



INTERNATIONAL FOOD
POLICY RESEARCH INSTITUTE

sustainable solutions for ending hunger and poverty

Supported by the CGIAR

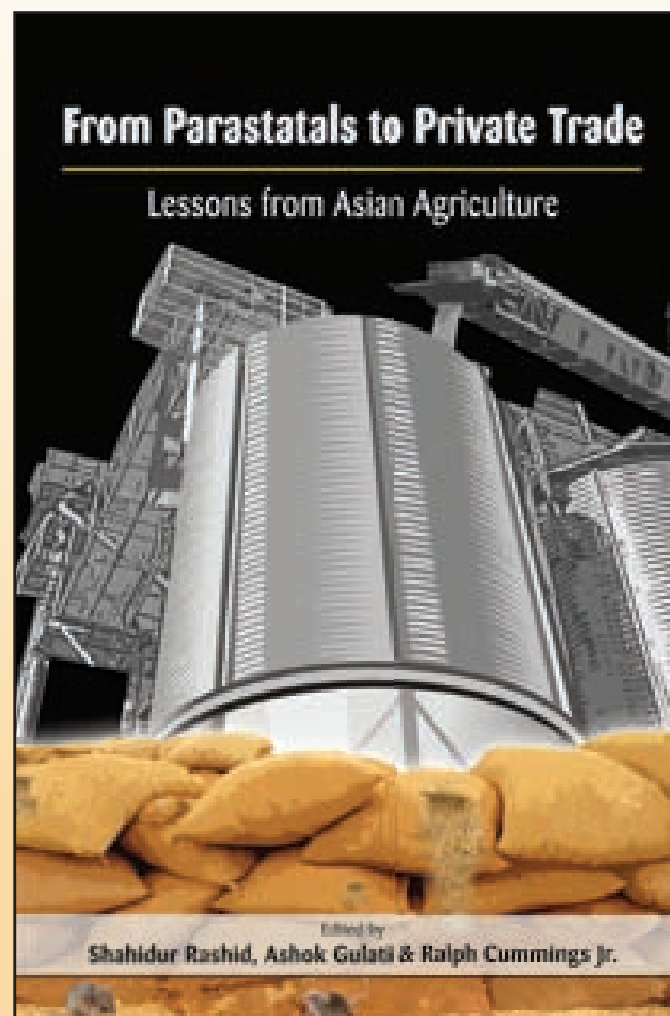
FROM PARASTATALS TO PRIVATE TRADE

Lessons from Asian Agriculture

IFPRI Issue Brief 50 • July 2008

Shahidur Rashid, Ashok Gulati, and Ralph Cummings Jr.

Governments in Asia used grain price stabilization as a major policy instrument when they began to promote the Green Revolution in the 1960s. In the process, they created parastatal agencies, which were quasi-governmental in nature, to undertake public marketing activities in basic staples such as rice and wheat. These operations often meant providing a support price to farmers, procuring staples on government account, holding public stocks, and distributing these stocks through public distribution systems or open market operations to hold the price line for consumers. This led to a sizeable degree of government intervention in most of these countries' grain markets, which continues to a large extent today.



However, the art of public policymaking is to know when to introduce government interventions and when to withdraw them. Frequently, governments forget the withdrawal part, leading to high costs that are sometimes unsustainable. Using case studies from South and Southeast Asia, a new book entitled *From Parastatals to Private Trade: Lessons from Asian Agriculture* (published for IFPRI by Johns Hopkins University Press for OECD countries and by Oxford University Press for South Asian countries) suggests five key lessons that can be learned from more than three decades of parastatal operations with regard to price stabilization in Asia.

