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The Political Economy of Food Price Volatility: The Case of  
Vietnam and Rice

**Murray Fulton**

Johnson-Shoyama Graduate School of Public Policy  
University of Saskatchewan  
Diefenbaker Building, 101 Diefenbaker Place,  
Saskatoon, Saskatchewan Canada S7N 5B8.  
Phone: (306) 966-8507. E-mail: Murray.Fulton@usask.ca.

**Travis Reynolds**

Johnson-Shoyama Graduate School of Public Policy  
University of Saskatchewan

## Abstract

This paper argues that the structure of the Vietnamese rice export system is, in political economy terms, a rational response to the inherent volatility present in the international rice market. In particular, it is argued that the Vietnamese Food Agency, along with VINAFOOD-1 and VINAFOOD-2, have been structured so that they can benefit from the domestic demands for export restrictions anticipated to occur as a consequence of international price volatility and the psychological demand of consumers for price stability. In turn the actions of these agencies also contribute to international price volatility and the resulting demand for export restrictions. Since the political and economic elite in Vietnam obtain both political and economic power from this system, it is unlikely to be replaced with more effective and efficient policies to combat domestic price volatility. Thus, continued volatility in the price of rice can be expected.

## Résumé

Cet ouvrage soutient que l'évolution de la structure des institutions vietnamiennes responsables des exportations de riz peut être rationalisée dans un cadre politico-économique en fonction de la volatilité inhérente dans le marché mondial du riz. Plus spécifiquement, nous avançons que l'Association vietnamienne de l'alimentation, ainsi que les firmes étatiques Vietnam Northern Food Corporation (VINAFOOD-1) et Vietnam Southern Food Corporation (VINAFOOD-2) ont été structurées pour exploiter les requêtes concernant l'imposition de restrictions sur les exportations de riz par des consommateurs en quête de prix internes stables. Des restrictions à l'exportation peuvent donc être anticipées lorsque les cours mondiaux sont instables. Toutefois, le comportement de ces firmes étatiques peut aussi exacerber la volatilité des cours mondiaux et par conséquent la demande pour des restrictions à l'exportation. Ce cercle vicieux permet à l'élite politique et économique du Vietnam de consolider ses pouvoirs et il apparaît peu probable que les politiques et institutions en place pour stabiliser les prix internes évoluent pour gagner en efficacité. On peut déduire que le prix du riz demeurera instable.

Keywords: Price volatility, Vietnam, loss aversion, extractive institutions.

JEL classification: Q17, Q18, N55, P26.

# **The Political Economy of Food Price Volatility: The Case of Vietnam and Rice**

## **1 Introduction**

From November 2007 to May 2008, international prices for rice tripled (Headey 2011), an event unprecedented even during the world food crisis of 1973-1975 (Dawe and Slayton, 2010). For example, Thai 100%B rose from \$335 USD per ton to over \$1000 USD per ton – the highest level in nominal terms ever recorded (Dawe and Slayton, 2010). Considering its significance as the most important source of calories for the world's poor (Dawe and Slayton, 2010, Childs and Kiawu, 2009), this spike in rice prices is estimated to have resulted in 130 million people driven into poverty, and 75 million additional people becoming malnourished worldwide (Headey, 2011).

Factors cited as having contributed to the crisis include: trade restrictions by major suppliers, panic buying by several large importers, a weak U.S. dollar, rising oil prices, increased focus on biofuels, and the changing diets and growing incomes of Asian consumers (Dawe and Slayton, 2010, Childs and Kiawu, 2009, Headey and Fan, 2008). Although there is little agreement on the relative importance of many of the factors, it is commonly held that the export restrictions enacted by Vietnam and India, as well as the panic buying by the Philippines, were among the primary contributors (Slayton, 2009, Dawe and Slayton, 2010, Headey, 2011, Anderson and Nelgen, 2012). For instance, Martin and Anderson (2012) estimated that changes in border restrictions accounted for over 45 percent of the explained surge in the international price of rice.

Underlying these border restrictions are strong psychological forces. As Timmer (2012) [p. 12315] points out, panic buying and a "... visceral, hostile response among producers and consumers alike to the very functioning of markets" are a consequence of psychological factors,

providing countries with the motivation to suspend their trade operations. Of particular importance is the psychological construct of loss aversion, first identified by Kahneman and Tversky (1979). With loss aversion, the cost perceived by consumers when prices rise is much greater than the benefit perceived when prices fall. The result is that, when faced with rising prices, consumers demand policies – such as export restrictions – that alleviate the increase.

