Do farmers in poor and remote upland areas respond to price signals?

Until recently, it was commonly assumed that most upland farmers are motivated only by the goal of meeting their subsistence needs. Their subsistence production decisions are supposedly only indirectly subject to market forces and thereby place them beyond the reach of most economic policies. This belief, if correct, has important implications on the design of programs aimed at economic development or environmental protection. Without market instruments, upland poverty alleviation efforts or programs to address the protection of forests, soils or watersheds must rely on direct interventions by government agencies, development projects or nongovernment organizations (NGOs). Such interventions are at the core of most resource conservation strategies in the Philippines and other tropical countries.

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Asian countries. In this respect, then, upland development and conservation strategies cannot fully address the core problems of their target areas. While pockets of more or less pure subsistence production persist in least accessible regions, road improvements and expanded market and communications infrastructure have brought the majority of upland farmers into close contact with markets. These resulted in a transformed basis of upland agricultural production decisions.

Accumulating evidence indicates that farmers in remote areas increasingly rely on markets for food supply while they specialize in the production of commercial crops. This commercialization increases the spatial and sectoral reach of economic policies. This paper explores land use decisions made by farmers in an upland area in the Philippines. The goal is to quantify responses to economic shocks, thereby providing an understanding of the leverage that policies affecting agricultural prices can be expected to exert in the uplands. A decade-long panel of data on agricultural practices and prices is used.

Markets, policies and land use in the uplands

Until quite recently, high transport costs, missing or imperfect markets for inputs, and extreme poverty typically meant that upland farm production in developing countries consisted mainly of staple food crops. In countries like the Philippines, migration to the agricultural frontier was driven by poverty, and nonfarm labor markets for upland populations were virtually nonexistent. This isolation, however, has greatly diminished in the past generation due in part to links created by migrants and in part to infrastructural improvements. Local and national markets for staples such as rice and corn are now, for the most part, integrated such that local supply shocks are important only for highly perishable crops and only for very short periods (Coxhead, Rola and Kim 2001). These findings form one link in a chain that relates the actions of farmers to a broad set of macroeconomic determinants. The other link, which this paper now explores, is the effect of farm-gate price signals on farmers’ decisions.

Over time, Philippine domestic prices of corn, vegetables, and some other important upland crops have been subjected to import-substitution policies such as tariffs, state trading, and/or outright import bans. These have raised producer prices substantially above world market equivalents (David 2003). Under the terms of its accession to the World Trade Organization (WTO) in 1995, the Philippines “tarrificated” all such restrictions but retained the implied tariff (taking account of low rates applied to ‘minimum access’ import volumes and much higher rates for ‘out-quota’ volumes) at a high level for some crops. This is clearly the case for corn, the crop most widely grown in upland areas: the nominal protective rate for corn has remained high and has even risen since the WTO accession (Figure 1).

Why is it important to quantify the response of upland farmers to policy changes? The hypothesis is that these policies are responsible, at least in part, for the substitution of corn and some vegetables, including perennials such as coffee, for other land uses, producing a shift that has increased deforestation and intensified the mining of upland soils. It follows then that policy changes could also have large environmental impact at a low cost.

Sources: Mendoza and Rosegrant 1995; Silvapulle and Jayasuriya 1994.
cost relative to the usual site-specific approach to sustainable upland development. The goal then is to discover whether prices, which transmit the effects of policy changes, induce significant land use responses when other determinants of behavior are taken into account.

The model
It is assumed that farm households choose land use strategies that are consistent with profit maximization over time based on a per period net farm income. In the short run, they are constrained by the quantity of land they control, the land characteristics (soil quality, climate, distance to market, etc.) and the labor endowment they have, the latter being shown by experience as quite different from generic hired labor because farm households have specific management knowledge of the plots they cultivate.

In any period, the whole land area need not be farmed; some may be fallowed as observed in the data. Farmers cite various reasons for fallowing such as soil fertility and difficulty of obtaining seed, inputs or labor. This paper does not attempt to directly construct a model based on these decisions or on soil quality dynamics. Rather, it simply focuses on the factors that govern the choice of land cultivated to crops.

Assuming profit maximization, land area for each period is fixed but allocable across several crops. The model assumes land allocation to crops to be a function of relative crop prices, wages and other input prices, and a vector of variables whose values are specific to the household or farm, such as family labor endowment, age and experience of the farm operator, distance of the farm from a main road, slope of the land, and so on. The model assumes prices in a given time period to be the same for all producers. Farm decisions are subject to exogenous changes in product and input prices and in exogenous or predetermined factors including farm size, family labor force, and weather. At the intensive margin, farmers adjust labor and input use by crop. Between the intensive and extensive margins, they adjust land allocation among crops. At the extensive margin, they alter the total area of the farm that is cultivated in a given period.

It is expected that total farmed area increases with output prices and declines with input prices. In addition, allocation of land to individual crops should be positively (negatively) related to expected own (cross) price or yield. Higher wages are likely to reduce profitability, which in turn, reduces land demand by crop; the extent of the wage effect should vary across crops depending on the labor intensity of production. Increases in the availability of family labor are likely to increase land demand, especially in management-intensive crops.

