Arson Alert: Philippines is Playing with Fire! Again!

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CGD Notes

Will the world rice market in 2010 go up in flames again? Today's prices are almost $150 per ton greater than those paid by Manila less than one month ago.

Today the National Food Authority (NFA), the rice-buying authority for the Philippines, held its first of three December tenders, with announced purchasing efforts for the month to total 1.8 million metric tons (mmt). Because of the string of tenders proclaimed widely to the press, reports that NFA buying might be 3.0 mmt before it is finished, and reports that India may buy 2–3 mmt, today's prices are almost $150/ton greater than those paid by Manila less than one month ago.

Assuming that NFA uses it entire budget allocated for the tender, it will pay an average price of over $624 CNF for 522,000 tons of an intended purchase of 600,000 tons. This compares to an average purchase price of $475 paid on November 3. Allowing for $40/ton for freight and financing—and making no provisions for commissions—this would equate to $584 FOB. As of October 9, the week prior to NFA's first tender announcement, the price of low-grade Vietnamese rice, the quality usually purchased by NFA, was only $340.

Will the world rice market in 2010 go up in flames again, repeating last year's crisis when world prices more than trebled in four months? An earlier analysis showed that world prices soared to over $1,000 per ton because of three intersecting events: [1]

- India's ban of non-Basmati exports as it sought to minimize wheat imports
- Vietnam's export restrictions as Vinafood 2, a state-owned company, attempted to maximize sales to the Philippines without having to compete for supplies
- Reckless buying by the Philippines

To understand how we got here, it is useful to recap the events of the last several weeks.

The Philippines

With a presidential election scheduled for May 2010 and increased import requirements because of typhoon damage that is officially forecast to have reduced this year's rice crop as much as 1.0 mmt below last year's output of 16.8 mmt, the Philippines has started its import campaign almost two months earlier than normal, despite comfortable government-held stocks. Its November 4 tender contained a number of restrictive features:

- The minimum offer was 100,000 tons.
- The maximum that could be supplied from the cheapest eligible origin (Pakistan) was 50,000 tons.
- Shipments via containers were prohibited.
- Expensive supplier credits of 270 days were required, and participating firms had

[1] Tom Slayton, "Rice Crisis Forensics: How Asian Governments Carelessly Set the World Rice Market on Fire," Center for Global Development Working Paper 163, http://www.cgdev.org/content/publications/detail/1421260.

to show proof of having performed on an agricultural contract worth $33.75 million.

The week before the tender, Agricultural Secretary Yap was talking up the price: "We are not very far off from possibly another rerun of 2008." However, the lowest prices offered in the tender came in much lower than expected. While NFA's budget provided for awards of $540 CNF, the successful purchases came in at an average price of $475, with Vinafood 2 selling 150,000 tons and the balance sold by Daewoo with an option to ship from either Thailand or Vietnam.[2]

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These contracts had barely been signed before NFA issued a December 1 tender for 600,000 tons for February–May arrival.[3] This tender was officially trumpeted as the largest ever, but it was not. (The May 5, 2008, tender was for 675,000 tons.) Even though prices in the first tender came in substantially below its publicized purchase price of $543, NFA announced it was again prepared to pay this level. The terms of this tender are even more restrictive: the minimum bid of 100,000 tons must now be made at a single price and participants must show experience in having successfully executed a rice contract worth $81 million. The maximum tonnage allowable from Pakistan was increased to 100,000 tons. Once again, no container shipments and supplier credits of 270 days are mandatory.

In a move that Manila must surely have expected would excite the market, NFA one week later issued a second tender for 600,000 tons which would be held on December 8 for the same delivery period (and terms). Three days later, a senior NFA official confirmed that a third tender of 600,000 tons had been authorized, while an unnamed NFA official told the press that this tender would be held on December 15 and an additional tender would be held one week later. The official said that December's third and fourth tenders would be for a total of 1.0 mmt. Indeed, on November 23 the third tender for 600,000 tons to be held December 15 was issued.

With an import window extending until September, it is both incomprehensible and reckless that the Philippines would attempt to buy 2.2 mmt within a single month. Further, the tendering process raises several key issues. Why do they publicly disclose the price they are willing to pay in advance? Why do they announce future tenders while earlier tenders are still outstanding, a practice that arguably contributes to higher prices? Why are tender terms so restrictive, to the point where they seem designed to discourage suppliers who can provide rice at competitive prices? And why did they pay prices so far above the market last year? Will they do so again this year?

While the December 1 tender prompted offers of $598–687 CNF, statements by NFA officials suggest that it does not find the prices unreasonable and will purchase as much rice as its budget of $326 million will cover, including 300,000 tons from Vinafood 2. It is also reported that NFA will likely increase the budgets allocated for the December 8 and 15 tenders—which could accommodate even higher prices paid.

India

Due to a combination of disappointing rains during the monsoon season and late floods, India's main crop has declined significantly this year. However, because of its export ban on non-Basmati rice in 2008 and 2009, the government is holding unprecedented stocks. Still, these stocks could be strained if the government needs to release large quantities to control local prices.

[2] The Vietfood Association (VFA) has warned its members that they will be prosecuted if they provide support to Daewoo.

[3] It is not clear if the firms winning the earlier tender even had time to respond to NFA's request for increasing their quantities by 25 percent before the new tender was announced—which would have made it foolish for the firms to increase their contractual amounts.

On October 14, India announced it was rescinding its 70 percent duty on imported rice to permit the private trade to import. On October 30, three parastatals each tendered for 10,000 tons and within weeks there were rumors that the country was in negotiations with Thailand to import up to 2 mmt, with another 1 mmt possible after assessing the situation in March or July. These rumors were subsequently confirmed by the minister of trade. Citing high prices offered on the three tenders, they were cancelled. Both the Indian ministers of agriculture and trade then indicated that no imports would be needed.