In Vietnam, the policies and political structures that allowed it to curtail the amount of rice it released into international markets had wide-ranging effects. Vietnam is the second largest exporter of rice, behind Thailand, and any restriction of its exports significantly affects world prices (Tsukada, 2011). In response to concerns over domestic supplies, the Vietnam Food Association (VFA) – the governing body responsible for regulating rice export levels – stopped granting new export contracts in late 2007 and early 2008 (Slayton, 2009, Van Arkadie et al., 2010, Tsukada, 2011). Essentially an export ban, this action limited the amount of rice available for international sales, further driving up world prices. Although Vietnam’s actions were an attempt to prevent domestic prices from rising, thereby benefitting consumers, it is argued that more self-serving motivations belie the VFA’s seemingly benevolent behavior.

Central to the Vietnamese rice export system is an organizational structure that privileges the largest state-owned enterprises (SOEs), VINAFOOD-1 and VINAFOOD-2, over farmers and non-state exporters. The institutional structure is such that the two SOEs are granted market share and state power “to extract rents from the small scale producers” (Van Arkadie et al., 2010, p. 26). This clout allows both VINAFOODs to purchase rice from domestic producers at depressed prices, and to garner substantial profits on lucrative export contracts (Van Arkadie et al. 2010). For example, in 2007, although export quotas were set to ensure sufficient levels of rice for domestic consumption, both VINAFOOD-1 and VINAFOOD-2 were exempt from such restrictions (Slayton, 2009). This allowed the two SOEs to reap the lion’s share of export contracts and earn over \$2 billion USD in 2008 (Vietnam News, 2009a). Moreover, VINAFOOD-2

is headed by the chairman of the VFA, ensuring that export practices favour VINAFOODs, an action “tantamount to putting the fox in charge of the hen house” (Vietnam News, 2009b).

The purpose of this paper is to show how the structure of the Vietnamese rice export system is, in political economy terms, a rational response to the inherent volatility present in the international rice market (on this latter point, see Timmer (2012)). In particular, it is argued, following Acemoglu and Robinson (2006), that VFA, along with VINAFOOD-1 and VINAFOOD-2, have been structured so that they can benefit from the domestic demands for export restrictions anticipated to occur as a consequence of international price volatility. In turn, the actions of these agencies contribute to the price volatility and the demand for export restrictions. In political economy terms, Vietnam’s political institutions provide certain actors with the political power to select the the country’s economic institutions. These actors, the political elite, have responded by choosing economic organizations and institutions (i.e., VFA, VINAFOODs 1 and 2) that are structured to exploit the anticipated volatility in the economic environment.

This political economy structure has a number of important implications for food security, price volatility and policy reform. Since the structure of VINAFOOD-1 and VINAFOOD-2 benefits those that have political power, there are strong positive feedback effects at work. The result is that the structure of these organizations will only change if the entire political economy structure is altered, and economic and political power is shifted to other groups in society. Since these types of changes typically take a long time, if they can be effected at all, policy reform can be expected to be either slow or virtually nonexistent.<sup>1</sup> Inasmuch as policy reform of the Vietnamese institutions is unlikely, and since the current institutions are constructed to benefit from price volatility, it can be expected that price volatility and food security will remain major issues in the foreseeable future.

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<sup>1</sup>Manion (2004) provides examples of how difficult it is to stamp out corruption, while Acemoglu, Johnson, and Robinson (2001) show that economic and political institutions in colonial countries have largely persisted through to the current time. While there are examples of revolutions (e.g., the French Revolution – see Acemoglu and Robinson (2012)) that have successfully transformed institutions, the norm is for institutions to persist over long periods of time.

The analysis in this paper also sheds light on a question often asked by policy analysts, namely why countries such as Vietnam choose to provide their consumers with relief from higher prices through the mechanism of export restrictions, rather than through alternative domestic policy routes such as direct subsidies, considering that these alternative policy routes are both more effective in addressing consumer price concerns and more efficient in terms their overall economic cost (Anderson and Nelgen, 2012). As this paper outlines, imposing trade restrictions provides an opportunity for rent capture by those that control the export process and own the export businesses. Given that alternate domestic policies would not allow this rent capture, nor contribute to a furthering of political and economic power, these options are typically ignored.

The paper is structured as follows. The next section outlines the food price crisis that took place in 2007-2008 and documents the role played by Vietnam in this crisis. Section 3 presents the theoretical models that are used in this paper. The starting point is Kahneman and Tversky's loss aversion, which is then applied to trade policy following Freund and Özden (2008) and Tovar (2009). With the loss aversion framework in place, the work of Acemoglu and Robinson (2006) is used to describe how those actors with political power can be expected to create economic institutions such as those found in Vietnam. Section 4 applies the insights derived in Section 3 to the case of the Vietnamese economic institutions VFA and VINAFOODs. Section 5 concludes the paper.

