



Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

Rapid Appraisal of the State of Competition in the Rice Value Chain

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DISCUSSION PAPER SERIES NO. 2014-25

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May 2014

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Rapid Appraisal of the State of Competition in the Rice Value Chain

Abstract

The rapid appraisal is mainly based on the interview of select players in various levels of the paddy/rice value chain from Pangasinan and Nueva Ecija to Metro Manila. It finds that the paddy and rice supply chain is multi-layered with many competing players in each layer with no evidence of any cartel-like behavior in the areas studied. Margins are limited to 2% or less of raw materials at all levels before retail. Profits are enhanced by volume, fast turnover of stocks, integration of operations across levels, and investments for quality consistency. The greatest threats to current players are weather risks and continuing tight local paddy supplies that spawn greater competition and increase management costs. The increased costs also highlight the lower cost option of bringing in foreign rice, which given government quantitative restrictions on rice imports, manifests in rampant smuggling.

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1. BACKGROUND

A project, entitled *Competition Reforms in Key Markets for Enhancing Social and Economic Welfare in Developing Countries (CREW)*, seeks to develop an approach for assessing the benefits of competition reforms on consumers and producers in developing countries. Being implemented by CUTS International (CUTS) with research support from Nathan Economic Consulting India Private Ltd (Nathan India), the project involves looking at selected sectors in a number of developing countries. The first or diagnostic phase of the project includes research on the institutional environment, reform efforts, and market structure of the sectors under study. The Philippines, through the Philippine Institute for Development (PIDS), is participating in the project with focus on the staple food sector. This rapid appraisal was thus conducted as part of the assessment of the market structure of the Philippine rice industry.

2. OBJECTIVES

The objectives of the rapid appraisal are as follows:

1. Conduct key informant interviews or focus group discussions, covering the various stakeholders along the rice value chain, namely: consumers, retailers, wholesalers, rice millers, paddy traders, farmers, and regulatory agency, the National Food Authority (NFA).
2. Evaluate the following aspects of the supply chain: i) the extent of competition amongst current competitors; b) potential for new entrants into the market; c) the effect of substitute products; d) bargaining power of consumers; e) bargaining power of firms that supply to the market.¹
3. Gather information from NFA that could shed light on market structure and entry barriers, e.g. data on licenses for various market players, data on sales or stocks as available, criteria for giving licenses, and ease or difficulty of licensing and registration.

¹ Based on Porter's five forces of competition. "Bargaining power" includes the idea of range of choice in selecting another seller (in case of a buyer) or buyer (in case of seller).

3. PROFILE OF KEY INFORMANTS

The rapid appraisal focuses on Manila and a few surrounding provinces. It is based on interviews of key informants from the NFA and each of the nodes of the rice supply chain beginning at the producing, trading and milling markets in Nueva Ecija and Pangasinan, the milling and wholesale markets in Bulacan and the wholesale and retail markets in Manila.

Among the informants are officers in the NFA Central Office, National Capital Region (NCR) regional office, and provincial offices in Bulacan, Nueva Ecija and Pangasinan. Also interviewed were retailers and wholesalers in Manila, millers/wholesalers in Bulacan, and traders, millers/wholesalers, retailers and farmers in Pangasinan and Nueva Ecija. Most NFA officers interviewed had worked for the institution for years and had been assigned to a number of NFA field offices in various capacities prior to their current office. As for the rice industry participants interviewed, most were recommended by the NFA provincial offices and chosen for their knowledge of the industry and willingness to be interviewed. A summary profile of the key informants is shown in following table.

Table 1: Profile of Key Informants

Number	Sector	Place of Operation
2	Farmer/ Cooperative	Pangasinan
1	Cooperative Miller/Wholesaler	Nueva Ecija
2	Trader/Wholesaler/ Retailer	Pangasinan
2	Miller/Wholesaler	Pangasinan
2	Miller/Wholesaler	Nueva Ecija
3	Miller/Wholesaler	Bulacan
2	Wholesaler	Metro Manila
2	Retailer	Metro Manila
2	Consumer	Metro Manila
5	NFA	Metro Manila, Bulacan, Nueva Ecija, Pangasinan

4. KEY FINDINGS

4.1. Market Players and Product Flow

Most of the rice sold in Metro Manila start out as paddy produced in Pangasinan, Nueva Ecija, Isabela, Cagayan, Tarlac, Pampanga and Bulacan (Regions 1, 2 and 3). Region 4 typically supplies the south; i.e. Davao, General Santos, Cebu and Leyte, because access to shipping facilities makes doing so more lucrative compared to competing in Metro Manila. Region 5 is typically rice- deficit and also gets from Region 4. There have been reported cases of rice coming from Cebu into Metro Manila but industry analysts think that these are possibly rice smuggled from outside the country.

