Impacts of Policy Reforms on Price Transmission and Price Volatility in the Coffee Markets: Evidence from Zambia and Tanzania

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Price is the most critical factor in determining the way markets function. In a perfect market a price shock is transmitted to other vertically or horizontally connected markets within a given period of time. However, monopoly or oligopoly markets, government policies or high transaction costs may lead inefficient price transmission. As a result, producers may not benefit from consumer price increases and similarly, consumers may not benefit from producer price decreases. Many developing countries have implemented measures to improve price transmission through agricultural market liberalisation policies and providing incentives for farmers. However, the nature of the transmission i.e. whether positive and negative price shocks are transmitted in the same way, remains subject to investigation.

This study takes a look at these issues in the analysis of coffee producer prices for Zambia and Tanzania. This dissertation consists of four papers. First, the study investigates coffee value chains in both countries. Next, price transmission between coffee world prices and producers' prices in Tanzania and Zambia is examined. The third paper examines impacts of trade liberalisation policies on price volatility and the fourth paper analyses coffee supply response in Zambia.

Results for Zambia indicate improved price transmission after economic reforms but not for although the transmission is asymmetric. Similar results are obtained from the volatility study where economic reforms led to an increase in coffee price volatility in Zambia, with negative shocks inducing more volatile prices than positive shocks. In Tanzania the inconsistent market reforms have had no significant effects on coffee price transmission and volatility. Coffee supply in Zambia is highly influenced by the exchange rate. However, coffee prices do not directly influence coffee supply. As the producers receive their revenues in US Dollars, the exchange rate eventually determines their incomes in the local currency.

These findings have important policy implications as they explain favourable policies for improving transmission from world markets to producer prices. However, inasmuch as efficient price transmission is hypothetically the desired economic outcome in the long-run, it may work to the disadvantage of producers in the short-run as producer prices become exposed to and driven by volatile world prices.