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Options for reform of the National Food Authority

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When the National Food Authority (NFA) was established in the early 1970s, both domestic and international rice markets were underdeveloped and highly distorted. Since then, the market has dramatically improved as a responsive food distribution system, although risks to food security remain.

With this development, the relevance of the mandate of NFA as a regulatory agency is now questionable. NFA-induced distortions—mainly in international rice trade—have prevented the private sector from maintaining sufficient inventory to head off price spikes. The sooner the distortions are removed, the better for stability of rice prices.

This *Policy Note* recommends transforming NFA into a pure buffer stocking agency with no regulatory mandate over the rice market.

Developments in the domestic market

Policy interventions in the Philippine rice market have a long history; past interventions were usually provoked by adverse shocks and the resulting political pressure. From the beginning of the Philippine Commonwealth, the reality of rice as a "political crop" has confronted the government (Doepers 2016). A rash of bad harvests in 1935–1936 were followed by reports of hoarding on speculation of rising prices and widespread protests. President Manuel Quezon was convinced that the population was vulnerable to the machinations of mostly Chinese rice traders, and that a government marketing entity was necessary to wrest control of rice distribution from alien hands. A National Rice Commission was established, and eventually a National Rice and Corn Corporation (NARIC), which commenced operation in 1936.

The NARIC aimed to assure consumers that rice would remain affordable, while guaranteeing a reasonable return to domestic rice farmers. Its rice importation was exempted from customs duties and sales taxes. Aside from stockpiling rice by importation and domestic procurement, it also tried to impose a retail price ceiling. Subsequently, numerous reports of black marketeering surfaced. Due to lack of funds, the participation of NARIC in rice market became limited, procuring less than 1 percent of the harvest in 1941.

The domestic rice market began from one that was characterized by few dominant traders to a diverse and private sector-led distribution system. Domestic rice trading in the 1920s and 1930s was characterized by several dominant traders under a vertically integrated system. Many Chinese-owned mills in Nueva Ecija (concentrated in Cabanatuan) were controlled by Chinese rice wholesalers based in Manila (Chiba 2010).

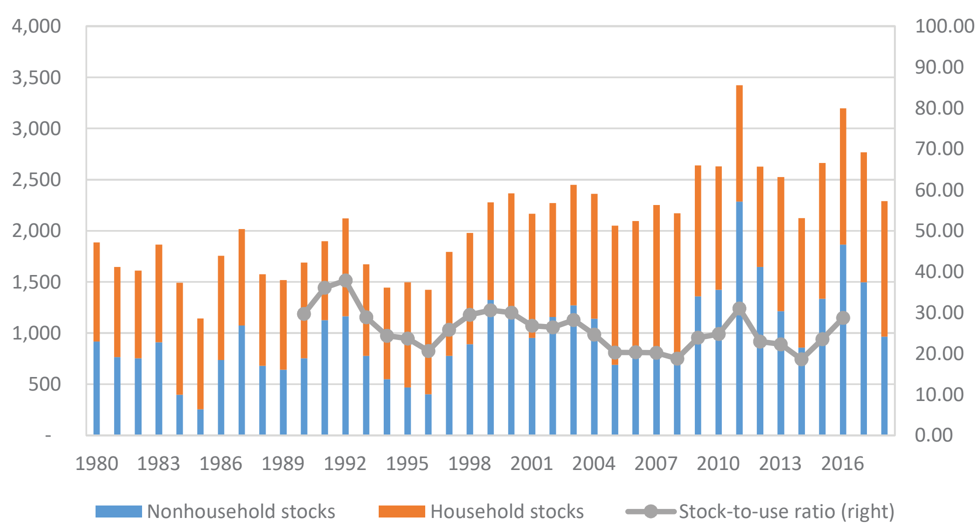
In the 1950s–1960s, the NARIC morphed into a Rice and Corn Administration, which distributed subsidized rice, while a separate Rice and Corn Board regulated rice and corn retail trade (NFA 2018). The next wave of policy intervention was in the early 1970s as a response to poor harvests and the great Central Luzon floods. Simultaneously, the international rice market was in the grip of a food crisis. The National Grains Authority, later renamed the National Food Authority, was established in 1972.

