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**Working Paper**

## The political economy of food price policy: The case of rice prices in Vietnam

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## WIDER Working Paper No. 2013/035

### **The political economy of food price policy**

#### The case of rice prices in Vietnam

Nguyen Manh Hai<sup>1</sup> and Theodore Talbot<sup>2</sup>

March 2013

#### **Abstract**

Rice is a key agricultural commodity in Vietnam, and the agriculture, forestry, and fisheries sector remains a major source of employment and value addition. This paper uses episodes of rice price volatility to understand how the interplay of market forces and political economy factors caused domestic and world prices to diverge, depriving producers of windfall profits, and preventing markets from clearing. The welfare consequences of mutually-inconsistent agricultural policies suggest that Vietnam and other transition economies must emphasize policy coherence by developing institutions capable of balancing the needs of distinct constituencies, such as net rice producers and consumers.

**Keywords:** Vietnam, political economy, rice, crisis, agriculture

**JEL classification:** Q02, Q18, D72

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## 1 Introduction

It is difficult to overstate the importance—cultural and nutritional—of rice to Vietnam's economy and society. As such, policies that influence rice production and prices provide a lens through which to understand broader agricultural policies both in Vietnam and other low- or middle-income economies where agriculture remains one of the major components of national income. This paper sheds light on the political economy of rice price policy in Vietnam by discussing the government's response to a rapid escalation in food prices. We document how agricultural policy and market incentives caused domestic production and prices to deviate from market-clearing equilibrium values, and draw broader lessons for agricultural policy in Vietnam and beyond.

This is an opportune moment for economists, agronomists, and policy makers to develop an understanding of how domestic political processes interact with market forces to determine prices. First, as in many low-income countries experiencing a combination of economic growth and rapid urbanization, Vietnam's arable land is under pressure: rising land prices and high prices for crops that can be produced with approximately the same inputs increase the opportunity costs of rice production. Second, the structural transformation of the Vietnamese economy is moving a large number of households away from agricultural production into higher value added activities, creating a large, growing, and politically influential group of net food consumers whose real incomes are compromised when food prices rise. Third, despite the primacy of industrial policy, agricultural policies—particularly food price policies—remain an important focal point for the Vietnamese government, particularly in light of recent dramatic increases in real agricultural prices: 152.1 per cent between 2000 and 2010. Although the share of the agricultural sector in the Vietnamese economy is slowly declining (to 20.58 per cent of total GDP in 2010), 69.8 per cent of the total population continues to live in rural areas where rice is either a major income source, component of the household consumption basket, or both (GSO 2011a). Finally, understanding how food prices are determined has become particularly urgent in light of countries' vulnerability to food price shocks revealed by a global run-up in food prices during 2007–08. The Vietnamese experience was, of course, not unique in this respect.<sup>1</sup> Prices reflect the interplay of market forces and government policies, and the agricultural price shock has made policy formulation in low- and middle-income countries an important contemporary research area. While purely economic analysis explains some share of overall price movements, a full account of price dynamics requires understanding the political economy of food price policy. This paper fills a gap in the literature by focusing on the case of rice prices in Vietnam. Specifically, we argue that observed prices reveal significant market intervention by the state, and that this intervention appears internally inconsistent because it reflects the competing demands of two distinct constituencies: net rice producers and net rice consumers.

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<sup>1</sup> See, for example, Cudjoe, Breisinger, and Diao (2008), de Janvry and Sadoulet (2009), Minot (2010), Phung (2011), Wondon and Zaman (2009), and Wright (2011).

## 2 Country context

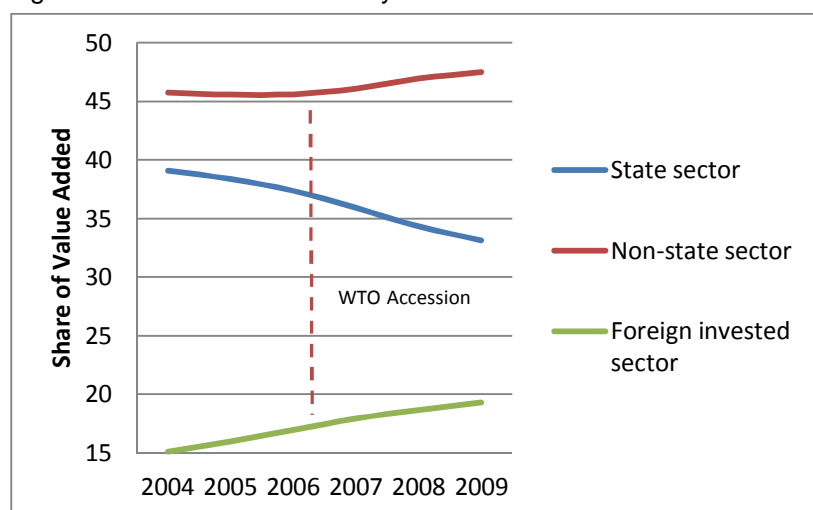
Most authors date the end of Vietnam's era of central planning to 1986, when the government implemented the *Doi Moi* (commonly translated as 'reform' or 'renovation') process, a series of market-oriented industrial and agricultural reforms reversing collectivization and successively introducing measures ranging from privately-held land use rights to decreased import taxes, including on key agricultural inputs like urea and fertilizer. During the 1970s, the country exhibited chronically low levels of agricultural production and, as a consequence, low levels of food consumption per capita, including localized instances of famine. As in many post-collectivist economies, liberalization generated significant increases in yields, culminating in the current situation: Vietnam is the world's second largest rice exporter by volume, with 7.015 millions tons of rice exported in 2011, second only to 8.5 millions tons exported by Thailand in the same year (VFA 2012). Vietnam's green revolution is remarkable, but should be contextualized: while a large exporter, Vietnam's total rice production remains lower than in countries such as China, India, and Indonesia, and while the country accounts for about one-fifth of annual world rice exports by volume, it accounts for only around 5 per cent of total exports by value, indicating a combination of lower quality and lower value added rice exports. Vietnam's macroeconomic performance has also delivered remarkable increases in average living standards: higher agricultural yields have been accompanied by dramatically higher rates of economic growth. From 2000 onwards, Vietnam's real (PPP-adjusted) per capita income has grown at an enviable 6 per cent per year.

While the economy continues to expand, there have been chronic structural and macroeconomic problems. Vietnamese agriculture has increased yields and total output but has not been able to substantially increase quality or value added. Further expansions in agricultural production are possible, but remain stymied by small, fragmented cultivation areas that prevent investment in agricultural equipment or exploiting economies of scale in crop production. The country is ranked 98th out of 183 in the World Bank's Doing Business index in 2011 (IFC 2012), indicating significant administrative and bureaucratic barriers, including corruption. Along with high growth rates, the country has experienced persistent and volatile inflation and, since 2009, a decline in investment, generating sufficient concern for the government to introduce a macroeconomic stabilization package in 2008. Finally, as a price taker in agricultural markets and an oil producer (oil contributes approximately 20 per cent to the country's GDP), Vietnam's current account is heavily exposed to international price movements.

