



# Policy Brief

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*The NFA's twin mandate of price stabilization and food security has cost the government billions of pesos in losses over the past few decades. As such, there is a need to reexamine the NFA to determine whether the benefits gained from its continued operation justifies the considerable funding it receives from the national government.*



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## Subsidizing the National Food Authority: Is It a Good Policy?

### Introduction

The dismal financial performance of Philippine government-owned and -controlled corporations (GOCCs) has contributed greatly to the huge fiscal deficits of the public sector despite the reforms undertaken in the past. Among these GOCCs the National Food Authority (NFA) was consistently one of the top fiscal-drainers, costing the government billions of pesos in losses.<sup>1</sup> In 2009, the NFA contributed PhP27.03 billion or 10.8 percent of the PhP251.5 billion consolidated public sector deficit for that year. As such, there is a need to re-examine the NFA to determine whether the benefits gained from its continued operation justifies the considerable funding it receives from the national government.

### The socio-economic significance of rice

Rice is the staple food in the Philippines. Everyday, the country consumes more than 30 thousand metric tons of rice. It is the single most important agricultural crop in the country, and therefore, a major source of income for millions of Filipino farmers. In 2009, palay contributed some PhP197.3 billion or 20.3 percent to the PhP969.9 billion gross value added(GVA) of the agriculture sector.<sup>2</sup> The next most important crop, banana, only contributed 7.1 percent while the combined contribution of other major agricultural crops such as corn (6.6%), sugarcane (2.6%) and coconut including copra (5.2%) is still less than the contribution of palay to the GVA of the agriculture sector.

Rice is a highly political commodity that an increase in its price can also prompt workers to demand for wage increases (Balisacan, 2007). Rice is a critical item, particularly in the diet of the poor, accounting for as much as 34 percent of the food expenditure of the bottom 20 percent of households (ADB, 2008).<sup>3</sup> The fact that the poor, more than the rich, depend on rice for food, highlights the importance of stabilizing rice prices.

<sup>1</sup> In a 2006 study by the Senate Economic Planning Office, it was noted that the outstanding debt of public corporations accounted for 31% of the increase in public debt from 1998 to 2004, which at that time amounted to PhP831.2 billion. It also accounted for 98% of contingent liabilities, which amounted to PhP850 billion in 2004. The SEPO study covered 16 of the biggest and most important GOCCs and of this group, 14 posted persistent deficits since 1994, reaching PhP90.7 billion in 2004.

<sup>2</sup> At current prices

<sup>3</sup> In contrast, rice consumption takes up 12 percent of the total food expenditures by the richest 20% of households.

## The Role of NFA

Given the wide-ranging significance of rice in Philippine society, the NFA was created with the intention of protecting the interests of both rice producers and consumers. As such, the agency's two primary mandates are to **stabilize the price of rice and to ensure food security**.<sup>4</sup> The price stabilization mandate means that the NFA tries to influence prices on two fronts. At one front, it must support the palay farm despite the reforms undertaken in the past gate price at a level that is enough to ensure a reasonable return for rice farmers. At the same time, it must also ensure that the price of rice is low enough to remain affordable to low-income consumers. The food security mandate, on the other hand, requires the NFA to provide an immediate supply of rice to calamity-stricken areas and to ensure that rice prices are restored to pre-emergency levels within two weeks.

The NFA aims to achieve its twin mandates through the regulation of factors that affect the demand for and supply of rice. To this end, the agency conducts a number of programs to intervene directly in the rice market including (1) the procurement of rice from rice farmers, (2) subsidized retailing of rice to low-income consumers, (3) maintenance of a rice buffer stock, and (4) the importation of rice during periods of shortages. The NFA has also instituted a number of indirect market interventions such as giving farmers access to their post-harvest and marketing facilities and services although, to date, this has remained a relatively small part of its activities.

In addition to these, the NFA is also set up as a corporation and is vested with the following powers: (1) it regulates the post-harvest facilities that service the rice and corn sector, e.g., mills, warehouses; (2) it has a monopoly on the importation of rice; and (3) it can borrow at commercial rates and with guarantees from the national government.<sup>5</sup>

### *NFA's price stabilization function*

The mandate of stabilizing rice prices requires the NFA to ensure a stable supply of rice through various measures. The NFA procures palay from farmers at a price that is higher than the market-determined farm gate price, and then sell the same to consumers at a price that is lower than the market-determined retail price.<sup>6</sup>

### *NFA procurement operations*

The NFA's procurement price is initially determined based on analyses conducted by the Rice Inter-Agency Committee (IAC), which then recommends to the Secretary of Agriculture the procurement price to be used by the NFA in a particular season. Based on the same analyses, the NFA Management also makes its recommendations to the NFA Council. Both the NFA Council and the Secretary of Agriculture then make their respective recommendations to the President of the Philippines, who then makes the final decision.

In 1999, the NFA set its national palay procurement price at PhP9.00/kg in the wet/main harvest season (September to February) and at PhP10.00/kg in the dry/secondary harvest/lean season (March to August). The practice of having different procurement prices depending on the season was abandoned in 2004 when the NFA set a year-round basic buying price at PhP10.00/kg. The basic buying price was adjusted again, albeit slightly, to PhP11.00/kg in 2007. The current basic buying price of PhP17.00/kg was set in 2008 and remains in place to this day.

