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Comments And Discussion On "When Economic Reform Goes Wrong: Cashews In Mozambique" By M. MacMillan, K.H. Welch, And D. Rodrick

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the analytical work based on firm-level survey data should help to promote evidence-based dialogue among stakeholders.

Finally, the World Bank has also mounted proactive initiatives aimed at addressing problems of market imperfections, including the bank's support of supply-chain-based marketing and production systems reforms. Assessing the potential of the bank's supply-chain projects, Ronald Kopicki notes that "depending on the product commodity and target market, bottom-up chains may have as their precise mission a number of different operational strategies. They may target, for example, the reduction of economic rents and the number of mediation levels that separate farmers from retail consumers. When rents or marketing margins decline, corresponding improvements occur in the net prices available at the farm gate."³ To the extent that such projects become mainstreamed in the bank's operational and capacity-building work, progress in addressing problems of imperfect market structures is possible.

Stephen O'Connell: Mozambique's export liberalization thus far has disappointed the hopes of at least some of its proponents. Among cashew farmers, the supply response has been weaker and the distributional impact less decisive than the World Bank had hoped. On the processing side, while the bank must have been prepared *ex ante* for the possible demise of the cashew processing industry, the rapidity of that demise was probably unexpected and has provided a focal point for groups opposed to the liberalization.

I enjoyed this paper very much. In characteristic fashion, the authors bring clarity and insight to the debate while shifting it in novel directions. I will focus on three claims that, in my view, constitute the paper's main contributions:

- credibility is important in understanding persistently weak supply response in Mozambique;
- standard arguments for liberalization pay insufficient attention to the implications of buyer-side market power;

3. Supply chains are forms of industrial-agricultural organizations that encompass multiple value-adding functions, typically including sourcing inputs, producing, and delivering products to customers. Supply chains operate in lieu of arms-length transactions to facilitate the transfer of products, information, ownership rights, and cash or credit between farms or firms and their ultimate customers. The ultimate aim of supply chains is to reduce risk and transaction costs for participants. See Kopicki (2003).

—and patterns of imperfect competition in world cashew markets favor a policy geared toward the export of processed rather than raw cashews.

Credibility and supply response. The analysis of credibility and supply response draws on Margaret McMillan's doctoral thesis, which provides an insightful account of pre-reform patterns of commodity export taxation in Africa. But reform has now held for a decade, export taxation is in wide disrepute, and Mozambique's government is nowhere near the fiscal straits associated with the predatory African regimes of the 1970s and 1980s. The last observation is mainly due to very high levels of foreign aid, but the government also introduced a value-added tax in 1999, thereby reducing the pressure on other tax handles. If there is a residual credibility issue, therefore, it would have to be associated not with fiscal predation but with the possibility of a major revision of government policy toward the processing industry or a precipitous decline in aid. Neither event seems likely, unless of course the government of Mozambique takes this paper really seriously, in which case we may have both an increase in the export tax rate and a decline in aid. Though I am kidding here, I do wonder about the traction of the credibility argument, not only in Mozambique but also in other African countries where it initially seemed very appealing. Ghana is a good example. Poor credibility was a very appealing explanation for low private investment in the 1980s, but after twenty years of sustained, market-based reform and political liberalization it is hard to believe that fears of reversion to an expropriation equilibrium play much of a role.

In the case of Mozambique, care should be taken not to discard alternative explanations for slow growth in cashew production. It may be that a merely liberal trade policy (that is, one that stops short of actually subsidizing cashew production), or merely a liberal trade policy (that is, one that stops short of complementary interventions in other policy areas) is not enough—even under certainty about the export tax rate—to offset poor prospects for world cashew prices, a strong real exchange rate, or nonprice barriers to new planting. In some other cases of tree crop sector regeneration, it has taken very determined government support and intervention to stimulate a major renewal of the capital stock, a good example being rubber in Indonesia. It would be a mistake, I think, to view these interventions as designed essentially to firm up commitments about producer prices. In fact the Bretton Woods Institutions (BWIs) have been oversold on policies designed to make policy reversals economically costly. The key, instead, is to make renegeing politically costly. This is harder to do, particularly when

failure can be blamed on the BWIs themselves. Therefore I am much more comfortable when the authors turn from the dangers of low credibility to those of weak ownership. Major price reforms are likely to fail, it seems to me, unless they emerge from a medium-term vision that the home government can embrace and articulate publicly, and that includes complementary interventions that directly support the private sector's supply response. What is clear from this paper is that the Mozambican government does not yet possess such a vision.

