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CRISES IN POLICY FORMATION

APAP Staff Paper No. 9

September 1986

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Foreword

This publication is one of a series of staff papers that are part of the continuing effort of the Agricultural Policy Analysis Project (APAP), sponsored by the Office of Agriculture in AID's Bureau of Science and Technology, to disseminate the experience it has been accumulating in agricultural policy analysis. Through interaction with policy makers, country analysts, and AID missions in Africa, Latin America and the Caribbean, the Near East, and Asia, APAP has identified and concentrated its technical resources on the following themes:

- Developing agendas for an informal mission-host country dialogue on economic policies constraining progress in agriculture
- Defining food aid strategies and programs that foster and support
- Identifying input and output price reform programs that stimulate agricultural production and productivity
- Fostering private sector participation in input supply and product marketing and redefining the role of parastatal institutions
- Developing the indigenous capacity of host country institutions to provide the information needed to analyze, formulate, and implement policies conducive to agricultural development

During the 1970s and 1980s many developing countries experienced agricultural crises of varying magnitude. While the primary causes were often beyond their governments' control, inadequate information, poor timing, and lack of resources for effective policy implementation may have contributed significantly to the recurrent crises and to poor agricultural performance. Liberia, whose rice policies evolved through two major crises in 10 years, is a case in point. This paper documents that experience, traces the evolution of Liberian rice policies, and illustrates the extent to which these policies may have been inconsistent with underlying economic trends. It suggests how the crises may have been avoided or at least moderated.

We hope that this and forthcoming APAP Staff Papers in the series will provide useful information and analysis to all those involved in the continuing agricultural policy dialogue between AID and host country governments. We welcome comments, criticism, questions, and suggestions from our readers.

Abstract

This paper traces the evolution of rice policies in Liberia for the past decade or more to identify some of the reasons for two major crises -- the rice riots of 1979 and the unexpected surpluses of 1984 that exceeded the country's capacity to store. While the vagaries of world markets were both a hindrance and a help at different times, the main contributors to the crises were (1) inadequate resources for effective policy implementation, (2) limited information about the trends and impacts of major economic forces, and (3) an apparent inertia or inability to make significant policy changes before economic and political pressures built up.

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Introduction

> An annual crop of short term crises is
> as perennial as the grass. [5][1]

Many developing countries today have come to the realization that the agriculture policies they pursued for the past decade have not served well the interests of agricultural or of the nation. After repeated crises, many have realized that the much sought-for price stability in the 1970s sometimes bore a high cost in terms of the budget, economic growth, and unrest. Equally important was the recognition that stable food prices alone did not assure the much sought-after economic and political stability.

Major developments in the formulation of Liberia's rice price policy from the mid-1970s to the present illustrate the crisis nature of the process and the high costs associated with it. Much of the cost is attributable to using policy instruments that were too costly to be implemented effectively and were not geared to cope with major uncertainties because they were inconsistent with the underlying economic trends. These shortcomings led to a

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1. The numbers in [] refer to the references cited at the end of this report.

recurrence of crises that were substantially unsettling and bore a considerable cost.

This paper attempts to identify the crisis proclivity of the policy process and offers some suggestions, in hindsight, that might help to avoid similar pitfalls in other commodities and in other countries similarly situated.

The information for this report came from several sources referenced at the end of this paper. An important source for more recent years, however, was the information and data developed for a workshop held in Liberia under the auspices of the Agricultural Policy Analysis Project in March 1985. The workshop papers were prepared by Liberian policy analysts with some assistance from personnel from Oklahoma State University.

The Premises

A major purpose of government is to intervene in the affairs of society -- to provide services and to reallocate resources among its various constituents. But the patterns of intervention are seldom the result of a grand design; more often they are the result of incremental adjustments and periodic reactions to crises and other decision-forcing events -- once in a while they are revolutionary.

Decisions to intervene, whether made in the comparative calm of a long-term planning effort or under the short-term pressure of a crisis, are always made in an environment of uncertainty; that is, the full impacts of policy decisions made today may be felt only a year or more later. By that time the conditions that prompted the action may no longer prevail, making the instruments of policy obsolete and no longer able produce the outcomes that were intended. In fact, the outcomes are often so different that the effects themselves constitute a crisis for someone. Thus, in an environment of uncertainty the policy pendulum can swing from crisis to crisis, not always because the decisions at the time were bad, but often because the environment, and hence the outcome, was unpredictable.