In addition to the basic buying price, the NFA also provides three types of procurement incentive payments: (a) drying incentive, currently PhP0.20/kg, (b) cooperative incentive, PhP0.30/kg, and (c) delivery or transport incentive, PhP0.20/kg. The drying incentive reduces the farmers' drying costs and improves the storability of the paddy. The delivery or transport incentive, which is paid for grain delivered direct to the NFA warehouse, obviates the need for pick-up from the farm. The cooperative incentive is provided to farmers' organizations (FOs) that sell to the NFA.

It must be noted that the cooperative incentive, which is called the Cooperative Development Incentive Fund (CDIF) is not paid to FOs upon their delivery of grain to the NFA. Rather, the funds are accumulated in specific accounts held by the NFA for the FOs. The accumulated funds are used at the direction of the FO for the acquisition of equipment, the hiring of services, the procurement of inputs, the payment of other expenses, or the placement of investments.

From 1999 to 2009, the NFA procured a total of 3.84 million metric tons of palay. The volume of procurement represents merely 2.53 percent of the total Philippine palay production for the same period. The annual volume of palay procurement during this period was marked by a continuous and at times dramatic decline from 2000 to 2007 before shooting up to near record levels in 2008 and then dropping slightly again in 2009. Within this timeframe, the years 2005 to 2007 were

<sup>4</sup> Annex 1 provides for the legal bases of the NFA mandate.

<sup>5</sup> Moreover, its off-budget spending is automatically appropriated.

<sup>6</sup> The NFA, therefore, is said to be "buying high and selling low."

particularly poor periods for the NFA with regard to palay procurement, with an average of only 61,015 metric tons, representing merely 0.40 percent of the country's total palay production for the period. Not surprisingly, 2005 to 2007 were the years when the NFA support price was actually lower than the prevailing farm gate prices at the time and the volume of NFA procurement was sourced from farmers and areas with excess production.

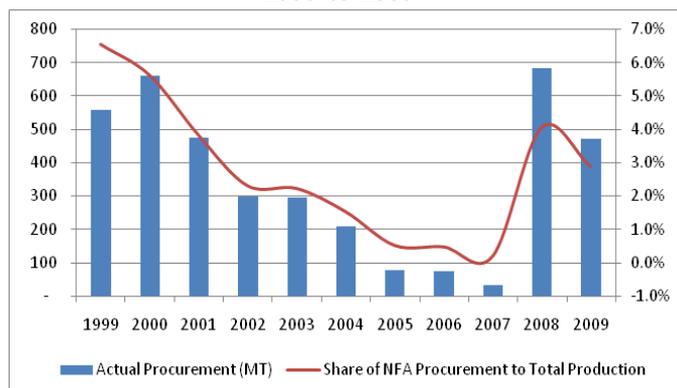
In 2008, as palay farm gate prices rose to above PhP14 amid fears of a global "rice crisis", the President of the Philippines ordered the NFA to increase its basic buying price from PhP11 to PhP17. As a result, NFA procurement levels spiked to a record 683,042 metric tons in 2008. Nevertheless, this amount only accounted for 4.06 percent of the total domestic production for the year. Procurement levels dropped again in 2009 to 2.89 percent of total production despite NFA's basic buying price remaining slightly above the prevailing market price.

**Table 1. NFA Actual Palay Procurement and Buying Price, 1999-2009**

Year	Actual Procurement (in MT)	Basic Buying Price (Peso/kg)	Remarks	
1999	580,503	10.00 and 9.00	For summer crops For main crops	Incentives
2000	663,326			a) Individual Farmer
2001	474,327			Delivery Incentive - 0.10
2002	299,802			Drying Incentive Fee- 0.15
2003	296,384		<b>Total 0.25</b>	b) CDIF-0.25
				Delivery Incentive - 0.10
				Drying Incentive Fee- 0.15
				<b>Total 0.50</b>
2004	207,625	10.00	For all year round	Incentives
2005	76,394			c) Individual Farmer
2006	74,072			Delivery Incentive - 0.10
				Drying Incentive Fee- 0.15
				<b>Total 0.25</b>
				d) CDIF-0.25
				Delivery Incentive - 0.10
				Drying Incentive Fee- 0.15
				<b>Total 0.50</b>
2007	32,577	11.00	Effective Oct. 15, 2007	Incentives
				e) Individual Farmer
				Delivery Incentive - 0.10
				Drying Incentive Fee- 0.15
				<b>Total 0.25</b>
				f) CDIF-0.25
				Delivery Incentive - 0.10
				Drying Incentive Fee- 0.15
				<b>Total 0.50</b>
2008	683,042	17.00	Effective Apr. 3, 2008	Inclusive of incentives
2009	470,798	17.00	Effective Aug. 1, 2008	Incentives
				g) Individual Farmer
				Delivery Incentive - 0.20
				Drying Incentive Fee- 0.20
				<b>Total 0.40</b>
				h) CDIF 0.30
				Delivery Incentive - 0.20
				Drying Incentive Fee- 0.20
				<b>Total 0.70</b>

Source: NFA

**Fig. 1. NFA Actual Rice Procurement (in thousand MT), 1999 to 2009**



Sources: NFA and Bureau of Agriculture (BAS)

Critics say that the current level of procurement as a percent share of total production is insufficient to influence the farmgate prices of palay at levels that are reasonable to farmers. Some studies have shown that for NFA to effectively influence the market, it must be able to procure at least 25 percent of the total production of palay (Glipto et. al, 2002). The NFA does not locally procure when price is high since farmers tend to get better market price for their produce. According to Rufino (2008), despite the geographic segregation that characterizes the Philippine rice market, price signals and other market information are transmitted efficiently across markets. As such, one can rule out the potential occurrences of unexploited arbitrage opportunities. A scenario wherein middlemen (i.e., rice traders) will wait for the NFA to run out of financial resources to buy palay from farmers and then move in afterwards and buy palay at lower prices hence cannot be ignored.