1. **Under certain circumstances, public grain-price stabilization can contribute positively to increased agricultural growth and overall economic development.** Price stabilization was vital to widespread adoption of new high-yielding wheat and rice varieties and benefited both producers and consumers, leading to increased economic growth and decreased poverty and undernutrition throughout the region.
2. **However, there are two pre-conditions for the success of public intervention in grain markets. The first is the presence of market failure.** Throughout Asia in the 1960s, infrastructure was weak, flow of market information was poor, international markets were thin and volatile, and foreign exchange reserves were minimal, which often led to market failures. **The second is that there should be a high level of government commitment in terms of improved incentives, institutions, and investments for increasing grain production.** Price stabilization through parastatal agencies is only one part of the package.
3. **Conditions change as times change.** During the past three to four decades, infrastructure has improved significantly. International markets are much more robust, although the current price spike in 2008 is troubling. The foreign currency reserves and import capacities of different Asian countries have increased dramatically. Promoting technology adoption is no longer a persuasive justification for intervention, since most of the farms in Asia are already using improved varieties of rice and wheat. And consumption patterns are rapidly shifting from staples to high-value agricultural products such as livestock, fish, fruits, and vegetables.
4. **Parastatal agencies can incur huge costs in stabilizing grain prices.** The financial costs, though initially modest, have become very large. The parastatals are less efficient than the private traders and are being increasingly exploited by special-interest and rent-seeking groups. Also, it is worth noting that once parastatal agencies are created, they are very difficult to reform or dismantle. The parastatals create strong political lobbies, which lead to even higher costs.
5. **Governments still have a positive, although different, role to play in their grain markets.** They should now focus on “getting the markets right,” instead of focusing just on “getting the prices right.”

India. During the mid-1960s, India experienced two consecutive droughts that reduced the production of foodgrains by almost 20 percent. India was bailed out by a large volume of U.S. food aid that severely strained the country’s pride. In 1963, new high-yielding wheat varieties first began to be grown experimentally, and by 1966, the prospects for a Green Revolution appeared promising. The Food Corporation of India (FCI) and the Agricultural Prices Commission were created in 1965 to ensure “remunerative prices” to the cultivators while the new seeds were being introduced. What marked the most significant departure from the old ways was the seriousness with which policy recommendations were translated into action through the emergence of an integrated food and agricultural policy.

During the past four decades, the successes have been spectacular. Wheat production has increased sixfold, and rice production has more than doubled. The proportion of hungry people has been halved. India is now one of the fastest growing countries in the world, aspiring to sustain an annual growth rate approaching double digits. However, subsidy bills for buffer stocking increased from US\$160 million in 1992 to US\$1.6 billion in 2002. And today, the FCI consists of about 40,000 officers and staff, 60,000 regular food-handling employees, 100,000 food-handling laborers, almost half a million ration shops, a quarter billion ration-card holders, and more than 6,000 state marketing and regulatory agencies.

Pakistan. The Pakistan Agricultural Storage and Services Corporation (PASSCO) was established in 1973 to mitigate seasonal price swings in the major urban centers. Under a new system begun in 1987, the government supplies wheat from its stocks at uniform issue prices to designated flour mills, which are required to supply atta (rough milled grain) through general stores in the market. In recent years, PASSCO’s role has been limited to the regular procurement of wheat and the occasional procurement of paddy. Intervention with other crops has been characterized by an ad-hoc approach. In 2002/03, the provincial food subsidy was more than US\$100 million, which was 12 percent greater than the entire Public Sector Development Program budget for the Health Division.

Bangladesh. Public policy has evolved to achieve multiple objectives: targeted distribution for poverty alleviation, disaster management, and price stabilization. Unlike its neighbors, Bangladesh controls price support and public distribution through the Department of Food. Moreover, unlike the other countries under review, Bangladesh liberalized trade policy in 1994 to permit imports by private traders.

Bangladesh’s experience demonstrates that reductions in public intervention can promote competition in the domestic markets, reduce subsidies, and release funds for development and poverty alleviation—all without jeopardizing price stability and food security. The share of public food in poverty-alleviation programs increased from as low as 32 percent during the pre-reform period (1971/72 to

LESSONS LEARNED FROM COUNTRY EXPERIENCES

1991/92) to as high as 85 percent during the post-reform period (1992/93 to 2002/03), the total number of traders increased significantly following liberalization, and annual food subsidy bills declined from US\$122 million in the 1980s to about half that amount in the 1990s.