In the data set, farmers allocate land mainly to corn and vegetable production. Vegetable crops are considerably more management-intensive than corn since corn production can be expanded by hiring more labor (given land) while that for vegetable production cannot. Conversely, relaxing land constraint (given family labor) should expand corn area but may leave vegetable production unchanged if the household cannot provide matching managerial resources. Land and labor constraints indicate a short-run model. Empirically, if these constraints bind, inferences may be drawn about the incentives for farmers to take steps to relax them, following a shock of a given kind.2

Data
Data come from a group of villages in the Lantapan municipality in the central Bukidnon province in northern Mindanao, Philippines. Lantapan is located in the upper Manupali River valley, a landscape that climbs from river flats to a rolling middle section to high altitude and steeply sloping mountainsides (1100 to 2200 meters). Lantapan’s population increased dramatically over the past 50 years, with an average annual rate of 4.16 percent in 1970-80 and 4.0 percent in 1980-90. It was only in the 1990s that this growth levelled down to the national rate of 2.35 percent (ISPPS data).

Why is it important to quantify the response of upland farmers to policy changes? The hypothesis is that these policies are responsible, at least in part, for the substitution of corn and some vegetables, including perennials such as coffee, for other land uses, producing a shift that has increased deforestation and intensified the mining of upland soils.

2 In later years of the panel, the introduction of large-scale banana plantations in the study site encouraged some farm households to rent out all or part of their lands. Income from this land should be counted as part of household income and the rental decision made explicit in the model. This is a refinement that is addressed in the ongoing research.
Output prices have a clear and unambiguous effect on the demand for agricultural land, even though quantifying environmental effects remains a challenge. Higher prices of land intensive crops such as corn lead to area expansion, while at the same time reducing areas of labor intensive crops such as vegetables.

The total farmed area in the municipality increased faster than population and this expansion has taken place at the expense of primary forest and other perennial crop and agroforestry systems (Coxhead and Buenavista 2001). The main crop grown according to land size allocation is corn. Sugarcane is dominant in the lower watershed while vegetables and coffee dominate in the upper watershed area. Commercial banana plantations established in 1999 have also begun to dominate local land use patterns but this information has minimal importance at this time in the land use data set used in this paper.

A series of farm surveys conducted in the dry seasons of even-numbered years from 1994 through 2002 produced a total of five observations per household. The sample farms are drawn from nine villages in the middle and upper regions of the watershed. The surveys collected information on the household composition, farm production and input use, land use history, sales, nonfarm income, and farmers’ perceptions of erosion and soil degradation as well as their expectations on types of crop to be grown and crop prices in the next cropping season. The original sample size was less than 200 but was later cut down to 80 farms.

Estimation and results
Several crops are grown in the study site but the analysis concentrates only on corn and vegetables whose land area per farm fluctuates from year to year. Vegetable production is highly labor- and fertilizer-intensive relative to corn. The statistical method takes into account two complicating factors.

One, not all farmers grow both crops every year (zero observations on some forms of land use). Two, there are many unobserved differences across farms in upland areas such as Lantapan, some of which may be important influences on land use decisions. A possible third complication is also dealt with—that is, the lack of cross-sectional price variation—by using expected crop revenues in place of prices.

The analysis thus captures farmers’ responses to changes in the expected earnings on crops, regardless of whether those changes come from prices or from yields. Finally, municipal fertilizer prices and barangay-level wage data are used to represent farm input costs. The explanatory variables in the land demand equations are total farm area, expected per hectare corn and vegetable revenues, wages, average slope, distance of the farm from national road, age and years of education of the household head, and number of adults in the family. The revenue and wage variables are normalized by fertilizer price.

Table 1 provides a summary of key variable values and Table 2 shows the key results. These are presented in elasticity form; that is, they show the effect on each type of land use of a one percent change in crop revenues, wages and so on. As the results reveal, the area planted to each crop increases when expected revenues from that crop rise and decreases when expected revenue from the other crop rises. For both corn and vegetables, wage increases have negative effects on area planted, most especially in the labor-intensive vegetable enterprise. Larger family labor endowments are significantly associated with greater area planted for vegetables, where specific management skills are important. This is not true for corn though. For the total area planted, increases in expected revenue cause area to increase, while increases in vegetable revenue reduce it. In addition, increases in wages reduce total area planted.

These estimates robustly complete the chain of causation between national markets and policies and the allocation of land by farmers in the uplands. Output prices have a clear and unambiguous effect on the demand for agricultural land, even though quantifying environmental effects remains a challenge. Higher prices of land intensive crops such as corn lead to area expansion, while at the same time reducing areas of labor intensive crops such as vegetables. Similarly, higher prices of labor intensive crops lead to more intensifica-

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3 For survey methods and instruments, and summaries of findings from individual survey rounds, see Coxhead (1995) and Rola et al. (1995).
4 For other details of estimation methods, data, statistical results and related discussion, see Coxhead and Demeke (2004).
tion while increasing fallow area. Fallowing and reduction in corn area constitute environmental quality improvement while expansion in cultivation of intensive vegetables could lead to environmental deterioration. However, if the difference between the environmental impact of corn and vegetables is small, a rise in vegetable revenue can have an environmental benefit while raising incomes of the poor farmers in the uplands.

It can also be observed that higher wages have a strong negative effect on land demand. Together with family labor on vegetable area expansion, this result indicates that labor market trends can influence the expansion of upland farming in the study site. In the later years, sample data reveal that strong local off-farm job growth in agribusiness and nonfarm employment expansion outside the watershed have been associated with rising farm wages. These trends can now be seen clearly to have slowed— and perhaps helped to reverse— the expansion and intensification of upland farming.