Other studies citing farmer and trader field interviews have indicated that the stringent quality standards for moisture content and cleanliness set by the NFA for rice purchases are also a factor affecting the low level of procurement. These standards are particularly troublesome for poorer farmers who do not have access to proper post-harvest facilities.<sup>7</sup> Farmers have even indicated that the additional trouble of having to encash payments from NFA as opposed to the more straightforward cash transactions with private traders also influence their decision as to whether to sell to the NFA or not (Ramos, 2000). As such, it is quite likely that NFA's domestic procurement activities have historically had little or no impact on rice prices.

<sup>7</sup> Ironically, there is a general perception that NFA rice is of inferior quality. According to Jah and Mehta (2008), there are anecdotal evidence pointing to misrepresentation of cheaply bought NFA rice as better-milled and processed varieties.

**Table 2. Farm gate Price of Palay vs. NFA Buying Price, 2003-2009 (in Php/kg)**

	2003	2004	2005	2006	2007	2008	2009
Palay [Paddy] Fancy, dry (conv. to 14% mc)	9.86	9.73	11.08	11.05	12.39	15.02	14.28
Palay [Paddy] Other Variety, dry (conv. to 14% mc)	8.84	9.45	10.43	10.46	11.22	14.13	14.63
NFA buying price	9.50	9.58	10.00	10.00	11.00	17.00	17.70

Source of basic data: BAS and NFA

### Rice distribution operations

In addition to providing support to farmers, the NFA also provides a subsidy for rice consumption. That is, it sells rice at a price that is lower than the market-determined retail price. This ensures that the price of the staple commodity remains affordable to consumers, particularly low-income families.

For instance, in 2008, the retail price of commercial (well-milled) rice was Php32.7/kg., while NFA sold the same at Php18.25/kg.<sup>8</sup> Thus, the NFA provided an effective subsidy of Php15.8/kg for the consumption of commercial rice.

**Table 3. Market Retail Price and NFA Selling Price for Well Milled Rice (WMR), 2003-2009**

	2003	2004	2005	2006	2007	2008	2009
Market Retail Price	20.20	21.04	22.88	23.56	24.72	32.70	34.12
NFA Selling Price	15-16	15-16	15-17	18.00	18-18.25	18.25	18.25
Difference	4.20-5.2	5.04-6.04	5.88-7.88	5.56	6.47-6.72	14.45	15.87

Sources of data: BAS and NFA

On the average, NFA's total rice distribution accounts for around 15.2 percent of total rice consumption of the country .

While the NFA has had little success in influencing prices for palay producers with its procurement program, the literature indicates that they have been relatively more effective in stabilizing prices for rice consumers (Cororaton, 2004). Yao et al (2005) found that from 1996 to 2003, domestic rice prices were more stable than world rice prices. However, the same study also found that domestic prices were twice as high as world rice prices. It is also important to note that the bulk of rice sold by the NFA is accounted for by (cheaper) imported rice; thus it might be implied that price stabilization is more a result of NFAs importation activities.

Historically, NFA actual rice distribution operations have been disproportionately concentrated in the National Capital Region (NCR). Data from 2005 to 2008 indicate that an average of 493 thousand metric tons, or 24 percent of the total NFA rice distribution went to Metro Manila. Regions such as Eastern Visayas and

<sup>8</sup> To stem its huge losses, the NFA has stopped selling well milled rice at Php18.25/kg in commercial outlets after the May 2010 elections. Similarly, the NFA increased its wholesale price of premium rice from Php23.50/kg to Php25/kg and its retail price of rice from Php25/kg to Php27/kg effective December 6, 2010.

**Fig.2. NFA Actual Distribution and Estimated Rice Consumption in the Philippines, 1999-2009 (in thousand MT)**

Source: NFA

ARMM received, on the average, a mere 111 thousand metric tons and 70 thousand metric tons, respectively for the period. This implies a misallocation of resources considering that poverty incidence is higher in the said regions.

A recent ADB study (Jah and Mehta, 2008) also found that the NFA's distribution program suffers from both substantial under coverage and leakage problems. The study showed that only 25 percent of all poor benefit from the program while 75 percent remain uncovered. At the same time, 48 percent of the beneficiaries are non poor. This may have been a result of limitations (e.g., availability of nearby NFA outlets, outlets run out of rice, or because households do not have physical access, especially in Mindanao and in rural areas) or fixed costs in accessing the program.

That the incidence of leakage is higher in urban centers (68%) than in rural areas (39%) is not surprising given that NFA rice availability is highly concentrated in urban centers, particularly in Metro Manila. However, this is particularly troublesome considering that the majority of the poor in the Philippines is located in rural areas. Interestingly, the incidence of heavy concentration of NFA rice distribution in NCR finds some explanation in the ADB (2008) study. While more urban regions have a lower ratio of participants in the NFA program, these urban participants are more dependent on the NFA for rice because there are fewer substitutes of NFA rice for the urban poor. Thus, those who participate in the cities buy more NFA rice than their rural counterparts.

