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'Good mechanism to stabilise prices'

The government recently announced plans to stockpile essential goods to keep prices down and supply stable. Will this work and what will it cost Malaysians? ELIZABETH JOHN and ANIZA DAMIS speak to Universiti Putra Malaysia's Dr Mad Nasir Shamsudin, and learn from this professor of agriculture and resource economics that it's an idea worth trying

Q: What is stockpiling about?

A: Usually, stockpiling involves commodities like rubber or cocoa. Stockpiling was originally (done) to stabilise the price, not to increase or reduce the price.

So when the market price increases, the government would release a little more into the market and the price would go down. If the market depresses (goes down), the government buys the commodity and puts it in the stockpile.

This will increase the price in the market, and keeps the price at a stable level. That's the theory.

It's a very good mechanism. It has been successful.

But what we are talking about here are retail goods — things like sugar, rice and cooking oil. Unlike commodities, retail prices have never declined.

The idea of stockpiling here is mainly to ensure supply, not just to stabilise prices.

Q: How should this be done?

A: The mechanism can only work if you have a good warehousing system, a good distribution system, good enforcement on unfair trade practices, and a good subsidy scheme.

You have to have a complete set to be successful.

An efficient subsidy scheme is important.

Someone has to produce the goods that go into the stockpile. So, a subsidy needs to be given to them.

Because labour costs and oil prices have been increasing, how can they sell at the same price? No way!

So, subsidies allow them to sell to the government and still make a profit.

Q: More subsidies?

A: As an economist, I would look at whether this is a good resource allocation or not.

Of course, resources are limited. The government has a good subsidy scheme, but that money could also be used for other things — for development purposes, for example. To build schools, to build universities.

It would be more economically efficient if we divert the money we would use on stockpiling subsidies to development.

At the moment, where there is a drastic price increase for oil and transportation, putting this money in a subsidy scheme would be socially efficient.

Although economically it is not efficient, socially it is.

Remember, the intention of this stockpile is not to decrease the price, nor to increase the price, but to stabilise it. When we speak of stability, it doesn't mean that there is no increase — there is — but it will be a reasonable amount.

This, I think, is socially efficient. When everybody gets a lower price, the purchasing power or the real income is more and consumers can use the extra money for other purposes.

It's very important that prices are stabilised as the percentage of wages we spend on food is still a lot. In Malaysia, on average, 30 per cent of our income is spent on food. In the 1970s, the US spent 12 per cent of its income on food. Now, it's probably 7-8 per cent.

And because we still spend a lot on food, it is pertinent for the government to stabilise the price as this will ensure that we still have enough money left over to spend on other things.

Because of that, I think it is a very good initiative to stabilise the price.

Q: So the system will be dependant on subsidies?

A: The main component would be the subsidy scheme. Although the price has been increasing, if you want to retain a lower price, then somebody has to pay. In this case, society as a whole — government.

Actually, price control is nothing new. It's been around for years. But this stockpiling is an extra mechanism due to the drastic increase in other factors, like oil. We need a better scheme to stabilise the price.

But remember, this scheme only works when all the factors are in place — market struc-

ture, subsidy scheme, price control, enforcement, warehousing, distribution, must all be there.

If not, it won't work.

Q: How big would the stockpiling subsidy be?

A: I do not know how much. It depends on how many essential items there will be. It should be substantial. But remember, it's for the betterment of society as a whole.

Q: Don't these goods have a shelf-life? Wouldn't you need to replace them at some point? How high would the turnover rate be?

A: The goods must be non-perishable. Rice, cooking-oil, sugar, can be stocked for years. After 5 to 10 years, they would need to be replaced.

Q: Would the government be buying goods at market rates?

A: It shouldn't be the case.

The way I understand the mechanism should be, when the government wants to stock up, it will ask producers to produce.

I don't think they will buy at the market price. The government won't go to the market and buy to put in its stock. They will ask producers to produce more.

