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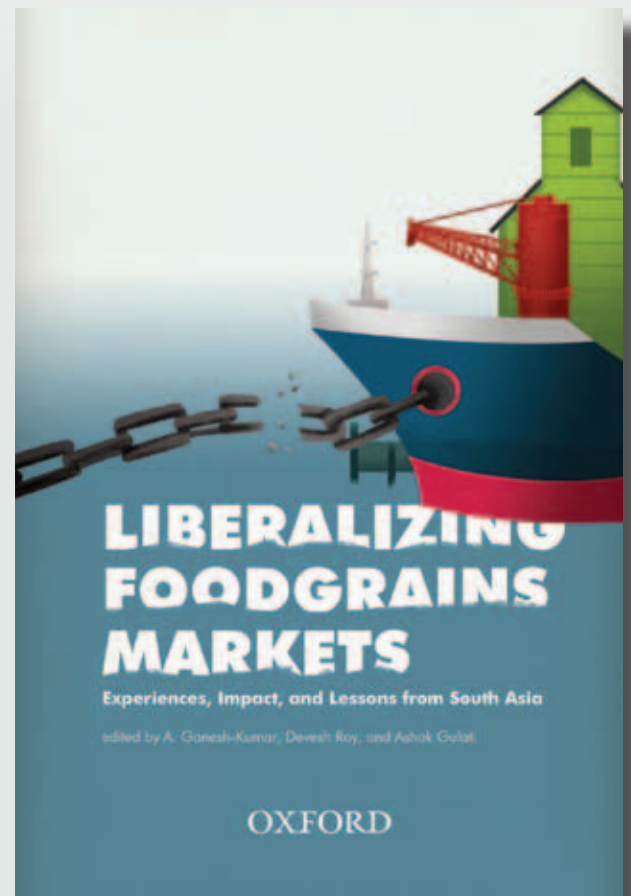
# LIBERALIZING FOODGRAINS MARKETS

*Experiences, Impact, and Lessons from South Asia*

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**S**outh Asia is home to the largest concentration of poor and undernourished people in the world, so food security—especially in basic staples such as wheat, rice, and corn—continues to be a major concern. With both persistent and re-emerging food price inflation reaching new heights in 2007–08 in global markets, South Asia saw sharp inflation—between 50 and 100 percent—in basic staples in Bangladesh, Pakistan, and Sri Lanka. These drastic price spikes drew comprehensive policy responses from the governments of these countries, addressing both supply and demand for foodgrains. India, the largest economy in the region, reacted by banning exports of common rice, wheat, and corn, as well as suspending these commodities from futures trading, to ensure comfortable supplies in the domestic market at affordable prices. India also launched a National Food Security Mission in 2007 and announced a special agricultural package (*Rashtriya Krishi Vikas Yojana*) of roughly US\$6 billion to rejuvenate its agriculture.



Today, South Asian countries want a greater degree of self-sufficiency; reliance on trade to achieve food security is being questioned by critics. Against this backdrop, a recent book published for the International Food Policy Research Institute (IFPRI) by Oxford University Press, *Liberalizing Foodgrains Markets: Experiences, Impact, and Lessons from South Asia*, studies the nature of reforms in foodgrains markets (both within-border and at-border reforms), their evolution, and their effects on food economy in general and food security in particular. Through country case studies, editors A. Ganesh-Kumar, Devesh Roy, and Ashok Gulati provide analyses and research-based evidence on decades of food policies in South Asia.

## FOODGRAINS POLICIES IN SOUTH ASIA

Due to their common colonial heritage and the universality of the problem, Bangladesh, India, Nepal, Pakistan, and Sri Lanka share similarities in their food policies. During the initial phases of development, the governments of these countries were slow to shift from a pro-industry bias, but the eventual adoption of agricultural technology brought about measurable improvements in food production and availability. India and Pakistan have emerged as food surplus states, Sri Lanka and Bangladesh have seen their food deficits decline, and Nepal currently faces only a slight food deficit.

As the situation of self-sufficiency in food production improved in South Asia, policymakers began to realize the drawbacks of interventionist policies, including spiraling costs, consistent inefficiencies, leakages, and corruption in the food management system. Hence, food policy changes—some of them in response to international commitments and pressures from donors—emerged. Governments of the region began to liberalize their food policies, with Sri Lanka leading the way followed by Bangladesh, India, Nepal, and Pakistan.

**Public procurement, storage, and distribution.** Parastatal agencies such as the Food Corporation of India, the Nepal Food Corporation, the Pakistan Agricultural Storage and Supplies Corporations, and specialized state agencies or departments within the government—including India’s Commission for Costs and Prices and Pakistan’s Agricultural Prices Commission—worked on a set of food security objectives: to protect farmers’ incentives; to stabilize prices, thereby reducing market risks for farmers; and to provide grains to consumers at subsidized prices. These elaborate systems of public intervention—from procurement to storage and distribution—have been scaled back in Bangladesh, Nepal, and Sri Lanka. In 1979, Sri Lanka replaced its system of universal rationing with a food stamps program while providing subsidies to consumers. In the late 1980s, Bangladesh dissolved its rationing system and limited public distribution to include only military, police, and public servants. In 1998, Nepal, too, began restructuring its distribution-related food policies. It downsized the Nepal Food Corporation and started placing greater reliance on open mar-

ket operations. India and Pakistan, however, continue to use elaborate systems of public intervention in different aspects of grain marketing.