## **2 The Food Price Crisis and Vietnamese Export Policy**

In late September 2007, continued concern over rising world food prices caused the Vietnamese government to ratify the temporary restrictions on rice exports that had been in place since July of that year (Tsukada, 2011) (Slayton (2009) contends that the motivation for the restrictions was at least in part profit-driven, a contention that is consistent with the frame-

work presented in this paper). Vietnam's rice exporters had overcommitted themselves for the 2007 calendar year (Headey, 2011), resulting in international sales being banned to ensure that domestic supplies remained at levels sufficient to avoid any increase in domestic prices (Tsukada, 2011). Government-to-government (G-to-G) sales to regular buyers, largely to the Philippines and Cuba, were still allowed through Vietnam's two primary SOEs, VINAFOOD-1 and VINAFOOD-2 (Childs and Kiawu, 2009). Vietnam's ban on commercial rice exports is often cited as one of the primary causes of the 2007/08 global food crisis (Childs and Kiawu, 2009, Headey, 2011, Shigetomi, Kubo, and Tsukada, 2011, Slayton, 2009).

Vietnam's rice exporters are comprised of SOEs and private companies of which VINAFOOD-1 and VINAFOOD-2 are the largest (Tsukada, 2011). Collectively, the two are responsible for almost half of Vietnam's total rice exports. VINAFOOD-2 is responsible for all G-to-G deals to Southeast Asia countries including the Philippines and accounts for 36 percent of all export sales, while VINAFOOD-1 is responsible for sales to countries in the Americas and Middle East and accounts for 11 percent of total exports. The remaining 53 percent of sales is divided amongst several other state-owned and private companies, with no share rivalling either VINAFOOD. For example, the next largest exporter, the Kien Giang Trade and Tourism Company, handles six percent of rice exports.

Each year the Vietnamese Prime Minister announces the annual target for rice exports based on recommendations by the Ministry of Agriculture and Rural Development (MARD), the Ministry of Industry and Trade (MIT), and VFA (Tsukada, 2011). The target is comprised of the combined export levels of all of the rice-export companies (both SOE and private). Once the target is reached, rice exportation is suspended, and the VFA stops granting new rice export contracts. Lacking any policy intervention associated with domestic markets, Vietnam's only course of action to maintain domestic food security is to enact export quantity control restrictions, a process it routinely does (Tsukada, 2011). Although Vietnam's rice export policies have the advantage of promoting competition amongst export companies, they generate a degree of

strategic uncertainty. Companies cannot predict when total exports will hit the government's target level, and therefore rush to submit export contracts to the VFA before trade is suspended. This causes a flood of applications, which in turn forces any exporting of rice to be prematurely halted (Tsukada, 2011). Such was the case in 2007.

In addition to early suspension, the rush to secure contracts before restrictions are levied often leads export companies to close deals without having adequate rice stocks in place (Tsukada, 2011). As the delivery date approaches, exporters are forced to secure rice on the spot market. Complications arise if current prices are above those initially agreed upon. This is what happened for the Vietnamese rice exporters' December 2007 and January 2008 commitments, as rapidly increasing domestic rice prices forced the contracts "underwater" (Slayton, 2009).

Given this background, the major events of Vietnamese involvement in the food price crisis of 2007/08 can be outlined (see Childs and Kiawu (2009), Slayton (2009) and Tsukada (2011) for details). In July 2007, the VFA announced that export targets for that year had been reached, and temporarily suspended commercial rice exports. It was felt that further sales would reduce domestic stores to insufficient levels. The government confirmed the suspension in September, and the export ban continued until January 2008, when the new export target was raised to 4.5 million tons. Trade resumed with new minimum export prices (MEPs) set for each grade of rice.

Although bans were lifted, the VFA informally requested that no sales of the lowest grades of rice be made. The following month, existing MEPs were revoked and no more export contracts were issued, causing an informal ban on new export sales. On March 6, 2008, another set of export targets were announced. Given that sales to the Philippines and other buyers were already contracted, these new quotas were low enough to essentially ban further exports. Despite these restrictions, five days later Vietnam sold just under a quarter million tons of rice to the Philippines in a G-to-G sale.

On March 17, 2008, the Vietnam government officially banned additional sales for March and April, allowing sales for May. Trade restrictions meant that VINAFOOD-2 had access to



domestic stores without having to compete with other companies seeking to cover rice previously contracted to international traders. The export restrictions failed to cap domestic prices, however, which almost doubled during the first half of 2008. The ban was further extended through June, despite a bumper 2007/08 winter-spring harvest.

Just over a week later, on March 26, the government announced that no export contracts would be approved unless the exporter already had 50 percent of the sale in stock. Other requirements were imposed: prices had to be in line with the MEP; and shipment had to occur within 60 days of signing. Additionally, export targets were revised for 2008, with a January to June quota of 2.25 million tons: 50 percent of total rice exports for 2006 and 2007 combined. Even with new restrictions in place, domestic prices still remained volatile, illustrated by the outbreak of "rice fever" in Ho Chi Minh City on April 25 as prices doubled in just two days.