The sources of uncertainty in the policy environment are many. In agriculture the most obvious ones are those related to weather, pests, diseases, and the international product and input markets. In addition to these are:

- The domestic economic and social environment, which keeps shifting so that the effects of policy adjustments, however well targeted, soon become enhanced for some and subverted for others
- The power relations among various interest groups, which shift from time to time to alter perceptions of what policy and economic performance should be
- The reactions of governments to crises with policy instruments and adjustments that fail to account for many of the uncertain changes in the economic, social, and political environment and so serve to enhance uncertainty and contribute further to crisis and cost

Many policy makers will deny that their actions may contribute to uncertainty and instability. Many, particularly in Africa during the 1970s, will point to long periods of stable consumer and producer prices as evidence to the contrary [3].[1]

The stable prices of the 1970s did not avert crises because, as prices held constant, the environment shifted so that they were no longer consistent with the changed conditions. These inconsistencies bore a high cost in the form of reduced farm production, increased food imports, loss of foreign markets, a drain on foreign exchange, unwieldy fiscal deficits, agricultural decay, and economic stagnation. Many of these were of crisis proportion and occasionally led to severe human suffering and violence.

It has become clea that a stable price can rarely be equated with a stable economy. Many countries today are therefore seeking more flexible food and agricultural policies to take cognizance of the changing environment so that the policies themselves do not contribute to instability. To do this several key conditions must prevail:

- Policy instruments need to be designed with an awareness of trends, potential variances, and uncertainties of the economic, social, and political forces that underly the food and agriculture system.
- Adequate managerial and financial resources must be available to implement policies with sufficient impact to counteract the forces that would produce outcomes different from those intended by the policy.

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1. Regional average consumer food price indices in developing countries increased only about 10 percent from 1968 to 1980, with virtually no significant variance and almost complete disregard to a 300 percent upward swing that occurred in international prices in 1973-75. Producer prices followed a similar general upward trend, but with only modestly greater variance associated with swings in world prices.

> Governments must be aware of the interaction of macro policies with the lower order sector and commodity policies.

Short of clairvoyance, analysis and information are major tools available to policy makers for reducing uncertainty and increasing the likelihood of good outcomes from their decisions. Appropriately directed, analysis of the major causal factors that change over time can help policy officials make better judgments about the probability that such events will or will not occur. With sufficient depth and coverage, analysis provides guidance to the extent to which the various constituents may be affected. In this context, it can be regarded as a substitute for trial and error -- it allows the effects of different policy options to be explored on paper and brings to the surface some of the crises that may be avoidable.

But information and analysis are not free of cost. The cost of producing them must be weighed against the risk of unsatisfactory outcomes. In situations where public resources are scarce and the demands many, the cost of information must be weighed against the possible benefits from using the resources in other ways. Most developing countries have severe resource constraints, which means that decisions are often made with less than optimum information. Thus, there is always a strong possibility that public interventions will miss their mark and result in high costs in one form or another. This is a major premise of this paper.