Farmers typically dry paddy in pavements under the sun and sell these to (a) paddy traders who set up buying stations in the farming communities, (b) millers who buy through independent agents that operate in the area, and (c) cooperatives who do trading for their members. Some cooperatives and mills also have mechanical dryers but these are viewed as mainly for emergency use during storm season because solar drying is definitely more efficient.

Traders who do not have mills also sell the paddy to millers or pay to have these milled and then sell the rice to wholesalers or retailers. Traders interviewed in Pangasinan have the paddy milled in nearby mills and sell the rice directly to consumers and to other retailers in surrounding municipalities although one brings some paddy to a miller/wholesaler in Bulacan. Traders generally put up buying stations and have stores to transact business but no significant warehouses.

Millers have warehouses where paddy and rice can be stored. Paddy stocks store longer and are thus intended for future sales while milling is done in anticipation of rice being sold in a few days. The big mills/warehouses, with capacity to store paddy longer, are reported to be in Nueva Ecija and Isabela while Pangasinan and other Luzon provinces generally have small to medium sized mills/warehouses. Millers interviewed in Pangasinan and Nueva Ecija buy directly from farmers, picking up the produce after volume and price agreements are made through their own or independent agents and profess going out of their province, notably to Tarlac and Isabela, in search of paddy. They also buy from paddy traders who deliver to their mills and likewise mill for traders. They eventually sell the rice to wholesalers in Pampanga, Metro Manila, Cavite, Laguna and Rizal with one miller in Nueva Ecija shipping to Cebu and Cagayan de Oro.

Bulacan hosts small millers/wholesalers, many in Intercity, an industrial estate where about 125 small rice mills do brisk 24-hour business buying and milling paddy and essentially acting as rice staging area for wholesalers and retailers in Manila. This privately-developed property in Bocaue is strategically located and, due to the number of adjacent independent mills/warehouses competing for the business, is known to offer very competitive prices to paddy traders and rice buyers as well as traders in need of milling services. Those who go to Intercity are described as “guerilla type” traders – they are not as established and they do not deal in big volumes. An NFA official estimates that some 70% to 80% of rice going through Intercity get distributed in Metro

Manila and Southern Tagalog. The rest may go to Visayas. Another private property near in Bulacan, the Golden City, is currently being developed for the same purpose and now hosts around 15 small mills/warehouses.

Wholesalers, mostly supplying retailers in the wet markets, normally maintain stocks good only for 2-3 days in Metro Manila warehouses. The stock is refilled regularly from own or contact mills/warehouses outside Manila which usually stock paddy enough for three months.

Retailers in Manila get stocks from wholesalers, mostly once or twice a week. Some pool together requirements and buy the pooled requirements from Intercity. Retailers are present, often more than one, in all the markets in Manila as well as in community commercial areas.

4.2. Competition among and Bargaining Power of Players

The interviews reveal very strong competition among the current players in practically all levels of the supply chain, at least among the places visited. At the farm level, interviewees report that farmers have a choice of buyers right in their communities due to the presence of a number of buying stations and agents competing for the product. Thus, farmers easily get the highest price for paddy, especially now that supply is tight. Some farmers still get production and/or harvesting loans from traders but these traders are forced to give them the highest price come harvest time rather than lose out to another buyer and risk not being able to collect the loan. One trader says “what is giving up a few centavos per kilo paddy compared to losing the loan amount due to non-payment?”

Competition in the paddy production centers increases further as agents, who get 10 centavos per kilo of paddy sold with their referral, prefer to be independent. These agents normally ask around for the highest offer from trader and mill contacts not present in the community but ready to pick up the produce once a transaction is agreed on. They strive to get the highest price for the producers because their business sustainability relies on their reputation of ability to get the best deals. Farmer members of trading cooperatives add to the competition as they also actively solicit business for their organization in consideration of patronage rebates.