Discussion

The econometric findings corroborate and strengthen those of several earlier studies. These have potentially important implications on understanding the environmental effects of trade and agricultural policies, real wage growth and internal migration, and macroeconomic policies affecting the prices of tradable farm outputs and inputs. These variables may all have direct and significant effects on the total area of upland agriculture, and also on the allocation of upland land by crop. These results, in turn, place importance on the design of policies and projects directed at the development of upland agriculture and the conservation of forest, land and water resources.

WTO compliance requires that the Philippines scales back agricultural tariffs over time; the book value of the corn tariff is supposed to fall to 50 percent by 2005 from its current value of nearly 100 percent (David 2003). This percentage reduction in the tariff will thus reduce domestic prices by 25 percent.

By how much will this change, if implemented, affect upland land use? If the findings from Lantapan are representative of corn-growing areas as a whole, a 25 percent fall in corn price will reduce corn area by 6.5 percent or about 0.065 ha per farm based on the sample data. If the sample is representative of corn farmers elsewhere, the tariff reduction will reduce corn area by about 45,000 ha in Mindanao and 225,000 ha nationally.\(^5\) Total farm area in the uplands could fall by about 2.5

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\(\text{Table 1: Summary statistics of variables} \)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Area of corn (ha)</td>
<td>1.02</td>
<td>1.46</td>
</tr>
<tr>
<td>Area of vegetable (ha)</td>
<td>0.14</td>
<td>0.33</td>
</tr>
<tr>
<td>Total area planted (corn plus vegetable) (ha)</td>
<td>1.16</td>
<td>1.45</td>
</tr>
<tr>
<td>Total farm area (ha)</td>
<td>2.68</td>
<td>2.95</td>
</tr>
<tr>
<td>Relative expected corn revenue (Pesos/ha)</td>
<td>20.00</td>
<td>7.38</td>
</tr>
<tr>
<td>Relative expected vegetable revenue (Pesos/ha)</td>
<td>44.80</td>
<td>30.08</td>
</tr>
<tr>
<td>Relative wage (Pesos/day)</td>
<td>0.17</td>
<td>0.02</td>
</tr>
<tr>
<td>Slope of the land (percent)</td>
<td>16.38</td>
<td>10.70</td>
</tr>
<tr>
<td>Average distance from national road (km)</td>
<td>2.86</td>
<td>3.64</td>
</tr>
<tr>
<td>Years of education of the household head</td>
<td>6.28</td>
<td>3.43</td>
</tr>
<tr>
<td>Number of adults in the household</td>
<td>3.31</td>
<td>1.93</td>
</tr>
<tr>
<td>Age of the household head</td>
<td>44.39</td>
<td>11.79</td>
</tr>
<tr>
<td>Total number of observations</td>
<td>592.00</td>
<td></td>
</tr>
</tbody>
</table>

Source: Coxhead and Demeke (2004)

\(\text{Table 2: Elasticity estimates from random effects, Tobit model}\)*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Corn area</th>
<th>Vegetable area</th>
<th>Total area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm area</td>
<td>0.905</td>
<td>-0.021</td>
<td>0.811</td>
</tr>
<tr>
<td>Corn revenue</td>
<td>0.258</td>
<td>-1.238</td>
<td>0.100</td>
</tr>
<tr>
<td>Vegetable revenue</td>
<td>-0.169</td>
<td>0.422</td>
<td>-0.127</td>
</tr>
<tr>
<td>Barangay average wage</td>
<td>-0.225</td>
<td>-1.733</td>
<td>-0.391</td>
</tr>
<tr>
<td>Slope</td>
<td>-0.212</td>
<td>-0.200</td>
<td>-0.271</td>
</tr>
<tr>
<td>Distance</td>
<td>-0.276</td>
<td>-0.092</td>
<td>0.245</td>
</tr>
<tr>
<td>Educ. of household head</td>
<td>0.029</td>
<td>0.150</td>
<td>0.054</td>
</tr>
<tr>
<td>Family labor force</td>
<td>-0.071</td>
<td>0.257</td>
<td>0.007</td>
</tr>
<tr>
<td>Age of household head</td>
<td>-0.396</td>
<td>-0.538</td>
<td>0.465</td>
</tr>
</tbody>
</table>

* Numbers in each row of the table show the predicted change (per cent) in each land use category due to a 1 percent increase in the value of the relevant variable in Column 1.

Source: Coxhead and Demeke (2004)

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\(\text{\(\text{\(\text{\textsuperscript{5}}\)) Using corn area data reported in Chupungco (2003).} \)\)
For policymakers, the lesson from commercialization in the uplands is that market instruments can (and should) now be incorporated in the upland environmental and development policy toolkit. This is not to assert that other interventions are redundant or counterproductive; however, the mix of instruments now needs to be adjusted and coordinated.

percent. These are rough measures of the extent to which this land-degrading crop is over-planted as a consequence of price and trade policies. If land previously planted to corn is retired into less erosive uses, these changes will substantially reduce deforestation pressures, loss of upland soil productivity, and downstream or offsite damages associated with soil erosion.