The Liberian Setting

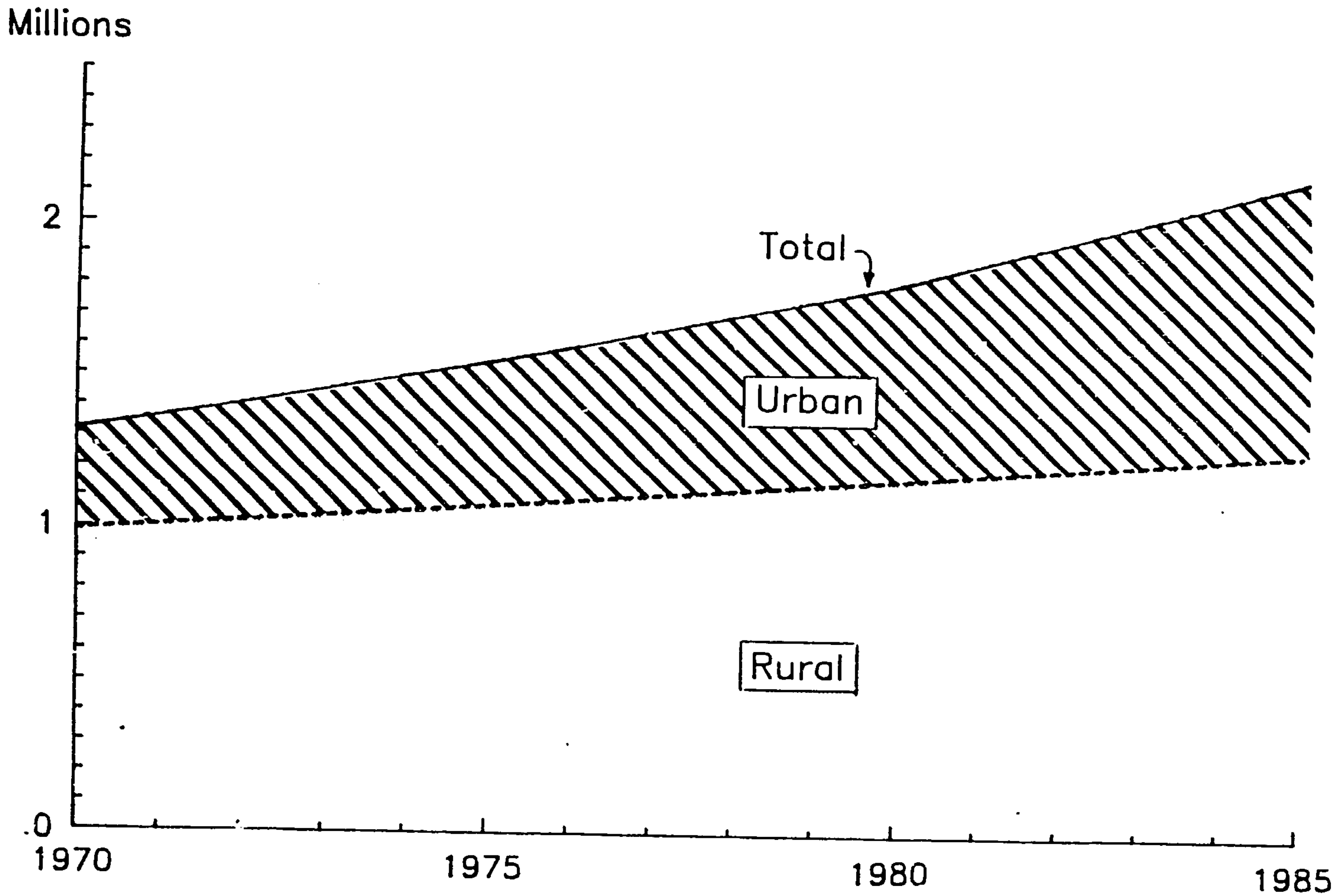
Liberians are traditionally a rice-eating people and for many years produced much of the rice needed for domestic use. But things changed. In the 15 years following 1970, the urban population increased nearly threefold, while the rural population increased less than 30 percent (Figure 1).

Through the 1970s and 1980s, rice production grew at a modestly respectable rate of 3.5 percent per year. This was more than enough to feed the rural population, which grew only 1.9 percent per year, but not enough to feed the urban population burgeoning at a 10 percent rate. Despite the government's announced policy of self-sufficiency, producers failed to respond with enough rice to meet the growing demands of the cities. Therefore, total rice imports, which had been steady at about 40-50 thousand tons per year before 1975, approached 70-90 thousand tons by the mid-1980s (Figure 2).

In 1984 the rice situation in Liberia reached a crisis. An unprecedented surplus developed as imports from neighboring countries mounted and PL480 shipments from the United States increased. For lack of storage much of the surplus rice deteriorated, and it became clear that adjustments were needed in the country's rice policies.

