Australia sounds the alarm on PNG's proposed rice policy

By Anthony Swan
31 August 2016

Sometimes all the hallmarks of an impending disaster are plain to see. The course of action has been charted and the engine is running at full steam, but a myriad of obstacles both big and small cover the tracks. Is there anything that can stop the train before it is too late?

In this case the proverbial train is PNG's proposed rice policy which aims to make the country's rice production self-sufficient by 2030. This is no small task. However, it seems that the PNG government is determined to press ahead.

The challenge is to increase domestic rice production by 20-fold, from around 15,000 tons currently to 300,000 tons by 2030, according to the Minister for Agriculture and Livestock, Tommy Tomscoll, in his introduction of the policy in parliament [pdf, p. 20 onwards]. Despite a poor track record of previous government attempts to increase rice production by smallholder farmers, the government seems convinced that a new super-sized approach of focusing on large-scale highly mechanised irrigated farming will generate success.

The current rice market in PNG is open and competitive, according to PNG's Independent Consumer and Competition Commission (ICCC) in its 2015 Rice Industry Pricing Review [pdf], and so there is nothing in particular that would stop an interested party undertaking this scale of rice farming in PNG if it were expected to be profitable.

Of course large scale rice production in PNG would not be profitable on its own for many years to come (and may never be) and so any serious investment in rice production would need to come with serious incentives. And on this front, the government plans to deliver.

Under the proposal, pioneering status will be granted to the investor willing to commit a large amount of funds (at least K200 million but possibly over US$2 billion) to build large scale rice farms in PNG. The pioneer investor will then receive protection and concessions to help it establish production, brand recognition and a customer base.

It just so happens that an Indonesian backed company – Naima Agro-Industry Ltd – has been negotiating with the PNG government over the last eight years to invest US$2 billion in a Central Province rice project. This project was approved earlier this year, and it may not come as a surprise that Naima has been slated to receive pioneer status. According to Trukai Industries [pdf], which currently commands an 80 per cent share of the PNG rice market, the PNG government is planning to implement an import quota system which would provide Naima with control over 80 per cent of the PNG rice market, clearly at Trukai's expense.

There are two important points to note here. First, the proposed quota system will not require Naima to supply 80 per cent of the PNG rice market with *domestically* grown rice but instead allow it to supply it through *imported* rice. Second, Naima's 80 per cent share of the PNG rice market would be the result of protective measures provided to it by the PNG government. This is in contrast to Trukai's current 80 per cent market share, which according to the ICCC's Review [pdf] reflects its product quality, strong distribution network, and marketing efforts, rather than any exercise of market power.

Under the proposal, total rice imports will be restricted, and because increases in domestic rice production are unlikely to occur for many years, the amount of rice supplied in PNG will fall relative to demand. The likely result will be an increase in rice prices in PNG.

The ICCC is currently able to regulate rice prices, and it has indicated that it would do this in the event a domestic rice monopoly was created [pdf, see p. 52]. However, the extent to which the ICCC limits price increases depends on how it defines a rice monopoly, the type of regulation it applies, and whether regulation applies to all types of rice (currently the ICCC only monitors the price of Trukai Roots rice, which is priced in the relatively cheaper end of the market). For example, if the ICCC were to apply regulation based on a "cost-based" pricing regime, then PNG rice prices could still increase significantly due to higher cost domestically produced rice entering the market as a result of the quota system.

Naima's exclusive right to source 80 per cent of total rice imports and sell it at potentially inflated prices in PNG will provide it with substantial earnings. There is no guarantee that these profits will be used to invest in domestic rice production in PNG at all, and if anything there may be a strong incentive for Naima to limit increases in PNG rice production to the extent that it keeps rice prices high.

How high can the price of rice in PNG go? Prime Minister Peter O'Neill recently responded to a question in parliament asking whether reports that the price could increase by 40 per cent were true by saying that he did not expect it to be that high, reflecting limits placed on it by potential ICCC price controls.

However, any actual restriction of rice prices by the ICCC, combined with a fall in the total amount of rice supplied in PNG (as can be expected under the quota system), would likely result in consumers facing rice shortages; rice demand would need to be rationed, and PNG could expect a black market for rice to result, in which prices are pushed above regulated prices. Ultimately, consumers are likely to face price increases but by how much is uncertain. Indeed, a 40 per cent increase may be on the low side given that Naima was previously reported to be seeking a 60-100 per cent increase in the rice price.

How long will PNG consumers have to pay higher rice prices for? Under the proposal, Naima would enjoy a near monopoly of PNG's rice market for a 10-year period, although international evidence suggests that once domestic industries become dependent on protectionist measures there is substantial pressure put on government to maintain them indefinitely.

Why is the PNG government so determined to push ahead with the rice policy?

According to Prime Minister Peter O'Neill not enough rice is produced in PNG to provide it with sufficient food security. Reinforcing the point, the Minister for Agriculture and Livestock even asserted in parliament [pdf, p. 21] that there is an imminent shortage of rice globally where "white rice will be traded as white gold and will even sell at a price forecasted to be higher than metal gold itself".

However, according to the ICCC's Review [pdf], food security concerns affecting rice supply in PNG are unfounded. In fact, the ICCC highlights that creating a reliance on a single supplier of rice and the supply failure risk that it entails will actually reduce food security in PNG. Indeed, it is not clear that Naima has any track record of any rice production at all, let alone successful rice production in PNG conditions. Furthermore, even if PNG was able to be self-sufficient in rice production, the tradable nature of rice means that Papua New Guineans would not be protected from price shocks in international rice markets.

Who gains and who loses from the proposal? We can expect consumers will pay significantly higher prices for rice, most likely to the detriment of health and nutrition outcomes in PNG. Naima, on the other hand, seems like a clear winner, especially since there is an expectation that it will receive substantial tax breaks on their earnings (see here [pdf] and here). Furthermore, Naima does not appear to face any significant financial penalty if it is not able to deliver on its promised levels of domestic rice production. Naima will also need to secure land for the project and so particular landholders in Central Province can also expect a windfall gain. Existing rice producers in PNG will also benefit, although the amount can be expected to be small compared to the overall cost to consumers.

Apart from PNG rice consumers, the clear loser from the proposal is Trukai. Two-thirds owned by Australia's SunRice and one-third PNG owned, Trukai stands to lose hundreds of millions of dollars' worth of revenue, potentially wiping out the value of the company. However, these potential losses to Australian interests have not gone unnoticed by the Australian government.

Last week, PNG media (see here and here) reported on a "strongly worded" letter from the Australian Trade Minister, Steven Ciobo, to his PNG counterpart, Richard Maru, in which he claimed that the proposed rice policy will amount to unilateral expropriation of an Australian investment (Trukai). Concerns were also raised about the inconsistency of the proposed quota system with PNG's obligations under World Trade Organisation rules, and that the proposal may be in breach of an agreement between Australia and PNG to protect cross-border investments.

The clear message from the Australian government was that it would be compelled to consider retaliatory action against PNG exports to Australia if the PNG government proceeded with its proposed rice policy.

Ironically, Richard Maru has recently threatened Fiji with a trade war if it did not remove controls that banned certain PNG products from entering Fiji's market. Hopefully the PNG Trade Minister will be able to convince his colleagues in government that, like Fiji, PNG should embrace open and competitive markets, and seriously rethink its rice policy strategy.

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