In June international demand began to slacken. Panic buying by major importers, especially the Philippines, began to slow, and the expected demand from Indonesia did not materialize. Additionally supply conditions changed. Cambodia and Thailand predicted record harvests, and Asian farmers, in reaction to record prices, significantly increased their rice plantings. In Pakistan, the rice harvest increased sixfold, to 6.5 million tons, as farmers switched from traditional crops, such as sugarcane and cotton, to rice. Finally on June 18, 2008, Vietnam lifted its export ban, allowing smaller provincial SOEs and private exporters to resume international sales efforts.

The remainder of this paper sets forth the argument as to why the Vietnamese rice export policy is structured the way that it is. Specifically, the paper examines why Vietnam relies on export restrictions to address rising food prices and why SOEs – the key ones being VINAFOOD-1 and VINAFOOD-2 – are so intimately involved in the process.

### 3 Theoretical Framework

The purpose of this section is to present the theoretical models that will be used in section 4 to analyze the structure and behavior of the food and rice organizations in Vietnam. It begins with a discussion of loss aversion, which is used in the context of a trade model to show why exporting countries, such as Vietnam, can be expected to react to rising international food prices by restricting exports. The section ends with a discussion of the political economy of policy formation and how those groups with political power choose policies to their advantage.

Figure 1 illustrates the key idea behind loss aversion. Starting from a reference point of no gains or losses, outcomes perceived as gains are valued according to the curve in the top right-hand quadrant, whereas outcomes perceived as losses are valued according to the curve in the bottom left-hand quadrant. Thus, as shown, a gain and a loss of equal magnitude can be expected to be valued very differently. Indeed, empirical estimates of the degree of this differential valuation are in the range of 2:1 (Kahneman, Knetsch, and Thaler, 1991) – i.e., a loss generates a degree of disutility that is twice the utility generated by a gain. Simply put, losses harm more than gains benefit. A consequence of this is that the value of a relatively small loss can outweigh the value of a fairly significant gain.

The theory of loss aversion has been used to explain certain anomalous features in trade policy. Freund and Özden (2008) show that loss aversion leads to what they call compensating protection, whereby a decline in the world price – and a corresponding loss of profits for trading firms – results in domestic protection designed to offset this loss. They also describe how this protection will persist after the shock has passed. Tovar (2009) shows that if the degree of loss aversion is sufficiently large, then there will be an anti-trade bias in trade policy – i.e., import competition is encouraged in importing sectors and exports are discouraged in export sectors.

Similar results apply to the case of a rice exporting country such as Vietnam. To see this, consider Figure 2, which graphs the economic surplus of rice growers against the economic surplus of rice consumers and taxpayers. The surplus transformation curve (STC) shows the

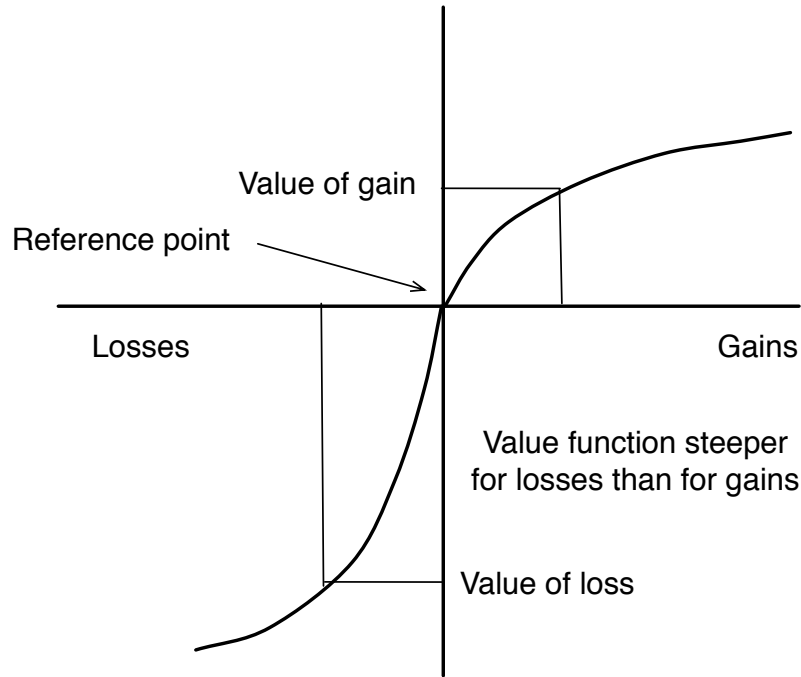


Figure 1: Illustration of Loss Aversion

combinations of producer surplus and consumer/taxpayer surplus that are possible under different trade policies. Note that each STC is based on a given world rice price – thus, underlying the lower STC curve is a lower world price.

The points FT and FT' show producer and consumer surplus under free trade (with free trade, taxpayers neither make nor receive payments). Note that when the world price of rice climbs and the STC curve shifts up, the presence of free trade means a loss of surplus to consumers and a gain in surplus to rice producers. Consumers experience a loss because they have to pay a higher world price for rice; these higher prices, however, benefit rice producers, since now they can sell their rice for more.