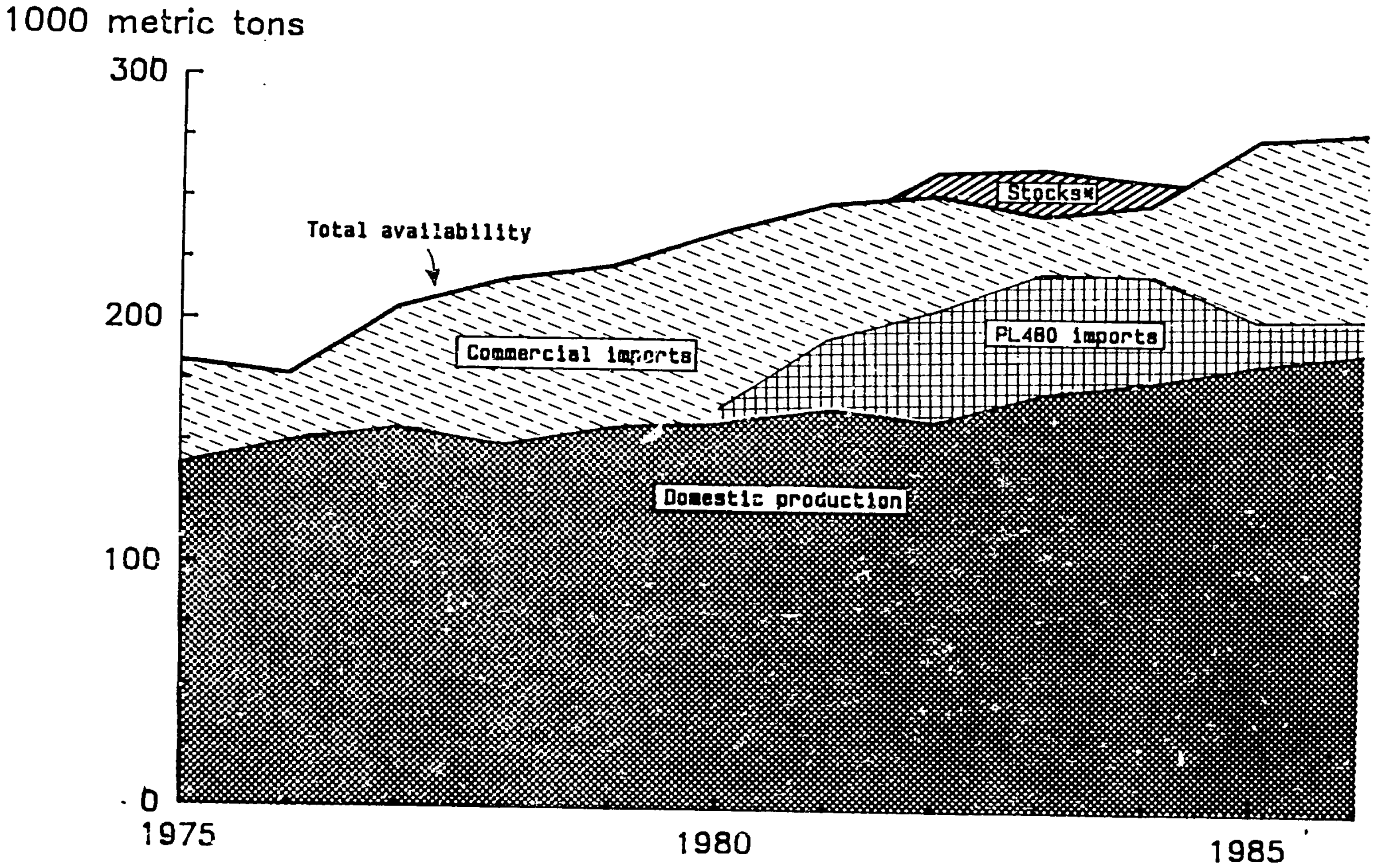
This crisis occurred only five years after the rice riots in Monrovia, when city consumers had revolted against price increases being considered by the government. In the face of sharply rising world prices and perceived shortages, it was deemed necessary to raise consumer prices so as to maintain the import levy, which had been a major source of

Figure 1. Population Growth and Composition, 1970-85



Source: World Bank Report No. 4200-LBR, 1984.

Figure 2. Total Availability of Rice, 1970-85



*Stocks in excess of normal carry-over.

Source: USDA, Economic Research Service and Foreign Agricultural Service.

revenue for the parastatal marketing organization. The riots forced the government to appease consumers by imposing a large subsidy instead.