The land use effect will be even greater if the WTO and/or autonomous trends in world markets or the Philippine trade policy would result in the continuing growth of nonfarm demand for unskilled and semiskilled labor. Local agribusiness sector booms manifest such a trend; others are seen in the country’s increasing prominence as a supplier of labor-intensive goods such as garments, electrical machinery and components, and services—such as call centers—to world markets.

Expansion of these labor-intensive industries encourages outmigration by members of farm families, both directly for employment, and indirectly for education and training, and applies upward pressure on farm wages. If wages rise by 25 percent—that is, by about half the rise seen in the data over a decade—the elasticities in Table 2 show that corn area could fall by about 5.6 percent per farm or almost 200,000 ha nationwide, and total area farmed in uplands by almost 10 percent. The reduction in agricultural area is comparable in magnitude to that experienced in Thailand during the latter’s economic miracle from 1988 to 1996. These numbers must, of course, be regarded as having large standard errors. But even so, the magnitude provides a clear indication of the potential for national level policy and economic changes to alter the demand for agricultural land in the uplands.

The commercialization of upland agriculture has created a powerful set of policy instruments that can influence the use of scarce natural resources in the Philippines. Policy reforms and economic growth, in general, are likely to have greater, longer-lasting, and more cost-effective impact on the management of the upland resource base than many location-specific sustainable agriculture projects, each of which must be replicated many times in order to reach a large number of farmers.

For policymakers, the lesson from commercialization in the uplands is that market instruments can (and should) now be incorporated in the upland environmental and development policy toolkit. This is not to assert that other interventions are redundant or counterproductive; however, the mix of instruments now needs to be adjusted and coordinated.

References


Proposed RP-US FTA may center on telecom and financial sectors

As the world becomes smaller each day because of globalization, trade and business between or among countries have become more intense worldwide. Hence, products that were before appreciated or acquired only by certain nations are now regular commodities elsewhere around the globe.

New generation of free trade agreements (FTAs) have recently evolved. Aside from trade facilitation and liberalization, diverse agenda and other enhanced features of cooperation have been incorporated in the establishment of FTAs.

As early as the late 1980s, the Philippines shifted its strategy from a protectionist regime to a relatively open economy, participating in three occasions of regional cooperation, the Asia-Pacific Economic Cooperation (APEC) in 1989, the ASEAN Free Trade Area (AFTA) in 1992 and the World Trade Organization in 1995. The rise of Asian bilateralism has only prompted the Philippines to jump into the bandwagon.

To date, the Philippines has begun negotiating or preparing to negotiate FTAs with a number of countries. Within the year or early next year, it hopes to conclude one with Japan. It is also preparing for an FTA with the United States (US).

The question is: how ready is the Philippines for an FTA with the US? And what are the possible inclusions in this agreement that would prove to be beneficial for the Philippines?

In a recent round table discussion sponsored by the Philippine Institute for Development Studies (PIDS) titled “Preparing for services negotiations for the proposed RP-US FTA,” the service industries—specifically the telecommunication and the finance sectors—were tackled as two of the crucial areas where the Philippines can have the best potential if the FTA agreement with the US pushes through.

Why the US and why the services sectors?

The US is the biggest trading partner and source of technology for the Philippines. In developing countries, the services sector is among the fastest-growing industries that have already outpaced other traditional industries.

The telecommuting work

For thousands of Filipinos nowadays, work means reporting to a number of contact centers mostly owned by American companies that have decided to put up their local branches in the Philippines. These foreign firms chose the Philippines primarily because of the strength in English of its population and the relatively low labor cost.

Clearly, the above reason spells out a big advantage for the Philippines in the telecommunication sector, something that may be a plus factor when talks for the RP-US FTA finally commence.

The US is the biggest trading partner and source of technology for the Philippines. In developing countries, the services sector is among the fastest-growing industries that have already outpaced other traditional industries.
However, Virgilio Peña, chairman of the Commission of Information and Communication Technology, says that for the country to be truly successful in its FTA with the US, the Philippines must first address the present digital divide besetting the Philippines. This means providing access to internet connection to 85 million population and, more importantly, making it affordable to all.

As a point of comparison, Peña notes that in Korea, 80 percent of the total population is connected through broadband. He adds that in a few years, the said country is targeting a 100 percent connection, even exceeding Singapore which has an 80 percent internet connection.

In stark contrast to the above figures is the three percent internet connection in the country right now. And these internet connections are not even wholly broadband but mixtures of dial-up, DSL and broadband connection.

Private sector support

Ideally, the connectivity of the more than 41,000 barangays all over the country should be managed and operated by the private sector to give it a revenue-generating component. The private sector taking the lead and the government only in the background would give the industry more capacity for growth and make it attractive to foreign investors. The private sector would then determine the type of technology applicable to the barangays, such as wireless, broadband or satellite, depending on the location and availability of the technology.

Most importantly, these community access points must carry one brand name identical to all barangays in the country. The private sector should also develop the traffic or application and content (or available services) for the community centers to succeed.

Peña cites as example the SMS services offered by cellphone companies and goes on to say that barangay internet centers could offer government services. “There must be e-learning and e-commerce involved in here,” he adds.

In the barangays, an e-government service would allow basic government services to be available in a click to even the farthest region in the Philippines without the need for people to personally go to the local or regional offices. The services would be available within the community centers in the barangays, thereby cutting costs and time for everyone.