Starting from free trade, governments can shift surplus among the various groups in the economy via different policies. For instance, by imposing export taxes or MEPs, a government can increase the surplus of consumers and taxpayers, while decreasing that of producers. For any given world rice price, this surplus shift is captured by movements downward along the STC from point FT (or point FT', depending on the world price) – the greater the export taxes

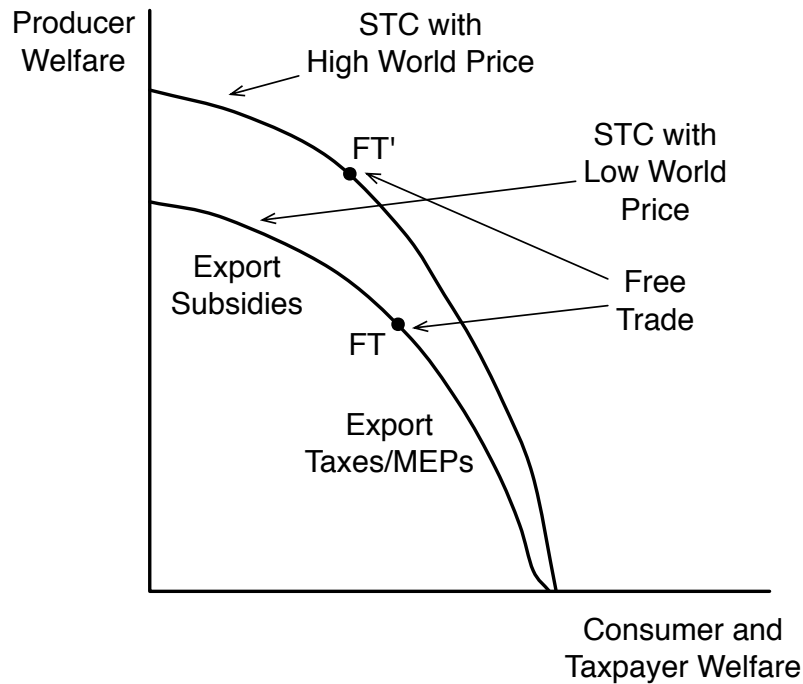


Figure 2: Trade Policies and Interest Group Welfare

or MEPs, the greater the movement along this curve. These surplus changes occur because the imposition of an export tax makes it more expensive to sell abroad, thus increasing the amount of production sold domestically. This increase in domestic sales reduces domestic prices, thereby increasing consumer surplus while reducing producer surplus. Similarly, a government could transfer surplus to producers (and away from consumers/taxpayers) by moving above and to the left of FT (or FT') through the use of export subsidies.

The surplus measures illustrated in Figure 2 are absolute measures of surplus. However, following Kahneman and Tversky (1979), what is important to producers and consumers is not the absolute surplus measure, but rather the surplus change – i.e., the surplus relative to the reference point. To see the implications of loss aversion for trade policy, suppose that a country, such as Vietnam, is initially operating under free trade. Suppose also that the world price of rice is relatively low. Thus, producers and consumers are located at point FT. Now consider what happens when the world price rises rapidly, so that Vietnam is no longer on the lower STC curve but on the higher STC curve instead. If the country maintains its free trade policy, the immediate

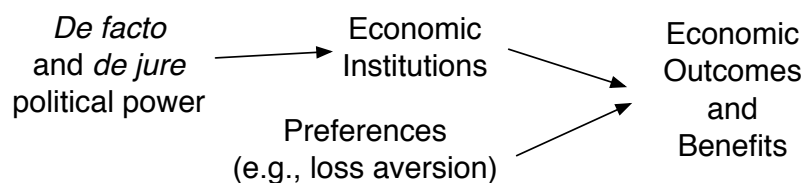
impact is to move to point FT' where the consumer surplus is lower and the producer surplus is higher.

As illustrated in Figure 1, the consumers' valuation of their loss is likely to be substantially larger than the producers' valuation of their gain. Because of this greater valuation and the public outcry that is often generated, consumers can be expected to have more influence than producers over government policy (Freund and Ozden 2008). To respond to consumers' demands for a return to their reference point – i.e., the prices and the welfare that they had before the world price of rice increased – governments can be expected to introduce such policy responses as export taxes or MEPs. These policies have the effect of moving the economy downward along the upper STC curve, as shown in Figure 2. In short, a government can more or less restore consumers to their reference point through the use of export restrictions. Such policy actions, however, exacerbate the rise in the world rice price (Anderson and Nelgen, 2012, Martin and Anderson, 2012). As Timmer (2012) points out, the result can often be a spiralling upward of prices as people respond in herd-like fashion by holding onto stocks. Consequently, these higher prices can lead to a demand for yet more government restrictions on trade.