Similarly, a recent WB study (2008) revealed that NFA rice accounted for only 13 percent of the total spending on rice by the poorest quintile, and this quintile consumes only 31 percent of the total consumption of NFA rice as shown in the 2006 Family Income and Expenditure Survey (FIES). Furthermore, as much as 41 percent of NFA rice leaks to non poor households. Meanwhile, the richest two quintiles accounted for 16 percent of total NFA rice consumed in 2006.

Clarete (2010) points out that the lack or absence of any monitoring/audit of program implementation opens up windows of opportunities for unscrupulous rice traders. He said that if the NFA monitored and assured that all of the rice it injected were sold at the official price, then the market price will move closer to its official price. Otherwise, the bulk of this rice is diverted to commercial transactions benefitting the retailers. In 2007, for example, the Commission on Audit (CoA) reports that 11 representatives were allowed to withdraw rice, with one representing some 217 cooperatives located in different parts of the country. Anecdotal evidence also point to some cases of retailers re-bagging NFA-purchased rice stocks or mixing NFA rice with commercial rice and selling these at much higher prices as commercial rice. Clarete furthered that even institutional buyers, which provide rice to their employees as incentives, had been reported to have purchased NFA rice. The more diversion, the more subsidy is leaked. Furthermore, the less frequent NFA adjusts its official price to market, the more subsidy is leaked.

While the government acknowledged this leakage and committed to limit the selling of NFA rice to poor households by selling only in *Tindahan Natin* outlets to identified Family Access Cards (FAC) beneficiaries, the implementation of this program leaves much to be desired. Some FAC beneficiaries are determined by local government officials without the benefit of hard data (i.e., local household census).

### **NFA's food security function**

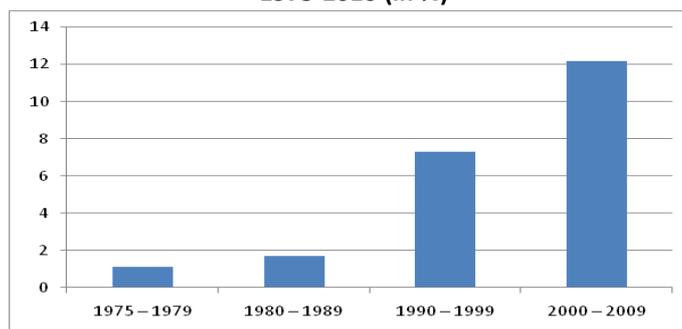
#### NFA rice importation

The second primary mandate of ensuring food security requires that the NFA maintain and manage buffer stocks. This may be done by importing rice.

Rice importation is resorted to only when there is an actual or projected critical demand-supply gap and during a state of calamity/emergency. The volume that is to be imported is determined by an inter-agency committee on rice and corn and is headed by the Department of Agriculture (DA) Secretary and composed of members from the Bureau of Agricultural Statistics (BAS), Department of Trade and Industry (DTI), National Agricultural and Fishery Council (NAFC), National Economic Development Authority (NEDA), NFA, Bureau of Animal Industry (BAI), DA-Rice Program, Philippine Farmers Advisory Board, and Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA).

Imported rice as a proportion of total rice supply has risen quite rapidly over the past three decades. In the late 1970s, it amounted to a little over 1 percent of total supply. This proportion grew to a little less than 2 percent in the 1980s and then grew to over 7 percent in the 1990s. From 2000 to 2009 this amount has risen to 12.2 percent (Table 3). Note that the statistics on rice imports into the country are even understated by the amount of smuggled rice.

**Fig.3.Philippine Rice Imports as % of Total Rice Supply, 1975-2010 (in %)**



Source: NFA

The bulk of rice imports contracted by the NFA are on a government-to-government basis. Up to the early 1990s, Thailand was the major supplier of rice to the NFA. Since then, Viet Nam has been the dominant supplier, accounting for about 95 percent of the country's rice imports in 2009.

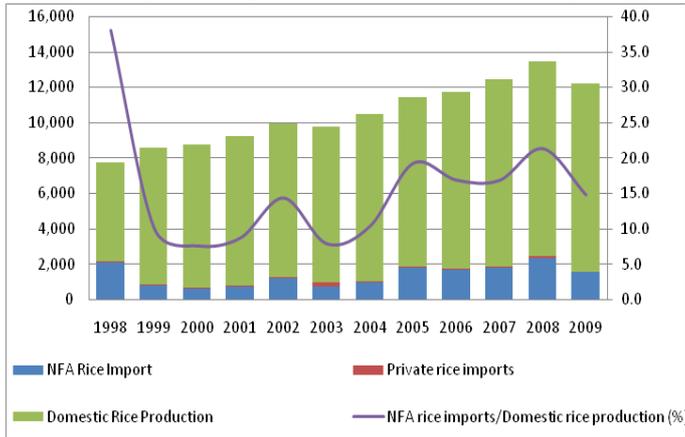
While NFA allows private traders to import rice through an issuance of a quantity restriction (QR) or setting a minimum access volume (MAV), the NFA continues to account for the bulk of rice imports. In 2008, for instance, the NFA imported 2.3 million metric tons of rice, well above the average 1.8 million metric tons between 2005 and 2007<sup>9</sup>. Private rice traders, on the other hand, imported 75 thousand metric tons, significantly higher from the 28 thousand metric tons imported in 2007, but still equivalent to only 3.2 percent of NFA's imports in 2008.

