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DIRECTORATE OF INTELLIGENCE

23 March 1987

The Philippine Coconut Industry: Taking the Rural Economy on a Rollercoaster Ride [redacted]

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Summary

The Philippine economy has benefited from the near doubling in the international prices of coconut oil since mid-1986, but prices have softened in recent weeks and lower prices probably will prevail for the rest of 1987. Increased world production of soybean oil--a leading vegetable oil substitute--will probably push prices down slightly by yearend. The Philippine coconut industry will probably remain relatively strong in the short term, and should continue to stimulate the economy, especially in the countryside, where coconuts account for at least 20 percent of agricultural production. The Aquino government should benefit from the economic gains generated by higher coconut prices in the congressional elections in May and local elections in August. [redacted]

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25X1 This memorandum was prepared by [redacted] Office of East Asian Analysis. Information available as of 23 March 1987 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Islands Branch, Southeast Asia Divison, OEA, [redacted]

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Our long-run forecast for the coconut industry is gloomy, given the plentiful supply of substitutes worldwide. If coconut prices plunge, Manila may try to support them and possibly look to Washington for help. But unless Manila develops a successful program to diversify large areas of the country away from a dependence on coconuts, the rural economy will remain hostage to the volatile international vegetable oils market and, like the depressed sugar-growing areas of the country, depressed coconut-farming areas provide fertile ground for the Communist insurgency to thrive. [redacted] 25X1

Coconut Oil Fuels the Rural Economy

The Philippine coconut industry benefited from a doubling in prices in mid-1986; this, in turn, has boosted the rest of the economy. Over a six-week span from mid-September to late October, the prices of coconut oil and copra (the raw meat from which coconut oil is milled) doubled to $.20 and $.12 per pound, respectively (Figure 1). They have settled slightly since then--in recent weeks coconut oil prices have dropped to $.16. [redacted]

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The Importance of Coconuts

The price increase is a boon to the approximately 15 million Filipinos dependent directly or indirectly on coconuts, the country's largest commercial crop. US AID estimates that about one-third of all Philippine households derive some income from the coconut industry and in the principal growing areas in the Visayan Islands and Mindanao, coconuts provide over 60 percent of the cash income earned by farmers. [redacted] 25X1

Foreign exchange earnings of about $480 million from coconut products accounted for approximately 10 percent of all 1986 Philippine merchandise export earnings, according to Philippine Government statistics. Coconut oil and copra sales account for most of the earnings. [redacted] 25X1

During the Marcos era, the coconut industry was controlled by Eduardo Cojuangco--a longtime political ally of Marcos--who monopolized the industry by controlling its governing body, the milling association responsible for 95 percent of the country's copra crushing capacity, and the industry's leading banks. According to AID studies, the monopoly was responsible for cutting farmers' income by at least one-third. The Aquino government has broken the monopoly by placing the Philippine Coconut Authority (PCA) under the Department of Agriculture, investigating and recovering funds from the Coconuts Planters Bank, and lifting the ban on the export of copra. [redacted] 25X1