The introduction of MEPs or export taxes has an additional economic impact besides lowering the price to both consumers and producers. Since an MEP/export tax creates a gap between the domestic price and the world price, any firm with the ability to buy rice domestically and then sell it on the international market stands to make a considerable amount of rent – this rent is equal to the difference between the domestic and export prices, multiplied by the amount exported. In short, MEPs/export taxes affect the welfare of not only producers and consumers, but also that of the exporting firms. As discussed above, the major rice exporters – and thus the prime beneficiaries of export restrictions – are VINAFOOD-1 and VINAFOOD-2. Not only do these organizations handle a large percentage of exports, but they are often given preferential access to international markets when export bans and MEPs are in effect. Thus, these orga-

nizations – and those involved in them – stand to benefit substantially from export restrictive policies.

The presence of VFA and VINAFOOD-1 and VINAFOOD-2 needs to be examined in the context of the broader economic and political environment of the country. Following Acemoglu and Robinson (2011), the distribution of *de jure* and *de facto* political power determines the economic institutions that are chosen (see Figure 3). *De jure* political power derives from the nature of the political regime in the country (e.g., democracy versus dictatorship), while *de facto* political power derives from the resources devoted to keeping power. As Acemoglu and Robinson (2006) indicate, elites may often be able to hold onto overall power even in democratic situations if the incentive to invest in *de facto* political power is sufficiently strong. In addition, Acemoglu and Robinson (2001) show that elites will use inefficient methods of distributing resources if *de facto* power is linked to the manner in which the resources are distributed.



Source: Adapted from Acemoglu and Robinson (2006)

Figure 3: Political Power, Political Institutions and Policy Choices

The economic institutions referred to in Figure 3 include such things as the tax and intellectual property regimes that are in place, and the degree of competition that exists in the industrial sector. Economic institutions, in conjunction with behavioral preferences, determine the economic outcomes that occur in an economy as well as the benefits (i.e., the economic surplus) associated with these outcomes. In short, economic institutions, combined with preferences, determine both the economic potential of the economy (the size of the pie) and how this pie is divided among different groups and individuals (Acemoglu and Robinson 2009).

Assuming there is an elite group in society that has *de jure* and *de facto* political power, this group faces the problem of choosing the economic institutions that allow it to benefit economically both now and in the future. Following the literature on strategic choices (e.g., Gibbons (1992)), those groups would use backward induction to determine their optimal choice. Backward induction involves examining what kind of outcomes would result under different types of economic institutions and then, armed with this knowledge, choosing the institutions that provide the greatest return.

In the case of rice in Vietnam, the starting point for this backward induction is the knowledge that: (a) rice prices are inherently volatile; and (b) due to loss aversion, consumers will react to increases in the world price of rice by demanding restrictions on rice exports. Given this understanding, those with political power would wish to create economic institutions that would allow them to benefit when food prices rise rapidly and when export restrictions are introduced. In addition, these elites can be expected to favor policies that generate additional *de facto* political power for themselves.

Specifically, those actors that are able to choose a country's economic institutions would not only want to choose institutions that are intimately involved in the export of food, but would also want preferential access to export markets, even as other groups are denied such opportunities. Although, in the wake of world price increases, domestic policy tools, such as price subsidies, are more effective and efficient at reducing how much consumers pay for food (Anderson and Nelgen, 2012), these policies offer fewer possibilities to capture rents than do policies that involve restrictions in rice exports. The reasoning is simple. Export restrictions reduce the domestic price to below the world price, thus providing a rent to those that are given the right to export. Moreover, since food prices are highly volatile, the opportunity to capture rents in this manner can be expected to emerge on a regular basis as loss averse consumers demand relief from higher prices – relief that can be met with export restrictions. Finally, the economic rents that are captured can also build and maintain *de facto* political power.

Thus, it is expected that countries with elites that have substantial *de jure* and *de facto* political power will set up economic institutions and organizations so that export restrictions can be quickly put in place. As well, it is expected that the elites will be given preferential access to export opportunities, since without this access they will not be able to benefit. Finally, the analysis above suggests that export restrictions provide the elites with additional opportunities to generate *de facto* political power. The next section tests these predictions by examining the structure of the VFA and VINAFOOD-1 and VINAFOOD-2, as well as the decisions that they made during the 2007/08 food price crisis.

## **4 The Political Economy of Vietnamese Rice Exports**

Acemoglu and Robinson (2012) distinguish between extractive and inclusive political and economic institutions. Political institutions determine who has the political power in a country – i.e., how the government is chosen and how it makes decisions. If the political institutions are both centralized (i.e., there is a single source of law and order) and pluralistic (i.e., political power is broadly distributed), then they are said to be inclusive. In the absence of one or both of these conditions, political institutions are said to be extractive. On the economic front, these institutions are structured so that economic resources can be extracted from society for the benefit of an elite. In contrast, inclusive economic institutions allow the benefits of economic activity to be shared widely.

