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## Improving credit access for the food and agriculture sector through enhanced implementation of existing policies and new strategies

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## UP School of Economics Discussion Papers

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### **Improving Credit Access for the Food and Agriculture Sector Through Enhanced Implementation of Existing Policies and New Strategies**

by

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# **Improving Credit Access for the Food and Agriculture Sector through Enhanced Implementation of Existing Policies and New Strategies \***

*Gary B. Teves*

## **Abstract**

For several decades, the government has sought to develop the agriculture sector through programs like agrarian reform, agricultural modernization and rural finance, but farmers and fisherfolk remain to be the poorest sector in the Philippines. This paper seeks to explore ways to improve small farmers and fisherfolks' access to credit provided by formal financial institutions. The government needs to implement and improve on its existing programs, identified in this study, and combine these with policy reforms and new strategies to fast-track the development of the food and agriculture sector to make economic growth more inclusive.

Keywords: Agriculture, Financial Institutions and Services, Agricultural Finance, Agricultural Credit

*Journal of Economic Literature* Classification Codes: G21, O13, Q14

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## **Improving Credit Access for the Food and Agriculture Sector through Enhanced Implementation of Existing Policies and New Strategies**

### **Introduction**

1. With exports like mango, banana, and pineapple, as well as fishery products and coconut oil, many still think of the Philippines as an agricultural economy. The agriculture sector remains the main source of income and employment for 30.9% of the working population. It is equivalent to about 12 million of the 38.5 million total employed workers, based on the National Statistics Office's 2013 Labor Force Survey. According to World Bank data, 40.6% of the country's total land area is agricultural and 51% of the total population still lived in rural areas in 2011.
2. While agriculture's role in producing food and generating income in the rural areas is essential, the sector's contribution to the country's gross domestic product (GDP) has been declining over the years. According to the National Statistical Coordination Board, about a third (29.7%) of the country's total output was agricultural back in 1946. By 1995, agriculture's GDP contribution was down to 21%; in 2013, the sector's share had further declined to 12%.
3. The Bureau of Labor and Employment Statistics' January 2014 report also shows that people working in agriculture receive the lowest average daily basic pay compared to those in non-agricultural sectors. In 2012, farmers and fishermen were the least paid workers, getting PhP165.3 and PhP191.7 a day, respectively. Those employed in the industry sector earned PhP328.5 a day, while those working in the services sector received PhP383.5 daily.
4. Given these figures, it is not surprising that farmers and fishermen had the highest poverty incidence from 2003 to 2009. Farmers' poverty incidence of 36.7% barely improved since 2003, when it was at 37%. Fishermen have it worse, with a poverty incidence that increased from 35% in 2003 to 41% in 2009. Poverty incidence in the Philippines in 2009 was 26.5%. (Albert, 2013) Further, out of the 4,135,834 households under the Department of Social Welfare and Development's (DSWD) Conditional Cash Transfer (CCT) program, 51.13% or 2,114,450 have at least one

member engaged in farming, fishing and/or forestry. (Reynoso, 2014) The Asian Development Bank (ADB) also observed that poverty in the Philippines is “a predominantly rural phenomenon affecting mostly farmers and fishermen...given that agricultural growth has not been sustained for a host of reasons [including] lack of investments.” (ADB, 2009)

5. For several years, the government has sought to develop the agriculture sector through policies like agrarian reform, agricultural modernization and rural finance but poverty statistics show that the assistance has not been able to significantly improve farmers’ lives.
6. The government recognizes the provision of adequate and affordable credit as a key intervention in boosting the agriculture sector. It is especially important to small-scale farmers who rely on credit for their working capital and often, for their subsistence, too. “From the 1970s to the mid-1980s, the government provided loans at highly subsidized rates to bring down the cost of borrowing among targeted sectors. The most famous example of subsidized credit was the supervised credit component of the *Masagana 99* rice production program.” (Llanto, 2005)
7. Financial market reforms began in the 1980s with the adoption of a market-based interest rate policy and the former Central Bank moving away from development financing and leaving this function to Land Bank of the Philippines (Land Bank) and the Development Bank of the Philippines.
8. Today, interest rates on agricultural loans are highest in the Philippines, where the average interest rate charged by formal lenders is 26.7% per annum, based on a study by the Agricultural Credit Policy Council. Neighboring countries like Thailand’s Bank of Agriculture offers 6% per year while Vietnam’s Agri Bank and Indonesia’s government bank both charge 12% per annum. India’s government bank provides 0% interest if a loan is paid within six months while the government bank in China charges 5% per annum, 80% of which is shouldered by the government. (PhilRice, 2013)
9. Filipino farmers also have to contend with high production costs amid relatively low government support (Please see Table 1). For instance, seeds and fertilizers are unsubsidized in the Philippines, unlike in China, India, and Indonesia. Irrigation water

is also free in Indonesia, Thailand, and Vietnam, but farmers in the Philippines pay US\$46-69 or PhP2,057 to PhP3,086 per hectare in irrigation fees.