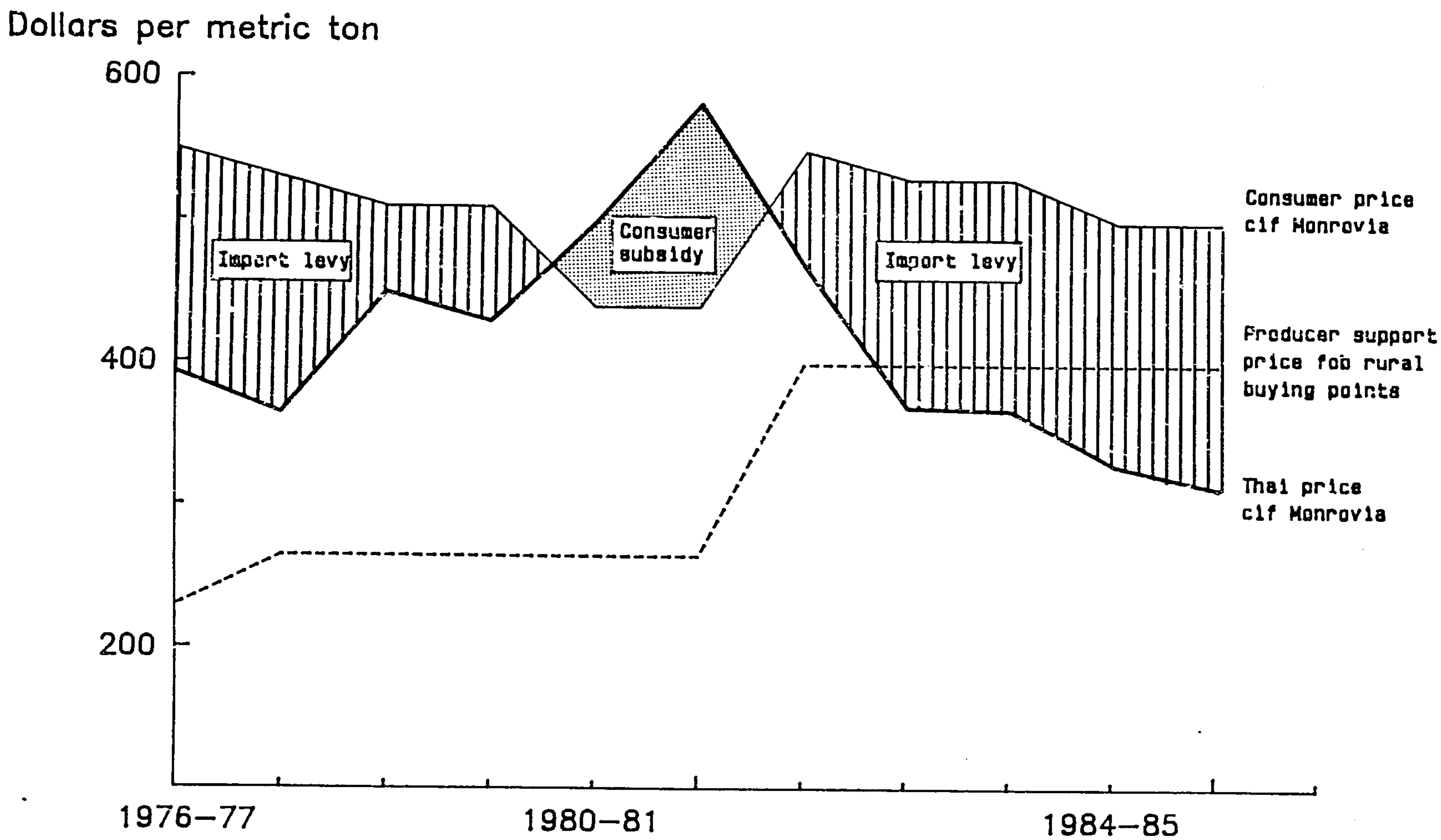
The Pre-September 1981 Period

From 1974 to 1979, Liberian consumer rice prices had been held fairly stable and above world prices by the use of a variable levy on imports. The levy varied from $50 to $150 per ton, depending on how much the world price was below the fixed consumer price. The revenues from the levies were made available to the LPMC (Liberian Produce Marketing Corporation) to help fund its operations, which included purchasing limited quantities of rice in the interests of price supports, operating rice mills in rural areas, and distributing rice obtained under PL480. But its main business was procuring, processing, and exporting all coffee, cocoa, and palm oil products.

Stability could not be sustained against the domineering forces of the international rice market (Figure 3). In 1979 and 1980, world rice prices increased so much that the variable levy was reduced to zero. As world prices rose even higher, the government, influenced by the interests of consumers, was forced to intervene with a subsidy that ran as much as $90 per ton in some months to keep the domestic price from rising too high. The subsidy, however, threatened the financial position of the parastatal when one of its major sources of revenue became a major source of cost.