Bridging the digital divide

“Aim high and go for it,” Peña says in response to the challenge of attaining a broad distribution of computers and, finally, internet connection for the entire Philippines.

He makes the following projections:

✦ By 2010, all the remaining barangays will be provided with computers; and
✦ By 2015, broadband connections will be available to all barangays in the country.

For the provision of computers to the 45,000 schools in the country—4,000 of which are high schools and the remaining are elementary schools—Peña makes the following projections:

✦ By 2008, all high schools will be computerized, and
✦ By 2010, all grade schools will be computerized.

In order to coordinate all these projections and work to be done, Peña bats for the creation of a specific department for ICT (a bill on this is, in fact, pending in Congress.) He notes that while most countries have created a specific department for their information and communication technology, the Philippines still has only a commission to oversee the work and development of the technology.

At the same time, he emphasizes the importance for the Philippines to develop itself as a worldclass ICT provider in order

Thousands of Filipinos are now employed as call center agents servicing outsourced jobs from foreign firms.

http://www.teledevelopment.com/ph
to take advantage, among others, of the many outsourcing jobs available. Peña adds that they are projecting 100,000 jobs in the next six years from contact centers, animation services and software services requiring the skills of Filipinos.

Telecommunication concerns

Undoubtedly, the US is the largest source of outsource market for the Philippines. Although there may be issues in some sectors in the US which frown upon outsourcing because it keeps the jobs out from the Americans, according to Rainerio Borja, chairman of the contact center association of the Philippines, it would be very hard to take off the outsourcing job from the other countries, which includes the Philippines, because it would mean taking away all the perks and cheaper prices the American people are currently experiencing. The American people will be in the losing end and would stand to suffer in return.

Borja also urges the Philippine government to fully support the development of the human resources needed through trainings and education. As it is, there are more demands than qualified people for the increasing numbers of contact centers in the country.

"We have participated in conventions abroad and have intensely promoted the country. Many are indeed interested but the problem now is that the talent pool is shallow," he said.

An even primary concern in the industry is the data security and privacy, not only of the individual but the companies as well. The weakness of the country in the aspect of Intellectual Property Rights is a serious issue that should be given immediate and solid action by the government.

Borja adds that they would appreciate the government crafting a law in the near future regarding the matter of data security. In the meantime, however, the private associations tackle the problems as they come. Moreover, the different contact centers practice self-regulation and implement strict and heavy internal audit among their companies. In short, they police themselves.

Constitutional issues in ownership and procurement provisions are again another area of contention in the Philippines. These areas need to be addressed immediately for the outsource opportunities to be truly successful in the Philippines. Since foreign companies are investing huge amounts of money in the business, they tend to want control of the whole establishment. However, Philippine laws still allow only 60 percent ownership for foreign entities, with Filipinos holding the top positions.

Concerns and prospects in the financial services sector

Millions of Filipinos have found work outside of the country and their remittances have undeniably put the country’s economy afloat. Dubbed the Bagong Bayani, overseas Filipino workers (OFWs) regularly send their hard-earned money to their loved ones back home. Aside from the traditional bank transactions, remittances are now being sent through money orders found almost everywhere in the world, and just very recently, also through cellphones.

There are indeed huge potentials existing for banks in the country to come up with new services and products that would handle the increasing demand for remittance transactions of our OFWs in the coming years. However, since the start of the financial services liberalization a few years ago, bank services including those for remittances, have been aggressively contested by foreign banks in the country. There are also a number of money order companies doing said business.

In the last 11 years, a number of major financial reforms have taken place in the country to
make it more responsive and adaptable to the changing times. In 1993, the Bangko Sentral ng Pilipinas (BSP) Charter created an independent central monetary authority and shortly a year after, under Republic Act 7721, restrictions on the entry of foreign banks were lifted.

Under RA 8366 enacted in 1997, foreign equity investment in investment houses was also liberalized while RA 8556 enacted in 1999 liberalized foreign equity investment in financing companies. Following a year after in 2000, the Securities Regulation Code (SRC) was enacted and in the same year, banking laws were attuned with global developments.

The Anti-Money Laundering Law was likewise enacted in 2001 and in 2002, the Special Purpose Vehicles Act (SPVA) was established. There were also structural improvements and better prudential regulation that were set for the local banks in the country. A shift from consolidated and risk-based supervision and improved corporate governance and disclosure were also imposed on the local banking sectors.

After the financial liberalization, a number of foreign banks have operated their local branches in the Philippines. This, in turn, has contributed positively to the local financial sector, in terms of, among others, the enhancement of banking products, introduction of new technologies, increase in competition, extension of loans, facilitation of foreign investments and provision of employment in the country.

Just like the telecommunication industry, the financial sector, according to Diwa Guinigundo, assistant governor in charge of research at the BSP, is another area which may be included in a possible FTA with the US.

Guinigundo, however, noted that the Philippines should be prepared when it enters into negotiation on an FTA, whether with the US or any other country. Is the country prepared to undertake binding commitments in an FTA, he asked.

While unilateral liberalization efforts in the banking system may allow the BSP to engage in discussions on FTAs, the FTA, he said, should provide authorities with the flexibility to undertake such commitments.

