# Bold Inclusive Reforms for Agribusiness for the Next Decade

In early 2016, the American Chamber of Commerce with the Joint Foreign Chambers of Commerce of the Philippines (JFC) organized a roundtable of industry participants to review the state of the agriculture sector and offer bold solutions to guide its resurgence over the next decade. In addition, JFC members meet regularly with officials from the Government of the Philippines and the Department of Agriculture (DA) to discuss mutual areas of interest and public-private collaboration. Informed by these discussions, this agriculture brief reviews past performance of the sector since *Arangkada* launched in 2010; identifies remaining challenges; and outlines specific proposals to boost its economic prospects as a meaningful contributor of inclusive growth.

## Sectoral Overview

Dominated by services (almost 60% of GDP in 2014), the Philippines has, over the decades, gradually moved away from an agrarian-based economy. The broad agriculture sector currently accounts for a little over 10% of GDP. Recent data reveals that agricultural output remained flat in 2015, nudging 0.11% (from PHP 788 billion in 2014 to PHP 789 billion last year). Over the past six years (2010-2015), the agriculture sector grew by an average of 1.3%, well below the average 6.2% growth rate of the broader economy. While the Philippines can no longer claim to be an agrarian society, the agriculture sector still plays an important part in the economy, particularly for rural households who depend largely on exploiting the land for their livelihood. Upwards of 73% of the country's poor resides in rural areas, where agriculture provides an economic lifeline and remains crucial to achieving inclusive growth. Among the poorest in the country, farmers and fisherfolk face the highest incidence of poverty (an estimated 38%), which has shown no significant change in over a decade. While the agriculture sector accounted for a small portion of GDP, its significance derives from employment, characterized as mostly informal, low-wage, and low-skilled. Close to one-third of the workforce (12 million out of 38 million in 2013) relies on agriculture for its livelihood. Yet, the sector's contribution to employment has declined in recent years. If the Philippines is to achieve broad-based and inclusive growth, a sense of urgency is needed to unleash, modernize, and diversify the business of agricultural and food production.

## Issues and Analysis

By many accounts, the country has not fully exploited its comparative advantage in agriculture, especially in the breadbasket of Mindanao. Beginning with high input costs during production, agribusinesses in the Philippines must also contend with a supply chain that progressively erodes the sector's competitiveness en route to consumer markets. Along this supply chain, a staggering 20-50% of fresh produce is estimated to be lost in transit from the farm to consumers. By comparison, post-harvest losses amount to an estimated 6% in Thailand. By the time agricultural products reach markets, transaction costs have escalated, rendering many agribusinesses susceptible to external shocks, at best, and uncompetitive at worst. As evidenced by growing markups from farmgate to retail prices for key crops (such as rice, corn, bananas, and mangos), constraints with logistics and supply chain compound already challenging production issues of quality and efficiency. Eventually, consumers pay the price. In comparison to regional peers, the Philippines spends the highest share of total consumption on food.

Formidable challenges and constraints along the supply chain continue to hamper the sector's full potential, including: the high and variable cost of production inputs; lack of mechanization to improve productivity; limited access to finance to scale up operations; inadequate provision of infrastructure, particularly in irrigation; and inefficient logistics and limited connectivity exacerbating post harvest losses. Compounding these issues, natural disasters continue to wreck havoc on this tenuous and vulnerable farm-to-market supply chain; flawed policies reinforce disincentives to invest in the sector; and weak/fragmented institutions limit the effectiveness of local extension services and agricultural support offices. As a result, agriculture exports (with few exceptions) remain broadly uncompetitive in the world market. Issues related to productivity, efficiency, quality, and price all compound the agribusiness investment climate.

## Business Recommendations

A multitude of complex challenges confront the agribusiness sector in the Philippines, with no easy solutions. Costs and benefits, as well as the political economy of reforms, weigh heavily into public policy considerations. And reform measures are being adopted, if not as consistently or rapidly as the JFC would deem meaningful to have impact on an anemic agricultural sector. As part of the broader *Arangkada* advocacy agenda, the JFC seeks to contribute to this reform dialogue by highlighting measures the could contribute appreciably to accelerating growth in agribusiness and other priority sectors first outlined in 2010. The following recommendations, while not exhaustive, point to sensible ideas that merit public policy considerations in the coming decade.

