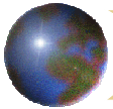


Price controls in food markets

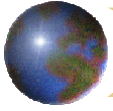
Nicholas Minot

Presented at the Comesa policy seminar
"Food price variability: Causes, consequences, and policy options"
on 25-26 January 2010 in Maputo, Mozambique
under the Comesa-MSU-IFPRI African Agricultural Markets Project (AAMP)



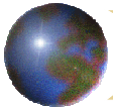
Outline

- Definition and types of price controls
- Motivation for price controls
- Effect of ceiling prices on food
- Effect of floor prices on food crops
- Cost of production as basis for floor price
- Other issues related to price controls
- Summary



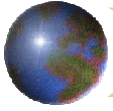
Definition and types of price controls

- Definition: “Law passed by the government which dictates a price for a good or service”
- Types of price controls
 - ▣ Ceiling prices (upper limit)
 - ▣ Floor prices (lower limit)
 - ▣ Price band (upper and lower limit)
 - ▣ Fixed price
- Methods of enforcement
 - ▣ Legal enforcement (e.g. fines)
 - ▣ Government purchases and sales (buffer stock)



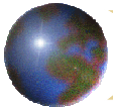
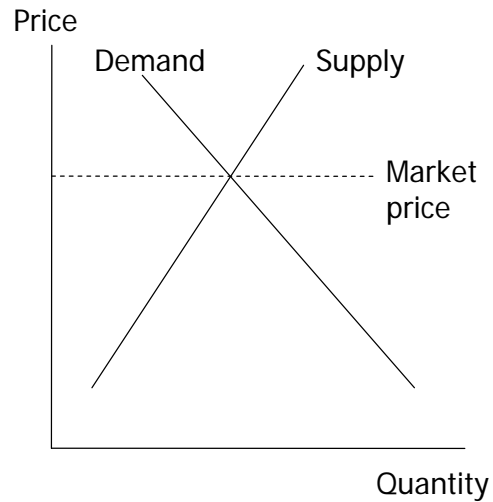
Motivation for food price controls

- Ceiling prices (upper limit)
 - ▣ Protect consumers from rising food prices
 - ▣ Break “psychology” of inflation
- Floor prices (lower limit)
 - ▣ Protect farmers from low prices after bumper harvest
 - ▣ Ensure farmers a “fair” price that covers costs
- Price band (upper and lower limit)
 - ▣ Reduce volatility of food prices



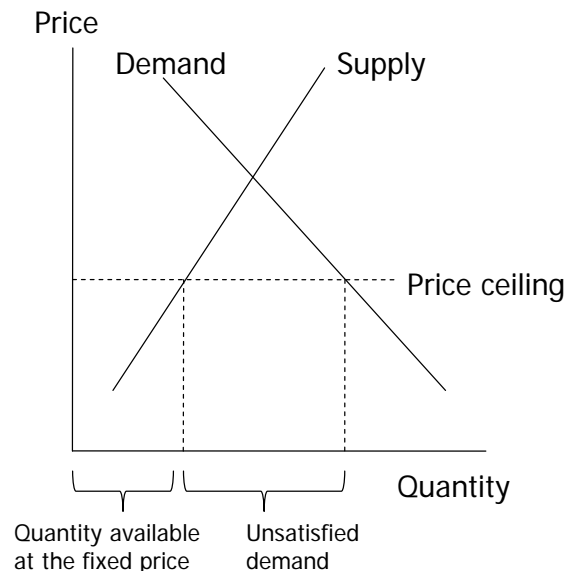
Market price

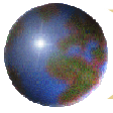
- Market price is where supply equals demand
- Market price depends on:
 - ▣ Crop yield
 - ▣ Cost of production
 - ▣ Cost of marketing
 - ▣ Price of competing goods
 - ▣ Trade policy and exchange rate (if commodity is tradable)
 - ▣ Expected changes in prices in the near future