The country's increasing dependence on the external rice market has put food security issues at the forefront.<sup>10</sup> In 2008, then President Macapagal-Arroyo instructed the DA to reduce the country's dependence on rice imports and achieve rice self-sufficiency by 2012. The present

<sup>9</sup> Only in 1998 and 2008 did the NFA exceed the two million metric tons level of rice imports. In 1998, the massive importation of rice was attributed to a number of factors such as the Asian financial crisis, the El Niño phenomenon, and the lack of seeds and fertilizers.

<sup>10</sup> Note that food self-sufficiency is not the same as food security. A country can be food-secure even if it imports a sizeable proportion of its food supply. Singapore, which imports virtually all of its food requirements, is a case in point. Food security means the availability, accessibility, and safety of food for all and at all times (Balisacan, 2007).

**Fig. 4. Total Domestic Rice Production and NFA Rice Importation, 1975-2010 (in thousand MT)**



Source: NFA

Aquino administration reiterated the focus on rice self-sufficiency by 2013.

There is merit in achieving rice self-sufficiency at the soonest possible time. The country is the single largest rice importer in the world.<sup>11</sup> This makes the Philippines vulnerable to fluctuations in the world supply and thereby, price, of rice. For example, the world price of agricultural commodities soared to new heights in 2008. At that time, the world price of rice peaked at US\$907/ton before gradually declining to US\$572/ton. Such an increase in the world price of rice resulted in a high import cost to the government amounting to US\$1.7 billion. This kind of vulnerability is minimized if the country attains some level of self-sufficiency in rice.

#### Buffer stocking activities

For most of the year (November 1 to June 30), the NFA is required to maintain in its warehouses rice stocks equivalent to 15 days of consumption for the entire country. During the lean months from July 1 to October 31, the required buffer stock increases to 30 days. The estimate of the daily requirement of rice is based on the assumption that there is a fixed per capita requirement for rice. As of 2009, that level was around 144 kg per head per year. The per capita requirement is combined with population data to ascertain the daily rice requirement for the nation as a whole.

The NFA's stock is part of the national stock of rice, with the balance being held in households and private warehouses. The "ideal" level of the national stock has been decided by government to be equivalent to 90 days of consumption, which is the period of the lean season when traditionally there are no harvests from the domestic rice crop.

<sup>11</sup> Thailand is the largest rice exporter and its export price is taken as the benchmark rate in the world market.

These rice reserves are used by the NFA to rice distribution requirements of emergency relief agencies (such as the DSWD) during periods of calamities and shortages.

It must also be noted that the Philippines is a participant in the ASEAN Plus Three Emergency Rice Reserve (APTERR) cooperation scheme.<sup>12</sup> As such, it is also committed to maintain 12 thousand metric tons of rice at any given time over and above its national reserve.

As of January 2009, total rice stock stood at 2.64 million metric tons, of which 935 thousand metric tons was secured by NFA. The NFA rice stock in January 2009 significantly higher by 165.7 percent over the same period in 2008. Out of this NFA rice stock, imported rice accounted for 61 percent. In anticipation of the coming lean months last year, the NFA increased its rice stock to 1.5 million metric tons as of July, 60 percent higher than the level recorded in July 2008, or 16.3 percent higher than the previous month. This NFA rice stock, with imports accounting for 76 percent of the total, is good for 41 days worth of domestic consumption in July 2009.

#### **The cost of NFA operations**

The two primary mandates of the NFA are goals that any good government must strive to accomplish. Prudence, however, dictates one to ask: At what cost should the government maintain what experts consider as a generally ineffective policy measure? For years, a growing number of critics have pointed out that any gain to be had by continuing the operations of NFA does not justify the costs that it entails.

The NFA has been eating up an increasing amount of public resources. In the period between 2003 and 2008, government spending on NFA programs, on the average, surpassed spending on agrarian reform, research and development (i.e., DOST and SUCs), and extension services (LGUs).

The NFA has six sources of funding: (1) official development assistance to the Philippine government such as food aid; (2) payments made by the NG on loans drawn by or for the NFA and NGA; (3) subsidy from the NG out of funds appropriated in the annual budget; (4) funding and organizational provisions intended for the national food programs including those provided as special financing program seed fund, cooperative loans, and livelihood projects; (5) loans from the government

<sup>12</sup> APTERR is a regional cooperation scheme among the members of the Association of Southeast Asian Nations (ASEAN) plus China, Japan and the Republic of Korea (ASEAN Plus Three) aimed at strengthening food security as well as delivering food aid in cases of emergency in the region.

and domestic private lending institutions; and (6) Central Bank of the Philippines (CBP) now the Bangko Sentral ng Pilipinas (BSP).

**Table 4. Public expenditures in agriculture (in billion PhP)**

Year	Total	Department of Agriculture				Agrarian Reform		DOST	SCUs	LGU
		Subtotal	OSEC	NFA	Other DA	DAR+ARF	LBP			
2003	39.20	25.20	11.70	10.70	2.70	7.90	0.90	0.10	0.80	4.30
2004	41.60	20.10	12.60	4.90	2.50	8.70	7.40	0.20	0.80	4.50
2005	48.50	29.00	13.10	12.90	3.00	9.70	4.10	0.30	0.80	4.60
2006	42.40	24.20	16.10	4.80	3.30	9.70	2.70	0.30	0.80	4.70
2007	65.30	43.10	22.70	16.60	3.80	10.90	5.30	0.40	0.80	4.80
2008	100.00	79.80	33.80	41.10	4.90	9.80	4.20	0.50	0.80	4.90
Ave.	56.17	36.90	18.33	15.17	3.37	9.45	4.10	0.30	0.80	4.63

Source: Monitoring Expenditure and Agricultural Policies (MEAP) Project c/o PIDS as cited in a presentation by Dr. Ramon Clarete in the SEPO Consultation-Forum on a Proposed Legislative Agenda for the 15<sup>th</sup> Congress on August 3-5, 2010.