To resolve the conflict between the survival of the LPMC and consumer price stability, the government opted to

Figure 3. Annual Average Rice Prices*



*Milled basis.

Source: USDA, ERS and FAS.

increase the consumer price of rice, not only to the equivalent of the world price, but above it to a level that would again produce a revenue. The timing was not right. When the move was considered in April 1979, rumors of the pending action spread quickly and riots broke out in Monrovia in opposition to it. This outbreak of violence not only terminated the deliberations, but caused the government to announce an even further reduction in consumer prices. The higher subsidies needed to sustain the lower price soon became financially intolerable. In 1980-81, the subsidy added more than $3 million to an overall fiscal deficit already in excess of $5.0 million [1]. These events contributed to an overthrow of the government.

In September of 1981, the new government, which had been in power less than a year, acted on its promise to assure adequate and regular supplies of rice. This was a change from the previous government's promise of fair and stable prices and a departure from a questionable commitment to self-sufficiency. Consistent with the new policy of "adequate supplies," the government raised the producer support price by more than 50 percent from the $265 per ton that had been held through five years of rising input and labor costs.

Aided by a new political environment and a fortuitous decline in rice import prices, the new government was also able to raise the consumer price of rice by 25 percent for the 1982-83 season. Since this was less than the black market price that had developed, it met with substantial consumer approval. As imports were increased, mostly through PL480, consumer prices settled back to the new target, which was now well above the declining world price.

The result was not only the elimination of subsidies, but a return to a variable levy of almost $50 per ton in that year -- and more in subsequent years.

While the rhetoric was substantially different, the policy instruments of the new government were similar to the old ones, albeit at somewhat different levels. More importantly, the lack of resources allowed little to be done to improve materially the effectiveness of the higher producer price supports; little could be done to enforce the collection of levies on rice being imported from neighboring countries; and little was done to reduce marketing costs for domestic production.

The Post-September 1981 Period

In the "new" environment, response to the 1981 policy adjustments was not always as expected, either in magnitude or direction. Rice producers did not come forth with great surges in production; domestic marketings increased only slightly; imports of rice from neighboring countries continued to flow while commercial imports from overseas sources declined almost directly with the increases in PL480 (Figure 2). Consumers were the only major constituent who reacted as expected. They decreased their consumption in face of higher prices.

The degree to which producers would respond to price incentives has long been a question [11]. There is, however, some suggestion in the trend that rice producers may have reacted modestly to the increase in support price and to the prospect of higher consumer prices in urban areas (Figure 3). A cursory examination of the production trend from 1982 to 1986 suggests that it rose an average of nearly 6,000 tons per year. This compares to an average annual increase of only 4,500 tons per year during the preceding five years. But while some positive response is suggested by these comparisons, it may well be statistically insignificant in view of possible errors in measuring the size of the crop and the many other variables that can affect production.

In contrast to the questionable response of producers, city consumers responded more noticeably to the higher price by reducing their consumption. Total consumption, which had increased persistently during the period leading up to the 1981 price adjustments, fell off the trend in 1982 and actually declined in 1983 for a total reduction of nearly 20 thousand tons. Much of this was undoubtedly caused by higher prices.

Prior to 1979, there had been only sporadic shipments of PL480 rice, but AID responded by sharply increasing shipments from only 6,000 tons in 1980 to more than 50 thousand tons in 1983. The sales of PL480 rice, mostly to city consumers, provided significant budgetary support to the LPMC and to the government. It also reduced significantly the country's foreign exchange burden, as commercial imports dropped from over 70 thousand tons in 1980 to less than 25 thousand tons in 1983.

The drop in commercial imports was primarily from overseas sources. Apparently, this did not apply to imports from Sierre Leone and Guinea. Aided by favorable consumer prices in Liberia, favorable exchange rates, and a demand for U.S. dollars (the primary currency of Liberia), producers in these neighboring countries apparently found it profitable to sell much of their rice in Liberia rather than in their own markets. The quantity of such movements is not known, although undocumented anecdotes abound to illustrate the point.