### 2.1 Socio-economic context

A useful starting point is disaggregating national value added by ownership, which demonstrates the continued importance of the state sector to the Vietnamese economy. The state sector's share of GDP has decreased from 35.9 per cent in 2007 to 33.2 per cent in 2009, reflecting increasing prominence of the private sector, including through privatization (referred to as 'equitization') and mergers and acquisitions of state-owned enterprises (SOEs).

Figure 1: Production structure by share of GDP



Source: CIEM (2010).

Vietnam weathered the global financial crisis relatively well: growth rebounded from earlier slumps to reach 6.78 per cent in 2010 (not shown above). But the agriculture, forestry, and fishery (AFF) sector continues to face serious challenges, with estimated growth rates of value added declining to around 3 per cent in 2010, indicating serious structural issues and persistent vulnerability to price shocks.

Table 1: Growth rates by sector, 2004–09 (%)

| Sector                  | Prior to WTO accession |       |       | Post-WTO accession |       |      |
|-------------------------|------------------------|-------|-------|--------------------|-------|------|
|                         | 2004                   | 2005  | 2006  | 2007               | 2008  | 2009 |
| State sector            | 7.75                   | 7.37  | 6.17  | 6.02               | 2.05  | 2.32 |
| Non-state sector        | 6.95                   | 8.21  | 8.22  | 9.38               | 8.37  | 6.65 |
| Foreign invested sector | 11.51                  | 13.22 | 15.22 | 12.81              | 10.22 | 8.77 |
| GDP                     | 7.79                   | 8.44  | 8.23  | 8.48               | 6.15  | 5.32 |

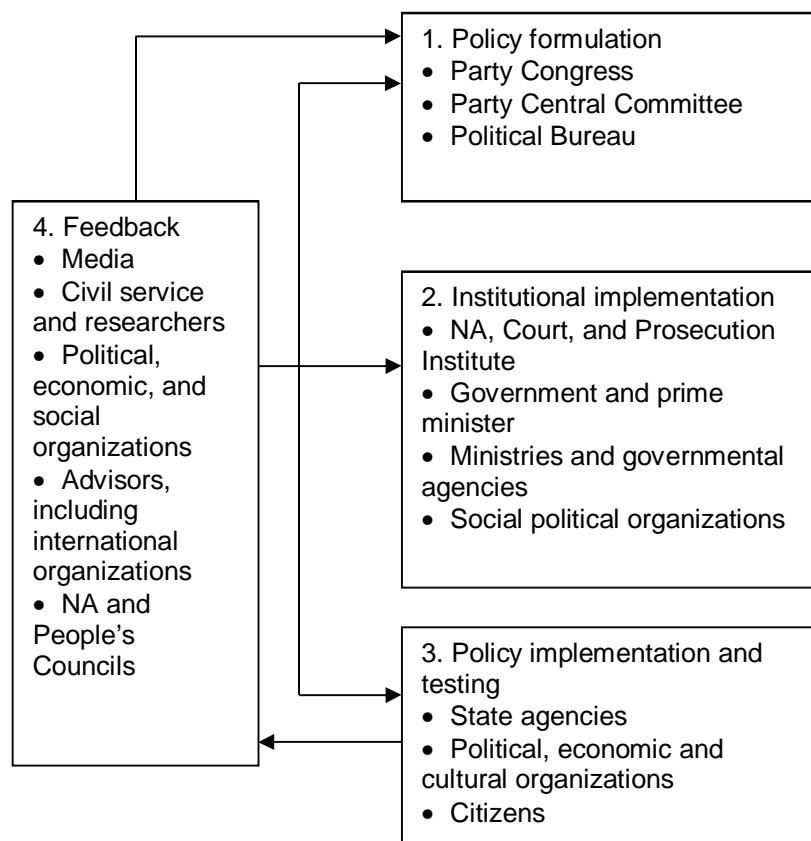
Source: CIEM (2010).

How inclusive has this growth been? While some groups have not benefited from macroeconomic growth, overall poverty has declined dramatically. The share of Vietnam's population living beneath the national poverty line has more than halved between 1998 and 2009, from 37.4 per cent to 14.2 per cent, much of which has been driven by a decline in rural poverty, which decreased from 35.6 per cent in 2002 to 17.4 per cent in 2009, while urban poverty rates have been relatively static: 6.6 per cent in 2002, and 6.9 per cent in 2009 (MOLISA 2011). Due, in part, to the financial crisis in 2008–09, the poverty rate increased from 13.4 per cent in 2008 to 14.2 per cent. While the overall trend for poverty is steeply negative, there is some fluctuation around this trend, and microeconomic evidence points to localized areas of persistent poverty, particularly in the north of Vietnam and amongst ethnic minority populations (Tarp and McKay 2011).

## 2.2 Political structure

Since 1975, Vietnam has been a Socialist Republic governed by a constitution promulgated in April 1992 that replaced the previous document drafted in 1980. The constitution establishes the country as a single-party state governed by the Communist Party of Vietnam (CPV), whose stated objectives include growth-oriented policies to increase welfare and the delivery of social services. A unicameral legislative system means that all laws are passed by the National Assembly (NA) of Vietnam. Nominally, the executive and judicial branches of government are subservient to the NA, which has a constitutional mandate of ‘close co-operation and co-ordination’ with the CPV. Government ministers and senior officials are largely drawn from the membership of the NA. Figure 2 illustrates the policy-making process in Vietnam.

Figure 2: The policy-making process in Vietnam



Source: adapted from Cong (2001) and McCarty (2002).

Despite its formal status as a one-party state, a form of electoral competition exists because members must be elected to the NA through locally-contested elections, while the Party Congress provides an opportunity for large-scale critique of existing policies and the introduction of radically new ones<sup>2</sup>. As with most contested political competitions, the Government’s incentives to minimize economic volatility increase around the time of the Congress or elections to the NA. For the former, price volatility or inept economic management can result in dramatic changes in economic policy. For sitting representatives in

<sup>2</sup> The 1986 CPV congress, for example, formally endorsed Vietnam’s departure from central planning.

the NA, economic mismanagement may prevent re-election. These ‘electoral’ cycles therefore create additional pressure for the state to move market prices.

