of the negative consequences of adjustment. The remaining hardships are often more closely related to the continuing distortions in market institutions than to removing central controls.

The theory of second best recognises that markets are not perfect and that any movement towards Pareto optimality is an improvement in efficiency. As discussed in Chapter 5, a second-best theory is equally applicable to equity.

Liberalisation can be achieved whilst improving equity and the situation of the poor. To achieve it, certain privileged groups may be affected, and it is necessary to have wide and honest articulation of all the costs and benefits. This will be important in order to create national lobbies to overcome the entrenched interests that have derailed most attempts at structural adjustment, decentralisation and market liberalisation in Africa.

Maize Marketing in Zimbabwe provides an interesting example of how market decontrol can stimulate rural development. [1]

History of Centralised, Controlled Marketing

The mines established with the first settlers in Zimbabwe encouraged Shona and Ndebele farmers to respond to demand for food, by selling maize. This rapid expansion of agricultural production and the commercialisation of their subsistence economy was short-lived with policies introduced to support the new immigrant farmers brought in when the mines proved to be disappointing. The centralisation of agricultural marketing systems and the depression in the early 1930s played a major role in establishing policies that discouraged growth and development in communal areas. Specialisation is a key factor to increasing growth but it can only occur where markets are effective, accessible and secure.

The introduction of parastatal commodity marketing was in response to the Depression and was designed to keep the newly arrived small white producers on the land. Large farmers and grain from agents in the communal areas were allocated prices related to the very poor export pool, while small white producers received prices subsidised by consumers and the government and sold on the local market.

The Grain Marketing Board was the only legal buyer and seller of maize grain. In some restricted instances communal areas could exchange grain but all other grain trade was stringently prohibited.

In most decades, the agricultural marketing boards in Zimbabwe were technically efficient and produced considerably less bias against farmers than similar organisations in other East and Southern African countries. They were effective at supporting the emergence of the strong large-scale commercial farm sector with its very high yields and a record of surplus food production. Zimbabwe's role in regional food security owed much to the success of these organisations, particularly the Grain Marketing Board (GMB). They were not always economically efficient, particularly in the 1970s and 1980s when pricing policies were directed

[1] Readers are referred to the appendices for a more detailed history and analysis of grain market reform in Zimbabwe

at self-sufficiency. They did not promote equity with pricing policies that favoured wheat and other commodities grown principally by large farmers. After independence in 1980, the attempts to extend marketing services to small farmers proved very costly and significantly increased parastatal debt. As in other countries in the region they were ineffective in providing services to smallholders.

Furthermore, the centralised system, controls and subsidies to large-scale millers, is largely responsible for the stagnation of communal areas. Because GMB operated a hub and spoke system with no potential for inter and intra community exchange, they limited the opportunities for rural commercialisation.

The marketing boards were successful in establishing viable production of a wide range of commodities in the large-scale sector. This was related to strong farmer representation on the boards in both a technical and policy capacity and to the political power of the farmers. There were some years in the 1950s and then again in the mid to late 1970s when consumer support on maize prevailed, but for the most part, large farm interests were protected by the parastatal marketing system and maize farmers were subsidised. The marketing board successes are also related to the fact that it is much easier to be financially efficient when dealing with only a few large farmers. In addition they had strong accountability to their clientele and were required to operate transparently. They were operating within a relatively small community where it was difficult to hide transgressions and where there was strong social and legal sanction against corruption.

The marketing boards did play an important role in encouraging increased production of maize by smallholders after independence in 1980 with heavily subsidised marketing board depots and collection points but the debt burden became too heavy to carry. Cotton in Zimbabwe provides a very interesting example of how marketing boards can be used to tax farmers heavily in order to subsidise manufacturing. Large farmers stopped producing cotton but smallholders had few alternatives.

In the processing and agro-industrial sectors, the price, exchange rate and regulatory policies of the 1980s reflect the influence of the small but powerful industrial lobby that favoured capital-intensive technologies and the formal sector. There was only a very small informal sector and no local competition because of the restricted access to imports. The centrist policies did not encourage competition and discriminated against new entrants, reducing the opportunities for achieving both growth and equity.