Over the postwar period, private sector assets and capacity gradually expanded (Figure 1). Official data differentiate commercial stocks, NFA stocks, and household stocks (PSA 2018). The sum of the first two are called "market stocks" as these are intended for sale in the market.

Utilization data began in 1990, hence a stock-to-utilization (STU) ratio became available from that year until 2016. Total stocks have been on an erratic but discernibly upward trend, in line with rising food consumption. STU has been fairly stable, varying within a 20–30 percent band, except for a period of four years, when it exceeded 30 percent.

Majority of stocks were in the hands of households. Among the market stocks, NFA intially held the dominant share (Figure 2), accounting for nearly four-fifths of market stocks in 1980. However, the 1980s financial crisis led to deep fiscal contraction, causing the share of NFA in market stocks to fall sharply. Continuing fiscal difficulties kept NFA stock share to just one-fifth by 1990. Private sector stocks rapidly to adapt to its expanded role in the rice market. While NFA stocks rose to significant levels in 2000s owing to its aggressive importation during that

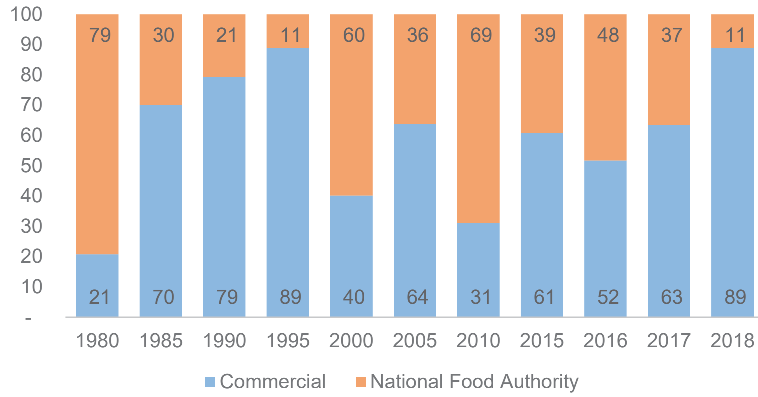
Figure 1. Beginning rice stocks ('000 MT) and stocks-to-use ratio (%), 1980–2018



MT = metric ton
Source: Philippine Statistics Authority [PSA] (2018)

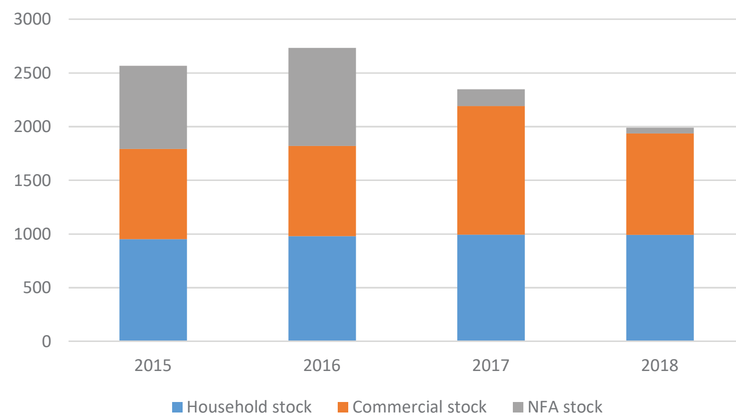
period, the private sector share has become dominant again in recent years, approaching a 90-percent share by January 2018.