The national government has been allocating more and more resources to help defray NFA's operating costs. From just PhP1.2 billion in 2000, the NFA received PhP4.0 billion of the PhP17.4 billion allotted for subsidies to GOCCs in the national government budget in 2009, the biggest share among all GOCCs.

**Table 5. New appropriations, total obligations, sources of funds of NFA, (in billion PhP)**

	2000	2005	2006	2007	2008	2009
New appropriations	1.24	0.90	0.90	1.10	2.00	4.00
Total obligations	1.73	12.94	4.83	16.64	41.10	24.52
Sources of funds	39.56	67.73	61.22	66.38	148.32	90.68
National government	-	9.15	4.81	18.17	45.92	24.52
-Subsidy	-	9.15	4.81	18.17	45.92	24.52
Corporate borrowings	15.33	30.38	27.21	16.12	64.98	14.87
Corporate funds	24.22	28.20	29.20	32.08	37.42	51.30

Sources: For 2000 to 2008 data – Monitoring Expenditure and Agricultural Policies (MEAP) Project c/o PIDS as cited in Clarete's Presentation in SEPO Consultation-Forum on the Legislative Agenda for the 15<sup>th</sup> Congress; For 2009 data – Budget of Expenditures and Sources of Funding 2011

Despite increasing financial support from the national government, the NFA is still unable to improve its financial standing (Table 6). As an agency that deals in cereal trading, NFA's main source of income is supposed to come from rice sales.<sup>13</sup> However, it operates at a loss by virtue of its mandate to subsidize both producers and consumers of rice (i.e., buy high, sell low policy). Clarete (2010) even estimated that the NFA loses PhP2.47 for every kilogram of rice that it imports.<sup>14</sup>

<sup>13</sup> In the 1980s, the NFA had monopolies in other grains such as corn (feeds) so as to maintain some sort of financial viability. In 1985, the deregulation of corn (feeds) caused the NFA to lose its main "bread and butter" and thus its net worth began to deteriorate.

<sup>14</sup> Such loss represents the cost of consumer and tax subsidies.

**Table 6. Income Statement of the National Food Authority (in billion PhP)**

	2000	2005	2006	2007	2008	2009
Gross revenue	22.2	28.6	28.7	36	41.5	42.3
Operating revenue	21.7	27.4	26.6	33	39.1	39.5
Non-operating revenue	0.5	1.2	2.1	2.8	2.4	2.8
Expenses	27.7	46.6	44.5	53.1	78.4	72.8
Net Profit (Loss) (Before Tax)	-5.5	-18	-15.8	-17.3	-36.8	-30.4
Subsidies	1.2	12.9	4.8	16.1	39.2	22.4
Subsidies from NG	1.2	0.9	0.9	16.1	2.0	4.0
Rest of subsidies	-	12	3.9	-	37.2	18.4
<b>Net profit and subsidies</b>	<b>-4.3</b>	<b>-5.1</b>	<b>-11</b>	<b>-1.3</b>	<b>2.3</b>	<b>-8.1</b>

Source: For 2000 to 2008 data – Monitoring Expenditure and Agricultural Policies (MEAP) Project c/o PIDS as cited in Clarete's Presentation in SEPO Consultation-Forum on the Legislative Agenda for the 15<sup>th</sup> Congress; For 2009 data – Budget of Expenditures and Sources of Funding 2011

Since its revenues (including subsidies from national government) are not sufficient to cover its operating costs, the deficit is funded by borrowings. The year 2008 is a case in point. When the world price of rice peaked that year, the NFA necessarily had to borrow more and rely more on subsidy support to be able to expand its procurement program (Table 7). While a cap on foreign loans was set at US\$500 million, there is no ceiling on domestic borrowings. Increased cost of borrowing and the rolling over of debt resulted in the escalation of NFA's debt stock over the years. In 2009, NFA's debt has shot up to PhP155.6 billion. As of May 2010, NFA's debt was recorded at PhP171.6 billion. This is a far cry from the 2000 debt level of PhP20.9 billion. Any debt incurred by the NFA is automatically and unconditionally guaranteed by the national government as primary obligator.

**Table 7. NFA's Net Worth (in billion PhP)**

	2000	2005	2006	2007	2008	2009
Assets	19.8	28.4	27.9	26.4	58.2	53.4
Current	14.7	13.1	4.6	11.8	42.4	40.7
Cash and investment in securities	2.2	1.5	1.6	1.2	2.0	2.4
Rest of current assets	12.4	11.6	13	10.6	40.4	38.3
Fixed	1.5	1.5	1.5	1.7	1.7	1.9
Equipment, land, and related assets	1.5	1.5	1.5	1.7	1.7	1.9
Rest of assets	3.6	13.8	11.9	12.9	14.1	10.8

Sources: For 2000 to 2008 data – Monitoring Expenditure and Agricultural Policies (MEAP) Project c/o PIDS as cited in Clarete's Presentation in SEPO Consultation-Forum on the Legislative Agenda for the 15<sup>th</sup> Congress; For 2009 data – Budget of Expenditures and Sources of Financing 2011

Thus, not only does the national government subsidize the operations of the NFA, it also pays for the agency's debt. The agency's financial losses have particularly been a cause for concern for the Department of Finance (DoF) because it contributes to the budget deficit overrun. Various measures have been proposed

to address the problem, including the Grain Sector Development Program (GSDP).<sup>15</sup> To date, none of these measures succeeded.

