

**USAID Development  
Information Services**

**Market Liberalization Processes And Lessons Learned Relevant to Iraq in its  
Transformation of Food for Peace to a Market-based Food Distribution System**  
(Response to an Information Request)

**April 2003**

USAID Development Information Services  
Information Request Response  
United States Agency for International Development  
Bureau for Policy and Program Coordination  
Office of Development Evaluation and Information  
1331 Pennsylvania Avenue, NW, Suite 1425  
Washington, D.C. 20004



## USAID Development Information Services

### Market Liberalization Processes And Lessons Learned Relevant to Iraq in its Transformation of Food for Peace to a Market-based Food Distribution System.<sup>1</sup>

Maxine Pitter Lunn  
August 1, 2003

---

#### **Suppliers**

##### Food Producers

- In Southern Africa, as in many other countries, production declined once structural adjustment demanded the elimination of state subsidies for inputs, state control of marketing and distribution and price controls. However, one study's authors claim this is not because of market liberalization, but rather, insufficient commitment to full liberalization:

**Quote:** ... the reformers have not necessarily gained the upper hand in local policy circles. The .. persistent doubts over the private sector's capacity to play the leading role in this objective have resulted in a second generation of controls and government (or NGO) distribution programs to subsidize inputs and output prices for smallholders. These public programs undermine private trading incentives and lead to a vicious cycle in which the private sector becomes reluctant to engage in activities in which government subsidies make it impossible to recover real costs. The lack of private sector response in turn creates a vacuum that rationalizes an even greater perceived role for government. Therefore, the prevailing situation is one where the reform process, having been initiated under external pressure, is being managed by policymakers with varying levels of commitment to, and understanding of, the process. This environment has clearly dampened the private sector's response to market reform in the region.<sup>2</sup>

**Lesson:** ensure full commitment by policymakers and avoid "second generation" controls by NGOs or others ostensibly "in the interest" of the small agricultural producers

---

<sup>1</sup> Caveats: Does Not Include Social Safety Net Elements  
Does not include fiscal implications  
Does not address food processing

Emphasis: Effects of liberalization on various market agents at specific stages in the process of establishing a market

<sup>2</sup> T.S. Jayne, Mulinge Mukumbu, Munhamo Chisvo, David Tschirley, Michael T. Weber, Ballard Zulu, Robert Johansson, Paula Santos, and David Soroko, "Successes And Challenges Of Food Market Reform: Experiences From Kenya, Mozambique, Zambia, And Zimbabwe," MSU International Department of Agricultural Economics Development Department of Economics Working Paper No. 72 MICHIGAN STATE UNIVERSITY, 1999, p. 4. <http://www.aec.msu.edu/agecon/fs2/papers/idwp72.pdf>

- In the Czech republic yields declined as the prices for agricultural inputs such as fertilizers and pesticides increased. Declining demand, however, did not lead to declining use of agricultural land, as crops were diverted into food and non-food processing (e.g., rape seed) industries.<sup>3</sup>
  - Lesson:** Liberalization may lead to fundamental changes in the market in which producers no longer produce for the same market. This works if it does not lead to shortages.

### Food Importers

- Zambia has relaxed restrictions on private importation of commodities but exports are still banned (because of chronic food shortages). However, since 1998 government, distrusting the capabilities of private traders, has intervened again, making the private sector reluctant to compete and creating somewhat of a vicious cycle. In addition, private importers do not have enough access to import information to re-enter the market:
  - Quote:** The risks associated with poor information flows may result in an under-provision of imports by the private sector, contribute to tighter supplies and higher prices, and reinforce the government's continued perceived need to intervene. The problem of coordinating private and public sector maize importation might be addressed through a public information system through which all maize imports are reported. This would allow traders to make import decisions with reasonable knowledge of the aggregate import decisions being taken by others, including FRA (Food Reserve Agency).<sup>4</sup>
  - Lesson:** Governments must be consistent in their commitment to reform.
- Kenya has had more success in privatizing food imports, with a more consistent policy of pulling government out of the importation business
  - Quote:** ...the decline in state maize trading and importation has precluded the problem experienced in Zambia of some marketing actors receiving preferential access to subsidized grain (with negative implications for competition and future investment by other firms). Several years of increased reliance on the private sector to handle both domestic trade and importation has shown that the private sector can respond to the task within a conducive policy environment. Since reforms were effected, Kenya has never experienced significant food hoarding or food lines in major cities – characteristics that were common during droughts in the days of government controls.<sup>5</sup>
  - Lesson:** By removing barriers and allowing the market to work, private importation of commodities can help meet demand.