Ceiling price

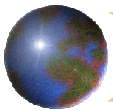
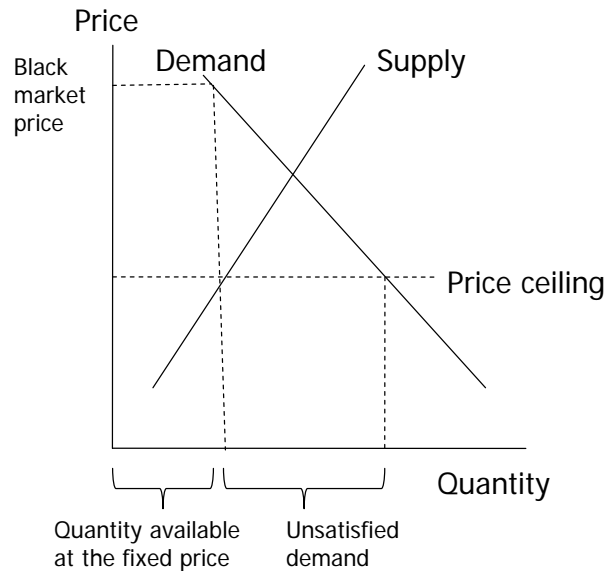
- Suppose government decides this price is "too high"
- Fixes ceiling price below the market price
- Now food demand is greater than food supply
- *If ceiling price can be enforced, there will be rationing of food*





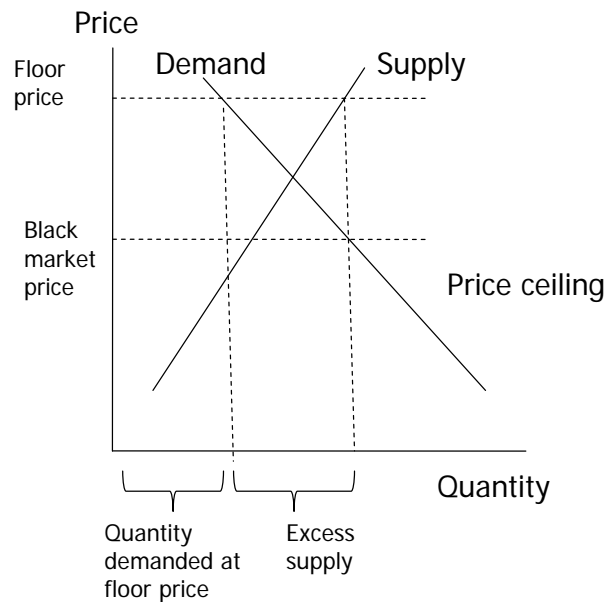
Ceiling price

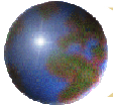
- More likely that the price cannot be enforced, in which case a black market will develop
- Black market price may be higher than market price
- Symptoms of ceiling price
 - Commodity disappears from shops
 - Vendors sell only to selected customers
 - Black market appears with price above ceiling and possibly above market price
 - Resales by consumers able to buy at official price



Floor price

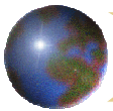
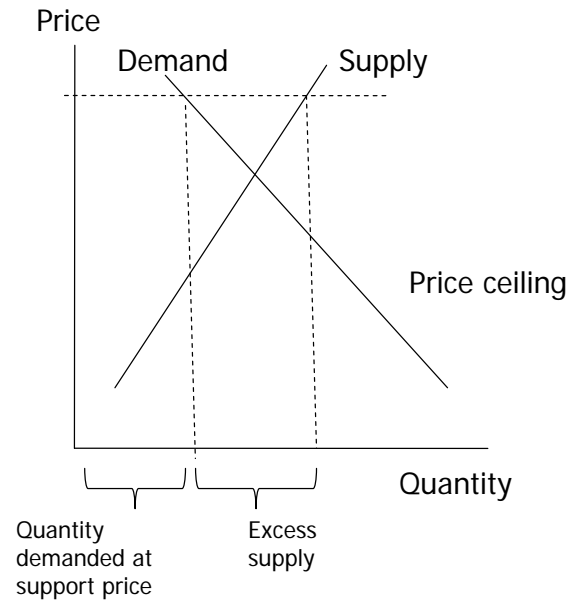
- Suppose government decides this price is "too low"
- Fixes floor price above the market price
- Now food supply is greater than food demand
- *If price can be enforced*, there will be a surplus i.e. unsold quantities of food





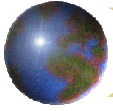
Floor price

- If government buys the surplus, floor price can be maintained
- If government does not buy the surplus, farmers will try to sell at price that may be below the market price
- Symptoms of a floor price
 - Traders reluctant to purchase, particularly in remote areas
 - Excess supply
 - Government may be "forced" to purchase surplus
 - Farmers may sell at a loss on parallel market