### Policy implications

The biggest concern regarding the NFA is that it is financially in dire straits and increasingly becoming dependent on the national government. That is, it is becoming costly for the national government to subsidize NFA operations, which many perceive as an exercise in futility. Not only is it costly in terms of the actual amount of resources invested, but also, such resources could have been used for more productive government programs (i.e., high opportunity costs).

The two primary mandates of the NFA comes with the associated tasks of ensuring low and stable prices for consumers and protecting farm prices for farmers. Evidently, these are two conflicting tasks such that the government cannot lower rice prices for consumers and simultaneously raise grain prices for producers. By doing both, the NFA is sure to lose financially. The situation is aggravated by the increasing cost of operations (i.e., procurement) as well as the unresponsiveness of NFA retail prices to changes in market demand. The SEPO study (2006) asserted that the NFA must record a gross margin of at least 20 percent to be able to break even. Gustilo (1999) estimated that in the early 1990s, NFA's gross margin was at 9 percent. It might be safe to assume that it is even lower today. That being said, various measures have been proposed to improve NFA's financial performance.

The most straightforward way to increase gross margin is to bring down the cost of grain purchases and/or increase the selling price of NFA rice. These measures would, of course, go against NFA's existing legal mandate and would also be politically unpopular.

Another proposal meant to reduce operational costs is to implement Executive Order No. 366, otherwise known as the rationalization plan (rat plan). NFA's rationalization would eliminate 1,242 redundant positions or almost a fourth of its current employment

level. Such measure would complement the proposal to design and implement a national targeting system to identify and limit the benefits of the agency's rice program to those who really need it. This proposed measure seeks to address the leakage errors of the NFA's rice program and increase the agency's efficiency.

Yet another proposal meant to prop up fiscal savings is to implement a (rice) price stabilization scheme – one that does not require maintaining buffer stocks – in conjunction with a more liberal rice import policy.<sup>16</sup> This proposal is rather controversial since its implementation would be tantamount to reversing the rice self-sufficiency program. While such proposal may be justified in terms of enhancing economic efficiencies, its social consequences may be too much to bear. That is, the displacement effect brought by the expected surge in rice imports may translate into an even larger negative income effect for agricultural households. Whereas all households will benefit from reduced rice prices brought by import liberalization, the drop in consumer prices may not be sufficient to mitigate the decline in income for those households that rely heavily on rice production. Thus, such policy may lead to a worsening of poverty and income inequality (Cororaton, 2005).

A rational and perhaps a more 'poverty-sensitive' approach would be to restructure the NFA in order to address the issue of conflicting functions that result in financial hemorrhage. There were several proposed measures filed during the 14<sup>th</sup> Congress that took on such strategy. To wit:

- Senate Bill No. 2618 proposed to transform the NFA from a grain marketing monopoly to a public regulatory agency that will focus primarily on the (1) maintenance of the country's buffer stock requirement to guard against price volatility; (2) licensing/registration of rice importers; (3) allocation of import quotas among licensed rice traders; (4) maintenance of marketing information dissemination systems; and the (5) inspection of stored food grains for inventory purposes. Moreover, the bill sought greater private sector participation in rice importation by removing such function from the NFA. It also sought to transfer the duplicative functions of the NFA (e.g., price stabilization, licensing of warehouses, etc.) to other appropriate agencies or local government units.
- Senate Bill No. 1396 sought to re-organize the NFA by separating its commercial and regulatory functions and thereby creating two agencies in lieu

<sup>15</sup> The GSDP is a comprehensive package of policy and institutional reforms, sector investments, and advisory technical assistance, geared towards improving the productivity and competitiveness of the grains sector. The GSDP was approved in 2000, the same year that the International Monetary Fund (IMF) advised Indonesia to reform Bulog (NFA's Indonesian counterpart) in order to trim down its deficit. While Indonesia heeded IMF's advice, the GSDP was scrapped in 2003 for the reason that "it was highly unlikely that the key reforms envisaged under the program could be instituted within the desired timeframe."

<sup>16</sup> A more liberal rice import policy requires lowering tariffs and removing QR on rice imports.

of the NFA. By assigning the commercial function to one agency and ensuring appropriations for such, this would allow for sufficient incentive to improve financial performance and promote transparency. It is further hoped that this would limit such agency's dependence on borrowing. The other agency to which regulatory functions (e.g., price monitoring, licensing, registration) are to be assigned is then expected to have limited exposure to financial losses.

- Likewise, Senate Bill No. 818 proposed to create a so-called National Grains Council to which the regulatory functions of the NFA are to be assigned. NFA's proprietary functions, on the other hand, are to be transferred to a new corporation with government equity. This was thought to enhance transparency in policymaking and rice import transactions, as well as promote information sharing on the maintenance of the required buffer stock for grains (i.e., rice and corn).