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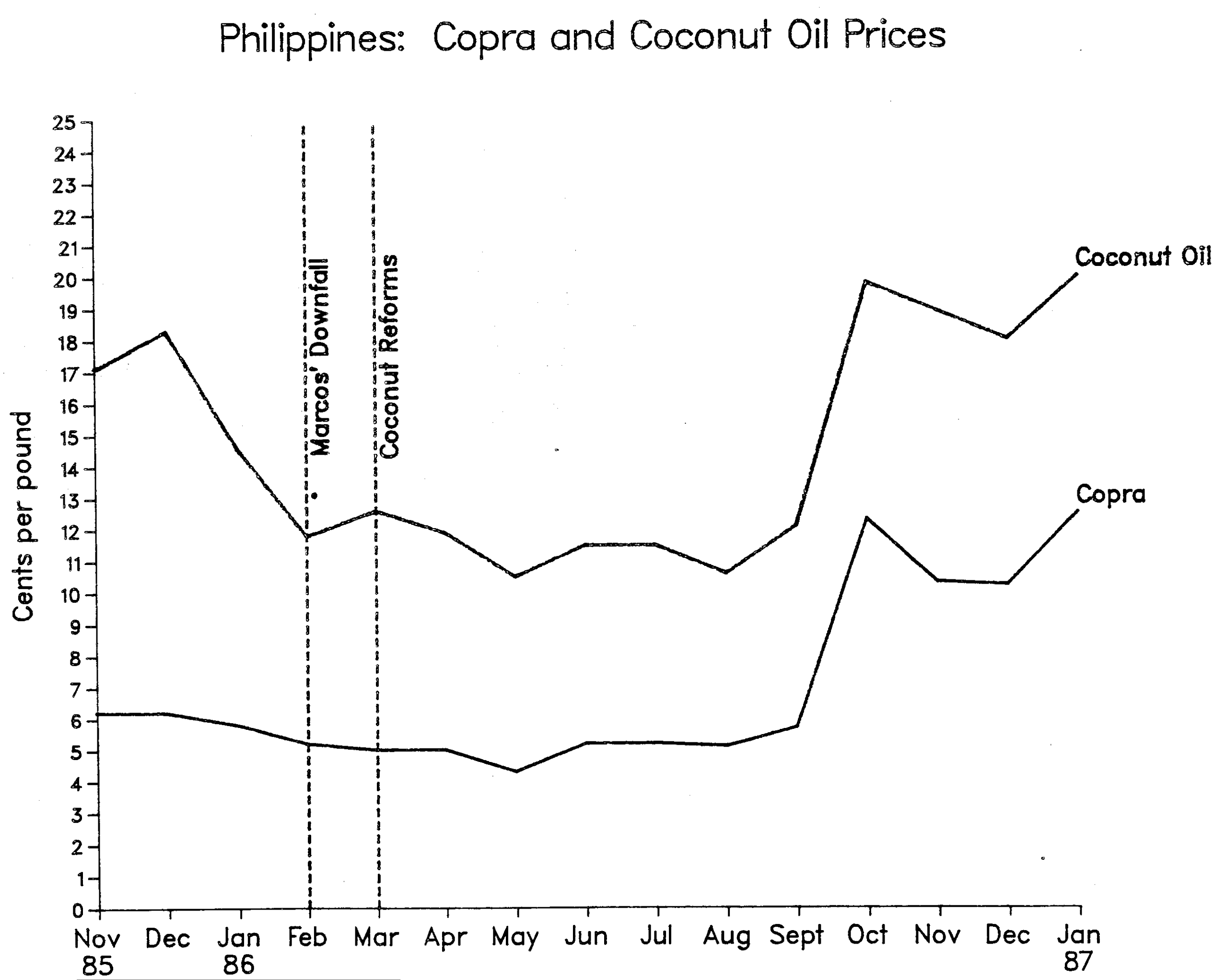
Figure 1



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Although today's prices are only a third of the peaks reached in 1979 and 1984, the government's recent dismantling of the coconut marketing monopoly has meant that much of the impact of the price increase has gone to the country's 1.4 million coconut farmers. The US Embassy reports that the larger share of the higher world prices received by the farmers has helped to boost farm income and consumption in many rural areas in recent months. Moreover, coconut prices helped spur a 5.4-percent growth in the agricultural sector in the last quarter of 1986, according to recently released Philippine Government statistics. [redacted] 25X1

The benefits of the price increase go beyond the farmers and the rural economy. By taking linkages to other sectors into account, the Philippine Finance Department calculates that a price increase in copra of 1 peso per kilogram has a 1 billion peso (about $50 million) impact on the economy. This relationship suggests that the more than 3-peso increase experienced during 1986 directly added over $150 million, or about 0.5 percent of GNP, to the economy. [redacted] the price 25X1 rise, in combination with Manila's pump-priming program for the rural economy, is largely responsible for the nearly 2-percent growth in GNP in the last quarter of 1986. The last quarter spurt pushed growth for the year to 0.13 percent, reversing the three-year decline in the economy and giving Manila hope that the stage is set for robust economic growth this year. [redacted] 25X1

Why Has the Price Gone Up?

