The Price of Rice Protectionism

By V. Bruce J. Tolentino

The global price of rice is soaring, and for the Philippines—the world's largest importer of rice annually—that's bad news. Food queues and fears of riots are real fears. But this is a problem of Manila's own making.

> The Philippines' food supply shortage.

Alone among World Trade Organization member nations, the Philippines imposes quantitative restrictions on rice imports, implemented by a government monopoly. Since the 1970s, the state-owned and controlled National Food Authority (NFA) has maintained tight controls on rice imports. This policy has stood in sharp contrast to other countries such as Vietnam, Indonesia and Bangladesh, which have abolished, privatized or sharply reduced the authority and scale of their food monopolies—and enjoyed more efficient production and cheaper consumer prices.

Not so in Manila, where succeeding presidents and NFA administrators have defended the NFA as necessary to shield rice farmers from low world prices and ensure stable supplies for consumers. Unfortunately, this policy has had exactly the opposite effect: The incomes of the Philippines' rice farmers have consistently ranked in the lowest quintile of the population, and domestic consumer rice prices are roughly double world prices. Worse, the NFA is now one of the largest drains on the nation's already precarious fiscal resources, requiring an annual subsidy of at least 1.2 billion Philippine pesos ($29 million) from national coffers, not to mention uncollected tariffs and opportunity losses due to price premiums borne by Filipino consumers.

It wasn't always so. In previous decades, thanks to low world and high domestic prices of rice, the NFA lost money when procuring from Filipino farmers, but turned a profit on imports. To finance growing imports, it drew against larger credit lines with commercial banks, backed by national government guarantees. Philippine rice policy increasingly became dominated by price interventions, in contrast to Thailand, Vietnam and Indonesia, which placed more emphasis on public investments in irrigation, technology and infrastructure.

Now, world rice prices have doubled in less than five years, due to a combination of increased demand from rapidly growing countries like India and China, production shortfalls in key food-producing countries such as Australia and Bangladesh, and a shift of many farmers to bio-crops such as corn in response to high fuel prices. Today the margin between the Philippines' imported and domestic rice prices has shrunk to around zero from an average of 100% of domestic prices, and the NFA's accumulated debt has mounted to at least 50 billion pesos. Should the banks stop lending to the NFA, it is doubtful that the government can effectively come to its rescue.

There are two reasons this policy has persisted for so long: a short-term outlook in governance of the agricultural sector since the 1980s, and financial interests embedded in current rice policies.

Philippine politics have been volatile for more than three decades, and a result is a highly politicized bureaucracy. Like other ministries, the Department of Agriculture has had more than a dozen secretaries, with average tenures of less than 20 months. This is not sufficient time to learn the job and focus on long-term, sustained productivity. Instead, price interventions have been designed for near-term political gain, with rice policy serving as a priority arena for visibility and so-called "high impact" interventions.

This kind of short-term policy making is particularly damaging to farmers. Public irrigation projects take about seven years from inception to operation. In addition, high-yielding rice varieties may require decades to bring to farmers' fields, and the upgrading of production technologies and farmers' skills require the strengthening of entire agricultural extension systems. The achievement of long-term productivity simply requires more years than allowed by the short tenures of Filipino bureaucrats.

The NFA has also been used by succeeding administrations as a convenient tool for the public distribution of commodities, including fertilizer. In 2006, the Senate Blue Ribbon Committee and the Committee on Agriculture and Food released a report that stated that in 2004, proceeds arising from fertilizer procurement and distribution helped finance the election campaign of President Gloria Macapagal Arroyo.

David G. Klein

The NFA finds approval among its key constituencies, including of course the well organized NFA Employees Association. Politicians often use the NFA to distribute low-priced rice and farm inputs to constituencies; some farmers are favored by its targeted procurement operations; commercial banks lend to it; and a host of wholesalers, retailers, warehouse owners and transporters count on its supplies and contracts.

It's not all a bad news story: In early April, President Arroyo announced the suspension of the NFA's monopoly on rice imports, and private traders are now allowed to import. However, total private imports are still a fraction of requirements and importers require licenses issued by the NFA. Moreover, private importers are expected to pay full tariff, whereas tariffs on the NFA's imports are likely to be waived or deferred. Given its relatively weak revenue base, the government cannot readily waive customs revenues on private imports. The NFA, worried about repaying its huge credit lines, knows it can hardly compete with private traders on a level playing field.