There is evidence that Vietnamese political and economic institutions are extractive in nature. Although Vietnam is often described as a market economy, it still retains a very strong state sector. Indeed, as Painter (2005, p. 279) argues, “. . . the programme of so-called ‘equitisation’ [privatization] is *de facto* a means of preserving and formalising informal ownership rights, in which party-state actors are still implicated. Hence, it proceeds at a pace suited to the interests of the owner-managers and their state and party clients and protectors. The case of SOE [state-



owned enterprise] reform illustrates a pattern common across the economic reform process in Vietnam: because the party-state remains enmeshed with the business interests that marketisation has given rise to, it is vital that the process of ‘transition’ is one which the party-state centre controls, or at least contains. In various ways, the centre has had to fight hard not to lose control over its own people and to maintain the integrity and effectiveness of its own systems of power and rule.”

In addition to a very strong and controlling state sector, Vietnam provides relatively few opportunities for its citizens to participate in the political life of the country. Table 1 presents statistics from the World Bank’s Worldwide Governance Indicators project for Vietnam over the period 1996-2010 (Kaufman, Kraay, and Mastruzzi 2010). The Voice and Accountability index captures “... perceptions of the extent to which a country’s citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media,” while the Control of Corruption index captures “... perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests” (Kaufmann, Kraay, and Mastruzzi, 2010, p. 4). Vietnam scores particularly poorly on the Voice and Accountability index, with a ranking of roughly eight during the period 2005-2010 (a rank of eight means Vietnam is at the 8th percentile relative to the other countries in the world). While Vietnam scores better on the corruption index, it is still in the bottom third of countries in terms of its level of corruption.

It is within this context that the operation of the rice export program needs to be understood. As is the case in the general economy, the rice export business is dominated by the state. As Van Arkadie et al. (2010) [p. 25] notes, “Exports of rice are regulated by the Viet Nam Food Association (VFA) to ensure food security. VFA is closely linked to the state trading companies VINAFOOD 1 and VINAFOOD 2. Farmers and non-state traders complain that VFA and the two VINAFOODs manipulate the export market – in essence, using their market power to buy cheap from farmers and reap huge profits on export contracts. Indeed, in 2009 it was discovered

Table 1: Worldwide Governance Indicators for Vietnam, 1996-2010

Year	Voice and Accountability		Control of Corruption	
	Estimate	Rank	Estimate	Rank
1996	-1.05	15.38	-0.43	39.02
1998	-1.36	10.58	-0.40	39.51
2000	-1.26	12.02	-0.61	31.71
2002	-1.50	8.17	-0.55	34.63
2003	-1.57	6.73	-0.56	36.10
2004	-1.36	9.62	-0.77	22.93
2005	-1.43	8.65	-0.77	24.88
2006	-1.54	7.69	-0.74	25.37
2007	-1.56	7.69	-0.57	33.98
2008	-1.51	7.69	-0.66	29.61
2009	-1.47	8.06	-0.52	36.84
2010	-1.43	8.53	-0.58	33.01

Source: World Bank (2012)

that VINAFOOD 2 was selling domestic rice at depressed prices to its wholly owned subsidiary in Singapore, Saigon Food Pte, with the approval of VFA, members of which are VINAFOOD 2 officials. In effect, large enterprises with market and state power use that power to extract rents from the small scale producers. In doing this they are not serving any larger public good, but they do increase the costs to farmers and firms of competing on global markets.”

Despite this extractive behavior, VINAFOODs’ expressed purpose is to ensure the stabilization of domestic rice prices. In a letter to the WTO, the Vietnamese government stated that VINAFOODs were established to “strengthen the state capability of food market control and stabilization as well as domestic price stabilization” (as cited in Son and Thang (2008) [p. 214]). However, considering that the SOEs neither ensure a floor price by purchasing from farmers, nor ensure a ceiling price by selling directly to consumers, it is unclear how VINAFOODs lives up to the official rationale (Son and Thang, 2008). Furthermore, the SOEs are supposed to provide a share of their profits to farmers for reinvestment in rice production, an obligation that has recently been ignored (Vietnam News 2009a).

Instead of functioning to stabilize domestic prices, Ghosh and Whalley (2004) argue VINAFOODs provide the government with an efficient source of revenue, as well as means to insulate the economy from external shocks. With producer prices intentionally set below international market value by the state, VINAFOODs are able to generate considerable revenue – approximately US\$ 2.3 billion in 2008 (Vietnam News, 2009a) – resulting in significant financial reward for individuals within the government. According to Hayton (2010), officials within the Trade Ministry receive sufficient commission from allowing the big SOEs to secure lucrative G-to-G contracts that they have little incentive to facilitate a more open-market export structure beneficial to the farmers. The result is a system whereby VINAFOODs has privileged access to both domestically-produced rice and international markets, while farmers and other exporters fail to receive any benefit from the current state institutions.