---

<sup>3</sup> Structuring Modern Agri-Food Sector in CEE Countries: Czech Republic. Dr. Tomáš Doucha, Deputy Director Research Institute of Agricultural Economics (RIAE) Prague, Czech Republic, April, 1996. [http://www.fadr.msu.ru/nap/april\\_96/structuring\\_modern.htm](http://www.fadr.msu.ru/nap/april_96/structuring_modern.htm)

<sup>4</sup> T.S. Jayne et al, "Successes And Challenges Of Food Market Reform: Experiences From Kenya, Mozambique, Zambia, And Zimbabwe." p. 7.

<sup>5</sup> T.S. Jayne et al, "Successes And Challenges Of Food Market Reform: Experiences From Kenya, Mozambique, Zambia, And Zimbabwe." p. 15

## ***Transport networks***

Market liberalization results in distribution based on price, which depends on costs such as the cost of transportation. In countries such as Mozambique, production centers are difficult or expensive to link with consumption centers (the urban core), so producers export and consumers import from nearby S. Africa. Improving the transportation infrastructure could also improve internal distribution channels.

**Quote:** In an open trade regime, then, Mozambique will import and export maize during nearly all years. At the national level, policymakers have largely understood this fact, and have not generally imposed restrictions on trade, nor has the government played any direct role in imports of maize since the ending of maize food aid shipments in 1994. In Maputo in the South, active formal and informal imports of maize meal and some maize grain (both white and yellow) from South Africa complement grain from the Center of the country, and this supply has been sufficient to maintain prices around a stable mean in the capital in recent years. Aside from requiring traders to go through a somewhat time-consuming process to obtain an import license for every formal import (thus leading informal trade to dominate), the government has had no role in this trade.

**Lesson:** Allow the market to find its own efficiencies, based on local conditions.

## ***Marketing, Storage and Distribution***

Government marketing boards are being abolished or transformed into entities that either oversee the liberalization process or oversee grain reserves.

- In Zambia the Marketing Board was dismantled, but the Food Reserve Agency (Strategic Grain Reserve) has been selectively releasing subsidized grain into urban markets, thus disrupting the liberalization process.

**Quote:** (S)elling grain at below-market prices to selected millers disadvantages the main competitors in the system that the reform process has been trying to develop – the small-scale trading and milling sector. While stabilizing food prices for consumers is a policy objective of fundamental importance in Zambia, a key challenge is how to meet these objectives in a manner compatible with other important food policy objectives.<sup>6</sup>

**Lesson:** Competing policy objectives can result in confusing policy outcomes. Decide on priorities (e.g., price stability or complete liberalization) and enact policies that do not undermine the primary objectives.

- In Mozambique, the former marketing board exists now as a financially troubled parastatal competing with private traders. Its only major competitive advantage is vast storage capacity.

**Quote:** By the early 1990s the marketing parastatal AGRICOM had collapsed, and in 1995 was restructured into the Instituto de Cereais de Moçambique (ICM). Since it's (sic) creation, government's objectives for ICM have been unclear. It has a remarkably broad mandate, including providing inputs and extending storage technology to smallholders, market information, developing grades and

---

<sup>6</sup> T.S. Jayne et al, "Successes And Challenges Of Food Market Reform: Experiences From Kenya, Mozambique, Zambia, And Zimbabwe." p. 7.

standards, strategic stock holding and acting as a buyer of last resort. Yet the institute has never received public financing. With the private bank financing that it has obtained, ICM has developed a role as the largest maize exporter in the country. It does this essentially as a private trader, buying and selling at market prices. In a country with poor infrastructure, this role is greatly facilitated by the nearly 160,000 metric tons of usable storage space that it inherited from AGRICOM.<sup>7</sup>

**Lesson:** Marketing Boards can use their resources to perform appropriate roles that support market liberalization, but they should not be involved in setting prices, distribution or any other essential steps in the process.