Figure 2. Shares (%) of the National Food Authority and commercial stocks in beginning market stocks, 1980–2018



Source: PSA (2018)

Figure 3. Monthly rice inventories as of August, 2015–2018, by category of stockholder ('000 MT)



MT = metric ton
Source: PSA (2018)

The dominance of ethnic Chinese traders also appeared to have diminished, as the private sector participation in the domestic rice trade burgeoned over the intervening decades. Currently, thousands of millers, wholesalers, and retailers, dispersed throughout the country, are all actively competing for *palay* at the farm gate level and for buyers at the milling, wholesale, and retail end. It is only in the business of rice importation where the NFA maintains its dominance owing to its charter monopoly (Briones and de la Pena 2015).

In the past few months, the lack of NFA stocks has been associated with round of rice price spikes. Note, however, that low inventories are afflicting not only NFA but also the private sector, although the latter's drawdown is not as sharp as that of the NFA (Figure 3).

By August 2018, the nation's rice stocks were down to 1.99 million metric tons (MT), from 2.57 million MT three years earlier. True, a large contributor to the decline is the depletion of NFA stocks, owing to continued releases and failure to replenish stocks. In turn, the failure to replenish is attributed to high market price for palay, dwarfing the NFA "support" price, as well as lack of import arrivals.

However, the import restrictions have affected not only NFA but also private importers. Hence, commercial stocks fell to 0.95 million MT, from 1.45 million MT the year earlier, even though households maintained the same level of inventory. Had private import decisions been liberalized, commercial stocks would have been higher and more strategically located to head off severe price spikes.

Developments in the international market

Aside from the domestic rice market, the international rice market has also been transformed (Dawe et al. 2001). In the 1950s, Myanmar and Thailand dominated world rice trade, with other players being Cambodia and South Viet Nam. For the largest exporters, the world market commanded an enormous share of domestic rice production, while export taxes made huge contributions to government funds. This changed dramatically in the 1960s, when domestic markets became paramount for governments of the traditional exporters. In Myanmar, the 1962 military regime severely restricted rice exports. Cambodia exports also declined, while South Viet Nam outright banned exports of rice in 1965. Even Thailand began to apply stronger controls, i.e., higher export taxes, not to draw in more revenues—as the share of export taxes to revenues had declined to just 1 percent in 1971—but rather to protect consumers from vagaries of the world price. Restrictions intensified in the 1970s, with the global shocks induced by an El Niño episode (1972–1973) followed by La Niña (1973–1974, 1975–1976). Cambodia, South Viet Nam, and Myanmar basically exited the world market. Even Thailand banned rice exports for several months in 1973. During this crisis, importing countries literally could not find rice to import. "[The] experience of this period continues to shape policies and attitudes in the region to this present day" (Dawe et al. 2001, p. 365).

From its peak of distortion in the early 1970s, the world rice market began to ease up in the ensuing decades. By mid-1990s, the share of global output internationally traded exceeded 5 percent, and averaged 6.1 percent in 1994–2001. This contrasts with the narrow band of 3.5 to 5 percent of output traded in the previous years. In this decade, Viet Nam reentered world markets, while India emerged as a major player. Meanwhile, Thailand abolished the export tax and adopted free trade in rice exportation. By late 1990s, rice prices continued with a noticeable downward trend. Dawe et al. (2001) predicted that prices would continue to be stable in the medium term, though they make no long-term prognosis.

Such caution was wise, as another food crisis erupted in 2007. While the long-term prognosis is continuing expansion in global supplies, intermittent bouts of extreme world price volatility cannot be ruled out (Sharma 2014).

Mandate and relevance of NFA

Based on the NFA charter, the powers of NFA provide for a command-and-control approach rather than market-based approach. The government adopts the role of importer and seller of rice, as well as buyer of palay. The NFA has the sole right to determine quotas for both its own and for private sector importation. The government also regulates the activities of private players in the rice value chain.

While this regime seemed appropriate when NFA was founded, it now appears anachronistic under current conditions, when the private sector and international market are well-developed. NFA operations have been the object of strong and persistent criticisms (Briones and de la Pena 2015).