I do think the discussion of supply response would benefit from a bit more attention to the macroeconomic context. Mozambique received a tremendous postconflict aid boom starting around 1994, followed in fairly short order by a substantial boom in foreign direct investment. These produced a sharp real appreciation in the mid-1990s, at least partially offsetting the influence of lower export tax rates. Aid may have had a pro-export bias in other respects, for example in helping to secure the countryside and restore rural transport infrastructure. But the Bank of Mozambique, like other African central banks on nominally floating exchange rates, at various points since the early 1990s has expressed considerable concern about the influence of real appreciation on traditional exports. And as aid flows have declined, their social spending component, which is heavily nontraded, probably has increased. A persistently strong equilibrium real exchange rate is not very good for export promotion. Some further discussion of the macroeconomic context, therefore, would be useful in putting into perspective the authors' partial equilibrium calculation and their before-versus-after graphs of cashew production and exports. Production and export trends reflect all of the important forces operating on the sector, not just trade policy per se. It may be that export response was stronger than it appears, relative to the relevant counterfactual.

Confronting the marketing margin. The paper reminds one forcefully and elegantly that export taxes form only a part of the wedge between FOB prices and farmgate prices. The remainder accrues to the various stages of the domestic purchasing chain, in the form of a marketing margin m :

$$P = (1 - m)(1 - t)EP^*,$$

where t is the export tax, E is the exchange rate, and P^* is the world price. What this means is that while cashews are internationally traded, smallholders are effectively quite distant from international markets. A lot of insight flows from this observation, and I think this structure might be used even

more systematically to organize the discussion of policy reform. As the authors point out, for example, even without buyer-side market power and with full pass-through of the export tax wedge to farmgate prices (that is, with a fixed m), a dollar of export tax relief goes mainly to the marketing chain and not to cashew farmers. By the same token, policies that work directly on m , for example by lowering transport and marketing costs, may target smallholder incomes much more effectively than export tax relief. So may policies that encourage the vertical integration of smallholders into cashew marketing,

When there is substantial buyer-side market power, smallholders are even further from world markets, and on top of this the level of cashew production is inefficiently low. I am somewhat uncomfortable with the authors' assumption that the number of active buyers in a market determines rents. After all, even with few buyers in each local market, the market may be contestable—or perhaps could be made more so, for example by publishing information on local prices. But the depredations of the middleman have been an important theme in African history. One of the important contributions of this paper is to make the case for more microeconomic evidence on this issue.

If market power is indeed important, then competition policy becomes a legitimate focus of agricultural policy. What interventions are appropriate when buyer-side market power produces double or triple marginalization and a cascade of rents? A tempting answer is to set minimum prices at each stage. Any increase in the minimum price at each stage toward the competitive equilibrium reduces the buyer's rent, shifting surplus to the seller while also enhancing efficiency. This approach looks a lot like the marketing board and price control mechanisms that became prevalent in Africa after World War II, often in response to lobbying by the interested groups (that is, the kind of grassroots collective action donors are trying so hard to restore). These arrangements fell into disrepute when they became instruments of fiscal predation, that is, when governments used them to enforce price *maxima*, not price *minima*. The analysis in this paper suggests that their removal was at best a compromise with reality, justified not by the unalloyed attractions of *laissez-faire*, but by a judgment that governments were not capable of handling a potentially important instrument of competition policy and poverty targeting.