Analyzing the coconut oil market is particularly difficult because of the complexities of the vegetable oil market. The price of coconut oil depends, for example, on a wide range of relationships, including such diverse factors as livestock prices in the United States and Australia. If the demand for the soybeans used in livestock feed increases, then the price of coconut oil will probably go up because it is easily substituted for soybean oil in baked goods and other finished food products, as well as in many nonfood and industrial applications. Intangible factors, such as market psychology, also play a role in the short run. On the other side of the price rollercoaster, the growing trend in this decade toward cheaper vegetable oil substitutes, such as palm oil and soybean oil, weakens coconut prices. Malaysian palm oil output, for example, has doubled since 1980. With the world coconut oil market so volatile, in our judgment any good news--such as government reforms of the industry--will have a positive impact on prices. Nevertheless, we believe several recent developments have combined to boost Philippine and world coconut prices in the short run. [redacted] 25X1

Domestic Factors

In our judgment, the Aquino government's reforms in the coconut sector have played a large role in the domestic price jump. When copra exports were banned in 1983, farmers could sell their copra only to the local coconut millers, who were almost all associated in some way with Eduardo Cojuangco. The millers kept prices low to maintain high profit margins on the finished coconut oil. As a result of Aquino's reforms, domestic demand for copra, for export or milling, has increased and bid up local prices. Indeed, our analysis shows that the domestic price of copra has risen more

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than the international price of coconut oil--from a copra/oil ratio of .4 when the reforms began to .63 early this year. [redacted] 25X1

Manila appears determined to allow market forces to prevail. Late last year, for example, the millers--squeezed by falling profit margins--proposed a 5-percent export tax on coconut oil and a 10-percent export tax on copra, ostensibly to finance the national coconut tree replanting program. We believe that the higher tax on copra exports, however, would have pushed prices received by farmers back down by favoring local mills over copra exporters. Largely for this reason, we believe Manila rejected the proposal, which was widely regarded as antifarmer. [redacted] 25X1

Philippine traders--through extensive forward sales of coconut products--probably provided some of the initial impetus to prices, but in our judgment trader activity has not been strong enough to explain the persistence of high prices since October 1986. More meaningful, we believe is concern about projected shortages of domestic supplies of copra and coconut oil. The United Coconut Association of the Philippines (UCAP), for example, forecasts an 11-percent fall in coconut output this year. UCAP bases its prediction on a five-year growing cycle which indicates that coconut production tends to drop after two successive years of good harvests such as those experienced in 1985 and 1986. Although the PCA adamantly disputes UCAP's prediction and claims 1987 production will equal or exceed last year's, we believe the possibility of tight supplies continues to provide a strong underpinning for prices. [redacted]

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International Market Forces

Our analysis indicates increases in world demand for Philippine coconut products--either because of shortages in other countries or increased competitiveness with substitute products--have accelerated the recent upward trend in prices.

- Global supplies have been reduced by a decrease in Sri Lanka's coconut output because of drought and Indonesia's ban on coconut exports to ensure sufficient domestic stocks.

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Outlook

Although most international commodity analysts agree that coconut prices will probably decline later this year as the production of soybean oil recovers, opinions vary regarding the timing:

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- The PCA and a number of traders have told the Embassy they expect prices to stay at current levels at least through the first quarter of 1987.

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Whatever the timing of the price decrease, we do not believe prices will fall to last year's lows, and the industry will probably remain relatively strong in the short run. The US Embassy reports that Philippine farmers appear to be giving much of the credit for the price increase to the Aquino government, and with Congressional elections scheduled for May and local elections in August, the government is taking all the credit it can get. 25X1

The corollary, we believe, is equally valid. Should prices begin to fall, Manila probably will be blamed--as Marcos was whenever copra prices fell. The danger is that another slide in copra prices could undermine Manila's efforts to keep the Communist insurgents from gaining additional support among impoverished farmers. 25X1

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In our view, however, the long-run forecast for the Philippine coconut industry is not bright. World markets will probably be awash in inexpensive substitutes for coconut oil, undercutting Philippine producers who accounted for more than 80 percent of the global supply in 1986. 25X1

We believe Manila has no quick fixes available. During the late 1970s and early 1980s, the Philippines did not invest heavily in its agricultural sector to either increase production of other agricultural commodities or to develop alternative uses of coconut. Aquino's economic advisers are well aware that the rural economy is heavily dependent on coconut, and in our judgment the danger exists that farmers will read the dramatic turnup in prices as a signal to plant more coconut trees, which will begin to produce in five to seven years, rather than diversify. Unless Manila develops a longer term program to reduce the dependency on coconuts, the rural economy will remain hostage