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**Regulations affecting financial services**

**A. Regulations Governing Commercial Presence**

**Limits on entry of Foreign Banks (RA Nos. 8791 and 7721)**
- Investment is permitted up to 100% of the voting stock of only 1 existing domestic bank within 7 years of the effectivity of the General Banking Law and subject to the provisions of R.A. No. 7721 liberalizing entry of foreign banks
- Acquisition is allowed up to 60% of the voting stock of a new banking subsidiary incorporated under Philippine laws
- Foreign bank branches with full banking authority may open 6 additional branches in the Philippines
- Must be ranked among top 150 banks in the world; and
- Control of 70% of the resources of the Philippine banking system should at all times be held by banks that are majority-owned by Filipinos

**Limits on Entry of Foreign Insurance Companies**
(DoF Department Order No. 100-94)
- Acceptable companies must be among top 200 in the world or top 10 in the country of origin and must have been in existence for at least 10 years and widely–owned or publicly–listed

**Limits on entry of other financial institutions**
(RA Nos. 8366 and 8556 and PD No. 114)
- Equity participation in other financial institutions are subject to different foreign ownership restrictions:

  **Financial institutions**
  - Investment house – 60 %
  - Financing company – 60 %
  - Pawnshop
    - single proprietorship – Limited to Filipinos only
    - partnership/corporation - 30% only
  - Lending Investor
    - single proprietorship – limited to Filipinos only
    - partnership and cooperation – 40 %

**B. Restrictions to trade in financial services**

**Requirements for securities holdings (RA no. 8799)**
- entities proposing to issue bonds must:
  - file registration statement with SEC
  - obtain credit rating on issue from reputable rating agency
- underwriters of securities must seek pre-approval of underwriting agreements
A number of safety provisions included in the GATS can also be included in the FTA framework, he added, such as:

✦ Liberalization terms must be a mutually advantageous process;
✦ National policy objective and the level of development of the country must be protected;
✦ Authorities shall not be prevented from ensuring the integrity and stability of the financial system and external accounts;
✦ Greater market access should be given to sectors and modes of supply of export interest to developing countries; and
✦ Technical cooperation and assistance should be in place.

How about an FTA specifically with the US? What can we expect from it?

Undeniably, the expansion in trade will promote growth and development. At the same time, however, Guinigundo cautioned that rapid liberalization can, in a way, create instability in the financial system, if it is not rendered strong and prepared accordingly, that would result in the undermining of the effectiveness of the monetary policy.

That is why it is important to weigh carefully both the benefits and risks of further opening up the country’s financial services sector in crafting an FTA between the Philippines and the US.

Guinigundo cited some of the benefits in the advent of an FTA between the US and the Philippines, to wit:

✦ Funds and expertise to purchase and manage/dispose Nonperforming Assets (NPAs) would be made available;
✦ Pressure will be put on authorities to improve supervisory oversight; and
✦ Customers would be given better and wider range of products and services.

On the other hand, he also cited some of the risks:

✦ Threat of systematic risks is present if foreign financial service providers are not monitored and supervised appropriately, and
✦ Competition could result in decline in profits and lead to financial distress in domestic financial service providers.

To be sure, Guinigundo asserts that with or without an FTA, efforts should be sustained by the Philippine banking officials to ensure the continuous soundness of the Philippine banking system. After all, even without the prospect of an FTA negotiation, the Philippines has to address all the pending problems that still hound the country’s financial sector. For one, the country has a high level of nonperforming loans (NPLs). There is also an inadequate legal and regulatory framework for bank supervision and a poor capital market development.

Guinigundo said that in addressing the problems, the country should implement the SPVA, work for the further development of the capital market and work on the amendment of the charter of the BSP.

The BSP, of course, has already implemented a number of initiatives in support of the strengthening of the Philippine financial sector. It has launched the Philippine Payment System (PhilPASS), supported the establishment of a fixed income exchange and proposed the creation of a credit information bureau.

There are also a number of proposed legislations in support of the financial sector which must seriously be considered:

✦ Credit reporting bill,
✦ Revised investment company act,
✦ Preneed code,
✦ Corporate recovery act, and
✦ Personal equity retirement account (PERA) Bill.

Finally, Guinigundo reiterated that in order for an FTA, especially one with the US, to be fruitful for the country, much preparation needs to be done for it is one crucial economic decision that the country will make and it has to be ready for it. DRN
Better-managed watersheds result in adequate and quality water supply for all.

This, in essence, is the message culled from a series of fora titled The realities of watershed management approach in the Philippines® which stressed the importance of having a clear understanding of the connection between promoting the protection and rehabilitation of our water resources like the watersheds and ensuring the supply of abundant, safe and quality water. The fora also delved on the elements of water management and people participation.

Presented during the three regional fora held in Los Baños, Iloilo and Davao were the assessments of four case studies relating to watershed management on the Balian, Pangil subwatershed in Laguna; the Magat watershed in Nueva Vizcaya; the Maasin watershed in Iloilo; and the Manupali watershed in Bukidnon.

Participants in the three fora included representatives from various agencies and sectors such as local water districts, academic and research institutions, nongovernment and people’s organizations, government regional offices (Department of Environment and Natural Resources, National Power Corporation, Department of Interior and Local Government, and Department of Agriculture), business clubs, local government units, cooperatives, civic organizations, religious-affiliated groups and media.