From this perspective one can readily see the huge attraction of public investment in transport networks, which may economize more directly on

the government's limited institutional capability. A better rural road network should improve smallholder incomes and incentives both directly (by lowering transport costs) and indirectly (by enhancing competition at the local and possibly wholesale level of the marketing chain). This is surely close to the World Bank's view. The problem is, again, that I do not think there is much microeconomic evidence on how strong the procompetitive effects of transport investment are, and over what horizon.

I also suspect that in pushing the liberalization of agricultural marketing, the World Bank made relatively few distinctions between situations in which competition was already flourishing in parallel markets and situations in which parallel channels were not well developed. This matters, because in the latter case there is perhaps some presumption for the country and crop in question that entry barriers are high and, therefore, that portions of the marketing chain may have substantial market power if the market is deregulated. Market liberalization may then create new, private rents in the marketing chain, thereby undermining to some degree the incentive effect of export tax reductions. If parallel channels are already active, then market power concerns are less immediately plausible, but one then has to worry about whether the export tax rate has much influence at all on the relevant supply price at the farmgate (and for that matter whether the data are measuring total output or just the legally marketed portion).

Protecting the cashew processing industry. This paper is admirably evenhanded. But given the stakes in the globalization debate, I wish the authors would tip their hands a bit more. The problem is that everyone is fallible, which implies that one can identify weaknesses in any reform effort. The real question is whether the case for reforms remains intact, given a few important corrections here and there. Or, should Mozambique be subsidizing cashew processing, as do Brazil, India, Vietnam, and Indonesia? And if Mozambique should be subsidizing the processing stage, should it do so, at least in part, by heavily taxing exports of raw cashews?

The authors bring a novel dimension to the argument by focusing on market structure. They observe that the world processed cashew market is competitive, while the raw cashew market is occupied by a monopsonist. Given this configuration, they argue, Mozambique enjoys a terms of trade gain on each cashew that it processes itself rather than selling in the world market. It seems to me, however, that Mozambique should process its own cashews only if one of two conditions holds. Either processing must be profitable at world prices (which include the monopsony discount on raw

cashews, kindly provided by India's self-restraint as a major buyer) and appropriate shadow prices of domestic resources, or the externalities to processing must be sufficient to justify protection. In fact under either of these conditions, Mozambique should process other countries' cashews too. Now, is intervention required to support cashew processing under these conditions? In the absence of distortions or externalities, if processing is profitable at world prices it should be profitable at domestic prices and protection should be unnecessary. If there are externalities, then intervention is potentially justified, but in the absence of administrative or political economy arguments, it should take the form of subsidies to cashew processing, not an export tax.

Where does this leave us? Actual experience tells us that the cashew industry cannot make money at domestic prices, at least not in the absence of a substantially higher tax on raw cashews than is currently in place. To say this another way, unless domestic distortions are the culprit, Mozambique does not appear to have comparative advantage in cashew processing. This is not necessarily surprising. As Adrian Wood has emphasized, processing, in some cases, is significantly more intensive in human and physical capital than primary production, a pattern that sits uneasily with Mozambique's relatively rich endowment of land and raw labor. The only way out of this conclusion, without appealing to externalities, leads to the labor market. Maybe labor is available to the processing industry only at a wage that is well above the social opportunity cost of labor. But then a wage subsidy or other labor market intervention seems the right approach, not a cashew export tax.

One therefore ends up having to rest the argument for intervention on a claim that there are substantial domestic externalities to cashew processing. What are these externalities? Again, the evidence is very limited. Even with the clarity contributed by this paper, one may simply need to take a stand on whether the Indonesia model or the World Bank model is the right one for Mozambique.