***Market Access.*** New free trade agreements (FTAs), including the ASEAN Economic Community, and other preferential trade privileges provide unprecedented market access, if Filipino agribusinesses can successfully compete in a more liberalized environment. Promising opportunities for agricultural exports are on the horizon, but Philippine food exports remain at modest levels. Their share in ASEAN has even declined, thus raising the need for clearer government policy/strategy to maximize FTA utilization. Moves to harmonize sanitary and phytosanitary (SPS) standards and reduce pervasive non-tariff barriers (NTBs) and non-tariff measures (NTMs) have started, but more work is required. To take advantage of new market opportunities, measures are needed to improve market information, technology transfer, marketing, export promotion, and broader trade facilitation measures. In light of the Supreme Court's misapplication of the Writ of Kalikasan, the country must double down and boost agriculture research and development, which accounts for a paltry 0.1% of GDP. In other countries, this figure exceeds 1%. Priority should be given to high value export winner crops, such as avocado, banana, cacao, coffee, mango, marine products, mongo beans, peanuts, pineapple, red hot chili, squash, and tobacco. Current and further expansion of high-value added crops like coconut and palm oil must be encouraged by the GPH to maximize the potential of non-traditional exports. Moreover, efforts are need to accelerate the identification of emerging comparative advantages as well. With more liberalized trade, the impact on local producers requires more analysis on those best positioned to take advantage of market access and others displaced by economic disruption. In addition, efforts to promote a level playing field need to look beyond tariff barriers and focus on discriminatory ways in which trading partners may distort market access for Filipino exports. As such, the GPH should do more to encourage ASEAN and other trading partners to develop common rules for their agricultural markets and reduce the various incarnations of NTBs/NTMs.

***Access to Finance.*** The agribusiness sector boasts a small pool of bankable projects, mostly concentrated with the larger commercial farm owners in possession of traditional collateral, secure property rights, and financial track records. Hampering investments, access to credit poses a daunting challenge for the sector. Many agribusinesses are small and financially weak, requiring business development support, collateral substitutes, and other credit enhancements to improve their risk profile. Given these longstanding challenges and ingrained market failures, fresh proposals by both public and private sectors are needed to unleash capital for agricultural development.

To expand agricultural credit, the GPH has resorted to a mandated lending policy with the Agri-Agra law, which requires banks to set aside 25% of their loan portfolio to the farm sector (Agri: 15% to agribusinesses and Agra: 10% to agrarian reform beneficiaries). To date, the law has produced mixed results in expanding agricultural lending, depending on the Agri-Agra threshold and type of financial institution. While admirable in its goal, the mandate fails to address core issues and risk premium that render much of the sector unattractive from a lending standpoint, particularly for beneficiaries of agrarian reform. By interfering with bank efforts to allocate capital efficiently, Agri-Agra and other mandated lending policies risk weakening the broader financial sector. Rather than mandating loan quotas, government effort should focus more on ways to reduce risks inherent to the agricultural sector (e.g., provision of basic infrastructure, appropriate technology, and improved market information). Government financial institutions can also play a much larger role. In 2013, the charter for the LandBank of the Philippines (LBP) was renewed. However, its amendments lacked provisions to strengthen the bank's mandate of providing financing for the agricultural sector and related support activities. Re-focusing of LBP's scope of business from universal banking activities to supporting the agricultural sector should be considered. In this vein, market participants continue to explore financial instruments to make farmers more bankable and competitive. Of particular resonance, the JFC recommends a more comprehensive approach to crop insurance, which can help mitigate the numerous environmental risks (e.g., typhoons, droughts) that many smallholder farmers face on a perennial basis. Crop insurance continues piecemeal (e.g. Philippine Crop Insurance Corporation, microinsurance schemes, reinsurance). Yet, to de-risk the agricultural sector, the Philippines requires a bold initiative for crop insurance (on par with the success of the Conditional Cash Transfer program) that reaches a large swath of an under-served market segment. Resources are needed to develop a comprehensive approach and capitalize such an initiative, as well as agricultural data to assess and apportion risk adequately (i.e., land, soil, weather patterns).