Specific organizations directly connected to watershed management in the localities of the case studies also participated in the fora. These included the Iloilo Watershed Management Council (IWMC), the Protected Area Management Board (PAMB), Kahublagan Sang Panimalay Foundation, Inc. (KSPFI), the Davao City Water District (DCWD) and the Watershed Management Coordinating Council of Davao.

The Philippine Institute for Development Studies (PIDS) was the major organizer of the first forum in Los Baños, Laguna in May 2004, with the Philippine Council for Agriculture, Forestry and Natural Resources Research and Development (PCARRD) and the Institute of Strategic Planning and Policy Studies (ISPPS) of the University of the Philippines (UP) Los Baños as cosponsors and facilitators. The succeeding forum in Iloilo, meanwhile, was spearheaded by the Philippine Watershed Management Council (PWMC) in partnership with the National Economic and Development Authority (NEDA) Region VI office, the KSPFI and PIDS. The Davao forum, which drew the biggest number of participants, on the other hand, was organized by DCWD, the PWMC and the Watershed Management Coordinating Council of Davao, a multisectoral body in Davao tasked to look into the protection and management of the province’s watershed resources.

The lively discussions and open forum sessions in the three regional fora opened the doors of communication for a better understanding of the watershed approach to water resources management and planning. Recommendations were raised on how stakeholders and the government can work hand in hand in preserving the watersheds with the common goal of providing quality water and, ultimately, quality living for everyone.

The fora highlighted three issues based on the differing but complementing results of the four case studies.

One, it is important to make people understand and appreciate the link between watershed protection and the...
provision of a regular supply of clean and good quality water. Awareness of the connection between the quality of the watersheds and that of their water supply will certainly spark the people’s interest to participate in the movement to protect and take care of the watersheds. As such, the fora put value on having the studies being understood, especially by nontechnical people from schools, community, farm groups and other stakeholders.

Two, people participation is the key factor in making the watershed approach a success. A perfect example is the management of the Magat watershed based on the principle of “managing people first.” This is an approach also being followed by communities in the Balian, Pangil subwatershed and the Manupali watershed when they started to manage their respective watersheds for their water supply and livelihood.

Three, the government must have a supportive role in the watershed management approach. For instance, the local governments in the Magat and Manupali watersheds became champions in managing their individual watersheds. In the Maasin watershed, the local government gave its full support to the people who led the initiative.

In the future...

Participants in the Iloilo forum focused on the possible adoption of the environmental services payment scheme for certain watershed communities in the Maasin and other watersheds in the

Editor’s Notes from page 1

...of or reversal of expansion and intensification of upland farming. This result emphasizes the importance of the "design of policies and projects directed at the development of upland agriculture and the conservation of forest, land and water resources."

The findings stress the important implications on "understanding the environmental effects of trade and agricultural policies, real wage growth and internal migration, and macroeconomic policies affecting the prices of tradable farm outputs and inputs." And when government interventions seem to address a few problems only, Coxhead and Demeke recommend that perhaps it is time that the government steps up its efforts to experiment on a new mix of policies that would benefit upland farmers and promote environmental concerns as well.

Meanwhile, even as the Philippines is faced with the challenge to come up with such mix of policies as mentioned above to be able to help upland agricultural communities and protect the environment as well, it also faces the challenge of ensuring that the interests of the country are put forward and safeguarded in an inevitable environment of free trade and economic relationship with other countries.

The services sector, as shown in the article on pages 7-11, is outpacing traditional industries, specifically in developing countries. With a possibility of forging an RP-US free trade agreement (FTA), two specific areas stand out as the biggest potential earners for the Philippines. These are the telecommunications and financial services sectors. Contact centers started operating in the country in the past few years and are now providing hundreds of thousands, if not millions, of jobs to Filipinos ranging from answering phone queries, electronic mail notification, accounting and bookkeeping jobs down to medical transcriptionist works. It has become an open market of opportunities where the starting pay is shamefully higher than those offered in other industries.

However, there are certain problems to be addressed before a possible FTA with the US materializes. American firms are wary of the poor enforcement of the Philippines’ Intellectual Property Rights Law. In the financial sector, an RP-US FTA will benefit not only the local market through better loan deals, longer credit payment or new packages of services but the millions of overseas Filipino workers and migrants in the United States (US) today as well. Fees collected from regular remittances of nurses, teachers and other professionals based in the US will be lessened and there will be more opportunities to tie up with other banks. But the financial sector is hampered by strict provisions in the Philippine Constitution that limit the ownership of foreign entities in the country and the number of their representatives in the company. This is a contentious issue that would require further commitment from the Philippines’ side.

Undeniably, an FTA with the US is an opportunity for the Philippines but just like in the case of promoting policies that are pro-development and environment-friendly at the same time, a firm commitment on the part of the government is needed so that the positive intent gets through as policies get implemented.
Study calls for inclusion of agriculture, food sectors in RP-Japan trade talks

For Philippine exporters to benefit from the economic partnership between the Philippines and Japan, Philippine negotiators should push for the inclusion of agricultural and processed food sectors in the proposed agreement.

This is the recommendation of Dr. Rosalina Palanca-Tan, professor at the Ateneo De Manila University, in her study titled Prospects and problems of expanding trade with Japan: a survey of Philippine exporters under the the Philippine APEC Study Center Network (PASCN) and the Philippine Institute for Development Studies (PIDS).

