

## Quantitative restriction on rice imports: Issues and alternatives

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**R**ice is integral to the Filipino diet, history, and culture. As the host of the International Rice Research Institute since 1959, the Philippines takes pride in its leadership in rice science and agricultural education. However, historical trade data reveal that the country has been a net importing country since the 19th century (Doeppers 2016)—a practice that Filipinos see as a national embarrassment.

This 2017, the country's quantitative restriction (QR) on rice will expire. The QR allows the government to limit the volume of rice that could be imported by the Philippines each year. It is intended to protect local rice producers from the adverse effects of cheap rice imports.

This *Policy Note* examines the impact of the QR on rice imports and presents policy options for the Philippine government given the looming deadline for converting QR into tariffs.

### **Rice importation at a glance**

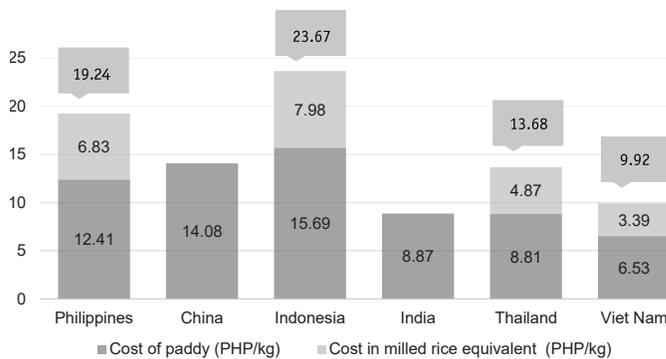
Rice from abroad is cheaper than domestically produced rice. The price gap stems from the difference in the cost of palay production. For instance, Moya et al. (2016) found that palay production in the Philippines costs 90 percent higher than in Viet Nam (Figure 1). The Philippines produces palay at PHP 12.41 per kilogram (kg), while Viet Nam's cost is only PHP 6.53 per kg.

The root cause of the production cost difference is geography (Dawe 2014). Exporting countries such as India, Thailand, and Viet Nam have wide flat plains watered by large river systems, such as the Ganges, Chao Phraya, Mekong, and Red Rivers, which enable them to produce large surpluses of rice at constant production cost. Meanwhile, relative to population, the Philippines has very limited lands suitable for rice cultivation. As a result, production cost

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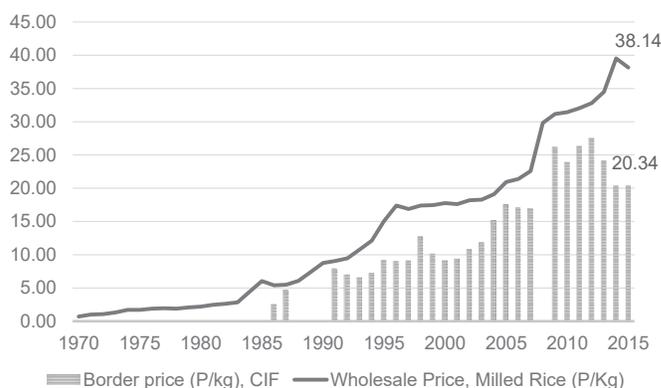
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**Figure 1. Comparative cost of producing 1 kilogram of palay, 2013–2014**



Source: Moya et al. (2016)

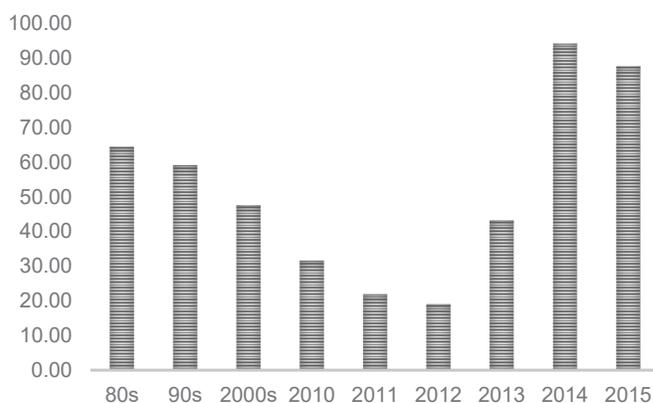
**Figure 2. Wholesale and border price of milled rice 1970–2015)**



Note: The border price is based on Thai rice 25 percent broken.

Source of basic data: Dy (1998), PSA (2016), and World Bank (2016)

**Figure 3. NPR of rice in percent, 1980–2015**



Note: Philippine rice against Thai rice 25 percent broken

Source of basic data: Dy (1998), PSA (2016), and World Bank (2016)

goes up before enough rice is produced to meet domestic demand.

While others claim that Viet Nam's lower production cost is due to subsidies, Moya et al. (2016) found no significant subsidies on inputs in Viet Nam that account for the differences in production cost.

Others eye collusion as an explanation to the high rice prices in the Philippines. However, Dela Peña (2014) found that the palay/rice value chain in the country is highly competitive, which suggests that any cartel-like behavior will not thrive.