Mills that buy paddy and sell rice earn through volume traded because competition keeps margins low at about P30 – P50 per 50 kilo sack of rice traded. They need to price at prevailing market levels when they buy and sell because a difference of 5 centavos per kilo paddy or P10 pesos per sack rice will send customers to the next buyer/mill/seller.

Millers also learn to be very flexible to maximize the use of their facilities and recoup investments, operating expenses and interest on loans. . To get supplies, they buy both from traders delivering to their mill and directly from producers through their own buying stations and independent agents in the farming communities. While they generally buy the paddy they store and mill, they also offer milling services at P60 per bag for those who do not want to sell their paddy and prefer to trade rice. Some mills also have mechanical dryers which paddy suppliers

can use for a fee but, if the sun permits, they also use their yards as no-cost drying pavements just to hold on to customers who face difficulty in drying paddy. As noted above, mechanical dryers are not a good investment, requiring fuel and, for the flatbed drier, manual shifting, while any pavement under the sun dries paddy faster at no cost. A farmer interviewed narrates how he delivered his wet paddy to the mill to dry during some rainy season but the mechanical dryer had a queue. While waiting, the sun shone so he asked the miller if he could just spread out his paddy in the miller's yard to which the miller agreed as long as the farmer did his own shifting. He did and sold his dried paddy to the mill before those in the dryer queue did. One miller says that he lowers his rice selling price to accommodate regular wholesale customers who haggle because he figures that he already earned in drying and milling, and even when he did not, he earns goodwill.

In Intercity, where warehouses are smaller, the rate of stock turn-over is the key to earnings. They are very conscious of prevailing prices because very small differences in price offerings matter where more than 100 mills exist side by side. Buyers and sellers normally go through agents who stand at the Intercity's two gates. These agents are independent of the mills and generally point the buyer or seller to the mill currently offering the highest prices or having the stocks or space.

An Intercity miller interviewed competes for buyers by ensuring that he has some minimum amount of stocks for each of the varieties or qualities of rice. He notes that retailers have boxes of different rice qualities and prices offered to consumers. Since most of those who go to Intercity are the small less-established traders, they are likely to need the various varieties when they buy. To better categorize and improve the quality of his stocks, he invested in additional equipment like color sorter and polisher.

To compete in niche markets that prefer premium quality rice, like restaurants, corporate and other institutional accounts, millers/wholesalers invest in mechanical weighing and packaging equipment. They brand their products and produce smaller packs of 5, 10 and 25 kilos for retail in supermarkets. One miller infuses his rice with plant-based fragrances like vanilla and pandan to enhance aroma. At the input end, they maintain a "suki" relationship with trusted sources in areas known to produce good quality paddy and buy at higher prices to encourage farmers to invest in good production inputs. They buy everything the "suki" sells even if the crop quality does not meet the quality standard in order to maintain goodwill. On the other hand, institutional buyers do not offer term contracts; instead they issue purchase orders, some over a duration of three months, with prices following prevailing trends.

Rice wholesalers who cater to retailers in Manila also rely on volume for profits and maintain low margins of P20 - P30 per sack to compete. They offer payment terms of 15 to 30 days to maintain regular clients.

The retailers compete by offering variety and convenience. Many make available different types of rice in terms of quality and price so that there is something suitable for every shopping

budget. Also, rice is only one among a variety of products these retailers sell. In fact, rice retailers are usually market variety stores or neighborhood convenience stores, including supermarkets. Market and neighborhood stores show rice offerings in boxes representing different prices and qualities from where rice is weighed and packed according to the customer's order while supermarkets sell different brands and varieties of rice in 5-, 10- and 25-kilo clear packs. Retailers generally price according to the price they buy the rice plus a margin of about P100 per 50 kilos. They can give discounts of up to P20 to those who buy 25- or 50- kilo sacks.

4.3. Price Information

Majority of those interviewed say that they follow prevailing prices. Many paddy buyers; i.e. traders and millers; source price information from rice buyers, especially big established wholesalers around Metro Manila as well as in fast markets like Intercity. Then they work backwards, imputing their costs to arrive at their maximum paddy buying prices. They work out actual buying prices considering competition and supply conditions in their area.