**Domestic trade policies.** Elaborate control over domestic trade was the goal for extensive government interventions in foodgrains markets. The policies were aimed at preventing private traders from undercutting government policies on procurement, storage, and distribution. Specifically, as a first priority, the government required farmers and millers to sell adequate quantities to government agencies to meet their supply targets. Stocking limits, zoning laws, and intracountry movement restrictions were also imposed on private traders. Bangladesh, however, put into abeyance the 50-year-old anti-hoarding act that had imposed stocking limits on private traders. Certain controls on intracountry grain movement in India have been more or less removed while others, such as compulsory procurement of rice from millers, continue to exist. In Pakistan, although the government monopoly on rice procurement and distribution was phased out and private trade was allowed, large-scale interventions and controls continue to prevail in wheat, the country’s main staple.

**International trade policies in South Asia.** International trade restrictions took several forms, from banning private-sector trade and requiring trade licenses to increasing tariffs and imposing quantitative restrictions. With the overall goal of helping farmers, import controls were meant to stop competition while export controls were maintained to ensure high availability and low prices domestically. These policies often had just the opposite effect, however, and farmers in the region were left completely unprotected when they received less for their product than the prevailing international price.

Sri Lanka liberalized its trade policy in 1977. In 1993, the country gave up its monopoly on rice imports and no longer required licenses on imports by 1996. In 1988, Nepal adopted a broad structural adjustment program that required elimination of all quantitative restrictions. In 1993, Bangladesh followed, with the legalization of private international trade in wheat and rice at modest tariff rates. Both India and Pakistan have allowed private trade in grains, removed several export controls and licensing requirements, and replaced quantitative import restrictions with tariffs. However, in 2007–08, India restored export controls in response to high international food prices.

## KEY FINDINGS

**Cost-effectiveness of public intervention in domestic grain markets.** In India and Pakistan, the magnitude of government intervention in domestic grain markets continues to be very large and fraught with serious inefficiencies. The marketing cost of private traders is only about 70 percent of the cost of the Food Corporation of India. Similarly, the “incidental” costs for Pakistan’s Agricultural Storage and Supplies Corporations were 15–27 percent higher than for private traders in 2000–

2003; in Nepal from the 1980s until the early 2000s, marketing costs for private traders were about 41 percent lower than for the Nepal Food Corporation. Bangladesh—where private traders have a slightly higher (by about 1 percent) cost than the government—seems to be the only exception.

Recently, the basic criticism of government involvement in procurement, storage, and distribution is that it results in significant price distortions. In Pakistan, the real prices of commodities remained more stable than the prices of commodities that involved government intervention. The Indian experience in intervening in grain markets highlights the problems with public procurement, stocking, and distribution at administratively fixed prices. If it aims to materially benefit the consumer, such a system will either impose an implicit tax on farmers or require enormous subsidies, which may not be fiscally sustainable.

**Impact of border trade reforms.** The country case studies in *Liberalizing Foodgrains Markets* clearly show that in net importing countries such as Bangladesh, Nepal, and Sri Lanka (and, until recently, Pakistan), trade liberalization will increase import competition, which will lower domestic prices. Lower prices benefit consumers but harm producers. Liberalization has also helped smooth seasonal fluctuations with the narrowing of the seasonal highs and lows in rice prices between the 1980s and 2000s.

Since the mid-1990s, India has replaced Thailand as the main supplier of rice into Bangladesh, and the real price of rice has fallen in Bangladesh by 2.57 percent per year from 1981 to 2003. That reduction in rice prices clearly benefited poor consumers, as seen in the narrowing of the gap in per capita consumption between the bottom 40 percent and the top 20 percent of the population. Similarly in Nepal, nearly 10 percent of rice consumed comes from India, which has benefited 60 percent of Nepal's landless households.

Following trade liberalization in Sri Lanka, rice prices have fallen by 34 percent, resulting in a 45 percent rise in demand and a 33 percent rise in calorie intake. However, the adverse incentive effect on farmers resulted in a fall in rice supply by 28 percent. Pakistan has recently turned into a net exporter of its main staple, wheat, which remains relatively untouched by the trade reforms there. Similarly, as a net exporter of cereals, trade liberalization in India results in higher domestic prices that benefit farmers but hurt consumers.