Q: So, the items for a stockpile won't come from the market?

A: From retail? No. Once you buy from retail, there will be a shortage there.

Q: Why are we facing a shortage?

A: Is there really a shortage? I don't think so.

I'm not sure if there is a shortage of supply, but there is a demand. Because these are controlled items.

If I am the seller of cooking oil, and the price of palm oil has increased because of a demand for it in non-food sectors, of course it is reasonable for me to increase the price of cooking oil, isn't it? But then, cooking oil is a controlled item.

So, the shortage is an economic shortage. Because the cost of production is high.

Q: With the stockpile, will all these threats of shortage be removed?

A: I don't like to use the word "threat". But I would like to say "ensure enough supply". So that if there is shortage, then the supply is already there to be supplied to the market within one or two days, so that there is less panic.

Q: What if these essential goods are imported?

A: Same thing. Raw wheat, for instance, is imported. We have to process that into wheat flour. So, of course, the subsidy element for processing has to be there. If not, we have to follow the world price of wheat flour.

Q: If the government keeps giving subsidies, doesn't that mean that the money we gain from low food prices will end up in paying higher taxes instead?

A: If we give these subsidies to producers, they can sell it at a lower price. This will translate into higher purchasing power. That means I can still send my children for better education because the amount we spend on food will still be low. If we leave the price to market level, then of course, I will have less to spend on my children's education.

Q: That's assuming that nothing else changes outside of these essential items.

A: Yes. But remember, 30 per cent of our income is spent on these essential items — things that we must have. You can delay purchasing non-essential items even if the price increas-

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es. Food, you cannot delay buying. If the price of oil increases and this affects the cost of a car, you can delay buying a car.

If a person who earns RM1,500 spends RM450 on food, this leaves very little to spend on anything else. That's quite a chunk, especially if they have five or six children.

Q: Will producers be able to meet demand for the stockpile?

A: They will but shortages will still happen. Because with producers, their objective is to make profits. So, with these stocks at hand, it will be a double security measure.

If we don't have the stock, and we only give subsidies, one day, the producers will say, "Not enough."

Q: But for stockpiling purposes, can they meet the government demand?

A: The government can make laws compelling the producers to produce.

Q: Are we self-sufficient in all essential items?

A: Not really. For instance, we don't have sugar, we don't have wheat, but we have cooking oil.

And we only produce 75 per cent of the rice we need.

We don't produce 100 per cent of rice, because it is very expensive. We give fertiliser subsidies to the tune of RM500 million a year. We have rice price guarantees, just to make the farmer produce rice, because the world price is half of that. But these price guarantees are for food security. Economically it may not be efficient, but socially, it is efficient.

Q: Should we try to become more self-sufficient?

A: We are trying. The government has allocated a lot for food production.

Q: What should we do to make food production viable?

A: We have Research and Development (R&D) to make us more productive.

In fact, in the Ninth Malaysia Plan, the government allocated a lot of money for agriculture. But to be 100 per cent sufficient requires a big budget.

Q: Do we have enough land allocated to agriculture right now?

A: Yes, but there's the issue of opportunity cost.

If people have land, they would rather grow oil palm than food as it will bring in more money.

Q: Is there enough land for food production?

A: Yes. Previously, estates had to set aside land for food production. It wasn't a law, it was just encouraged.

But where is this land now?

Housing development and palm oil are more profitable.

Q: You said earlier that sometimes we have to look at the bigger picture, the social benefits. Are we failing to calculate the social benefit of being able to produce more food for our own consumption?

A: The government has put in a lot in the Third Agriculture Policy. Government spending on food production has increased. Even for research in agriculture, there is no problem securing funding.

We have enough suitable land for food production. But the people will ask, which is more profitable?

Until we can find a food crop which is as profitable as palm oil, they will always ask that question.