How the marketing boards affected growth:

- the boards may have been financially and technically efficient but they were not economically efficient

- in 1980 to redress the past inequities the system developed for large-scale agriculture was simply expanded to include smallholders. This was very high cost and was both financially and economically inefficient

- it continued the pattern of hub and spoke, reducing local specialisation and exchange

- the client community expanded and became increasingly divorced from the daily running and policies of the marketing boards so that they in turn became less and less answerable to the farmers and increasingly answerable to government

- the expansion of the marketing boards to service smallholders created a climate of expectations for government to pay prices to farmers that covered their costs, regardless of market conditions and farm inefficiencies. At the same time consumers expected the government to provide food at prices they could afford, regardless of whether these prices covered the costs of supplying the food.

Market Liberalisation

By 1990 the fiscal burden of the agricultural parastatal subsidies and the shortage of foreign currency contributed to the decision to embark on a structural adjustment of the Zimbabwe economy. The liberalisation of markets was particularly successful for smallholder cotton producers who saw a marked increase in prices and agents coming to collect their cotton. It also reduced the fiscal burden with real subsidies declining, despite the burdens placed on the system by the 1992 and 1995 droughts.

Although the national policy documents were vague about decontrolling markets, agricultural market decontrol was one of the first areas to be addressed as part of the economic structural adjustment programme (ESAP) and the subsidy on maize-meal was one of the first to be removed.

In February 1991, Parliamentary changes to the marketing board constitutions, gave the boards greater autonomy in pricing and business decisions and by August 1991 independent Boards of Directors were established. In May, two commercial dairy co-operatives were given permission to market milk products and compete with DMB. The dairy marketing board went from receiving a Z$50 million per annum subsidy to making a profit within a short period (although in part this resulted from a shift of the burden to consumers through its monopoly position).

In August, sorghum and millets were decontrolled becoming regulated crops for which the GMB would set floor prices and remain a residual buyer. In September private coffee marketing was permitted in co-operation with GMB. Cotton and groundnut farmers received supplemental payments and final prices approximated export parity for the first time in decades. Yellow maize had been partially decontrolled in 1990, with farmers free to sell to any domestic buyer. However, in 1991 farmers were threatened with the re-control of yellow maize if they continued the switch from the production of controlled white maize to the uncontrolled yellow maize. The GMB announced plans to close more than twenty uneconomic depots but few closures were enacted at the time.

The post reform period reduced the implicit taxes of the 1980s. In the 1980s implicit taxes on agricultural commodities were around 40%, whereas only tobacco was slightly taxed in the 1990s.[2] However there remained other distortions and regulations that reduced opportunities for new business and competition.

Maize was gradually decontrolled and by 1996, the GMB maize account deficit had been significantly reduced. Farmers were now able to freely sell their maize and traders were now legally allowed to transport maize to anywhere in the country. However political factors at the end of the Century saw maize re-controlled and GMB was once again operating at an increasingly high deficit.

[2] The adjusted NPCs for agricultural commodity exports in the 1980s averaged around 0.6 whereas in the 1990s they remained closer to 1, except for tobacco which varied between 0.8 and 0.9, depending on assumptions.

The marketing reforms performed better than even the most ardent free market advocate had anticipated. The market no longer operated along a single channel between major cities and the rest of the country. As the marketing of major commodities opened up, traders became established and marketing of other commodities and opportunities for local industrialisation, trade and exchange, widened.[3]

The decontrols were also effective because they were accompanied by the lifting of restrictions on foreign currency and imports, thus allowing for purchase of transport, processing equipment and other inputs by new entrants. Rural entrepreneurs were now able to take advantage of the investment made in road building in the previous decade. Producers, local processors[4] and rural traders continue to be hampered by the high tariffs on vehicles, taxes on fuels, unwieldy regulations and poor telecommunications. In addition, with little collateral and very high interest rates, access to finance continued to restrict entry. Anecdotal evidence indicates that in those areas with network access, cell-phone communication has increased market efficiency and resulted in some cross-country trading as a result of better access to information.

The multiplier and dynamic effects of maize market liberalisation appear to have been considerable as rural trading and processing expanded and communal area farmers became more active in commercialised agriculture toward the end of the century, and the informal sector throughout the country grew significantly in the 1990s.