A somewhat similar alternative is offered by Clarete (2010) which is to decouple the proprietary and regulatory functions of the NFA. A new regulating agency would be placed under the direction of the DA. The NFA is then kept only as a trading corporation. NFA's assets are then restructured to induce a profit remittance goal. The new NFA (i.e., trading corporation) is envisioned to work closely with the Food Security Body which is expected to contract the services of the NFA for food security purposes.<sup>17</sup> Disaster coordinating bodies may also contract the services of the NFA to distribute rice in the aftermath of a calamity.

In the current Congress, there are several bills filed relating to the decoupling of NFA's functions. Senate Bill Nos. 2347 and 772 seek to streamline the functions of the NFA. Specifically, SB 2347 proposes the decoupling of NFA's proprietary and regulatory functions. The maintenance of strategic reserves in basic food commodities will be provided by a National Strategic Food Reserve Corporation, while the regulatory functions of the NFA will be reverted to the DA and the management of food subsidies to the poor will be transferred to the Department of Social Welfare and Development. Similarly, SB 772 seeks to streamline government intervention in the rice sector by removing the rice importation function of the NFA and allowing private sector participation. Specifically, SB 772 proposes the transformation of NFA from a grain marketing monopoly to a public regulatory agency focused primarily on maintaining the buffer stock.

Other bills relating to the NFA that are filed during the 15<sup>th</sup> Congress include Senate Bill Nos. 741 and 876. Both bills seek to establish a strategic food security and rice reserve equivalent to 15-day national rice consumption to be managed by the NFA. A seed money amounting to PhP4 billion is to be appropriated and be treated as a revolving fund held in trust by the NFA.

## Conclusion

NFA's twin mandate of price stabilization and food security are replete with issues. Evidently, the rice operation of the NFA is proving to be too costly for the national government. Large leakage errors and poor availability of subsidized rice to its intended target both contribute to the ineffectiveness of this policy measure, and seemingly does not justify the considerable subsidies it receives from the national government. This brings to the fore the need to review NFA's mandate.

Designing efficient safety nets customized to the specific conditions of a country is a challenge both to government agencies and development institutions. Nonetheless, some measures are available to reduce leakage errors and improve the poor's access to subsidized rice. One of the measures presented was to design and implement a national targeting system to identify the deserving beneficiaries of NFA rice.

Similarly, policy proposals to restructure the existing NFA require a thorough review. A rational and perhaps poverty-sensitive approach is the proposed decoupling of NFA's regulatory and proprietary functions to stem the increasing fiscal losses from its continued operation as well as to improve its efficacy.

An important policy lesson that may be drawn for policymakers is that while market reform is generally necessary for efficiency purposes, such reform measures must be carried out carefully, especially if it involves a critical commodity such as rice. While market reforms in rice can potentially benefit consumers in general, some household groups where poverty is most severe may be negatively affected by the surge in rice imports should the government decide to say, eliminate the QR on rice. Policy measures may have to be designed to counter these effects. One such measure is direct government transfers (e.g., conditional cash transfers) to the adversely affected sector. Note, however, that this is more of a stop-gap measure. The government cannot sustain this in the long-run. Other policy measures that may have favorable long-term implications and should interest policymakers include productivity improvement through a vigorous program of intensified use of high-yielding rice varieties, and improving the cost of rice production through provision of better farm-

<sup>17</sup> The Food Security Body can also contract the services of grains traders from the private sector when necessary.

to-market roads, better irrigation and post-harvest facilities, and improved access to credit with flexible payment terms. Measures to encourage the growth of other non-rice crops could also help mitigate risks inherent in rice production.

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**Annex 1. Pertinent Laws and Other Issuances on NFA**

<b>Statute (Date)</b>	<b>Salient Provisions</b>
Annex to Presidential Decree No. 4 (06 September 1972)	The National Grains Industry Development Administration (or National Grains Authority) was created to promote the integrated growth and development of the grains industry.
Presidential Decree No. 699 (12 May 1975)	The mandate of NGA was further expanded to include the establishment, acquisition, and/or operations of grains processing, handling, storage, and transport facilities aside from the development, culture, or production of grains.
Presidential Decree No. 1485 (11 June 1978)	<p>The mandate of the NGA was expanded to include the growth and development of grain substitutes such as mongo, soybeans, and cassava.</p> <p>The NGA was granted regulatory and supervisory powers exercised by the NGA Council. The NGA Council was also mandated to establish rules and regulations concerning the importation of grain and their substitutes.</p>
Presidential Decree No. 1770 (14 January 1981)	<p>The NGA was reconstituted as the National Food Authority (NFA) with the mandate to promote the integrated growth and development of basic food commodities. The authorized capital stock was set at P5 billion.</p> <p>The composition of the NFA Council was modified to include the Minister of Human Settlements as Chairman.</p> <p>The investment and loans of the Human Settlements Development Corporation in the Food Terminal, Inc were transferred to NFA.</p>
Executive Order No. 1028 (31 May 1985)	<p>It is declared a state policy to achieve and maintain an adequate supply of food grains at mutually satisfactory price levels for both farmers and consumers, primarily through reliance upon the market mechanism and by encouraging the participation of competitive private enterprises in the production and trading of food grains as well as of related agricultural inputs, such as, fertilizer, seeds, and pesticides.</p> <p>The stabilization functions of the NFA are limited to rice and corn. NFA was mandated to relinquish or transfer to another government entity or to the private sector its non-grain stabilization and trading activities.</p>