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Foodgrain Price Stabilization in Developing Countries: Issues and Experiences in Asia

Nurul Islam and Saji Thomas

The government of almost every country has intervened in the market pricing of foodgrains to promote price stability. But the rules of the game are changing as countries abandon trade restrictions and protectionist policies in the wake of the Uruguay Round agreement of the General Agreement on Tariffs and Trade (GATT). Will food prices fluctuate more or less with trade liberalization?

Foodgrain Price Stabilization in Developing Countries: Issues and Experiences in Asia, Food Policy Review 3, by Nurul Islam and Saji Thomas, looks at these issues from three perspectives. The first part reviews the literature and briefly summarizes the macro and micro policies that governments in developing countries have adopted to stabilize prices. It also considers alternative policies that do not seek to stabilize prices per se but deal with the consequences of price instability for food producers and consumers, such as crop insurance or futures markets. The second part focuses on the foodgrain price stabilization experiences of five developing countries in Asia, the circumstances underlying price stabilization policy for rice and wheat over time in each country, and the design and implementation of the schemes adopted. The third part examines the implications of the policies adopted for future price stability.

Pros and Cons of Stabilization Policies

Traditional microlevel welfare analysis of price stabilization finds benefits from price stabilization to be small unless consumers and producers attach great importance to risk aversion. Conventional treatment of risk aversion cannot fully capture the benefits of price stability to the poor, who place high priority on economic security in order to ensure minimum subsistence. Moreover, the macroeconomic benefits of price stability are totally ignored in such an analysis. This gap in theoretical analysis of price stabilization urgently needs to be filled.

The most commonly used stabilization scheme in developing countries is a buffer stock (held by the government) or a combination of buffer stock and trade policies. To know when to release stocks, a public agency sets a trigger price. When the price reaches the trigger, stocks are released to fill the demand so that prices will not rise higher. When prices are set within a band, the floor price (which protects farmers) is the price below which grain will not be sold. The ceiling price is the price above which prices will not be permitted to rise, which protects consumers. To be viable, the margin between the buying and selling prices must cover the direct costs of stabilization.

Price stability can also be achieved by varying imports and exports. Distribution becomes crucial to maintaining stability. Imports must be distributed in all regions or prices will rise in the regions where supplies are short. If trade transaction costs, including delivery, are high, stockholding may be cheaper than importing.

A system of taxes and subsidies on imports and exports can be used to shelter domestic prices from variations in world prices. When the world price rises, an exporting country can impose a marginal tax on exports to prevent the domestic price from rising proportionally. An importing country taxes imports when world prices are low and subsidizes them when world prices rise. When the world price is low, exports are subsidized. If an objective of the government is to protect consumers from rising prices, then provision of rations can be an effective alternative policy. However, identifying target groups and delivering rations can be difficult and costly.

Objectives of the Five Asian Countries

All of the selected countries—Bangladesh, Indonesia, Pakistan, the Philippines, and Thailand—sought to moderate cereal price fluctuations from one season to another and from year to year. However, this objective was pursued along with other interrelated objectives. In all five countries the cereal sector played a major role in the

production structure and as a source of rural income. It also accounted for the largest share in the consumption basket of the poor. Price stabilization per se—reducing the variability of prices—was not the sole objective. In general, all five wanted to ensure a floor or incentive price to producers and a ceiling price to consumers in order to protect the consumers, especially urban dwellers, from high or sudden rises in food prices. The importing countries—Bangladesh, Pakistan, and the Philippines—were pushing for increased self-sufficiency in rice or wheat (whichever was their main food staple). Their governments distributed food at subsidized prices to designated consumers with varying degrees of effectiveness and coverage. Although Thailand's objective was to ensure low, stable food prices for civil servants and urban laborers, its highest priority was to maximize foreign exchange earnings from rice exports by maintaining high, stable export prices. Pakistan's rice price objectives were similar to Thailand's in that rice was an export crop and not the principal cereal for food consumption (which was wheat).

The experiences of the five countries emphasize that for a price stabilization program combining buffer stocks with trade policy to be effective and successful, a few essential conditions have to be met:

- The buffer stock agency must have an assured, flexible access to adequate financial resources since its requirements cannot be predicted.
- The buffer stock agency must be in control of the timing of its purchases and sales. Inappropriate timing would detract from its ability to influence market prices.
- Public stocks must be expertly managed. Cost-effective purchases and sales must be made and stocks must be rolled over frequently to avoid spoilage in storage.
- Timely and efficient management is also essential to avoid counterspeculation, wherein traders, lacking confidence in the public agency, refrain from buying in times of surplus and buy rather than sell in times of shortage.
- If publicly held stocks reduce or substitute for private storage, the success of the public effort is compromised. Policies should encourage private trade; otherwise the costs of public stock will be higher.

In meeting these criteria, in general, Indonesia was relatively more successful than other countries. The long-run domestic real price of rice went down in Bangladesh, the Philippines, and Thailand, whereas in Indonesia and Pakistan there was a moderate upward trend. Instability of domestic food prices was lower than the variability of world prices in all countries. In several countries, price variability during the 1980s as a whole was lower than during the 1970s.

Policy Implications

Theoretically, the elimination or reduction of protectionist policies is expected to help reduce instability in the world market for foodgrains because fluctuations in domestic prices will no longer be shifted to the world market. But world cereal stocks are being reduced as domestic support programs are withdrawn in developed countries. In the past, these stocks have helped curb fluctuations due to drought or other natural causes.

As per capita income rises, self-sufficiency increases and the relative importance of staple cereals in the consumption basket decreases. Concern about domestic price stability, including the impact of world price instability, decreases. However, countries may still seek to reduce wide variations in food prices by smoothing out fluctuations with the help of taxes and subsidies on imports or exports around a long-run trend in world prices, within a flexible price band that changes in response to variations in underlying demand and supply conditions. The band should be wide enough to provide adequate incentive for private stocks, which should play a stabilizing role.

Because public-sector purchasing agencies are often slow to react to changes in market conditions, private enterprise should be encouraged to operate in foreign and domestic markets because it is quicker to respond to signals. Although reliance on trade policy and private traders cannot totally do away with the need for public stocks, residual public stocks can be small. Public trade or stocks can only be reduced gradually over time as private traders learn to function effectively in import and export markets. Also, when surpluses or shortfalls are unusually large, public intervention may be needed to supplement the efforts of private traders. Domestic buffer stocks may also be needed to tide the country over a time lag between ordering of imports and their arrival. Most countries need a safety-net program for the poorest people. When food prices rise abnormally, vulnerable groups must be fed through targeted food distribution or work programs. Also, public procurement at floor prices as a temporary measure in times of market glut acts as a safety net for producers.

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