

Government Intervention in Rice Market

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With the adoption of liberalisation policy in the late 1970's, the country embarked on a series of economic reforms directed towards an open economy. Liberalisation of trade was embarked upon in latter part of 1977 while the other major tariff reforms were delayed until the late 1980's. Government intervention in domestic marketing became insignificant and import duties and controls such as licensing were utilized as mechanisms to control imports and protect domestic producers whenever needed while buffer stocks were maintained by the bondsman for food security. However, recent reforms in trade policy have adversely affected economic stability in the domestic food crop sector in the country. This is reflected by the seasonal fluctuations along with sudden spiralling of prices. It also became a political issue in the country. One of the severe shocks suffered by the paddy sector in the last season affected by adverse weather is the subject of this analysis.

This case study was first initiated to investigate the validity of a statement made in a newspaper article in 1998 January. According to the newspaper "90 paddy mills had closed down by the middle of January 1998". A field investigation was carried out to ascertain the situation in the milling industry. This investigation disclosed some facts which endorsed the virtue of government intervention in rice marketing in Sri Lanka. Therefore the objective of

this case study is to emphasize the significance of government intervention within the context of economic liberalisation to optimize the welfare of the people.

Paddy milling is the second largest agro-industry in Sri Lanka (next to tea processing). About 20,000 paddy mills are operating at present, according to official records. Of them 9,000 are medium and large scale mills with modernized machines and are located in major paddy producing areas: Ampara, Anuradhapura, Hambantota, Kurunegala and Polonnaruwa. In addition, milling industry has spread to Puttlam, Gampaha, Batticalo, Trincomalee, Moneragala and Badulla districts.

Case Study : Fully liberalized rice imports in 1997 and their impact on milling industry in Polonnaruwa district.

The bad weather experienced during the two consecutive seasons, 1996/97 Maha and the 1997 Yala resulted in severe decline in paddy production in the country. Hence the cumulative or the carry-over stocks available with paddy millers had diminished. It is a general practice for millers as well as paddy assemblers to store paddy which was purchased during the harvesting season at a low price to be used in the lean production period. However less paddy was stored during this harvesting season due to low production.

This is true for Polonnaruwa too, the district focus of this case study. Polonnaruwa is a major paddy producing district which contributes about 12 % to the total paddy production and is the second largest surplus district. Paddy milling is the main agro-industry in Polonnaruwa. The situation during the last Maha and Yala seasons referred to above had subsequently affected the milling industry as follows:

Many small and medium scale millers had stopped milling once their stocks were over. They have limited capacity to store paddy in bulk and therefore had to depend on regular purchases of paddy from paddy assemblers. The increasing paddy prices due to the short supply of stored paddy during this season did not permit them to realise their profit margin from milling, making it difficult for them to remain in the industry.

One of the highest ever producer prices was recorded during the period between November 1997 and January 1998 (Table 1). Therefore, if they mill paddy at this price, rice would be traded at Rs 24.00 -26.00 at wholesale and Rs 28.00 - 30.00 at retail. This price was not competitive in relation to the market price which prevailed in this period. The wholesale and retail prices are shown in the table (Table 2). It is inevitable therefore that the small and medium scale millers, i.e. those who have been purchasing paddy for milling, had to move out of the milling industry.

Accordingly more than 100 mills had temporarily stopped their operation by mid January 1998. However about 20 large scale millers had continued to operate in the industry as they had stored stocks of paddy.

Meanwhile to correct the short supply during this period, the government decided to let private traders import rice with zero duty and no license were issued. This policy decision was taken in October 1997. The CIF price of rice had declined continuously from March 1997 to October 1997 and started to increase thereafter (Table 3). By this time the rice prices had gone upto the highest ever recorded during the recent past in the domestic market. Following the decision of October 1997 ample stocks of imported rice started to come into the market in bulk. More than 50 % of the rice imports for 1997 was recorded during the months of November and December (Table 4). Mainly 4 importers were dominating the imports and there were no government imports.

Even though there was an abundant supply of imported rice, the price drop was marginal. There was only about Rs. 2.00-2.50 price gap between the imported and the local rice (Table 5). The government took steps to distribute imported rice purchased from the importers through the co-operative outlets, to make it freely available to the consumers.

The observations in this case study are as follows:

1. Decline in national paddy production and production in Polonnaruwa; hence diminished carry-over stocks
2. Fully liberalized rice imports
3. Distribution of imported rice by the co-operative outlets in addition to the private sector trading

The following are the outcome:

1. High producer prices for limited paddy stocks during lean production period.

2. Temporary stoppage of small and medium scale milling while large scale millers continued their operations.
3. Large price gaps between CIF and domestic market prices (wholesale and retail).
4. Small difference between the prices of imported rice and local rice.

The above situation was general, although it was profound in the Polonnaruwa district, and the influence it could make in the Colombo wholesale market was significant.

Underpinning

The large scale millers who continuously operated in the industry, were able to determine the market prices for rice, based on the prevailing paddy prices. The price determined by the millers prevailed in the wholesale market where trading is on commission basis. There was a substantial increase in rice prices during this period. However these prices were not high enough to ensure a profit margin for small and medium scale millers.

The increased prices had lowered the demand for local rice and shifted it in favour of imported rice (which were of good quality) even though there was only a marginal difference between the prices of local and imported rice. The wholesalers enjoy the benefits of consumer behaviour in the elastic region of the demand line by maintaining a higher price for the imported rice. Thereby the wholesalers received higher profits by trading imported rice. This situation was aggravated by the fact that few importers are also wholesalers and there were no government imports.

Policy Impact

Welfare analysis would show that neither the consumer nor the producer nor even the government benefited by the implementation of such policy measures even in a situation of severe shortages in production in the country. Fully

liberalised rice market allows traders to benefit from price speculations in the domestic rice market.

Traders or the market intermediaries gain their power in price determination by a number of ways in the domestic market:

Paddy assemblers purchasing paddy at the lowest prices and commanding higher prices during the lean production period,

Determining rice prices by the large scale millers based on rice milled by the small and medium scale millers who buy paddy at the market rate,

Determination of price of imported rice by few large scale importers who themselves are the wholesalers in the Colombo wholesale market.

Thus the imperfect market conditions in the rice market call for government intervention as a regulator of competitive behavior by:

Identifying the market influencing producing areas such as Polonnaruwa and Hambantota.

Purchasing paddy from the beginning of the harvesting season thus preventing the price from falling to the minimum and defining the thresholds of buying, and avoiding extended price speculations.