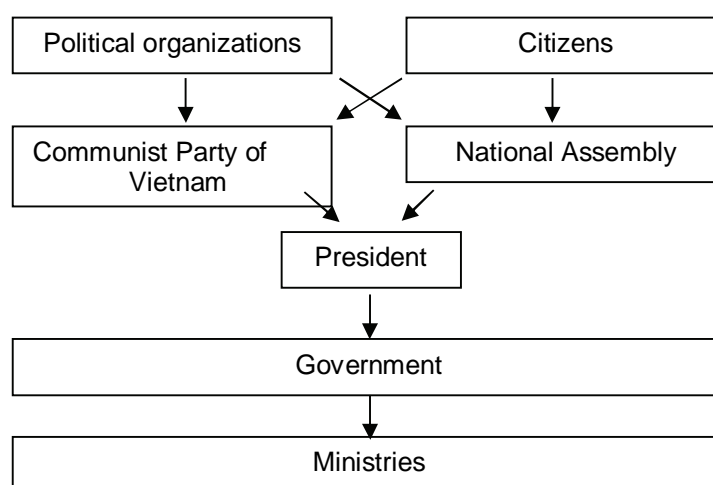
The combination of a strong, centralized bureaucracy and a single-party system has resulted in a relatively stable political environment. The tone of CPV’s policy is increasingly oriented towards liberalization and, having previously prioritized economic growth, emphasis is shifting towards macroeconomic resilience and stability.

## 2.3 Key decision-making actors

The key political bodies are the NA, the state president, and the government, led by the prime minister. The NA is the most senior decision-making body, determining domestic and foreign policy, including national defence and state security. The NA is also the only body able to revise and approve the constitution and draft legislation. (Vietnam has numerous, highly specific legislative tools, such as codes, decrees, decisions, laws, and resolutions, each with subtle differences in scope and authority).

Article 4 of the Vietnamese constitution defines the role of the CPV as ‘... the leading force of the state and society.’ While the CPV and the NA are theoretically distinct, 90 per cent of NA members are also on the membership rolls of the CPV, as are the majority of senior government officials, including the prime minister and the cabinet.

Figure 3: Political structure



Source: authors’ compilation.

The NA has significant power over political appointments, and collectively selects the president. Candidates for this office are drawn from the elite deputies of the NA, and the holder of this office has a mixture of legislative and executive responsibilities. According to Article 103 of the 1992 Constitution, the president promulgates legal documents adopted by the NA, has command of the armed forces, holds the office of Chairman of the National Defence and Security Council, and appoints or proposes the appointment of vice presidents,



the prime minister, the chief judge of the Supreme People's Court, and the Head of the Supreme People's Procuracy.<sup>3</sup>

Policies decided by the NA under the leadership of the president are implemented by the government, and senior government officials are typically party members. The government is accountable to the NA, in particular to the standing committee and the office of the president. The most senior executive officers of the government are the prime minister, deputy prime ministers, ministers and the heads of ministerial level agencies.

As the head of government, the prime minister is the head of the cabinet and responsible for delegating authority to line ministries through their respective ministers. A minister or a head of a ministerial agency is directly responsible to prime minister and the NA for his or her respective sector (CIEM 2011). While ministries' authority is ultimately mandated to them by the NA, these mandates often overlap in scope and authority, an issue we highlight here in the inconsistent set of policies implemented in response to volatile rice prices in 2008.

## **2.4 Non-political actors**

More open political discourse began following the *Doi Moi* era, creating space for several non-political actors to influence government policy, including independent and official research institutes, civil society, international organizations, and the media. To various degrees, each of these actors influenced the government's actions to stabilize rice prices during the price shock of 2008.

Government research institutes have a formal consultative role in the policy process, and are mandated to report to ministers or senior officials. The research agenda is often set by the government, but significant flexibility means research institutes have been able to develop their own research themes, including through co-operation with researchers outside Vietnam. The Central Institute for Economic Management (CIEM) in the Ministry of Planning and Investment, amongst others, has a direct reporting role about economic policies, including food prices and agricultural policies.

Legal civil society has also emerged and has been empowered by better communication tools, especially widespread internet access. These organizations are distinct from mass political organizations such as the Vietnam Fatherhood Front that are closely aligned with the government or the CPV. In 2008, the NA passed a law formalizing such civil society organizations' right to comment on draft legislation (CIEM 2011), an important step forward in formalizing civil society's role in policy formation.

In addition to domestic civil society, there is extensive engagement with the international donor community. A consortium of donors, including the World Bank, the UN System, and several national aid agencies such as AusAID, remain active in Vietnam despite the country's recent graduation from low- to middle-income status. Notably, the UN and World Bank publicly argued against a restriction on rice exports, contradicting the government's policy to impose this restriction in the second quarter of 2008.

Finally, increased space for public discussion has resulted in an increase in media freedom, which has increased the accountability of policy makers. Food prices, both international and

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<sup>3</sup> This term dates to the Soviet era. The Supreme People's Procuracy of Vietnam is tasked with ensuring the legal compliance of the Vietnamese state, including the military.

domestic, were extensively covered during the crisis, and national media outlets directly and publicly questioned senior officials about the policies implemented.

### **3 Rice: production and prices**

The AFF sector's relative share of GDP is declining but remains around one-fifth of GDP and absorbed roughly 50 per cent of the labour force between 2005 and 2010. These workers are comparatively low-skilled or remain confined to low-productivity activities. As growth in other sectors creates labour demand, wages will rise, possibly damaging Vietnam's competitiveness in other sectors. Contrary to popular perception, Vietnam remains a predominantly rural country where, as of 2010, 70 per cent of the population lives in rural areas.

#### **3.1 Rice production**

Collectivization of land, lack of key agricultural inputs, and a shortage of mechanical agricultural equipment caused chronic rice shortages until 1989, forcing Vietnam to import 300,000–500,000 metric tonnes of rice annually between 1985 and 1988 to meet domestic demand (Luu 2002), with much of the shortfall between domestic subsistence consumption and production met through food aid from the USSR. This aid was cut off shortly after the Soviet collapse in 1989, making agricultural reform an urgent priority.<sup>4</sup> In April 1988, Resolution 10 of the Politburo assigned agricultural land to individual households for up to 15 years, effectively privatizing production. The march towards private ownership (accompanied by increases in yields) continued with the land laws of 1993 and 2003 that granted farmers private 'land use rights'.

The cumulative effect of these reforms has been a consistent increase in rice production from 1989 to the present, enabling the country to satisfy internal demand and sell surplus production internationally. While the total area under cultivation has remained roughly static, paddy rice production has increased from 2000–11 by almost 3 per cent (GSO 2011b), largely through mechanization in some areas and planting hybrid rice varieties in preference to traditional open pollination varieties. In 2009, Vietnam's exported rice value reached 5.95 million tonnes (nominal US\$3.23 billion).

Despite the centrality of rice to the traditional Vietnamese diet, it has a negative income elasticity of demand: wealthier households substitute away from rice consumption, with the effect that per capita consumption is decreasing (as in many other high-growth Asian economies) while aggregate consumption has increased due to a combination of population growth, demand for feedstock, and increased demand from secondary processing industries.