Indonesia. The downfall of the Sukarno government in the late 1960s triggered an aggressive public approach to food security in Indonesia. The new government was especially sensitive to the social unrest generated by high rice prices that had created political instability under the previous government. Key elements of President Suharto's New Order approach were heavy investment in the rural economy to increase rice production and sustained efforts to stabilize the price of rice, including the implementation of a price band.

Rice production has quadrupled since the beginning of the Green Revolution, while GNP per capita, which grew at an amazing 5 percent per year, has tripled. Poverty and undernutrition have been significantly reduced. However, the total costs of the price stabilization agency's inefficiency (the subsidy) have grown and were estimated at US\$2 billion from 1993 to 1998.

Philippines. The government has regulated and intervened in rice and corn markets for decades. In 1981, during a crisis in which the global rice supply was scarce, the domestic supply of white corn (a substitute for rice) was short, and the retail prices of both rice and corn were high, the government decided that it had to implement a price ceiling and rice rationing to defend the ceiling. The National Food Authority (NFA) was given the mandate to protect consumers, promote rice self-sufficiency, and develop post-harvest technology for grain. Today, it is both a regulator and a corporation engaged in grain trading. It has been the sole importer of rice into the Philippines for more than 25 years.

Rice production in the Philippines has tripled during the past three decades. However, this has not translated into dramatic increases in GNP or reductions in poverty and food insecurity, as has been the case in other Asian countries. Between 1996 and 1998, average annual losses due to inefficient and ineffective NFA operations were estimated at more than US\$414 million.

Vietnam. In the initial phase of the unification of North and South Vietnam, agriculture was a major disappointment, making reform imperative. Farmers responded impressively to the new incentives, and, as a result, per capita food production grew from 273 kg in 1981 to 304 kg in 1985. However, the fiscal deficit ballooned, and the government announced it would move toward a more market-oriented economy. By 1989, compulsory government procurement of farm products was eliminated, and private traders were allowed to purchase directly from farmers.

Market liberalization has contributed to increased production, enhanced technology adoption, and increased competition in domestic rice markets. Rice production grew at a rate of more than 5 percent between 1988 and 1995, transforming Vietnam from being a chronic food-deficit country to a leading exporter of rice in Asia.

Why Do Parastatals-Centered Policies Have to Change?

There are three main reasons. First, the rationales for public intervention in foodgrains markets, especially in Asia, have changed over the years. The key determinants of market integration—infrastructure and information flow—have improved dramatically, and recent studies suggest that domestic markets are well integrated in all Asian countries. Notwithstanding the current situation, international markets for wheat and rice are much more robust. The justification for protecting farmers against technological risks is no longer convincing because farmers have mastered new technologies and high-yielding varieties now cover almost all area sown to rice and wheat. The international liquidity constraint has improved so much that the value of potential cereal imports now accounts for only a tiny fraction of total foreign currency reserves in the countries reviewed.

Second, the food marketing parastatals are becoming increasingly expensive and wasteful, and alternative institutional mechanisms for achieving price stability and food security are far less expensive and distorting. The unit marketing costs of parastatals are higher than those of the private sector, the margin of costs between parastatals and the private sector are widening, and parastatals' operations are being increasingly dictated by special interests.

Finally, rice and wheat, the main focus of the parastatals, are not as likely to drive agricultural growth in the future. On the demand side, consumer preferences are changing away from cereals. On the supply side, small farmers cannot expect to make a satisfactory living from growing wheat and rice on their progressively smaller landholdings. Therefore, a rational farmer would consider other options for increasing income—for example, high-value foodcrops such as fruits, vegetables, and oilseeds—in addition to or in place of wheat and rice.

When Must This Change Occur? The parastatals and the regulations enacted to facilitate their operations have outlived their usefulness. Prolonging the inevitable will mean losses in growth and employment at considerable economic and political costs to each country. Moreover, prolonging the inevitable will allow special interests to become more entrenched, making change even more difficult. Both Bangladesh and Vietnam have liberalized, although to different degrees, and have successfully demonstrated that the same set of food-policy objectives can be achieved through reduced intervention.

How Must This Change Occur?—The Way Forward. Changing parastatals-centered policies will require opening up the economy, letting private trade compete on a level playing field with public parastatals, and using public policy to regulate and supplement, rather than replace, the private market.