The convergence of a reduction in consumption, increases in imports from neighboring countries, increases in PL480 shipments, and sustained growth in domestic production created another major crisis. In the three years from 1982 to 1984 an estimated excess of 40,000 tons of rice had to be stored. Since this was far in excess of the capacity of available storage, it caused huge losses. In Monrovia the spoilage was largely of PL480 rice, as private importers undersold the LPMC which was chained to less flexible pricing policies. In rural areas, it was primarily rice that had been purchased by LPMC in the interests of price supports. Some sources suggest that nearly 20 percent of the surplus rice may have been wasted [7].

By 1984 it had become clear that a new round of policy adjustments was needed to correct the situation and to avert a further crisis. USAID responded again by progressively decreasing shipments under PL480. The Liberian government responded by announcing temporary restrictions on commercial imports. When these were relaxed, commercial imports from overseas sources were phased in as PL480 was phased down. By 1985 and 1986, commercial imports were back to the 1979 and 1980 levels.

Today, imports from neighboring countries are reported to have moderated, if not stopped. This was not the result of improved border controls, but because the value of the

U.S. dollar declined and both Guinea and Sierre Leone have raised their respective support prices to rice farmers.

It is not likely that the current set of policies will bring economic stability to the Liberian rice industry. The chances are that periodic crises are likely to recur. In particular, the government does not yet have sufficient resources to intervene effectively to meet its announced price commitments, particularly to producers. Additionally, it does not have the resources for improvements to overcome the high cost of marketing, to guard the borders when needed, or to maintain the stocks necessary for price stabilization. Even if the resources were available, it is doubtful whether the costs would be justified in economic terms [7].

There is still a major doubt about how much producers would respond to the higher price supports and whether the current "high" price supports are justified. There are those who suggest that subsistence farmers, who represent about 90 percent of Liberia's rice producers, are not very responsive beyond their own needs. This argument is supported further by an alleged comparative advantage of tree crops which presumably puts a prior claim on labor and other resources [2, 11]. But even if rice producers would respond significantly to higher prices, there is the added question of whether the LMPC can commit enough resources to provide an effective support mechanism, particularly in view of (1) the high cost of the pan-seasonal and pan-regional pricing systems which they maintain and (2) the very high costs of marketing from areas other than those close to urban centers. The high marketing costs also preclude farmers from competing effectively in the cities against PL480 and commercial imports from overseas sources.

Summary and Conclusion

Few, if any, governments are sufficiently omnipotent, wise, or informed to anticipate all (or even most) of the important effects of their interventions on the economic affairs of a society. At best, they work with limited information and a limited understanding of the environment in which they operate, and at best they have limited resources with which to design, implement and monitor effective instruments for counteracting the uncontrollable economic and natural forces. This suggests three improvements: (1) limiting the degree of intervention, (2) better timing to avoid an unmanageable build-up of pressures and counter pressures, and (3) enhancing the information base.

The Liberian experience clearly indicates that a major contributor to economic and political instability is the lack of resources needed for effective implementation of its policies. This suggests one of two options: to reallocate the necessary resources from other endeavors (which is financially difficult) or to minimize the cost of intervention to what can be administered effectively. This implies that governments:

- Intervene only to the extent that resources will allow and mainly to ameliorate extremes
- Require constituents to share in the risks of enterprise
- Promote the efficient operation of markets

In general, this means that more of the costs of domestic and international market uncertainty would have to be borne by consumers, producers, and marketers, and less by the government.

In most cases it is desirable to allocate some resources to analysis and information to relieve the unease of decision makers by helping them to:

- Improve their assessment of the risk that the environmental assumptions underlying their decision will be different than expected
- Examine, on paper, the costs and effects of major options for intervening
- Explore important side effects of major options, particularly those likely to lead to further crises
- Monitor the costs and effects of major interventions to obtain early warning of approaching crises and permit timely action

The timing of intervention in markets can be particularly critical. The Liberian government did not plan to create crises, but at times waited for decision-forcing events to arise before taking action. Such inertia is common and all too often leads to under- and over-adjustment and tends to perpetuate a crop of crises of greater or lesser gravity and of greater or lesser economic cost [7]. While good timing is often a matter of good fortune, it cannot be obtained without an awareness of changes in the economic and social environment and of the effect of intervention. This puts a high premium on information and analysis which can reduce the risk of bad outcomes and the frequency with which crises result.

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