BRIEFING NOTE 29
ON: The need for Market Reform Now

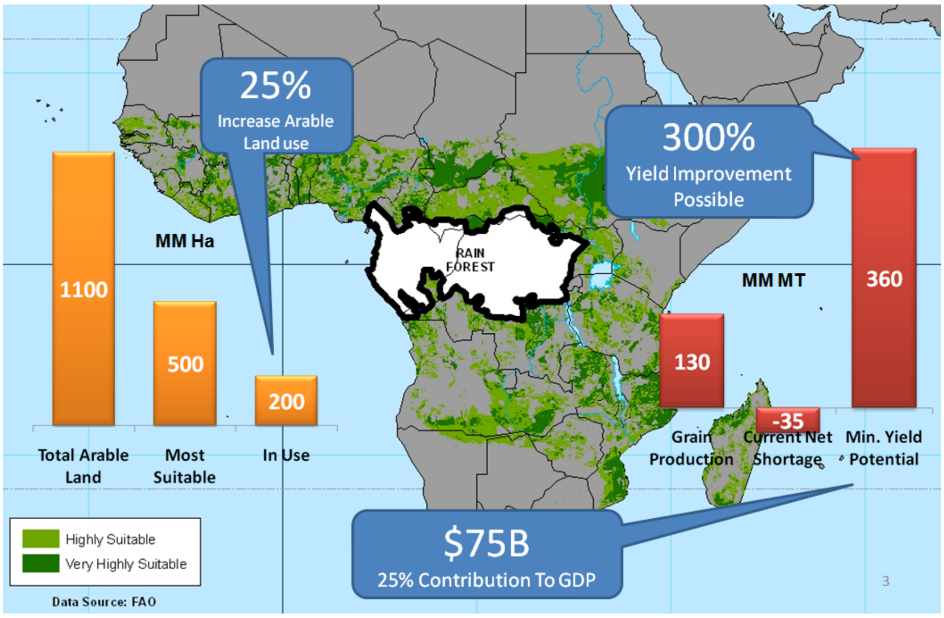
Sub-Saharan Africa has twenty per cent of the world's arable land, but makes only a two per cent contribution to world trade in grains, oils, sugar and feed. Currently, world trade is at 440 million metric tons (mmt) and is projected to grow to 625mmt by 2020 (source: ADM[1]). With only 200 million ha in use out of sub-Saharan Africa's 500 million ha of most suitable land, and with yields at 300-500 per cent below their potential, the opportunities for increased production are vast. For East Africa:

- In Kenya, 26 per cent of the 6 million ha of suitable and highly suitable land is unused.
- In Uganda, 34 per cent of the 11 million ha of suitable and highly suitable land is unused.
- In Tanzania, a staggering 70 per cent of the 31 million ha of suitable and highly suitable land is unused.

A Beckoning Opportunity

ADM estimates that sub-Saharan Africa could increase GDP by 25% (worth an additional US$75 billion) if it increased arable land use by 25% and raised yields by 300%.

But before that there are many trade opportunities in making up the large domestic shortfalls.



Marketing Mayhem

Anyone who buys and sells agricultural products tells the same sorry story in East Africa. Small farmers, middlemen, processors, wholesalers and retailers all talk of markets being inefficient, unreliable, unpredictable and highly risky. Some notable exceptions exist. Commodity markets, like coffee, tea and sugarcane, organized through larger corporations binding producer to factory to auction house, work better. But for the rest of small farmer products it's a sorry story.

[1] *Archer Daniels and Midland.* www.admworld.com

"We recently experienced in Northern Uganda 400 tons of sunflower sitting with small farmers because they are unwilling to pay for transport and storage to get their crop to the buyer. They do not trust the buyer to pay for the produce when he gets it! The buyer, in his turn, does not trust the farmer to send in good quality produce so refuses to pay a price up front. This sad stalemate means that around four hundred small farmers will lose out on $100,000 and the processer will lose out on getting 400 tons of produce."