### Protectionism and its implications

Rice trade policy in the Philippines is highly protectionist. The National Food Authority (NFA), by means of its statutory monopoly on rice importation, has applied QR mainly to protect domestic producers from foreign competition. Consequently, the retail price of rice has been kept excessively above the world price, making rice less affordable to consumers.

Since the 1990s, the price of rice has remained cheaper in the world market than in its domestic counterpart (Figure 2) and this is expected to continue (FAO 2016). Moreover, the nominal protection rate (NPR), which expresses the difference between domestic and world price at the border in percent, has shot up in recent years (Figure 3).

The country's self-sufficiency policy intensifies this rice protection. In 2012, the Department of Agriculture (DA) launched its Food Staples Sufficiency Program (FSSP) aimed to achieve 100-percent rice self-sufficiency by 2013. The

department mainly anchored their strategies on faster production growth. However, implicit in the FSSP is the squeezing of the import quota to support self-sufficiency targets.

Moreover, the more the government tightens up import quota, the more the consumers suffer from higher retail price in the domestic market. Briones and Galang (2013) assessed the FSSP's feasibility and found that projected yield and area growths were highly ambitious compared to historical trends. In January 2013, they warned the Philippine government of a price surge as import quota shrank. The prediction follows historical experience in 1995, when the price of rice had risen by 50 percent over a six-month period due to overestimation of domestic production and underestimation of import requirement.

### Policy options

The QR regime of the Philippines was mandated for conversion into tariff protection in 1995. The country obtained a special treatment for rice up to 2005, which was later on extended up to 2012. Eventually, the Philippines secured a waiver to maintain QR up to June 30, 2017. There are two options open to government in lieu of the lifting of the QR.

#### *Option 1:*

##### *Extension of QR for two additional years*

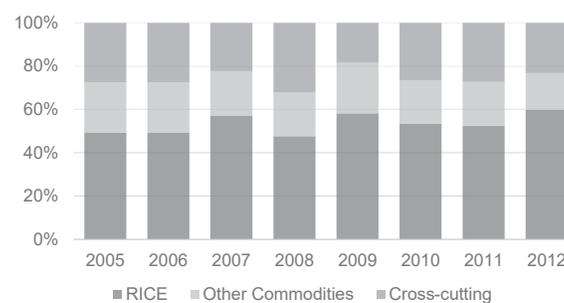
The secretary of Agriculture suggested requesting another waiver up to 2019 to give enough time for rice farmers to become competitive. However, for many decades now, the DA has implemented numerous programs aimed at making Filipino rice farmers more competitive. In fact, rice has historically taken the lion's share of the agriculture budget (Figure 4). Likewise, half of the agricultural support

services budget is dedicated for irrigation services, which are mostly for rice (Table 1). As for the proposed budget for 2017, the National Irrigation Administration will be receiving PHP 36.36 billion (DBM 2016), which is greater than their budget for 2016 amounting to PHP 32.74 billion. Currently, the DA is undertaking a 10-point program for Philippine agriculture, including rice. Hence, production support for rice is sufficient.

Despite this, the cost of rice production in the country continues to be high. It is unlikely that production cost can be brought all the way down to the level of Viet Nam, and that it could be achieved in two years. Moreover, the government still has no clear strategy to fast-track domestic farmer competitiveness within two years.

A QR extension means consumers shall continue to bear the burden of overpriced rice, with the poorest households bearing the brunt. Based on the *2012 Family Income and Expenditure Survey*, the richest 20 percent of households only devote 3 percent of their spending on rice. Moreover, poorer income groups tend to allocate greater share for rice. In fact, the people in the poorest 20 percent of households spend 21 percent of

**Figure 4. Percentage share in agriculture appropriations, by commodity, 2005–2012**



Source: Briones (2013)

**Table 1. Department of Agriculture expenditures (in PHP million) by major final output (MFO), 2001–2010**

	2001	2002	2003	2007	2008	2009	2010
MFO 1 Agriculture support services	20,199	21,758	18,702	14,748	20,803	36,006	33,858
MFO 1.A. Production support	2,523	2,468	4,608	na	na	na	na
MFO 1.B. Market development	267	143	115	na	na	na	na
MFO 1.C. Credit	312	124	184	na	na	na	na
MFO 1.D. Irrigation	9,981	13,124	9,044	na	na	na	na
MFO 1.E. Other infrastructure	2,800	2,012	1,667	na	na	na	na
MFO 1.F. Extension	2,630	2,514	2,126	na	na	na	na
MFO 1.G. Research and development	1,686	1,373	958	na	na	na	na
MFO 2 Regulation	512	2,257	2,244	689	1,186	1,197	1,353
MFO 3 Plans and policies	2,076	1,382	1,103	3,059	1,767	2,469	2,617
Total	22,787	25,397	22,049	18,496	23,756	39,672	37,828

Source: Briones (2013)

their budget on rice. Making rice cheaper is therefore an enormous boon for them.