4.4. Costs and Margins

Paddy currently costs around P18 - P20 per kilo or some P900 – P1,000 per 50 kilos. Milling costs are P60 per kilo and milling recovery (rice produced from paddy) ranges from 60% to 65%. Using 64% recovery, the norm used by the BAS, the cost of rice ex-mill is about P1,716 per 50 kilo bag. Transport costs of some P70.00 per bag bring the rice cost ex-Manila at P1,786 per bag. A miller explains that the cost difference between low quality vs medium quality and medium quality vs high quality rice is P200 per bag. This means that low quality rice will cost around P1,586 per bag, medium quality will be around P1,786 while high quality rice will be around P1,986 in Manila excluding all the margins.

An interviewed Metro Manila retailer says that their average margin is P100 per bag while the interviews with traders, millers and wholesalers suggest that their margins, including storage costs are about P20 for the trader, P40 for the miller and P20 for the wholesaler or P80 cumulative up to the wholesaler and P100 for the retailer. Adding these to the costs, the computation places the price of rice in Metro Manila at about P35 pesos per kilo for low quality, P39 per kilo for medium quality and P43 for high quality, which are very near what we are seeing now in the markets. Rice packed in smaller volumes cost P2 higher per kilo (P100 pesos per 50 kilos) when it leaves the mill and with wholesaler and retailer margins bigger, prices in the supermarkets are, not surprisingly, much higher.

Table 2: Estimated Costs and Prices of Rice, Metro Manila

Cost of Rice (P)				
Palay price	20.00		per kilo	
	1,000.00		per cavan	
Milling cost	60.00		per bag	
Milling recovery	64.00		%	
Cost ex-mill	1,716.25		per 50 kg bag	
Transport	70.00		per bag	
Cost ex-Manila	1,786.25			
Price of Rice (P)				
	Low	Medium	High	Smaller Packs
Cost per bag ex- Manila	1,586.25	1,786.25	1,986.25	2,186.25
Repacking per bag				100.00
Margins per bag				
Trader's	20.00	20.00	20.00	20.00
Miller's	40.00	40.00	40.00	40.00
Wholesaler's	20.00	20.00	20.00	20.00
Retailer's	100.00	100.00	100.00	100.00
Total cost and margins	1,766.25	1,966.25	2,166.25	2,466.25
Price per kilo	35.33	39.33	43.33	49.33

4.5. Potential for New Entrants and Investments

The interviewees say that entering the market will be easy if you have the capital and the supply source or the potential market. But the financial requirements are quite substantial. A 10,000 bag warehouse will easily require a minimum of P15 million for working capital for rice alone at P1,500 per bag.

Also, like any business, there is a learning curve and the first few years can prove very risky for a new comer. In fact, many of the interviewees, despite their long years of operation, admit to still feeling vulnerable to the following risks: (a) bad weather severely limiting supplies that will further make competition intense especially from the big players; (b) unplanned or hastily-decided imports and uncontrolled smuggling that make huge volumes of low-cost rice available after they bought stocks or sold on credit at higher prices; and (c) swindlers who get your trust through regular good orders but disappear once you give them credit. For the last reason, more than a few millers/wholesalers interviewed express reluctance to enter the Metro Manila market where the norm is for wholesalers to give 15- or 30-day term credit to retailers and where stories of swindling of those who tried to enter the market in the past abound.

While the NFA licenses all types of grains businesses from paddy trading, warehousing, and milling to wholesaling and retailing and registers rice facilities and equipment, further requiring that licenses and registrations be renewed annually, none of the interviewees had any issue with the same. For them, the requirements and procedures are clear and easy to comply with. The documentary requirements are the standard proofs of legitimacy of business, location and facilities layout plans, proofs of compliance with applicable zoning and environmental regulations and proof of insurance and guarantee of stocks. Provided the requirements are complete, the application can be processed and a temporary license can be issued in 30 minutes. Table 3 shows the number of license applicants for rice milling, warehousing and retailing in 2012.