Many Asian countries are hesitant to open up their economies and continue to restrict international foodgrains trade in one form or another. A more effective and strategic response

would be to use variable tariffs, in a transparent and WTO-compatible way, to guard domestic markets against world price volatility. Complementarities between changes in the international trade environment and domestic policies are at the core of how developing countries will be affected by the future international trade environment.

Creating a level playing field requires that policy decisions in such areas as movement, storage, credit, transportation access, and public distribution be credible, transparent, and predictable. The private sectors will thrive if policies are clear and consistent, if red-tape does not hinder their day-to-day operations, and if public policies do not prevent them from adopting new risk-mitigating institutions, such as futures markets.

Arguably, the public sector has a role to play in price support and stabilization. Compared to the world market, all reviewed countries successfully stabilized the prices of foodgrains. However, the levels around which stability was achieved, the approaches used, and the distribution of benefits (or costs) varied widely among the countries.

The lesson that emerges is that prices should be stabilized around a band that leaves enough room for private traders to cover all marketing costs, including the opportunity costs of human and physical capital. The potential benefits of stabilization around a band are high. It provides much more flexibility than stabilizing around a point, can reduce the costs, encourage private-sector investments, and potentially defuse powerful opponents. Higher arbitrage opportunities from wider bands (and withdrawal of other restrictions) should attract more private traders and increase competition, which in turn can drive prices down. The criteria for devising such a band depends on several factors, but the rule of thumb is to use free-on-board (f.o.b.) costs as the lower bound and cost, insurance, and freight (c.i.f.) costs (including trade margins) as the upper bound.

Very little policy emphasis has been given to developing institutions such as agricultural commodity exchanges, which, in combination with warehouse receipts and futures markets, have historically been shown to improve market efficiency and alleviate credit and insurance constraints. As the private sector grows and the role of parastatals diminishes, there will be a

need to promote these mechanisms, which have proven track records to mitigate price risks, reduce public expenditure on price stabilization, and minimize the size of buffer stocks.

Even if the private sector can be relied on to ensure efficient allocation of resources, the need for social safety nets (SSNs) remains. A review of various SSN programs in India concludes that self-targeted programs are more cost effective than universal food-subsidy programs. Therefore, from the efficiency point of view, it is best to move away from universal food subsidies to more focused distributions in combination with employment programs that target disadvantaged areas and commodities that the poor consume.

THE CHALLENGES OF MAKING THE CHANGES WORK

The economic arguments for making policy changes are very clear. But in the end, political decisions prevail. Politicians want to be re-elected, and political survival depends upon ensuring that the public has adequate and accessible food because urban unrest can bring down governments. But farmers often have strong lobbies, as do embedded public institutions, particularly those with rents to distribute. Thus, politicians tend to play it safe in cases where many people would gain only a little from a particular reform, but a few powerful people would lose a lot.

Success will depend on understanding and responding to the concerns of various stakeholders and adjusting the government's role as the policies change. The good news is that the level of information technology (a key factor in the implementation of desirable price bands, targeted SSNs, and stockholding in strategic locations) has grown dramatically in Asia, as has the human capital needed to implement and promote the changes. Thus, it is high time for the food-policy managers to put this technological know-how to work and develop the strategic information systems necessary to implement successful reforms.

Shahidur Rashid is a research fellow in IFPRI's Markets, Trade, and Institutions Division. **Ashok Gulati** is IFPRI's Director in Asia. **Ralph Cummings Jr.** is a consultant at IFPRI who has served in research and administrative capacities for the Rockefeller Foundation, the U.S. Agency for International Development, and others.

INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE

2033 K Street, NW • Washington, DC 20006-1002 • USA • T + 1.202.862.5600 • SKYPE: ifprihomeoffice • F + 1.202.467.4439 • ifpri@cgiar.org

www.ifpri.org



This brief has been printed on recycled paper with a high-recycled content and is processed chlorine free.

Copyright © 2008 International Food Policy Research Institute. All rights reserved. Sections of this document may be reproduced without the express permission of but with acknowledgment to IFPRI. Contact ifpri-copyright@cgiar.org for permission to reprint.