The extension may also encourage some World Trade Organization (WTO) members to bargain for nonrice concessions. In 2012, Australia, Canada, and the United States asked for nonrice concessions, such as for meat, poultry, vegetables, and fruits, for them to support the Philippines' request for another waiver.<sup>1</sup> In the annexes of Executive Order 109, series of 2015, the temporarily modified most favored nation (MFN) rates of duty on rice and on nonrice products were enumerated. Section 2 of the order articulates the expiration of the concessions once the waiver lapses. For instance, the rate of mechanically deboned meat from poultry will be reverted back to the 2012 level, which is at 40 percent, from the current 5 percent rate (OP 2015).<sup>2</sup> Another waiver will provoke a new round

<sup>1</sup> Thailand, a rice exporter, bargained for a bigger rice quota.

<sup>2</sup> Rate of duty of other nonrice products would either be maintained (e.g. grapes, and other nuts) or slightly be increased (e.g., butter, and cheese) upon expiration of the waivers.

of negotiations, at least for the same, and likely an expanded set of concessions.

### *Option 2: Tariffication*

The better option is to convert the QR into tariffs and earmark the tariff revenue as safety net for rice farmers. To comply with the WTO Agreement on Agriculture (AoA), the initial step would be to identify the tariff rate equivalent. As prescribed in AoA Annex 5, QR measures are converted to tariffs by taking the difference of international and domestic prices from 1986 to 1988. Following the formula, our estimated tariff equivalent for rice is 38.5 percent. However, given almost all our imports are from Viet Nam and Thailand, the existing 35-percent Association of Southeast Asian Nations (ASEAN) Free Trade Area tariff rate should be used. In practice, applying a higher MFN in non-ASEAN countries will hardly matter as they account for under 1 percent of imports by market share (Briones and Tolin 2015).

Removal of the QR will also increase imports and depress palay prices. We used an economic model,

the Total Welfare Impact Simulator (TWIST), to assess the impact of the repeal of the QR with a 35-percent tariff rate on imports. Based on our projections, imports are expected to double and reach 4.4 million tons per year on the average from 2017 to 2022. Tariff revenues are expected to be around PHP 27 billion–PHP 28 billion during the same period. Meanwhile, farm gate and retail prices are projected to decrease by PHP 4.56/kg and PHP 6.97/kg, respectively (Briones and Tolin 2015).

Safety net measures are needed to mitigate the adverse impacts of the increase in imports, such as massive fall of domestic prices, which would inevitably hurt farmers' income. While increased production support under DA is among the options for supporting rice farmers, alternative support instruments (e.g., deficiency and decoupled payments) must also be explored (Briones and Tolin 2015).

The traditional support, the most common type in developing countries, refers to price support and procurement programs. In the Philippines, this is exercised through the NFA support price.<sup>3</sup> Deficiency payments, based on the difference between the benchmark and target prices, are paid by the government if market price falls below the benchmark price.<sup>4</sup> Meanwhile, decoupled payments are unrelated to price and quantity<sup>5</sup> and intend to assist farmers to adjust to a free market. These are usually time bound and reduced overtime (Briones and Tolin 2015).<sup>6</sup>

Our review of various options leads us to recommend the decoupled payment scheme. The recommendation is based on cost effectiveness, coverage of rice farmers, and compliance with WTO rules and regulations. The government

can source funding for such payments from the tariff revenues. Using a “unit value x quantity” formula, the estimated cost for such transfers is at PHP 17 billion–PHP 18 billion annually from 2017 to 2022, which is below the projected tariff revenue. The remaining amount can be used for other programs also directed to assist farmers. With four million hectare eligible area, the estimated payment for a farmer with two hectares is PHP 19,000 (Briones and Tolin 2015).

Note, however, that the purpose of the payments is to compensate farmers from income loss. It does not intend to displace ongoing productivity enhancement measures nor does it aim to increase the competitiveness of farmers. At the most, it eases the pain of transition to other crops and even other livelihood.

### Conclusions and recommendations

Rice imports are cheaper than domestically produced rice. Under a free market, the market price of rice will decline with the influx of cheaper rice imports. The Philippine government has been applying QR on rice imports to boost rice self-sufficiency and protect rice farmers.

Given the expiration of the third special treatment extension this 2017, this study presented two policy options for the Philippine government. First is to extend the QR for two more years. The second and the preferred option is to pursue tariffication, with revenues

<sup>3</sup> Thailand's palay pledging scheme, wherein the government provides soft loans to farmers and accepts harvest as collateral, is another example.

<sup>4</sup> Countries that implemented this type of payment include the Thailand, United States (US), and South Korea.

<sup>5</sup> These incur minimal to no market distortions.

<sup>6</sup> US, Turkey, and Mexico are among the countries that distributed decoupled payments.

earmarked as safety net for rice farmers. Moreover, a 35-percent tariff rate seems appropriate as a tariff equivalent. A safety net for rice farmers can be as much as PHP 20 billion annually and can be financed entirely by earmarking funds from the tariff revenue. In short, tariffication with safety nets will bring down the price of rice and ease the dislocation of rice farmers. 📄

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