After price and marketing decontrol, many small traders and even some multinational corporations began to offer marketing services to farmers. The first year of private trading following the good 1994 harvest resulted in producers being paid less than the GMB price by private traders in communal areas (ZFU Marketing Survey). However, the main advantages to producers of using private traders were instant payment, farm-gate collection, packaging and grading services with the result that farmers often preferred to use private traders even at discounted prices. The 1995 harvest was poor and the prices paid by private traders were more than double those paid by GMB in early 1996. Despite very good rains and large supplies, the prices did not drop the following year. The reduced inefficiencies in the maize market system appeared to offset the supply effect on price in the new free market system. The decontrol of maize, combined with increased access to vehicles and reduced tariffs, considerably increased marketing activities between rural and urban areas. There were also beneficial effects for other commodities that were able to "piggy-back" on the transporting and trading in maize and the improved access to small-scale processing. The activities of traders in the area and better transport resulted in increases in horticultural sales and in the more widespread marketing of wild fruits, insects and small mammals.

In 1999, maize again became a political tool with government providing heavy subsidies and supplying or withholding maize to specific communities to obtain political rents. However, despite the controls, there is still illegal trading in maize so that some of the rural development gains from decontrol in the mid-1990s remain. However, the transaction costs of this trading have increased. Growth of rural marketing has also been negatively affected by the re-introduction of high tariffs on vehicles and the poor access to fuel. Some of the vibrancy of the five years of decontrol have remained and are being encouraged by the high prices faced by consumers from the formal sector. Both rural and urban consumers are increasingly turning to locally processed grains and oils and to illegal markets.

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[3] There was a marked increase in the sale of traditional foods in urban areas.

[4] There was an increase of 115% in the number of hammer millers between 1992 and 1995. The surplus grain areas having the strongest response (Zim. National Hammer Miller Status Study, USAID, 1996).

For consumers the removal of subsidies in the early 1990s was expected to have negative impacts on the poor. However, in very little time the informal market was supplying at the old controlled price so that despite removal of subsidies only those who did not want to eat hammer-milled maize were paying more. In 1993 hammer-milled meal was selling at $5.50, slightly less than the $5.82 of subsidised roller meal in 1991. In January 1992 only 5% of urban consumers were purchasing hammer meal but by January 1994 half the population were estimated to be using it. In rural areas the estimated improvement for rural consumers purchasing maize was greater because they had not benefited from the subsidised meal but they did benefit from the dynamic effects of the establishment of small millers and processors. The increased competition from the informal sector also encouraged industrial millers to become more efficient, reducing real prices, although reducing formal employment. Overall employment in the informal sector increased more than the losses in the formal sector, but at lower average wage rates.

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Lessons and the Way Forward

The remarkable speed with which the informal sector took up the opportunity created by reducing restrictions and removing the subsidies that had been paid only to the large-scale millers, shows what can be done. It provided a text-book example of the benefits of deregulation. The direct effects have been partially documented but the dynamic effects are less clear. The fact that increased traders were able to buy trucks and invest in servicing rural markets, resulted in much closer links between rural and urban areas. This resulted in better access and lower prices for inputs. It meant more opportunities for the marketing of other commodities. However, the increased freedom was not good for political control and towards the end of the 1990s, the maize markets were re-controlled.

Maize is the staple food in Zimbabwe and the principal crop produced by all smallholders. Control over its production and supply provides agencies with very effective political rent.

If agriculture in Africa is to be allowed the opportunity to become an engine of growth, then it needs to be depoliticised. This means that only those regulations critical to the health of the population should remain in place. The markets need to be as open as possible. If governments want to provide a safety net for consumers and producers, then they should only do this by working through the market. They could sell maize to the poorest and most remote regions in times of drought and buy maize from them in times of surplus. This would provide those who are unlikely to be serviced by private traders in extreme years, access to markets. It would also help to stabilise prices throughout the country and not just in the remote regions the government is servicing.

Governments could become effective facilitators of efficiency and equity if they invested in improving information, communication, infrastructure and institutions which reduce transaction costs.

Market liberalisation could be more effectively entrenched if farmers were able to demand a more independent market. The fact is that all too often even the farmers are fragmented with many farmers looking to government to subsidise or support their own particular situation. There needs to be a much greater recognition of the ability of the market to service farmers, provided the farmers have access to information and provided there is a choice of traders. Where the distance from market and economies of size make it uneconomic to trade a product, policy-makers need to be careful of subsidising the continued trade in that commodity. Unless it is only a short-term investment required, it is better to provide opportunities to farmers that are in accordance with their comparative advantage. Farmers need to claim their power but to recognise that they need to lobby for long-term investment rather than for short-term subsidies which will depend on the whim of political forces. The rural areas house the majority of the population and as democratic systems take hold, these farmers will have increasing power to effect changes.

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