Rice exports have persistently increased in terms of volume and value since measurement began in 1989, and the share of rice in total export value in 2011 was around 3.6 per cent,<sup>5</sup> which has been increasing since 2008 due to the high export demand. In 2008, Vietnam exported 1.7 million tonnes of rice to the Philippines, the single largest buyer by volume

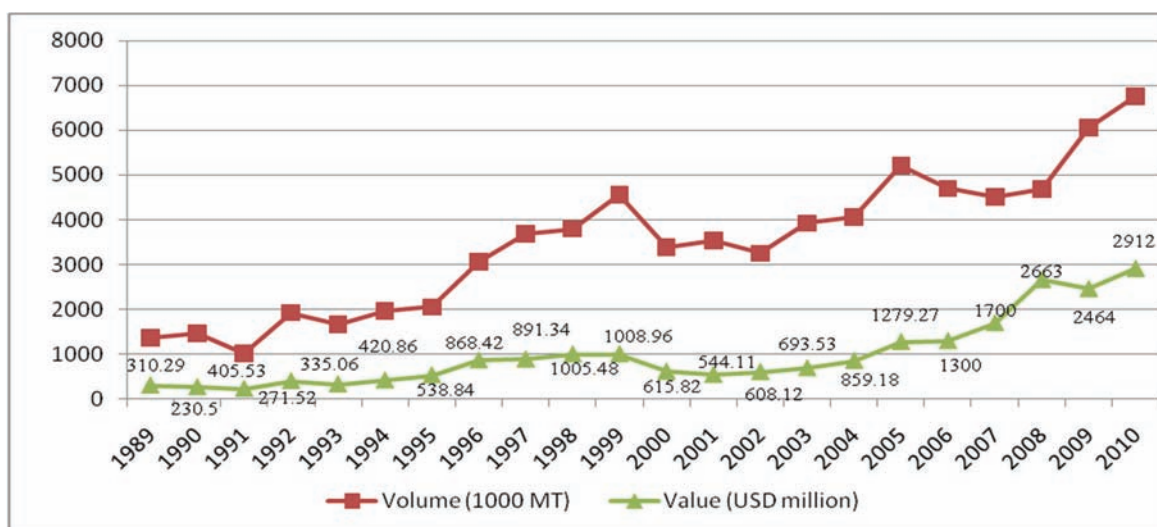
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<sup>4</sup> Some tentative reform efforts in fact pre-dated the collapse of the USSR. In 1981, the 'Directive 100' policy assigned agricultural land to farming groups or individuals through a system of agricultural co-operatives, under which farmers directed production while co-operatives had a monopoly on sales; farmers received payment on rice based on how much they produced (Marsh, MacAulay, and Hung 2006).

<sup>5</sup> Estimated from the data of VFA 2012 and VCO 2012.

(USDA 2011); this strong demand for rice exports is predicted to continue to 2030 (MARD 2006).

Figure 4: Rice exports 1989–2010



Source: authors' calculation based on data from VIFAP (2011).

### 3.2 Rice prices

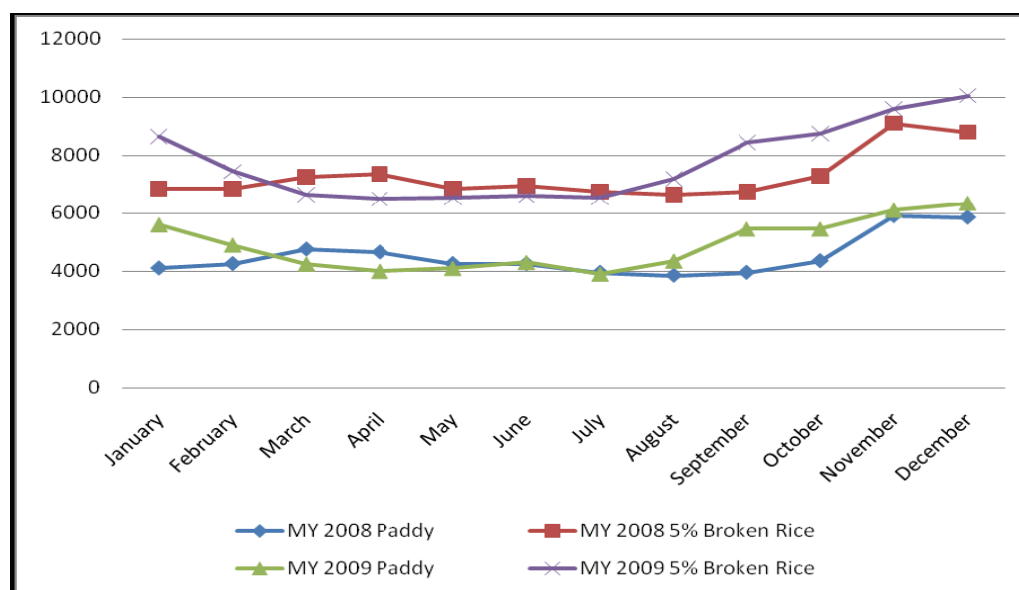
Much has been written about price dynamics of agricultural commodities in Vietnam and other low- and middle-income countries. Here, we establish some empirical regularities about price movements to motivate a political economy analysis of prices. First, Vietnam's economy has achieved gains in integration, but considerable regional price dispersion remains and indicates the persistence of transportation costs and other frictions. Second, there is a systematic difference in rice prices between 2008 and 2009 as markets priced-in the global increase in rice prices. Finally, the data shows a persistent but unstable price wedge between domestic and international prices.

The percentage difference in rice prices across Vietnam is relatively large, indicating high transaction costs: the price gap for paddy rice between the highest priced region and the lowest rose from 15.5 per cent over 1996–99 to 26.8 per cent in 2000–02. More recent data (MARD 2006) shows the percentage gap between rice prices in the Red River Delta and Mekong River Delta has doubled from 10.3 per cent to 20.2 per cent (MARD 2006). The overall picture is one of significant price dispersion across Vietnam, due to the interaction of transaction costs that create frictions for cross-province arbitrage and regional differences in production costs and efficiency.<sup>6</sup>

To get traction, we see that due to the impact of the global price shock in agricultural commodities, particularly during the period from August to September, there are large differences between prices of marketing year MY 2009 paddy as well as 5 per cent broken rice compared with those in MY 2008, graphically displayed by the shift in the time series of Figure 5.

<sup>6</sup> The Red River Delta and Cuu Long River Delta are the main sources of rice, accounting for 66 per cent of total rice production area, and 70 per cent of total paddy output.

Figure 5: Price trends: paddy and milled rice, 2008 and 2009



Source: USDA (2011).