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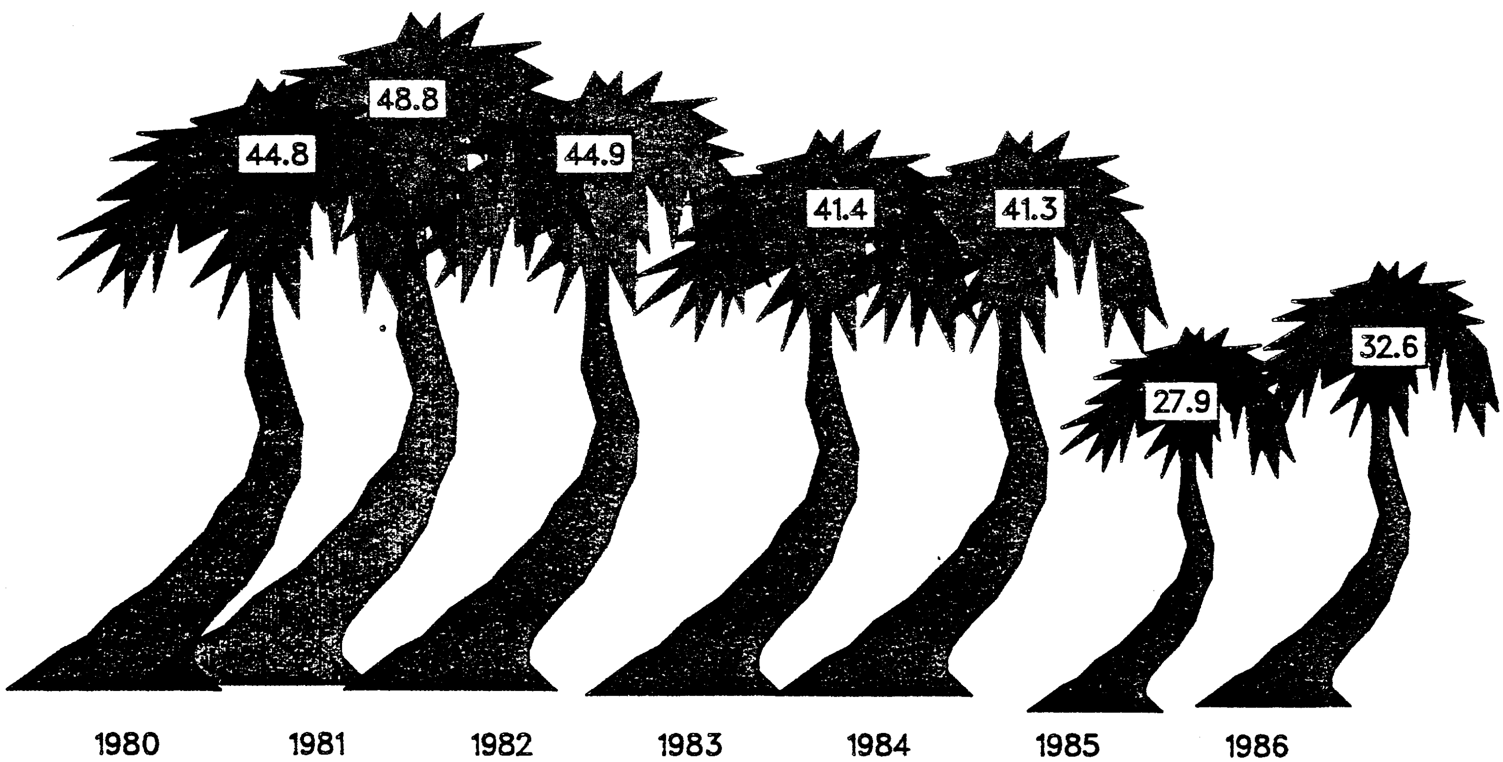
Figure 2

US Imports of Philippine Coconut Oil 1980–86 (percentage of US imports of world vegetable oils)



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to a volatile international vegetable oils market in which prices have routinely increased and decreased by as much as three-fold. [redacted] 25X1

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