Food producers should eventually benefit from any price increases as a result of market liberalization. In the former Soviet Union, a number of points in the marketing chain were identified that needed strengthening in order to work towards this result:

**Quote:** The first phase of the structural transformation of the food production, distribution and marketing chain should include the following steps:

- Accelerate privatization for small-scale enterprises, retail stores and truck transport
- Minimize licensing requirements, operating standards, and other impediments to new firm entry and enterprise diversification
- Redefine the role of enterprise associations to head off the formation of regional cartels or monopoly structures
- Rescind traditional territorial restrictions on state input dealerships, procurement, transport, processing and marketing enterprises
- Reduce state procurement quotas for agricultural commodities...
- Permit the leasing or lease-purchase of some state-owned assets, particularly trucks, warehouses and retail space in public buildings<sup>8</sup>

### ***Sales – Wholesale and Retail***

In 1992 in the former Soviet Union, the state retained a great deal of purchasing power because of its very large state procurements. Market liberalization, however, required that the procurements be carried out at prevailing market prices.

**Quote:** The Russian government has retained the system of state procurement orders, but state agencies are required to procure agricultural commodities at prevailing market prices. In the absence of robust markets, however, state procurement prices may be lower than market prices and thus provide disincentives to farms sell their marketable surplus to state agencies.<sup>9</sup>

---

<sup>7</sup> T.S. Jayne et al, “Successes And Challenges Of Food Market Reform: Experiences From Kenya, Mozambique, Zambia, And Zimbabwe.” p. 18.

<sup>8</sup> The World Bank. “Food And Agricultural Policy Reforms In The Former USSR An Agenda For The Transition.” Country Department III, Europe And Central Asia Region. P 6. [http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/1999/10/19/000178830\\_98101911143694/Rendred/PDF/multi\\_page.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/1999/10/19/000178830_98101911143694/Rendred/PDF/multi_page.pdf)

<sup>9</sup> The World Bank. “Food And Agricultural Policy Reforms In The Former USSR An Agenda For The Transition.” Country Department III, Europe And Central Asia Region. P 4.

**Lesson:** Decentralize and minimize state procurement in order to avoid destabilizing market price formation.

### **Consumers**

Whereas in Iraq, public control of food distribution ensured continued availability of food, this is not always the case and at the very least market liberalization can result in more variety as well as continued (and fiscally sustainable) availability of food. In Mozambique, for example ,

**Quote:** (T)he general pattern ...is of a reformed marketing system which offers regular availability of a range of food staples accompanied by relatively high prices for them in the major consumption center of Maputo. This pattern encapsulates both the success of market reform in Mozambique, and the limits of what it, alone, can accomplish. The informal private sector (and increasingly on the export side, the formal private sector) has responded aggressively to the liberalization and has succeeded in linking surplus and deficit regions within and outside the country. The system is generally competitive and returns to labor are often low. Yet poor yield and the small scale of maize production and marketing in the country, and the very poor transport, storage, and sales infrastructure, impose very high marketing costs. As a result, consumers in Maputo, the poorest in the region, pay more for their maize grain and meal than do consumers in neighboring countries.<sup>10</sup>

**Lesson:** For the poor, the social safety net must be in place if the market is to be allowed the latitude to form prices and establish efficient marketing and distribution channels.

### **Pricing**

Price instability is a commonly feared consequence of market liberalization, particularly in countries with poor populations that cannot handle even small changes. Experiences in Southern Africa point to specific points in the process where policies can assist in avoiding extreme price volatility:

**Quote:** Both the productivity and stability of the food systems in the region could be substantially improved by public investments and policy change that reduce the costs of distribution – internally, between countries in the region, and with the wider world market. Examples of investments with high payoffs include (1) the strengthening of regional market information systems, reporting local currency prices, exchange rate information, and the direction of trade flows for a number of market towns across countries; (2) development of better telecommunications and internet infrastructure between market information reporting services (e.g., FEWS reports); (3) rehabilitating regional road, rail and port infrastructure; and (4) providing the means for smallholders to benefit from market-oriented mechanisms of absorbing price risk, such as commodity exchanges<sup>11</sup>.