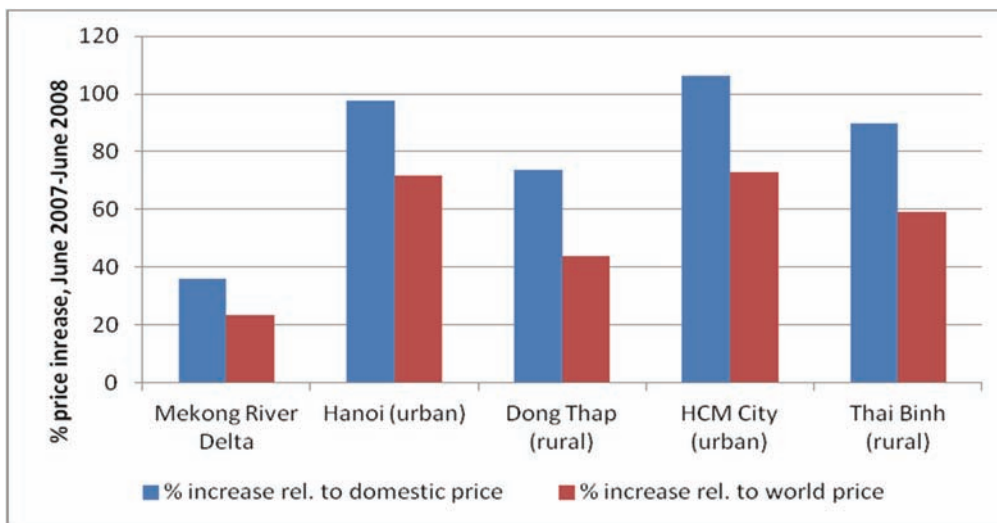
During the 2008 food price shock, the average domestic rice (normal type, 5 per cent broken) prices increased quickly, while regional rice prices varied substantially. Figure 6 shows, for example, that the Mekong River Delta had the smallest year-on-year increase in prices, in contrast to significant increases in urban and peri-urban areas. These price differentials are driven by asymmetries in agricultural efficiency, endowments, and transaction costs, particularly the cost of transportation from the south to the north.

The effect of agricultural production can be seen in the difference in the size of price changes in, for example, the productive Mekong River Delta area (35.8 per cent) relative to Ha Noi (100 per cent), and Ho Chi Minh City (106.2 per cent), and suggests significant spatial differences: Ho Chi Minh City experienced a doubling of rice prices despite being geographically close to the rice-producing region of the Mekong River Delta.

Markets may be described as integrated when prices of a homogenous or related (for example, close substitutes) goods track one another closely over time (Asche, Bremnes, and Wessells 1999). The stylized facts of rice price dynamics are simple: firstly, regional differences still matter, and, secondly, frictions drive a persistent (albeit variable) wedge between domestic and international prices.

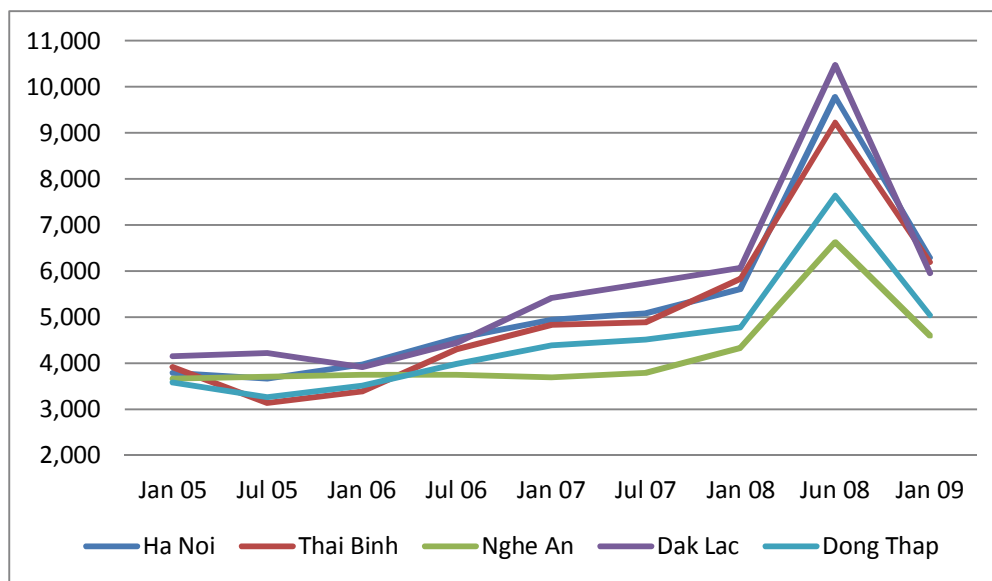
Luu (2002) shows that rice price movements are co-integrated across Vietnam, so while the level of rice prices may be different due to differences in rice production and transportation costs, changes in prices are roughly consistent over time. Domestic cost differences, where they exist, arise mainly from different geographical conditions, with substantially higher transportation costs in highland and mountainous regions (for example, Lao Cai province, bordering China). Figure 7 shows this informally by tracking prices over time based on available time series data.

Figure 6: Rice price differentials, 2007-08



Source: authors' calculations from GSO data.

Figure 7: Local rice prices (nominal) per kilo, 2005–09



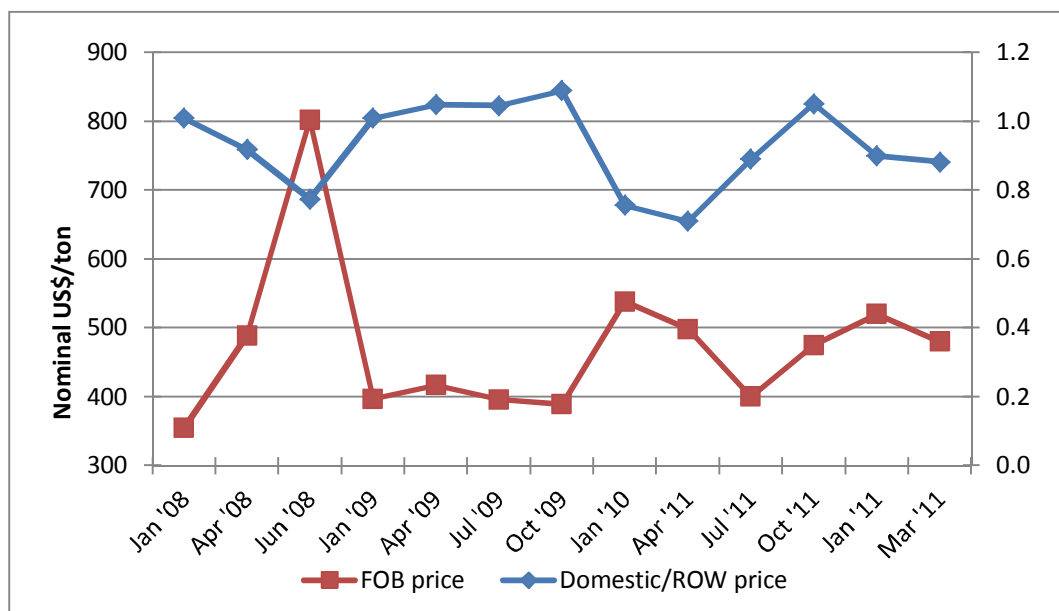
Source: authors' calculations from GSO (2011b).

