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How far down the path to free trade? The importance of rice price stabilization in developing Asia

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Abstract

International trade agreements are pushing the world in the direction of free trade. But price stabilization, which is inconsistent with completely free trade, remains important in developing Asia because of the large share of rice in economic output. A policy of pure price stabilization for rice, without consistent protection (either subsidization or taxation), can help to create the macroeconomic stability that is essential for sustained rapid economic growth by increasing the quantity and efficiency of investment throughout the economy. Pure price stabilization can also generate significant equity gains by protecting poor consumers and farmers from sharp fluctuations in prices. While domestic commodity price stabilization schemes have a checkered history around the world, the experience of Asian countries in stabilizing rice prices offers more scope for optimism. Asian governments have been generally successful in stabilizing rice prices, and there are several instances where this has been accomplished without sustained protection of either consumers or farmers. However, there is room for improved stabilization mechanisms that would lower the costs of intervention. © 2001 Elsevier Science Ltd. All rights reserved.

Keywords: Price stabilization; Rice; Asia; Free trade; Policy

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Introduction

Rice is one of the most important commodities in Asia, especially in poor countries. It accounts for >70% of total caloric intake for the average citizen in Myanmar and Bangladesh, and it accounts for nearly two-thirds in Vietnam. Even in relatively wealthier countries such as Thailand and Indonesia, it still accounts for nearly 50% of caloric intake (FAO, 1999). Rice eaters comprise the bulk of the world's poor: according to the *Human Development Report* (UNDP, 1997), ca 70% of the world's 1.3 billion poor people live in Asia, where rice is the staple food. Rice is also important to millions of small Asian farmers who grow the crop on millions of hectares throughout the region, and to the many landless workers who derive income from working on these farms.

During the past few years, the world has moved rapidly in the direction of free trade. The agricultural sector has generally lagged behind in this process, however, especially rice in Asia. There are at least two key reasons why policymakers in developing Asia are reluctant to move rapidly to free trade in rice. First, there is concern over the stability of domestic prices: large sudden adjustments in prices (either up or down) for such an important commodity can lead quickly to political instability. Second, there is a strong desire for national self-sufficiency as a route to food security. Part of the attraction behind self-sufficiency is the historical instability of the world rice market: the virtually complete closure of the world rice market during the world food crisis of the mid-1970s is seared deep in the memory of many Asians. If adequate supplies of staple food can be reliably obtained on international markets, policymakers might be more willing to accept higher levels of imports.

Thus, stable supplies (and prices) are at the heart of the argument over the move to free trade in rice in developing Asia. But the ability to insulate the domestic rice economy from domestic production variability and shocks on international markets is incompatible with completely free trade. Under free trade, domestic prices will follow world prices one for one (after adjustments for transport costs), and any attempts to stabilize prices will be counteracted by private traders seeking to arbitrage domestic and world prices.

Before discussing the tradeoffs between free trade and price stabilization, it is crucial to define stabilization as contrasted with consistent subsidization/taxation. Pure stabilization is taken to mean a reduction in the variability of prices without any change in the average level of prices. A policy that results in substantial deviations of domestic prices from world prices in a consistent direction over an extended period of time is considered to be taxation or subsidization. It is important to maintain the analytical distinction between the two concepts, and the word stabilization when used in this paper should always be taken to mean pure stabilization. At the same time, it is important to appreciate the potential for government interventions to substantially alter the average level of prices, and this issue will be discussed later in the paper.

This paper will summarize the case for completely free trade and argue that it is weak at best for staple foods such as rice. Then it will make the case for pure rice price stabilization, including a brief discussion of how stable the world market is

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