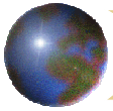
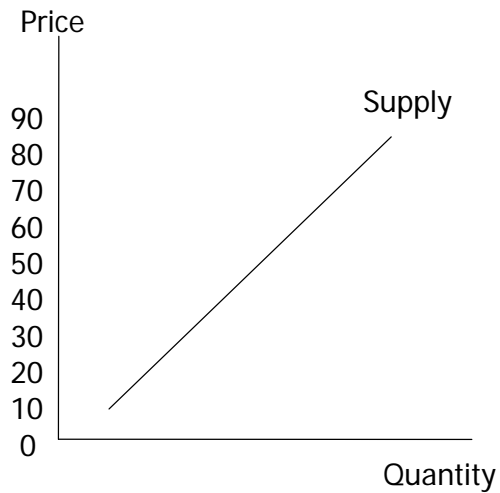
Cost of production as basis for price controls

- Many countries use farm surveys to estimate cost of producing main crops, which are used to set support prices for crops
- Problems with cost of production estimates
 - Cost of production estimates often based on recommended input levels rather than actual input levels
 - Two largest elements of cost of crop production (land and labor) are difficult to value.
 - Land values often affected by agricultural prices
 - Cost of production different for each farm.



Cost of production as basis for price controls

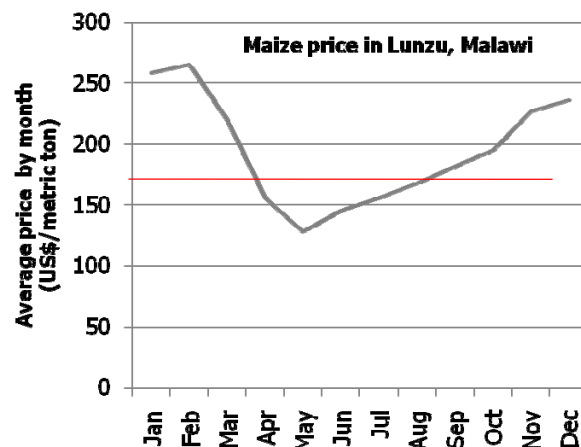
- There is no single “cost of production”
- Cost of production varies across farms depending on location, yield, labor costs, land costs, etc.
- Supply curve reflects fact that, as price rises, it becomes profitable for more farms to grow the crop
- “Average” cost of production too low for some, too high for others

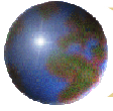


Other issues related to price controls

Changes over seasons.

- If price remains fixed over seasons, effect will vary over year
- Ceiling price on food become more binding in off-season.
- May eliminate incentives for farmers and traders to store during harvest and release in off-season
- Example of maize prices in Lunzu, Malawi: If price ceiling set at US\$ 170/ton, no incentive to store from May harvest to December

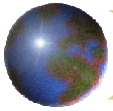
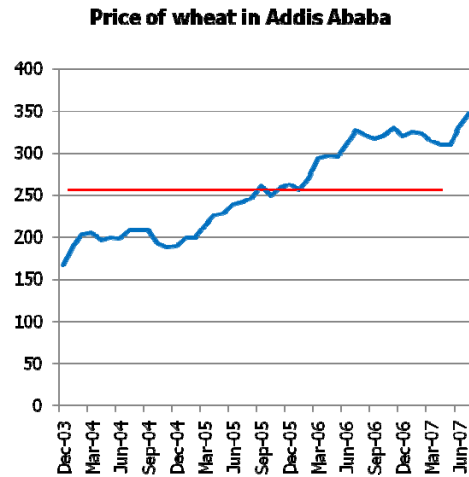




Other issues related to price controls

Changes over year

- If price remains fixed over several years, inflation will erode real price
- Ceiling price will decline in real terms, becoming even more binding over time
- Floor price will be eroded until no longer binding.
- Example of wheat in Addis Ababa: floor price of US\$ 250/ton no longer binding after 2005



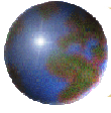
Other issues related to price controls

Variation by location

- If price fixed throughout country, effect will vary by location
- Ceiling price will be more binding in cities and rural deficit zones. May eliminate incentives to take food to cities and remote deficit zones.
- Example of maize in Tanzania: If ceiling price of US\$ 120/ton, no incentive to ship maize to Singida or Arusha

Price of maize in June 2007





Summary

- Advantages
 - Quick response to extreme prices
 - Satisfies political pressure to “do something”
 - Alleviates burden of extreme price for some households
 - No cost to government unless it “defends” price with purchase/sales
- Disadvantages if no government purchase/sale
 - Creates shortage or surplus of commodity
 - Often leads to black market activity
 - Benefits well-connected or lucky rather than poor
 - Disrupts signals to motivate storage, shipments, and production
- Disadvantage if government purchase/sale
 - No shortage or black market but...
 - Often involves large costs to government
 - Disrupts signals to motivate storage, shipments, and production