---

<sup>10</sup> T.S. Jayne et al, “Successes And Challenges Of Food Market Reform: Experiences From Kenya, Mozambique, Zambia, And Zimbabwe.” p. 22.

<sup>11</sup> T.S. Jayne et al, “Successes And Challenges Of Food Market Reform:

**Lesson:** Price instability can be mitigated on the input side and by developing the underlying market infrastructure, in addition to targeting policies toward the specific activities directly related to price-setting.

In Egypt, contrary to expectations, market liberalization did not result in price volatility:

- Egypt's experience with liberalizing its market for wheat indicates that participation of the private sector in marketing activities leads to more stable and integrated markets and lower retail prices. Partial liberalization, in contrast, dampens the potential investment response of the private sector and leads to leakage of the controlled commodity into the free market.<sup>12</sup>

Agricultural commodity exchanges present additional opportunities to offset market instabilities, but in countries lacking such a tradition, their establishment also presents some challenges.

**Quote:** Agricultural commodity exchanges now exist in South Africa, Zimbabwe, Zambia, and Kenya... (but) effective use of the exchanges will require traders, farmer organizations, and cooperatives serving smallholder farmers to become more conversant with the operations of these exchanges. So far, farmer organizations have mainly focused on acquiring and repaying credit through group schemes.... Most recently, some associations have entered into agreements with the public extension service and with private input dealers in an attempt to ensure timely delivery of fertilizer and extension assistance to intensify maize production. These activities point to important future roles on a broader scale for farmer organizations: greater involvement in the gathering and dissemination of market information, the diffusion of technical advice on both production and improved on-farm storage, and the bulking of farmer surpluses for participation in commodity exchange trading, thereby opening up a number of market-oriented mechanisms for reducing the risks of price and supply instability.<sup>13</sup>

**Lesson:** Just creating an exchange is not sufficient in transition economies. Actors from all levels of the sector must be trained to benefit from the exchange's activities.

In the former Soviet Union, commodity exchanges were established in many areas – not just agricultural products. A Congress of Commodity Exchanges was established to provide a basis for consolidating exchanges and integrating them into networks. Initially, the most successful were specialized exchanges – i.e., for construction materials and petroleum products. By 1992, however, multipurpose exchanges such as the Russian Commodities and Raw Materials Exchange were stimulating more growth.

---

Experiences From Kenya, Mozambique, Zambia, And Zimbabwe.” p. 31-32

<sup>12</sup> Tamar Gutner, “The Political Economy of Food Subsidy Reform: the Case of Egypt,” *Food Policy*, 27, 455-476, 2002

<sup>13</sup> T.S. Jayne et al, “Successes And Challenges Of Food Market Reform: Experiences From Kenya, Mozambique, Zambia, And Zimbabwe.” p. 31-32.

### **Government support**

- The private sector's response to liberalization is sensitive to a broader range of government actions than commonly understood.
  - In Eastern and Southern Africa, statements of key politicians in local newspapers critical of a market-oriented system were incorporated into the private sector's expectations of the payoffs and risk to future involvement in the system.
- Governments should shift their resources from food production and marketing activities, that can be conducted more efficiently by the private sector, toward more public-good activities, such as:
  - Conducting research
  - Offering extension services
  - Providing public market information
  - Investing in roads and communication infrastructure
  - Implementing regulations regarding market conduct
  - Developing safety nets for the poor.
- Governments should create the conditions necessary to increase private sector investment in food distribution and markets. Governments cannot finance all of the required infrastructure and facilities for these activities and must attract private investment.
- Recognize and incorporate in city urban development plans the need for adequately sized and located food distribution facilities and adequate supporting services to cater to the future food needs of the urban population.