Vietnam

On November 16, Prime Minister Dung instructed the ministries of trade and agriculture to monitor production and demand so as to ensure no rice shortage at *Tet* in February. This may be a precursor to new export restrictions by Hanoi. While Vietnamese exporters were officially reported to be sitting on an unprecedented 1.6 mmt of stocks, it simply is not known if Vietnam will once again impose export restrictions—especially if Vinafood 2 seeks to maximize sales to both the Philippines and India.

What happens next?

Today's world rice market has an unnerving similarity to 2008. All three of the elements in the price explosion then are again in play, with the twist that India might add 2–3 mmt to world market demand in 2010 instead of subtracting 3 mmt from market supply in 2008.

Vietnam hopefully has learned an important lesson from 2008: withdrawing from the market when prices are high just guarantees they will have to sell later at lower prices. Still, concerns to keep domestic rice prices stable and affordable, especially over the *Tet* holiday, could prompt Hanoi to restrict exports.

It is hard to understand what the Philippines is doing with their aggressive tendering and officials actively talking about the potential for another rice price flare up. One explanation is that the country just wants to get its imports ordered before they have to pay even higher prices. If that is the case, quiet tenders over an extended period of time with flexible terms and longer delivery dates would be the better approach. The alternative explanation is that the government actually wants to pay higher prices because these contracts carry larger "commissions" that fill political coffers. With such an explanation, NFA's behavior suddenly makes sense.

How can another rice-price explosion be prevented? Panicked hoarding by farmers, traders and consumers (and governments) can easily drive up prices to levels double or more what are justified by fundamentals of supply and demand.[4] In the first instance, calmer heads need to prevail. India can easily get through the next year without importing rice and, in any case, does not need to buy at this time. Vietnam has more than adequate supplies for domestic consumption. And the Philippines can smooth out its understandably large import needs over the next 10 months.

The 2008 crisis caused domestic food prices to soar in countries where the poor often spend 20 to 50 percent of their income on rice alone. Another rice crisis would be a serious blow to food security in a world where one billion people are already undernourished.

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Export prices (dollars/ton)

	Oct 9	Oct 19	Nov 19
Thai 100% broken	515	515	550
Vietnamese 5%	400	410	495
Vietnamese 25%	340	360	450

[4] C. Peter Timmer, "Rice Price Formation in the Short Run and the Long Run: The Role of Market Structure in Explaining Volatility," Center for Global Development Working Paper 172, http://www.cgdev.org/content/publications/detail/1422136.

Chronology

August 2009

20 India announces a 5 percent increase in the minimum support price for rice.

October

1 Government-held carryover rice stocks in India are 15.35 million tons, more than double the buffer norm of 5.2 million tons and year-earlier holdings of 7.9 million tons. Wheat stocks are 28.5 million tons, up from a buffer norm of 11.0 million tons and 2008 holdings of 22.0 million tons.

12 Philippines announces October 30 import tender for 250,000 tons of 25 percent brokens for January–April arrival

14 India suspends 70 percent import duty on rice until September 30, 2010.

27 Opening of the Rice Trader World Rice Conference 2009 in Cebu, Philippines. During the conference, which runs until October 29, a number of attendees make bullish predictions about world prices.

28 Agriculture Secretary Yap of the Philippines tells rice conference that world prices may return to 2008 levels.

29 India announces it will pay a bonus of Rs 500/ton, bringing its increase in its support prices to 11 percent over one year earlier.

IRRI economist forecasts India will import 3 million tons of rice.

30 Three parastatal companies in India each issue identical tenders for 10,000 tons of 25 percent brokens for December arrival.

November

1 Government-held rice stocks in India are 21.7 million tons—vs. 14.1 million tons one year earlier; wheat stocks are 26.8 million tons, up from 21.0 million tons last year.

4 Tender held in Philipinnes with lowest bid $468.50 CNF.

India announces its preliminary production estimate for the 2009 *kharif* harvest at 69.5 million tons of rice, 15.1 million tons below it official estimate for the 2008 crop. Press reports India plans to import 2 million tons of rice.

5 Philippines awards contract at average price of $475.40 CNF for rice from Vietnam and/or Thailand.

Press discloses India imports may be as high as 3 million tons of rice with the last 1 million tons to be decided after evaluating the situation in either March or July.

13 Philippines announces December 1 import tender for 600,000 tons of 25 percent brokens for February–May arrival.

16 Philippines announces December 8 import tender for 600,000 tons of 25 percent brokens for February–May arrival; rumor circulates that another tender will be held before end of month.

In Vietnam, Prime Minister Dung instructs the ministries of trade and agriculture to monitor production and demand so as to ensure no rice shortage at *Tet* in February.

18 Minister of Trade Sharma discloses that India is pursuing government-to-government negotiations with Thailand and others.

Press report in the Philippines quotes member of interagency committee responsible for calculating import needs as saying the country needs to import 2.2–2.4 million tons.

19 Unidentified NFA official in the Philippines is quoted as saying new tender will be held December 15 and another one week earlier for a total of 1.0 million tons. NFA Assistant Administrator Cordero indicates a new tender for 600,000 tons may have been authorized.

20 India scraps parastatal import tenders.

23 Philippines announces December 15 import tender for 600,000 tons of 25 percent brokens for February–May arrival.

December

1 Philippines holds tender for 600,000 tons and receives offers of $598–697 CNF. Budget for tender will cover only 522,000 tons at an average price of $624.11 per ton. NFA suggests buying price in coming tenders will be increased.

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