**Spatial integration of domestic markets.** Spatially integrated markets ensure that local shortages in certain food items do not translate into a sharp rise in food prices. Removing the restrictions and constraints on intracountry movement of goods can result in large efficiency gains that can be reaped fairly quickly. Difficult physical terrain—such as hills and mountains in Nepal and extensive rivers in Bangladesh—requires sustained investment in transport infrastructure to achieve greater spatial integration. Grain markets in Bangladesh that invested in roads and river-transport infrastructure are better spatially integrated than those in Nepal, where lack of investment in transport infrastructure often results in local

scarcities in remote hills and mountains as well as often significant price differentials.

The case studies in India and Pakistan demonstrate that government policies that regulate the movement of goods across states also result in a lack of spatial integration. The findings for India showed that large-scale gains in efficiency arose with the removal of zoning restrictions because then private trade could occur between neighboring states driven by arbitrage possibilities rather than their deficit-surplus status. This is in contrast to the practice of government agencies, which traded directly between surplus and deficit states over long distances. Additionally, the removal of zoning laws combined with external trade liberalization allowed some deficit states to source their food from international markets rather than from surplus states within the country, because of differences in the international and domestic transport costs.

**Role of domestic market structures.** In agricultural markets, especially food markets, traders have relatively more market power than either farmers or consumers. This works in two ways: Traders have oligopsony—that is, the market position of many sellers with few buyers—in their transactions with farmers while having the position of oligopoly—many buyers with few sellers—in their transactions with consumers. This strong position allows them to be price fixers and not price takers in both transactions. The large margins for traders are often touted as the justification for government intervention in agricultural markets.

The Sri Lankan case studies suggest that losses to paddy producers from trade liberalization can certainly be minimized if the oligopsony power can be restrained and border reforms implemented. In Bangladesh, absence of large-scale government intervention in the output market is a major cause for the increase in competition in trading services. The number of rice traders increased twelvefold in approximately 30 years—from 4,000 in the 1960s to more than 48,000 in the 1990s. This rise in competition between traders has ensured that farmers are able to (1) avoid distress selling, (2) hold a fairly high proportion of on-farm stocks, and (3) sell their produce at the farmgate rather than in distant markets, thereby avoiding transportation costs.

## THE WAY FORWARD

**Country policy changes.** Divergence in the evolution of South Asian food policy measures over the past four decades indicates that each country in the region faces different challenges. In order to potentially achieve higher gains from agricultural production and stronger markets from better promotion, the Government of Nepal must invest in infrastructure and the Government of Bangladesh in irrigation, storage, transport, and communication. Subsidizing general purpose public goods such as agricultural research and extension services will benefit all farmers—small and large—while input subsidies benefit only a few farmers who use those inputs.

In Sri Lanka, maintaining stable trade policies—rather than varying the tariff rates frequently imposed in response to domestic supply conditions—will be a more effective way to achieve relatively steady levels of domestic consumption. These and effective measures to improve agricultural productivity will help Sri Lanka attain food security sooner than it would under the current set of policies. As food-surplus countries, India and Pakistan must undertake further measures to correct market imperfections. It is time to restrict the government control over private participation in trade and maintain orderly conditions in the foodgrains markets.

Promoting competition, devoid of policy-induced distortions, will help improve resource allocation by farmers, as well as allow consumers to benefit from competitive prices of food. In a competitive environment, the private sector can also deliver in other spheres with a direct bearing on agriculture and food security, such as in agricultural extension services, value addition in agriculture, and the development of infrastructure.

**Intraregional trade.** There has been a rise in intraregional trade in rice and wheat within South Asia. Nepal and Bangladesh, unlike Pakistan and Sri Lanka, have relatively porous borders with India, and, therefore, would feel the impact of input- and output-subsidy policies in India (as, perhaps to a lesser extent, would Sri Lanka). This clearly emphasizes the need for greater policy coordination between the countries of the region and especially greater policy discipline on the part of India. The platform of the South Asian Association for Regional Co-operation should be explored to further strengthen policy coordination.

The food price crisis brought out the stark consequences of uncoordinated actions aimed at achieving greater national food security. In November 2008, recognizing that surplus and deficit countries are neighbors, members of the South Asian Association for Regional Co-operation proposed to set up a regional granary to which all countries would contribute and which, in turn, could be used to help any member country tide over idiosyncratic supply shocks. The experiences of the food stocking, distribution, and domestic trade policies of individual South Asian countries suggest that a regional food bank would prove largely ineffective unless trade within the region was also liberalized—just as internal movement restrictions within a country impede government efforts to smooth prices. Hence, free trade agreements, such as those provided for in the South Asian Free Trade Area, complement effective food security through collective action. Moreover, the realities in South Asia also suggest that the design of such regional food reserves would be complicated less by economics than by the complex politics of the region.

There is potential for cooperation between South Asian countries in the transport of food commodities and the direct related implications for food security. For example, it could be advantageous for certain states in India to transport goods to northeastern Indian states by shipping them through Bangladesh.

Effective food policy measures have great potential to reduce poverty and, hence, enhance economic growth. It is the combined effect of evidence-based policy reforms, good governance, and liberalized markets that will ensure food security for the current and future generations of South Asia.

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