The ratio of the domestic to international prices provides further evidence of market imperfections due to price differentials. In an integrated market with no changes in frictions like import tariffs, the market structure of importing firms, or, as we argue here, state-sponsored market interventions, the ratio of domestic prices to world prices should be approximately stable over time, since changes in the world prices would pass one-for-one into domestic prices. In fact, this ratio fluctuates dramatically. International to domestic markets.

Figure 8 is an intuitive look at the cross-price elasticity between international and domestic prices. The world prices for Vietnamese rice are stable from early 2009 to the fourth quarter of 2010, and the ratio of domestic to world prices is flat. Before that, increases in world

prices accompany a less-than-proportional increase in domestic prices (the ratio falls below one); after that, increases in domestic prices exceed increases in world prices (the ratio rises above one). Even when world and domestic prices move in the same direction, the sizes of the relative price changes are different and inconsistent. Despite significant steps towards market integration, some form of friction that is not stable over time evidently affected the transmission of price signals from international to domestic markets.

Figure 8: Free on board (FOB) rice prices: pass-through relative to the world market prices



Source: authors' calculation based on data from ASEAN Secretariat (2010) and GSO (2011b).

## 4 From prices to policies

The previous section argued that in addition to regional price dispersion within Vietnam, rice prices diverged from world prices during the relevant period. Two wedges could have caused observed prices to be different from (unobserved) equilibrium prices: market integration and price intervention policies. The previous section argued that price dispersion across Vietnam roughly reflects transaction costs. At the same time, domestic prices exaggerated world price movements, and moved in the *opposite* direction to world prices during the crisis of 2008.

Food price policies distort market prices in any country. In some cases, distortionary policies are defensible on the grounds of equity or food security; in others, they create opportunities for rent extraction. We do not take a position on how 'good' it is for the state to move rice prices. Rather, we argue that these price movements can be understood by examining changes in government agricultural policy over this horizon, and that these policies were motivated in turn by a desire to cater to the competing demands of distinct domestic constituencies of net-producers and net-consumers. We start by examining the set of available policy measures to influence rice production and rice prices.

### 4.1 Domestic policy space

Policies can be implemented through the passage of legislation or through instruments such as decrees that govern the interpretation or implementation of existing legislation. We group

the policies designed to affect rice prices (though not necessarily only rice prices) into two categories: long-term policies to increase yields and short-term policies to respond to price fluctuations.

To understand short-term deviations from world prices beyond those explained by transaction costs, we turn to a set of government policies that enable the state to intervene directly in markets by setting export levels and domestic prices when prices are high or volatile.

While investment incentives and other fiscal policies are designed to tilt production towards increasing agricultural output, the focus of short-term policies is to directly move market prices. Price decreases benefit consumers: since rice is part of every household's consumption basket, lower prices increase rice consumption or enable substitution towards other foods. Symmetrically, lower rice prices are a negative income shock to net rice producing households.

The incompatible objectives of keeping prices low to benefit consumers while keeping them high to guarantee rural incomes gives rise to inconsistent price stabilization policies that combine procurement and price interventions with quotas. When rice prices are low, the central government provides state-owned firms with capital to buy rice from producers, putting upward pressure on prices. When world prices are high, the government is able to impose an export quota. When world prices are above domestic equilibrium prices, the export quota effectively reduces prices, harming farming households while benefiting net rice consumers.

There are two tools to move rice prices: direct intervention through purchasing rice and trade policy to limit rice exports. Direct intervention is enabled by the 'Ordinance on Prices' drafted by the NA in 2002 which theoretically subjects a range of agricultural products to price stabilization by the state; Article 6 of this ordinance allows the government to set minimum purchase prices that large state-owned buyers and the Vietnam Food Association (VFA) pay for rice.

These large purchases by the state can be timed to coincide with price decreases to raise profits to farming households. Decision No. 1518/QĐ-TTg dated 22 September 2009 of the prime minister, for example, released government funds to increase rice stockpiles.<sup>7</sup> Using strategic stockpiling to move market prices will likely remain an aspect of the Vietnamese agricultural policy over the medium-run: the state has invested heavily in storage capacity, and a government resolution in 2009 earmarked funds to upgrade a 4 million ton rice storage facility and begin construction of a new 2.8 million ton storage facility. To contextualize this, the state's export target for rice through 2020 is around 4 million tons per year.

Recent government policies further institutionalize the state's ability to determine market prices through controlling exports. In 2010, Decree No. 109/2010/ND-CP was issued with the nominal goal of increasing 'export efficiency'. According to the decree, exporting firms have to meet extensive minimum requirements, for example owning at least one specialized warehouse with a minimum capacity of 5,000 tonnes and a rice milling facility with a minimum capacity of 10 tonnes rice/hour. The net effect was to push smaller scale exporters out of the market. A reasonable recommendation, therefore, is that a better quality control

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<sup>7</sup> The legislation theoretically enables the government to compel private companies or traders to sell rice or other agricultural products to the government at prices set by state agencies; fortunately, this provision is very rarely used

system be implemented to replace the current licensing regime that reduces competition in the rice export market.

The government's most effective tool for moving market prices remains trade policy. Intervention in markets is implemented through the VFA and the Ministry of Industry and Trade (MOIT). From 2000–10, the government enacted numerous export measures, including several during the period of record increases in world agricultural prices.<sup>8</sup>

## **5 From policies to prices**

Having established a set of tools available to the state that can plausibly affect market prices, we move to arguing that were used to respond to world price movements during the period in question. While domestic markets are relatively well integrated, the price of rice is determined at the margin, so domestic prices reflect any manipulation of export quantities or prices. The balance of this paper explores how government policies generate these price inconsistencies by examining the rice price crisis of 2008 by studying the set of policies that generated this crisis, the responsible actors and relationships between them, and evaluating the efficacy of the state's overall response. These short-run policy responses provide a unique laboratory in which to understand the domestic political pressures on agricultural prices.

During non-crisis periods, price signals are transmitted relatively efficiently. Internal differences exist, but are driven by unequal endowments, productivity, and transportation costs, while an export monopsony (only state-owned firms and a few private companies can export) drives a wedge between world and domestic prices. Within these constraints, prices are set by bidding between exporters in light of world prices and domestic demand.

During periods of high food prices such as 2008, however, the price transmission was significantly distorted by a temporary restriction on rice exports, motivated by concerns about domestic food security. The government's desire to protect the welfare of net rice consuming households therefore caused the implementation of a policy that effectively taxed rice producers by depriving them of windfall profits.