Table 3: Number of License Applicants
NFA, 2012

	MILLING							WAREHOUSING			RETAILING			
	STATIONARY			TRAVELLING			TOTAL MILLERS	NEW	RNW	TOTAL	NEW	RNW	TOTAL	UNITS
	NEW	RNW	TOTAL	NEW	RNW	TOTAL								
PHILIPPINES REGION	486	7,361	7,847	53	426	479	8,326	1,007	11,476	12,483	7,725	44,507	52,232	55,044
NAT'L CAP'L REGION	-	2	2	-	-	-	2	63	462	525	779	3,473	4,252	5,194
CORDILLERA ADM REGION	17	184	201	1	3	4	205	15	112	127	174	988	1,162	1,247
ILOCOS REGION	63	1,194	1,257	4	37	41	1,298	29	761	790	278	2,228	2,506	2,539
CAGAYAN VALLEY	65	913	978	15	73	88	1,066	186	1,497	1,683	289	1,916	2,205	2,276
CENTRAL LUZON	23	598	621	1	6	7	628	36	777	813	297	2,614	2,911	3,013
CALABARZON	22	269	291	-	-	-	291	64	886	950	615	3,567	4,182	4,284
MIMAROPA	17	610	627	-	18	18	645	43	1,004	1,047	332	2,836	3,168	3,275
BICOL REGION	71	710	781	-	1	1	782	18	378	396	629	4,765	5,394	5,518
WESTERN VISAYAS	15	356	371	24	258	282	653	13	358	371	558	3,613	4,171	4,413
CENTRAL VISAYAS	46	476	522	1	2	3	525	172	1,636	1,808	815	4,252	5,067	5,762
EASTERN VISAYAS	38	408	446	-	7	7	453	20	320	340	459	3,386	3,845	3,883
ZAMBOANGA PENINSULA	25	289	314	1	-	1	315	20	364	384	133	982	1,115	1,117
NORTHERN MINDANAO	17	349	366	3	10	13	379	57	650	707	604	2,576	3,180	3,245
DAVAO REGION	21	219	240	-	1	1	241	51	887	938	457	1,886	2,343	2,388
SOCCSKSARGEN	24	276	300	-	2	2	302	179	685	864	569	1,582	2,151	2,216
CARAGA REGION	21	480	501	3	8	11	512	20	598	618	599	3,240	3,839	3,931
ARMED REGION	1	28	29	-	-	-	29	21	101	122	138	603	741	743

SOURCE: ISD-IRD

After licensing, there is little monitoring of registered businesses outside of processes involved in the estimation of commercial stocks which NFA does monthly by province or sub-province; i.e. provincial offices estimate total commercial stocks based on data on stocks from a sample of millers/warehouses, normally 100% enumeration for big and a small sample for small players.

With respect to additional investments, many of those interviewed are not keen about investing more to expand facilities. Some want to upgrade to make their operations more efficient but the aforementioned risks discourage them. They figure that rice areas are not getting bigger, the population is growing, and the incidence of adverse weather will be increasing so paddy supplies will always be tight. Also, the high paddy prices mean the traders and millers need more working capital to maintain the same level of operations so any additional investments go to the back burner. Moreover, they feel that the Bureau of Customs will never be able to control smuggling and smuggled rice, because it is tariff free and undocumented, is difficult to compete with. In fact, some in the industry would prefer that government allow imports as long as these are controlled, taxed, properly documented and transparent, because they can work around this.

4.6. Effect of Substitute Products

Consumers buy rice according to ability to pay the price, but if the budget permits, they prefer rice that is white, has few broken, and is fragrant. This is why those interviewed say that they will not buy the cheaper NFA rice, which they believe is of poor quality. The retailers say that the most demanded varieties are those of the medium-price range. Among the discriminating, one of the most preferred varieties is the high-priced dinorado known for being aromatic and slightly sticky.

Interviewed consumers claim that they will continue to consume the same amount of rice even though rice prices increase because available substitutes like bread and pasta are still more costly. They eat bread or pasta for convenience and variety of fare. They will cope with rice price increases by choosing what they feel is the best rice variety they can afford instead of the variety they really prefer. It is however accepted that instant noodles substitute for rice among the poor because of affordability and because of convenience for other income classes.