The Philippines' food supply challenges can only be met through determined, long-term efforts to rebuild domestic agricultural productivity—specifically through major investments in irrigation and agricultural technology. The rice trade must be fully opened to all players, with the NFA's regulatory role severely reduced and its operations tightly focused on the targeted distribution of food to impoverished communities.

If not, the Philippines will need to import ever-growing amounts of rice, at an ever-greater cost. As that cost starts to eat into government finances, it could hobble the Philippines' efforts to achieve fiscal health. It's time for Manila to ditch its iron rice bowl once and for all.

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Growing Pains

By Jonathan Woetzel
And Janamitra Devan

China's dramatic economic growth is now presenting a new challenge: urban policy. Mass migration to cities is leading to the loss of arable land and urban sprawl; spiraling demand for energy and natural resources; and the rising challenge of providing social services like education and health care, particularly to migrants. It's time for policy makers to rethink their approaches to all these problems.

About 600 million Chinese already live in cities, but that represents only 45% of the population, compared to over 80% in the United States. That suggests Chinese cities are likely to grow considerably. New research by the McKinsey Global Institute projects China's cities will add another 350 million to their populations by 2025, of which 240 million will be migrants from the countryside.

This influx could push cities to their breaking point. By our estimates, demand for energy in urban areas will likely more than double; demand for water will increase by between 70% and 100%. Providing healthcare and education to new migrants will severely strain cities' ability to fund these critical services. Depending on the shape that urbanization takes—more concentrated, or more dispersed—arable land could be depleted by 7% to 20% nationwide.

Rather than addressing each problem on its own, it's time to think of all these problems as facets of a bigger underlying challenge: how to increase urban productivity to enable both economic growth and more livable cities. By urban productivity, we mean an agenda for both the public and private sectors that would improve the quality and efficiency of urbanization, while moving away from the current focus on maximizing GDP growth of China's cities at any cost.

This approach would require systematically tackling the factors that currently make Chinese cities so inefficient. Urban planners would focus on growing its cities up, not out. Using zoning laws to encourage the more efficient clustering of taller buildings, along with a beefed-up investment in transportation infrastructure, would create more livable city environments while containing land and resource pressures. Policy makers would also devote more attention to managing the demand for resources, rather than simply building supply infrastructure as needed. By introducing peak-hour electricity price premiums, deregulating gas prices, and mandating the use of more energy efficient technologies such as compact fluorescent lighting and light-emitting diodes in the construction of all new buildings, urban China could reduce its energy demand growth and potentially cut oil demand by more than four million barrels per day.

> How to manage China's urban expansion.

Improved urban productivity will also deliver real financial benefits, particularly to small- and medium-sized cities which are finding the funding of urbanization itself more challenging. Sourcing sufficient funds to provide for adequate infrastructure and to improve public services for migrant populations without raising taxes is a challenge that all urban planners already face. One step will be improving the productivity of the public services that cities deliver. For example, deploying capital investment in transit infrastructure more efficiently through better rail network planning and increasing non-fare revenue, or better managing the more than $100 billion spent annually by local governments on fixed asset expenditures.

Despite the expense and challenges, this kind of holistic strategy is the best—and perhaps the only—way forward. And the benefits could be considerable. Our research suggests that such policies could help reduce government spending in 2025 by more than 1.5 trillion yuan ($215 billion at today's exchange rate) per year, the equivalent of 2.5% of China's projected GDP that year.

A comprehensive "urban productivity" model is already working—in China, no less. Since 2006, the central city of Wuhan has launched a progressive, transparent performance-management system designed to promote sustainable economic development and raise public-sector productivity. Wuhan has implemented a broader set of performance measures for government entities that reward the reduction of energy consumption, or the design of more environmentally friendly economic development policies. Since these measures have been put into place, Wuhan has reduced energy consumption per unit of GDP by 4.5%, compared with the nationwide average of around 3%, and cut administrative red tape in half. At the same time, GDP growth has increased to 15.5%, from the average 13% growth of previous years.

Through policy direction and incentives, the central government can do much to influence how urbanization plays out in China. But while Beijing plays an important role in guiding the overall direction of urbanization at the national level, it is city leaders who make many of the key decisions that shape the path and pace of urbanization. For the long-term sustainability of China's new urban economy, it is vital that the broad swathe of China's cities—rather than a far-sighted few—adopt an urban productivity agenda. Getting the process right now will be far less costly than attempting to fix problems further down the road.

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