***Freeing up the Land Market.*** In another significant area of market distortions, the property rights regime contains major deficiencies and greatly undermines the investment climate. The business of agricultural production relies heavily on exploiting and developing land for human needs. Indicative of inefficiencies in the land market, a staggering 11 million parcels of untitled properties litter a country of 24 million parcels. Land use planning, zoning, and overall management are weak, undermining property development and associated tax collection vital to public investments. After six decades, the country's land reform remains incomplete, creating uncertainties for agribusinesses, limiting collateralized lending in finance, and discouraging investments in agricultural production. The controversial Comprehensive Agrarian Reform Program Extension with Reforms (CARPER) law expired on June 30, 2014. In its wake, significant uncertainties around property rights linger – much to the dismay of smallholder beneficiaries in waiting and distress of large landholders subject to land redistribution. Land redistribution has created a new class of landed poor, who lack the resources, access to finance, post-harvest facilities, market information, and associated support services to cultivate the productive benefits of newly acquired land.

Strong measures are needed to unshackle the land market in the Philippines. Currently under legislative review, CARPER law amendments and the Farm Land as Collateral bill provide opportunities to correct some of the market distortions created by agrarian reforms. Limits on landholding and its consolidation should be lifted, along with restrictions on selling or mortgaging newly redistributed land. Also yet to materialize, the Land Use Policy and the Land Administration and Reform Act could help address core issues in agribusiness. To improve productivity and create economies of scale, efforts should be made to integrate small farmers into larger enterprises. Here, case studies by the JFC point to successful examples of integrating small farms into larger agribusiness enterprises. SMC's Cassava Assembler Program; Thailand's Charoen Pokphand Foods in the Visayas; Universal Leaf in Northern Luzon; Nestlé's relationship with small coffee growers; and Unifrutti and La Frutera's model of development in the conflict areas of Mindanao all suggest the possibility of large agribusiness ventures harnessing many small farmers successfully. More such efforts need to be encouraged and appropriately incentivized.

***Infrastructure Investments.*** As the JFC emphasizes in the *Arangkada* report, long-standing farm infrastructure requires on-going investment to allow more local value-added for agribusinesses. These priorities areas include: farm-to-market roads, post-harvest processing facilities, irrigation, SPS inspection facilities, food terminals, cold storage, and food processing factories. The lack of post-harvest facilities cries out for more private sector investment, as part of efforts to manage overall supply chains. Farm-to-market roads provide much needed linkages. Yet, only 3.5% of barangay roads are paved. Of particular concern, the Philippines faces a large gap in irrigation infrastructure. Only 1.7 million hectares (some 57% of the 3.0 million hectares of total irrigable area) of the country's agriculture lands receive irrigation. Coupled with this year's El Niño effects, the deteriorating public irrigation system has compounded land degradation resulting in less productive agricultural lands. Large scale investments are needed to rehabilitate, modernize, and restructure the country's large surface irrigation schemes, so as to improve their productivity and efficiency in water usages.