In the first quarter of 2008, a combination of speculation on commodities exchanges and expectations of supply shortfalls drove up world rice prices across all quality classifications. Domestically, rice harvests were forecasted to be low. The combination of high world prices and low expected rice yields generated significant concern in the Vietnamese agricultural policy community about a potentially destabilizing contraction in the quantity of rice available to domestic consumers.

In response, as global food prices rose steeply in 2008 and rice reserve stockpiles were depleted (Pham 2009), and based on advice from the Ministry of Agriculture and Rural Development (MARD), the government issued Announcement No. 78/TB-VPCP, revising its export target of 4.5 million tonnes down to 3.5 million tonnes. A temporary restriction for rice exports was also applied, with a ban on signing further contracts for rice exports imposed between May and July of 2008. In non-crisis periods, rice prices are determined by the interplay of supply and demand, and world and domestic prices move together. However, steep increases in rice prices create domestic winners and losers. Because world prices are

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<sup>8</sup> In addition to export controls that are sometimes implemented, taxes on rice imports remain in place, but these mainly target imports of small quantities of high-quality rice varieties that are not available domestically.



higher than domestic prices under autarky, exporting results in higher domestic prices; the export ban and binding quota therefore reduced domestic prices and export quantities, effectively subsidizing domestic consumers by taxing producers.

In fact, Vietnamese rice yields (particularly in the Southern provinces) were exceptionally high in the first quarter of 2008, while world rice prices for the highest quality grain reached US\$1,000 (nominal 2008 prices) per tonne, a windfall profit above production costs that was not available to many farmers due to the export ban; the government's export restriction effectively deprived producers of above-average profits. At a meeting of the NA, the Minister of MARD admitted responsibility for the pessimistic harvest forecast and the resulting imposition of an export quota (Khanh 2008). Notably, once the export quota was imposed, it was not revised to reflect new data about agricultural production or high world prices.

Following the boom in global rice prices in early 2008, commodities markets began to bid down contract prices, creating a sharp reduction in rice prices across quality grades. In an effort to protect farmers from this collapse in rice prices, a secondary set of Government actors intervened. The purpose and remit of the VFA are clarified by its original name: the Vietnam Food Import & Export Association. Hierarchically, the VFA is part of MOIT, retaining the power to set a price floor for rice exports. By mid-2008, the VFA, acting on policy advice from the MOIT rather than MARD, contradicted these signals from the international markets and established a price floor of US\$ 600 per tonne, raising this to US\$650 in mid-August of 2008.

With world prices now below this price floor, Vietnam's community of rice exporters were not able to clear the domestic market, a textbook case of a price control creating a mismatch between supply and demand at a non-market price point. Establishing a price floor was therefore ultimately highly inconsistent: manipulating external trade policy lowered prices while setting a price floor—if it became binding—would raise prices above their new equilibrium level.<sup>9</sup>

The first intervention, by MARD, effectively reduced export profits while world prices were high, while the second, by the VFA, prevented the market from clearing when world prices were low. In both cases, lower domestic prices may have increased net consumers' real incomes, but at substantial and potentially offsetting costs imposed on net rice-producing households. A key element of the mismatch of policies, problems, and policy instruments is that controls were implemented by two distinct sets of actors with two distinct objectives: in the first case, to insulate domestic consumers from high rice prices, in the second case, to ensure profits for rice producers.

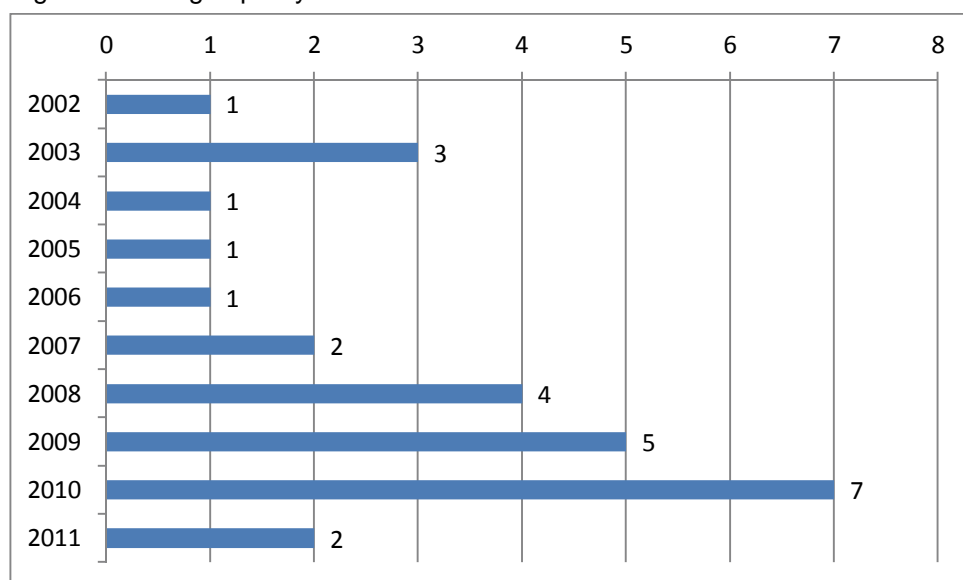
## **5.1 Timing of market interventions**

Twenty-seven agricultural policies were issued between 2000 and 2011. Tracking the introduction of new policies over time suggests that political pressure and policy innovation are correlated: as rice prices increased, the number of agricultural policies to indirectly or directly affect rice prices increased dramatically. Figure 9 shows the number of new policies introduced, and informally indicates that rising prices put pressure on the political establishment to act.

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<sup>9</sup> The office of the prime minister reacted by ordering Vietnam's rice exporters to buy paddy rice based on a floor price that would ensure profits of around 40 per cent for farmers, but could not or did not specify what this price floor should be