Interviewed consumers also say that they change rice varieties or the stores they buy from when they sense that the rice they get is not as they expected. Because stores present rice in boxes, one really does not know what one gets even if the retailers place the variety common names beside the prices to identify the contents of the boxes. It is widely known that not a few retailers or wholesalers -- each one pointing to the other -- mix poor quality stocks with higher quality rice just to move the former or to moderate prices for the latter. Thus a consumer may buy dinorado rice but actually get only 75% dinorado rice. The assurance of quality is another reason why branded packed rice in supermarkets are priced much higher. In this regard, product labeling regulations on rice need to be better enforced while consumer awareness of rice quality standards

need to be enhanced.

4.7. Cartel Behavior

Given the number of layers in the chain and the apparent number and variety of players in each level, it is difficult to imagine how one or a group of market players would be able to influence market directions to their advantage. In fact the cost estimates and prices show no substantial margins as these are apparently limited to 2% or less of raw materials up to the wholesaler level and 5% at the Metro Manila retailer level. Interviewees consistently say that the competition is really stiff, especially with tight paddy supplies, a situation especially pronounced at the time of the interviews which were done following the end of the rice lean season (July to September) and around the occurrence in October of a typhoon that destroyed crops ready to be harvested in Nueva Ecija, the biggest rice producer in the country.

However, some analysts do not discount that a group may be able to control certain markets in certain situations. That the Philippines is an archipelago, there is lack of sufficient infrastructure and rice production is seasonal make possible circumstances in which certain groups are able to control the market.

In Metro Manila, it is opined that a group that can control 20% - 30% of commercial supply, possible in September, may be able to influence price movements. The NFA accounts for 15% - 25% of the retail market during the lean season but the reputation of the quality of its rice makes it a less preferred product among many buyers, thus limiting its impact on the commercial sector. However, industry players are quick to point out that some price increase in September should be expected because palay stocks shrink by 1% - 2% per month of storage, cost of money is 5% per annum, and there are other storage costs. Besides, storing and price speculation are legitimate business practices. The only issue is how many have the wherewithal to do so. Also, there is considerable risk in speculation because government allows some importation during the lean months and it cannot seem to control smuggling.

One wholesaler interviewed notes that the current importation quota distribution rules, where the importer has to bring in a minimum of 2,000 tons and as much as 5,000 tons, favor big players thus facilitating cartel-like behavior. Two thousand tons of rice cost about USD 700,000 or P30.8 million (at USD350/mt ex Hanoi and P44 = USD 1) without freight and tariff. If the system will allow smaller players to import, say a 10- or 20- ton container load, the supplies cannot be concentrated in a few big players. In this regard, many of the interviewees believe that the country will never be able to attain self sufficiency and thus support some controlled importation policy. One interviewee points out that controlled and transparent legitimate importation may not disrupt their market operations the way uncontrolled smuggling does.

5. CONCLUSIONS

Consistent with previous studies done on the rice supply chain, this rapid appraisal finds that the paddy and rice supply chain is multi-layered with many competing players in each layer. While not discounting that some conditions may allow a group to influence price direction in specific markets for limited periods, the rapid appraisal also finds no evidence of any cartel-like behavior in the areas studied. Margins are limited to 2% or less of raw materials at all levels before retail. Profits are enhanced by volume, fast turnover of stocks, integration of operations across levels, and investments for quality consistency. The greatest threats to current players are weather risks and continuing tight local paddy supplies that spawn greater competition and increase management costs. The increased costs also highlight the lower cost option of bringing in foreign rice, apparent in the reported rampant smuggling that the government cannot seem to control.

Among the challenges of attaining self-sufficiency is ensuring that the risks and costs of bringing rice to consumers are controlled. Thus, rice importation policies need to be rational and effective in protecting not only the interests of producers but also consumers and other market participants. Huge differences in the costs of bringing in imports and moving domestic supplies to consumers makes smuggling lucrative. Quantitative restrictions on imports as exemplified by NFA's regulations allow the concentration of legally imported supplies in the hands of a few. A properly-set tariff level under a liberalized importation policy -- allowing anyone to bring in rice with the payment of tariffs -- can still give protection to producers and will provide more stability in domestic supplies and prices and deter any attempt to control substantial supplies to manipulate market prices.