Part of VINAFOODs' domination of the export market can be accounted for by several state-endowed advantages. The two SOEs are exempt from complying with government-set quotas and MEPS, thereby affording them the majority of exports in any one year (Slayton, 2009). Moreover, VINAFOOD-2 is headed by the chairman of the VFA, Truong Thanh Phong (Slayton, 2009) – consequently the “fox” can shape policy to the benefit of VINAFOODs. VFA is one of the three organizations responsible for determining the yearly quantity control restrictions on rice exports – the remaining two agencies being MARD and the MIT. Aside from being a trade organization supposedly representing all exporting companies, the VFA serves as the government's agent, implementing its rice export policies and approving new rice export contracts (Tsukada, 2011); this practice helps to partially shield the government from unpopular decisions, while granting it control over Vietnam's rice economy (Slayton, 2009). Additionally, VINAFOODs enjoy government-funded zero-interest loans unavailable to private-sector exporters, as well as exclusive access to G-to-G contracts (Son and Thang, 2008).

Although the SOEs were established in 1995 (Son and Thang, 2008), less than twenty years ago, the key elements of VINAFOOD-1 and VINAFOOD-2 can be traced to the extractive

institutions set up under French colonial rule more than a hundred years ago. The consolidation by the Vietnamese government in the 1990s of numerous enterprise unions and small and fragmented state firms into larger corporatized, state-owned general corporations resulted in organizations that were similar to the state monopolies of the colonial regime. Both sets of enterprises – the colonial monopolies and the general corporations – were predicated on access to government resources and protection, constituting a pattern of state-sponsored accumulation of resources, and highly opaque networks of state control (Sasges and Cheshier, 2012). Both are “highly diversified investment house[s]” (Sasges and Cheshier, 2012, p. 23), and represent the attempts of each regime to use state-created monopolies to extract economic rent, as well as promote modernization and economies of scale.

The parallels between the colonial and current Vietnamese political economy provide yet another example of the finding by Acemoglu, Johnson, and Robinson (2001) that colonial extractive institutions have persisted into the present. The result is that “. . . in the absence of ‘shock therapy,’ state enterprises [will] continue to play a preponderant role in the [Vietnamese] economy” (Sasges and Cheshier, 2012, p. 9).

## **5 Concluding Remarks**

The rice market is highly volatile, with prices fluctuating considerably from year to year (Timmer, 2012). One reason for this fluctuation is that the behavior of exporting countries like Vietnam, in an apparent attempt to stabilize their own domestic prices, exacerbate international volatility by restricting exports at precisely those times when the world market is tight and prices are already rising. Martin and Anderson (2012), for instance, estimate that over 45 percent of the explained surge in the international price of rice during the 2007/08 food price crisis was a result of changes in border restrictions.

Although commentators have called for alternative domestic policy policies, such as direct subsidies, to deal with internal price surges in exporting countries such as Vietnam (see, for instance, Anderson and Nelgen (2012)), the argument put forward in this paper is that such outcomes are highly unlikely (even though these alternative policies would be more effective at dealing with the problem and more efficient in terms of their economic cost). The reason lies in the political economy of these exporting countries.

In the case of Vietnam, one of the legacies of its colonial past is a set of economic and political institutions that have supported and maintained a number of extractive economic policies. These institutions and policies – which are formalized in terms of state-owned and controlled agencies (VFA, VINAFOODs) that are run by an economic and political elite – have been strategically chosen to generate substantial economic rent and to buttress the political power of the elite. The strategic element emerges because those with economic and political power recognize that, because of loss aversion, consumers will react strongly to rising food prices and will demand trade restrictions as a way of alleviating these price changes. Faced with this demand, those with control of the government food agencies exploit the situation by restricting trade, thereby creating the opportunity to capture significant rent by ensuring that they have preferred access to export opportunities. Trade restriction policies, such as MEPs and export taxes, also strengthen the elite's political power, since control of resources underpins *de facto* political power.

The positive feedback effects at work in the system mean that, barring a very significant shock, the political and economic institutions in Vietnam are likely to remain extractive in nature. This degree of entrenchment has serious repercussions for the Vietnamese economy, market stability and global food security. Unless current political and economic institutions can be changed, Vietnam will continue to behave in a manner that benefits the political elite, to the detriment of those reliant on rice for their livelihood or daily sustenance. In addition, international price volatility can be expected to persist, since the policies (e.g., trade restrictions) that

benefit the political and economic elite are precisely those that contribute to international price volatility. Furthermore, because food security depends critically on price volatility (Timmer, 2012), concerns over adequate caloric intake for those with the lowest incomes will persist and be difficult to address.

Vietnam, of course, is not the only player in the international rice market. A subject for future research is to apply the political economy framework developed in this paper to other countries such as India (a major exporter) or the Philippines (a major importer). Of particular interest will be how the interaction of political economy considerations in a number of countries affects the policies that are pursued, the volatility of world prices and the nature of food security around the globe.

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