Figure 9: Timing of policy interventions



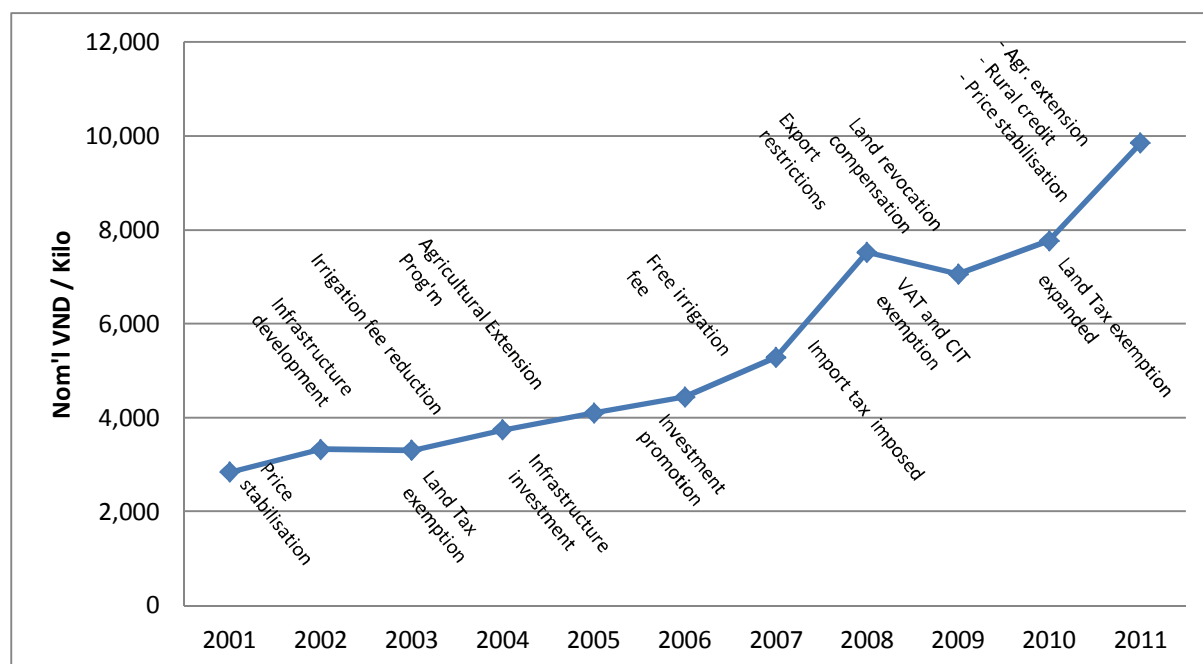
Source: authors' compilation.

Relevant policies can be broadly grouped into those that affect: land issues, infrastructure investment, agricultural extension, taxation and tax incentives, direct intervention through state rice purchases, and export quotas. Figure 10 dates these innovations relative to rice price movements. The intention is not to formally (i.e., econometrically) establish a causal relationship, but to provide suggestive evidence that the government resorted to a wide range of policy tools in reaction to movements in market prices, and that the use of diverse policy instruments increased dramatically following the crisis period 2008.

## 5.2 Evaluating the policy response

As expected, the hardest hit amongst the poor were urban, low-income households that did not benefit from an increase in rice prices. In Table 2, we provide some simple estimates of the effect of higher rice prices on urban real incomes in the absence of a behavioural response (for example, substituting away from rice). While crude, these estimates suggest a significant impact of higher food prices on the urban poor. Since rice prices continued to rise despite government intervention, it is reasonable to conclude that the full set of policy tools were not used effectively to stabilize prices or protect the real incomes of net rice consuming households.

Figure 10: Rice price policies, 2001–11



Source: authors' compilation.

Table 2: Rice prices and real incomes of urban poor households, 2008

| Indicators   | Province/city |           |          |          |         |
|--|---------------|-----------|----------|----------|---------|
|  | Ha Noi        | Thai Binh | Lam Dong | HCM City | Can Tho |
| Rice price increase (%)  | 73            | 57        | 42       | 80       | 65      |
| Real income reduction of households poor due to price change (%) | 18.25         | 14.25     | 10.5     | 20       | 16.25   |

Note: Real income effects of rice price increases are based on assumption that 50% weight on food in low-income households' consumption baskets (Vu and Glewwe 2011).

Source: authors' estimates based on GSO data.

While net rice producing households benefited from higher prices, only about 37.4 per cent of Vietnamese households enjoyed higher real incomes due to the increase in rice prices, mainly in the rice producing regions of the Red River Delta and Mekong River delta. Most of these households were already above the national poverty line in 2008, and non-poor households enjoyed, on average, twice the increase in income of poor households (Phung 2011).

On balance, market intervention lowered domestic prices, but not enough to prevent significant hardship amongst rice consuming households, particularly the urban poor. Banning rice exports simultaneously harmed rice producers by preventing them from benefiting from dramatically higher world prices. During the ban, rice exporting firms agitated for a lift in the ban because of indications from rice-producing regions of a bumper

crop.<sup>10</sup> At the end of May 2008, the MARD acknowledged this but continued to comply with the suspension of rice exports.<sup>11</sup>

The export restriction was combined with a price floor that, while intended to support rice producers with higher purchase prices by the export sector, in fact simply prevented the domestic rice market from clearing. The form and timing of policy interventions reflect the overlapping authority and competing interests of ministries and agencies within the government, which sought to simultaneously satisfy the competing constituencies of rice consumers and producers.

The net effect of these inconsistent policy interventions was a smaller decrease in real incomes of urban rice consumers relative to the counterfactual (full pass-through of world prices to domestic prices) achieved through the introduction of several price stabilization policies, and an effective tax levied on rice producers.

## 6 Conclusions

We have argued that the observed time path of policies is not consistent with a social planning model of policy-making. Rather, it can be explained by a political economy narrative in which the state attempted to balance the competing interests of consumers and producers. While Vietnam's markets are increasingly liberalized, the state continues to have, and use, a large set of policy instruments that move market prices.

The issue of rice prices in 2008 suggests two potential areas for reform in the domestic policy-making process. First, the set of policy instruments should be streamlined and made more transparent. The nature of Vietnam's political system is that numerous actors can issue decisions with varied levels of relevance, policy coherence, and coverage. This introduces substantial uncertainty amongst producers and consumers, and, in the case of rice prices, generated mutually incompatible policies that were not easy to reverse. Second, coherent policy formulation requires a large set of actors to act collaboratively and communicate clearly. In the case of market intervention in rice prices, relevant stakeholders were represented at the Ministry level by, variously, the MARD, the Ministry for Industry and Trade, the Ministry of Finance, the VFA, and others. It will be important for future agricultural policies to be shaped by input from each of the relevant decision-making actors.

Vietnam's economic prognosis is generally positive. The country enjoys a growing economy with rising capital intensity, which has regularly delivered high rates of economic growth. To maintain this growth path, the state ultimately needs to develop a clear set of tools for market intervention and a clear framework for discussion between relevant political and non-political actors about which policy instruments should be used, and when. Effective governance will balance the competing claims of winners and losers from unexpected price shocks, and ultimately increase the set of feasible policy responses, for example funding safety nets that prevent households from slipping into debt or poverty due to price shocks. Vietnam is poised

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<sup>10</sup>Truong Thanh Phong, general director of the Southern Food Corporation, stated that although rice was scarce elsewhere in the world, Vietnam, particularly the Mekong Delta, would not experience shortages (*Vietnam News*, 21 May 2008).

<sup>11</sup>'The signing of rice-export contracts may continue after the 30 June deadline for them to stop', according to Cao Duc Phat, Minister of Agriculture and Rural Development. (*Vietnam News*, 21 May 2008).

to realize significant returns on market-oriented reforms and investments in education, public health, administration, and infrastructure, and the gains made so far from continued, broad-based growth highlight the importance of getting policy formulation right.

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