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It's Not the Size, But How It's Used: Lesson for ASEAN Rice Reserves

By Jose Ma. Luis P. Montesclaros

Synopsis

ASEAN's approach to stabilising rice markets and averting crises has focused on having sufficient rice stocks as a buffer. Insights from stabilisation in currency markets show that reserve size is not as important as the way it is used to reduce overall risk exposure.

Commentary

STABILISING ASEAN rice markets is a crucial concern for averting crises such as the 2007-08 global rice crisis. The current strategy towards this is by growing the size of rice reserves in the ASEAN-Plus-Three Emergency Rice Reserve (APTERR), although the APTERR has been critiqued for its small size relative to total demand and low utilisation.

A look into the stabilisation policies in currency markets shows that more important than size is the way the reserves are used to incentivise actors towards behaviours that reduce risk exposure. As such, the limited reserves in APTERR can be used for encouraging behaviours such as increasing transparency/reporting, increasing partner diversification, and addressing structural imbalances in agricultural production and consumption within countries.

Current criticisms on reserve size

Rice, as a commodity, is subject to unstable market dynamics. For instance, chance events such as a drought in India's wheat market, combined with panic reactions by both exporters and importers, triggered world rice prices to soar in 2007-08. This developed into a crisis when Thailand and Vietnam, major exporting countries, closed their export gates following India's lead. This left rice importing countries unable to purchase the needed amounts for meeting their own demand.

Structurally, risks of the recent crisis recurring are high since the top five exporters (India, Thailand, Vietnam, the United States and Pakistan) occupy 81% of global rice trade, as reported by the International Rice Research Institute. Production shortfalls in any of the five countries are likely to cause panic. Worse still is if they engage in strategic behaviour of holding stocks to drive prices up (in fact, a rice cartel was proposed by Thailand in 2012). Lastly, countries hardly provide accurate data on how much stocks they have, making it harder to assess risk.

To address instability in the rice market, the 10 ASEAN countries plus China, Japan and South Korea developed the ASEAN-Plus-Three Emergency Rice Reserve (APTERR), a multilateral institution that

holds rice reserves contributed by member countries for use during crises. The attention given in the media is often to the low amount of reserves relative to demand. ASEAN reports show that compared to an ASEAN demand of half a million tonnes of rice per day, APTERR is small as its overall size is only at 787,000 tonnes (enough to cover a day and a half of consumption). Overall recommendations for APTERR have focussed on increasing accumulation and accessibility of its reserves for crises.

Of the total reserves, 87,000 tonnes come from all 10 ASEAN countries combined while the rest are sourced from the “Plus Three” countries (Japan, Korea, China), leading to calls for increasing contributions by ASEAN countries. Relatedly, it has been critiqued for its low utilisation rate: member countries prefer to have country-to-country rice purchases because the APTERR’s mechanism poses the risk that the needed rice/funds are not delivered soon enough. For instance, it requires a time-consuming process of crisis declarations by countries in need and approvals by member countries.

How reserves should be used: It is not the size

However, the approach to rice market stabilisation through the APTERR may be insufficient from the standards of currency market stabilisation. Rice and currency markets are comparable for a few reasons: Firstly, they both deal with priced commodities, the latter being priced based on the exchange rate.

The International Monetary Fund (IMF) was setup after the Second World War for the purpose of stabilising exchange rates. Similar to the APTERR, the IMF also has a system of holding reserves and releasing them for stabilisation purposes though it has committed to doing things differently, learning from the 2007-08 global financial crisis.

The IMF has moved on from issues of size and utilisation. A key insight to be learned from its practices in currency market stabilisation is its shift from crisis resolution to crisis prevention.

What the IMF will be doing differently is its use of reserves to influence countries towards reducing risk, by tailoring the criteria for accessing reserves. Firstly, data adequacy is a key criterion for which country receives funds, and how much of it a country can tap. Next, these criteria also include behavioural adjustments which would reduce structural instabilities in the countries concerned, in the areas of external position and market access, fiscal policy, monetary policy and financial sector soundness. In sum, the use of reserves is only a last resort for the IMF while most of its work focuses on stabilising the structures of economies so that they will have no need for the said emergency mechanism in the first place.

Moving forward: A change in perspective

Applying this to rice market stabilisation, the criteria for release of rice reserves can be tailored towards incentivising countries to reduce their vulnerability to risk, individually. Firstly, net-importing countries can be incentivised to prioritise rice production so that they can reduce external dependence, and to spread their risk by diversifying into other export partners. Strategic indicators may be drawn from current food security databases, including the Economist Intelligence Unit’s Global Food Security Index, or Syngenta’s Rice Bowl Index.

Next, the APTERR can also adopt the data adequacy criterion used by the IMF to reward countries for reporting country data on rice stocks held. This would allow it to perform effective surveillance in countries, which in turn would feed into better recommendations for reducing long-term structural risks.

Learning from stabilisation practices in currency markets, APTERR reserves should be used not simply as a buffer for crisis purposes. Instead, they should be tapped for incentivising countries towards reducing overall systemic risk. In this regard, it would not be the size of APTERR, but its potential for reducing overall risk, which should be the focus in the next APTERR meeting in 2015.

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