Q: Couldn't the government, at least in the beginning, try to subsidise food crops so that they become almost as profitable as palm oil?

A: Not unless the government has a mechanism to ensure the rate of return for food crops is at par with palm oil.

Q: Is stockpiling an achievable goal? Aren't we setting our sights too high?

A: There have been price controls for years. This (national stockpile) is just to make it firmer — better mechanism.

Now, we are controlling prices but we don't have enough tools or rules.

It doesn't make sense when the people say there's not enough supply and we cannot do much to correct the situation. Now, the government can only ask producers to produce more, that's all.

Q: There are so many complaints of traders raising prices and poor enforcement. If that is not addressed, what's the good of stockpiling?

A: Don't you think with all the stockpiles ready, it would be easier to supply to the market?

Currently, there is no warehouse or stock. We cannot pro-

duce 10,000 tonnes of something within one or two days. Stockpiling will make things better, because we can easily flood the market. But this has to happen within one or two days of the need arising. More than that, and it's not efficient.

Q: But if the enforcement problem is not addressed and the stockpile system isn't efficient, won't you have a black market in these goods?

A: That is for the authorities to answer. Under this proposed system, if there is a shortage of cooking oil in the market, the government would need to release the stock to the market in one or two days. That is the most time it should take. Otherwise, people will panic.

Q: How important a factor is enforcement going to be in making this a success?

A: Enforcement of unfair trade practices must be dealt with. How difficult it is, I don't know. But it is a pre-requisite for success.

The stockpile might be able to stabilise the price, but may not be as effective in overcoming inefficiencies and leakages along the way. There has to be good enforcement. It must be one package.

You can see that certain initiatives have not been successful because the important elements are in place, but not enforced.

Q: Couldn't Malaysia just manage with current price control mechanisms and better enforcement?

A: I don't know. That's a question for the authorities to answer.

Q: Are other countries using other mechanisms to control the price of food? Should we be considering other alternatives?

A: In the United States and European Union, which are food producers, they pay farmers to produce.

When there is a surplus, they pay farmers not to produce. This keeps the production cost

low, and the benefits trickle all the way down the line.

Although they don't have price-control mechanisms like ours, they give a lot of subsidies to their farmers, to make production cheap.

Q: How much do countries stockpile anyway?

A: I do not know. But, the rule of thumb would be for six or seven months. In a disaster, it would take that long to recover.

Q: The Federation of Malaysian Consumer Associations (Fomca) has suggested a Price Commission instead of a national stockpile. The commission would mediate between consumer groups and producers on price increases.

A: If the objective is to stabilise the price, then it is not a better option.

But if the objective is to have a fair price — and when I say fair price, it means the cost of production has increased, then I think it's all right for the retail price to increase.

The government's objective is to stabilise the price. So, this mechanism is better than a price commission.

If we don't control prices, our inflation rate might be more than four per cent.

To have good purchasing power, our inflation rate shouldn't be more than four per cent.

Our income doesn't increase by more than four to five per cent a year.

If the Consumer Price Index (CPI) is more than our salary rise, then we are poorer.

Q: How is the removal of raw materials from food production (for other sectors) affecting prices? Like the use of palm oil in biodiesel production?

A: In my opinion, the impact of palm oil use in biodiesel is not that much. But if you're talking about corn for ethanol, it's a lot.

Brazil and the US are pioneers in producing biofuels. Instead of using corn as livestock feed, they use it to make fuel.

Q: Hasn't this pushed up the commodity's price? Doesn't that impact us?

A: Yes. Palm oil, soybean and corn oil — if the price of one increases, the others will follow suit as they are substitutes for each other.

When there is less corn for cooking oil, then the price of palm oil will increase.

Q: So should we follow the Brazil and the US example, seeing how it has impacted world food prices?

A: This is an ethical issue. Is it ethical to turn this food into energy when a lot of people are still hungry? I do not know how to answer that.

But all this is determined by market forces.