- NFA rice distribution accounts for 10 percent of rice consumption. However, the agency procures less than 1 percent of palay harvest on average. Rice distribution is mostly dependent on imported stocks.
- NFA releases into the retail market have failed to reduce domestic prices or even align them with world prices. Since the 1990s, world prices have trended downward, but this has not been communicated to domestic prices. In January 2018, domestic wholesale was 66 percent higher than comparable world price at the border.
- Failure of convergence is due to quantitative restrictions (QRs) in rice importation. However, imposition of QRs violates the World Trade Organization (WTO) Agreement on Agriculture to which the Philippines acceded in 1995. The country negotiated an exception for rice up to 2005, and renewed to 2012 and finally to 2017. Since then, the country has technically been in breach of its treaty obligation.

- Large amounts of subsidized rice are diverted to the commercial sector. In 2006, Mehta and Jha (2008) estimated that about half of NFA rice was diverted and sold at market price.
- The cost of distributing rice for the poor is also high. For instance, the cost of transferring PHP 1 of subsidy is PHP 2.2, of which a significant portion goes to the nonpoor. Jha and Mehta (2008) found that about half (48%) of NFA recipients were nonpoor and as much as 75 percent of the poor did not receive NFA rice.
- The government incurred several financial loss as a result of NFA operations. The systemic reason for this is its mandate of selling at below-market price, maintenance of large inventories for buffer stocking, even as imports are restricted, and the procurement of domestic palay at an above-market support price. By end-2017, its negative net worth weighed down public indebtedness to the tune of PHP 152.2 billion.

Both executive and legislative branches have agreed to achieve compliance with WTO by amending the Agricultural Tariffication Act of 1995 (NEDA 2017). The House has already passed its version of the amendment as House Bill 7735, while the Senate has yet to pass Senate Bill 1998, the version endorsed by the Committee on Agriculture and Food.

Given the recent developments in the international rice markets, the relevance of the mandate of National Food Authority (NFA) as a regulatory agency is now questionable. NFA-induced distortions have prevented the private sector from maintaining sufficient inventory to head off price spikes. The sooner the distortions are removed, the better for stability of rice prices. (Photo by Shubert Ciencia/Flickr)

Options for NFA reform

Status quo

Under the status quo, NFA maintains its import monopoly and licensing powers while officially abandoning QRs. While this is technically permitted even under tariffication, the involvement of state trading enterprises (STEs) in trade falls under a stringent set of international trading rules (WTO 2018) to ensure that STE trade is not used to circumvent WTO obligations. Retaining the licensing power of NFA, as provided in the House version, is likewise problematic, as NFA tends to implement import licensing as a nontariff barrier. Hence, the status quo is deemed an untenable option after tariffication.

Decoupling with government-owned stocks

Under this option, the mandate of NFA to regulate imports is repealed. Nonetheless, it maintains its status as STE with mandate to maintain its food security stocks. NFA only participates in the market as part of its buffer stocking function; the function of regulating rice trade is assigned to other government agencies.

Decoupling with goverment-controlled stocks

Under this option, the private sector owns stocks but is contracted to sell them to NFA in the event of emergency at market price (OECD 2017), thereby realizing greater efficiencies from private sector management. For instance, the Sugar Regulatory Administration maintains a mandatory warehouse receipt or quedan system, under which it can impose a policy of minimum reserve of sugar on rice traders and millers.

Note that the third option assumes the presence of a strong private sector with vigorous competition among diverse players. This assumption may not hold during episodes of supply scarcity when the large traders can manipulate the market price. Hence, the Philippine Competition Commission must consistently enforce fair competition in the rice market. In the long run, the ideal setup is reliance on the private sector in all provinces. Transitioning to this involves a wider private sector development thrust, aimed at, *inter alia*, setting up of mandatory rice grades and standards, establishment of a warehouse receipt system (Briones and Tolin 2016), and upgrading of the value chain.

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