"Since majority of Philippine agricultural exports, which include tropical fruits like banana, pineapple, mango and papaya, are not cultivated in Japan, there is no reason why the Japanese agricultural sector needs to be protected from Philippine exporters," Tan argues.

She notes that even with the General System of Preference (GSP), in which industrialized economies are directed to grant duty-free treatment to specified products from designated developing countries, Japan’s tariff rates on agricultural products are still high.

Moreover, Japan imposes quantitative restrictions on fisheries products.

Thus, Tan recommends that zero percent GSP for all Philippine fresh fruits and vegetables should be a key item in the Philippines’ wish list in the negotiation. In addition to tariff and import quota barriers, Filipino firms’ access to the Japanese market remains difficult and costly because Japan’s distribution system remains complex, multilayered, non-transparent and dominated by exclusive relations among producers, wholesalers and retailers.

“There is a need, therefore, for information on the needs and wants of the Japanese market. Specifically, there should be a more defined set of standards of the Japanese market. Procedures for claim verifications as well as accreditation procedures for private testing centers to increase capacity for testing food products must also be established,” Tan suggests.

Likewise, Tan recommends that Japan must commit to undertake import promotion programs particularly for Philippine-made products. These would include seminars and workshops on the Japanese market, buying missions to the Philippines, sales promotion missions to Japan, accreditation program for Philippine private testing centers, and system and procedures for claim verification.

On the other hand, Tan maintains that Filipino exporters must also improve in order to get a bigger share of Japan’s imports.

“Most Philippine food exports suffer from a lack of competitiveness in terms of both price and quality. Factors affecting these problem areas include tractability of food products, lack of technological knowhow, packaging, sourcing of raw materials, absence of economies of scale and insufficiency of credit facilities with respect to small and medium enterprises (SMEs),” she claims.

Tan also points out that high tariffs on sugar, a major ingredient in food exports, and wage rate policies are hurting Filipino exporters.
On managing the country’s water resources

DENR urged to set clear rules on using watershed approach

While there is a general recognition by the Department of Environment and Natural Resources (DENR) that there is indeed a need to adopt the watershed as the relevant planning unit for the management of the country’s water resources, the full adoption of this approach within DENR has yet to be institutionalized.

A study conducted by a team of researchers from the Philippine Institute for Development Studies (PIDS), UP System and De La Salle University (DLSU) attributed this problem to the absence of a watershed management program within the DENR and the lack of appropriate funding support from the national government.

“Not unless this funding appropriation is made possible to boost the capacity and capability at the DENR at all levels, will the operationalization of this concept on a bigger scale be realized,” said Dr. Herminia Francisco, professor at the College of Economics and Management, UP Los Baños and member of the study team.

The study team likewise noted that even the recently signed Philippine Clean Water Act does not specifically require the use of the watershed approach in managing pollution in water bodies. Nevertheless, it hopes that the watershed approach to water resources management may be more explicitly mentioned in the Act’s Implementing Rules and Regulations.

The watershed approach, which rests largely on interagency collaboration on issues pertaining to water and on major stakeholder involvement and strong local government unit (LGU) leadership, is being endorsed by the study team as the main strategy to improve water resource management in the country. While the watershed approach is basically the same as the river basin approach which is being espoused in the Clean Water Act, its scale is smaller and more manageable.

“There is now a growing recognition that water infrastructures, providing water supply for whatever uses, must be supplemented by efforts to repair and/or protect the ecosystems that support them. Such an ecosystem is that of a watershed,” the team noted. It likewise believes that the watershed approach will help set priorities for action on a systems basis, thus promoting cost-effective control policies and targeting of funds, and promote public participation and public-private partnerships.

Meanwhile, the study also called for the integration of actions and programs concerning the sources of water and water quality conditions being implemented by several government agencies.

“One of the problems for the weak implementation of the watershed approach is the proliferation of agencies responsible in watershed management and the absence of efforts to consolidate their activities and programs,” the researchers cited.

Specifically, it was noted that while DENR is responsible for the biophysical components of the watershed, the National Water Resources Board (NWRB) remains responsible for the granting of withdrawal rights to water on these watersheds.

In addition to the DENR and NWRB, other agencies which exercise control over some watershed areas of the country are the National Irrigation Authority, the National Power Corporation and the Philippine National Oil Company. They particularly control those watersheds that support irrigation and power infrastructure projects. DRN

One of the problems for the weak implementation of the watershed approach is the proliferation of agencies responsible in watershed management and the absence of efforts to consolidate their activities and programs.
Watershed from page 13

The proposal is to be initiated by the IWMC, the multisectoral and multilayered structure tasked with the management and protection of the various watersheds in the Iloilo province.

The Davao City Council also plans to work on the recommendations culled from the case studies presented, especially in their continuing information, education and communication (IEC) and advocacy programs on the approach not only in Davao City but also in the entire province of Davao.

At the same time, the PWMC is featuring the four watershed case studies in its various issues of the Watershed— a regular advocacy magazine for watershed management.

Meanwhile, the PIDS and ISPPS will continue to highlight the results and lessons from these studies and translate these into policy notes/briefs and research articles to be disseminated to national and local leaders as well as decisionmakers.

Discussion Papers* on the watershed approach to water resources management and planning


* Available at http://publication.pids.gov.ph in portable document format (PDF).