***Rationalization of Extension Services.*** With low productivity, the business of agricultural production would benefit from adopting new and innovative technologies. Even with advances in R&D, the latest research and information on improved agricultural practices (including intercropping) have not reached farmers sufficiently. As such, agricultural extension services provide a vital link in the mass diffusion of agricultural research, transfer of appropriate knowledge, and sharing of best practices. However, the structure of extension services requires rationalization in the Philippines. Initiatives to publish and disseminate information on best practices have produced mixed results in efforts to instill more innovative and modern farming practices. Consequently, farmers have moved slowly and reluctantly to adopt new technologies. Devolved to municipal governments (through the Local Government Code (LGC), agriculture extension services in the Philippines appear weak, limited, and fragmented – reflecting technical and financial constraints at the local level. Overall quality of agriculture extension services, as many now concede, has gradually eroded since the LGC came into effect in 1991. In the face of agrarian reform, a responsive system of extension services has become even more vital to ensuring that new smallholder farmers are not left to fend for themselves. Barring a complete recentralization of extension services, the DA has a larger and more strategic role to play, especially in communicating a clearer roadmap for agriculture. The Philippines claims an astounding 1,891 publicly funded agencies and municipalities with recognized extension or advisory function and resources. Into this fragmented environment, the DA should ideally reassert its leadership and bring order to this chaos by guiding and coordinating extension units, while also strengthening their links to R&D institutions and think tanks. At the minimum, a broader streamlining of extension services is essential, providing stronger links between R&D and productive changes in farming behavior. The private sector is poised to contribute appreciably where public institutions falter in the provision of otherwise public goods; and innovative extension practices should be appropriately encouraged.

## Conclusion:

### In Search of Food Security

Smallholder farmers form the bulk of the poor and food insecure in the Philippines. At the mercy of changing weather patterns and commodity prices, they typically lack access to technology, information, capital, and markets to deliver food security and lasting agricultural transformation. Bold measures are needed to open up markets, unleash capital, address land reforms, improve infrastructure, and rationalize extension services. In terms of public resources towards these goals, the deployment of even a portion of the coco levy funds to aid coconut farmers would go a long way towards enhancing (credible) extension services, access to credit, investments in much needed farm rehabilitation, and other poverty alleviation measures. Working with policy makers, the JFC remains committed to sustaining the momentum for economic and agricultural reforms now and over the next decade.

## Endnotes

1. Poverty incidence in rural areas (at 37.8%) more than doubles that of urban centers (14.2%). Asian Development Bank, Poverty in the Philippines: Causes, C onstraints, and Opportunities, (Mandaluyong City, Philippines: Asian Development Bank, 2009).
2. According to government statistics, 11.8 million (or 31.0%) of the 38.1 million people were employed in the agricultural sector in 2013, down from 33.0% in 2011. See http://countrystat.bas.gov.ph/ .
3. Gilberto M Lanto, “How Critical is Transport and Logistics Infrastructure to Interregional Trade? The case of high-value fruits and vegetables in Mindanao,” Policy Notes, Philippine Institute of Development Studies, December 2012: 1-8.
4. See World Bank. Philippine Development Report 2013: Creating More and Better Jobs. Philippine Office, East Asia and Pacific Region (Makati, Philippines: World Bank, 2013.pp. 104-5).
5. Growth in agricultural productivity lags behind that of regional peers, as well as other parts of the economy (industry and services). Research points to anemic productivity growth, as measured by TFP (total factor productivity), linked to underinvestment in rural infrastructure, including roads, electrification, and irrigation. See World Bank (2013), p. 94, footnote 104.
6. Many observers in the development field have longed recognized these challenges. Yet, structural reform of agricultural production has been slow to materialize, and the agribusiness sector is less competitive than it could otherwise be. See, for example, Asian Development Bank, Sector Assessment (Summary): Agriculture and Natural Resources, Country Operation Business Plan: Philippines, 2014-2016, (Mandaluyong City, Philippines: Asian Development Bank, 2013); and World Bank (2013).
7. Of the 7.87 million hectares covered by CARP (from 1970 to June 2014), only 5.00 million hectares (or 63.5%) have so far been distributed, according to the GPH.
8. On a good case study of six firms that chose to operate in the conflict areas of Mindanao and reaped the benefits, see Cielito F. Habito, Braving It and Making It: Insights From Successful Investors in Muslim Mindanao (Australian Aid, 2012).
9. Recent data from the Philippines Statistics Authority (http://countrystat.psa.gov.ph/) and Business World, available at http://www.bworldonline.com/content.php?section=Agribusiness&title=adb-investments-in-irrigation-needed-for-asia&8217s-food-security&id=121802. Elsewhere, the World Bank cites a figure of 9.3% (2011) for agricultural irrigated land in the Philippines (data.worldbank.org).