"The buyer had introduced a group contract where each farmer was supposed to co-guarantee his/her neighbour's loan for seed. This didn't work because some farmers within the group sold to brokers/middlemen hence defaulting on the loan and forcing the buyer to deduct seed money from the loyal farmers. This led to all the groups being dissolved. The reason for side selling is because middlemen have proved to be very successful as they enjoy full support from the buyers. For instance, a buyer will contract farmers to grow snow peas at a contract price of Ksh 70/kg, then when the produce is ready for harvest, the same buyer approaches middlemen asking them to deliver snow peas to them at Ksh 150/kg. These middlemen visit the contracted farmers and buy the contracted snow peas at Ksh 130 for later delivery to the buyer at Ksh 150. Contracted farmers sell to them at almost double the price they had been contracted for! In so doing the farmers then do not pay the buyer's loan of seeds. From the farmers' point of view the buyers are the ones encouraging middlemen by buying produce from them at higher prices than the producer's prices. The question farmers have is why can't the buyers get back to farmers and review the contract price instead of sending in the middlemen?"

Private Sector Failure

Prices are low and exploitation by middle men is rife. Bigger buyers can never get the right quantity and quality of produce at the right place at the right time. In this mayhem a huge amount of money, maybe 60% of trade value, will be spent on drying wet grain, cleaning out debris and stones so doubling handling costs. Side selling means that trucks will go half filled so doubling transport cost. Produce will be stored for longer in transit raising storage costs. All these 'middle costs' keep rising as farmers and middle men try to cheat each other to gain advantage. All these middle costs eat into everyone's profits driving down prices to small farmers and increasing cost of sourcing produce for big buyers.

The private sector has failed to invest in what ADM calls the 'missing middle' that separates farmers from processors. It is the 'middle costs' that no one wants to cover. Entrepreneurs do not invest because the margins and value added are low and the risks are high. Farmers do not invest because they are uncertain of the returns: so crop productivity remains low as does the quality of produce. All players in the market chain want secure transactions for their produce and their payments. Clearly, the private sector appears unwilling to make the necessary investments to undo decades of cheating and exploitation, and it is unable to overcome the entrenched interests of those who gain in marketing mayhem.

Farmer group picking snowpeas in Ndaragua

Public Market Reform

Marketing must be reformed and governments must step up to the challenges. The challenge is joint investment by public and private sectors. The challenge is public policy and private self regulation. Building market services that offer fair trade to all, are trusted, durable, reliable and that can operate at scale in a business where margins must necessarily be low is going to take a lot of money and a lot of time. Investing in large scale operation that's trading fairly with small farmers, is reliable and can endure the inevitable droughts, is not for those who seek a fast return.

Needed Private and Public Sector Investments

- Public investments in loan guarantees to banks to make credit available on 'easy terms' to: a) local market service enterprises to build their business and offer services to all small farmers; b) processors and other volume buyers to solve cash flow problems associated with paying farmers when they hand over the produce; c) farmers to get credit for inputs to expand their scale of operations, and insurance to compensate for the inevitable droughts.
- Public direct investments that: a) build the capacity of rural entrepreneurs so that they can offer high quality market services and operate financially viable businesses; b) give small farmers free access to local market intelligence services.
- Private investments to stimulate the development of private public partnership to develop commercially viable market transaction security services that will assure farmers and buyers that their transactions are: a) at agreed times and locations, b) with agreed volumes and qualities, c) payments according to agreed conditions and times, d) trackable in case something did not work out as agreed, and e) traceable produce through the whole chain back to the producers.

Necessary Private Sector Self Regulation

- Agricultural Chambers of Commerce to explore ways to: a) raise standards of market service providers in fair trade; b) name and shame businesses who break their contracts with small farmers; c) license and train market service providers; d) support the emergence of branding that improves market services.
- Farmer Unions to explore ways to: a) educate and certify farmer associations and groups for contract marketing; b) discipline farmer associations that break their contracts with buyers.

Suggested Public Policy

- Provide more resources to the enforcement of: a) the use of standard weights and measures at the points of sale used by small farmers; b) laws to protect those who have been subject to a breach of contract including legal assistance to small farmers to bring actions against big buyers.
- Find ways to: a) dismantle tax disincentives to producers like produce cess taxes, market levies and taxes on inputs; b) provide tax breaks for big buyers engaging in fair trade with small farmers tracking produce from farm to factory; c) develop crop and livestock insurance instruments for small farmers and big buyers to mitigate the effects of drought, d) tackle price fixing and other forms of high level corruption in the market.
- Provide additional support to: a) agricultural advisory and R&D services for greater attention on quality control for market specifications like Eurogap, Organic certification, and fair-trade; b) local government to convene market chain key players to remove market inefficiencies and facilitate linkages between players.

What we need now is market transaction security that enables small farmers to learn what they must do to access profitable markets, trade under fair conditions, and break through the presently prevalent default behaviour of "everybody cheats everybody". Ways to begin building trust will usher in improved trade.

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