With respect to the authors' cost-benefit calculation, I am not fully comfortable with the inclusion of large gains from employment. Certainly one of the costs of a noncredible reform is to leave labor temporarily idle, as laid-off workers wait around for the policy reversal that will reemploy them. The employment gains from not reducing the cashew export tax may therefore be temporarily large. But if one wants a welfare analysis of alternative trade policies, which I think is the real issue, the temporary costs of non-

credibility should be downplayed relative to the permanent costs and benefits of alternative regimes. To assess the latter, one needs a medium-term, general-equilibrium treatment of the opportunity cost of labor used in the processing industry (and, for that matter, the capital as well). As suggested above, if a substantial wage gap remains from this perspective, it may be driven by a labor market distortion like an urban minimum wage that should be carefully scrutinized before being compounded into trade policy choices.

In sum, export promotion has proven a slower and harder task in most of Africa than many expected, starting in the early 1980s when it seemed so clear that reforming hugely distortionary trade and marketing regimes would unleash a strong supply response and generate a highly progressive distributional impact. The Mozambican case provides a rich illustration of themes the authors have emphasized in other work on trade reform, including the dominance of income transfers over efficiency gains and importance of credibility. It also demonstrates the potentially powerful influence of the long marketing chains that characterize many of Africa's commodity exports. The paper makes a convincing case for sustained further work on the nature of these chains and many ways in which government policies may affect the nature of competition and size of the marketing margin. Everyone is aware, at some level, that the poorest are rarely those with market access or market power. The challenge is to take this observation seriously, as this important paper does.

Discussion: There was an active discussion of this paper. Marc Melitz argued that the issues of policy credibility and sustainability warranted more attention than they had received in the paper, and he expressed the view that they were likely to have been important determinants of the outcome. Dani Rodrik agreed. Domestic cashew processors held demonstrations and actively pressured the Mozambican government, so that whether the policy would be maintained was certainly in question.

In Melitz's view, the discussion of monopsony in India was surprisingly detailed. Building on Stephen O'Connell's remarks, he identified three interrelated questions around which he would have focused. First, would the cashew farmers prefer to export rather than sell domestically? From the analysis presented, it seemed to him that the answer was yes, despite the lower export prices that may have resulted from Indian monopsony. The second question, then, was whether Mozambique should process cashews domestically. If the answer to this question is also yes, perhaps because of

some types of externalities, then one should ask how best to achieve this goal. In this context, he would have liked more discussion of the pros and cons of export quotas, taxes, and other policy alternatives.

Penny Goldberg found it difficult to evaluate the effects of trade reform without a fuller discussion of the counterfactuals. For example, if the processing industry would have collapsed in any case, a trade reform that redirected sellers away from domestic purchasers to exports was presumably desirable. She also found it odd for the processing industry to blame its demise on farmers if, in fact, farmgate prices did not increase much during the relevant period.

In a similar vein, Cathy Pattillo noted that it would be useful to take the macroeconomic context into account more explicitly. She suggested that a discussion of how the industry might have fared under alternative macroeconomic scenarios would make the trade policy analysis more convincing.

Gianni Zanini found the case study of Mozambique's experience very interesting but cautioned against drawing general policy conclusions from a single example. While not based on formal analysis, his own knowledge of the effects of liberalization of hides and skins, frankincense, and myrrh in Somalia suggested very different outcomes: liberalization had tended to result in reduced price margins. Zanini was puzzled by the claim in this paper that the marketing margins for cashews in Mozambique had more than doubled from \$117 before liberalization to \$262 afterward, especially because the main change appeared to have been for cashews to be sold to traders, who would then sell to wholesalers and exporters instead of to domestic processing plants, which he would interpret as an increase in competition.

Thomas Palley commended the authors on their interesting analysis, which he believed highlights the importance of South-South concerns in the debate about globalization. The implications of liberalization in Mozambique were influenced by potential monopsony in India, as well as production subsidies in Brazil and Vietnam. These factors warrant more attention than they often receive. Palley also saw lessons for both sides of the globalization debate. For proglobalizers, the case study spotlights the need to involve stakeholders, while for antiglobalizers it flags the importance of incentives. Finally, he was curious about the production situation in 1973 and how important this history may have been relative to more recent political and other pressures in explaining the subsequent production decline.

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