**Table 1. Government Support Services in the Philippines and Selected Neighboring Asian Countries**

ITEMS	Province, Country					
	Nueva Ecija, Philippines	Zhejiang, China	Tamil Nadu, India	West Java, Indonesia	Suphan Buri, Thailand	Can Tho, Vietnam
Seeds	No subsidy	Free inbred seeds; free hybrid seeds only to cooperative members	\$0.2 subsidy per kg of seeds	\$0.91 subsidy per kg of seeds	No subsidy	No subsidy
Price of urea	\$27.91/bag	\$20.83/bag	\$5/bag (subsidized)	\$9.10/bag (subsidized)	\$24.38/bag	\$26.43/bag
Irrigation	\$49/ha (wet season); \$69/ha (dry irrigation); Irrigation is free if crop is damaged	Free	Free	Free	Free	Free
Land tax	\$28/ha per year	Free	\$0.21/ha per year	\$56/ha per year	\$0.98/ha per year	Free
Interest on credit	24% per annum from cooperatives	5% per annum (4% is paid by the gov't and 1% is paid by the farmer)	0% interest if loan from gov't bank is paid within 6 months	12% per annum from gov't bank	6% per annum from Bank of Agriculture	12% per annum in Agri Bank
Machine acquisition	85% discount on farm machinery and post-harvest facility for qualified irrigator's assoc. and farmer cooperatives.	30% discount on tractors and combine harvester-thresher; 50% on mechanical dryer	Gov't custom hires combine, leveller, mechanical transplanter, and tractor at 50% lower rental rate; but gov't can service only 2% of the area	No subsidy	No subsidy	70% of the value of principal have low interest during the 1 <sup>st</sup> year
Gov't paddy procurement	Gov't procures less than 5% of production at a support price	Gov't procures inbred rice production. Gov't offers protection price for inbred rice.	Gov't procures around 60% of harvest; gov't has minimum price support	Gov't does not procure paddy from farmers but from traders	Gov't procures all production at a guaranteed price	Gov't procures through state-owned companies at a price giving 30% profit margin to farmers

Source: Rice Science for Decision-Makers (December 2013 issue) of the Philippine Rice Research Institute

## Current Government Programs, Interventions and Challenges

### **(a) Agri-Agra Reform Credit Act**

10. Presidential Decree (PD) 717, issued on May 29, 1975, sought to mobilize more resources to the agriculture sector by requiring private banks to allocate at least 25% of their net loanable funds for agricultural credit. Of which, 15% must be allocated for general agricultural credit (agri) and 10% for the agrarian reform sector (agra).
11. PD 717 intended to tap urban-based commercial banks and their substantial resources to participate in rural lending and, thereby, mobilize more funds for agricultural development. Through the years, however, Congress and the *Bangko Sentral ng Pilipinas* (BSP) expanded alternative modes of compliance — such as development loans to educational institutions, hospitals, socialized housing and local government units — channeling funds away from the agriculture sector.
12. In 2009, PD 717 was superseded by RA 10000 or the Agri-Agra Reform Credit Act, which upheld the 25% mandated allocation but rationalized alternative modes of compliance to only those that help advance the agriculture sector, i.e., wholesale lending to and/or investments in accredited rural banks and rural financial institutions, bonds declared eligible by the Department of Agriculture (DA) and the Department of Agrarian Reform (DAR), loans for the construction or upgrade of rural infrastructure, as well as loans to the National Food Authority (NFA) and its accredited warehousemen, millers and wholesalers.
13. Banks that fail to comply will have to pay a penalty fee equivalent to one-half of one percent (0.5%) of the amount of non- or under-compliance. Ninety percent of the fines collected is split equally between the Agricultural Guarantee Fund Pool (AGFP) and the Philippine Crop Insurance Corporation (PCIC) to augment their funds, while the remaining 10% is remitted to the BSP to cover its administrative expense. (Ravalo & De Villa, 2014)

14. The DA said that over the past 10 years, banks have been able to comply with the 25% mandated allocation only from 2003-2005. Between 2006-2010, average agri compliance was 13.9% while agra compliance averaged 9.5%. After RA10000 rationalized alternative compliance mechanisms in 2011, there was over-compliance in the agri component with 27% and under-compliance in agra with only 3.4%. Since RA10000 was passed, banks in general have been able to comply with the 15% agri component but fell short of the 10% agra component.

**Table 2. Bank compliance to Agri-Agra Law, in PHP Billion as of Dec 2012**

ITEM	Total	Universal/Comm'l Banks (UKBs)	Thrift Banks (TBs)	Rural & Coop Banks (RCBs)
<b>A. Total loanable funds</b>	<b>1,129.81</b>	<b>1,046.84</b>	<b>51.27</b>	<b>31.70</b>
<b>B. Minimum amount required to be allocated</b>				
1. 10% Agra	112.98	104.68	5.13	3.17
2. 15% Agri	169.47	157.03	7.69	4.76
3. Total	282.45	261.71	12.82	7.93
<b>C. Compliance with 10% Agra</b>				
1. Direct Compliance	21.89	11.41	1.95	8.54
2. Alt. Compliance	1.94	0.77	0.42	0.75
3. Total	23.83	12.18	2.37	9.29
4. % of Compliance	<b>2.10%</b>	<b>1.16%</b>	<b>4.63%</b>	<b>29.30%</b>
<b>D. Compliance with 15% Agri</b>				
1. Direct Compliance	106.62	75.43	14.39	16.80
2. Alt. Compliance	136.69	132.75	3.23	0.70
3. Total	243.31	208.18	17.62	17.5
4. % of Compliance	<b>21.54%</b>	<b>19.89%</b>	<b>34.37%</b>	<b>55.21%</b>
<b>E. Total Compliance</b>				
1. Direct Compliance	128.51	86.84	16.34	25.34
2. Alternative Compliance	138.63	133.52	3.66	1.45
3. Total	267.14	220.36	19.99	26.79
4. % of Compliance vs 25%	<b>23.64%</b>	<b>21.05%</b>	<b>39.00%</b>	<b>84.51%</b>

Source: Bangko Sentral ng Pilipinas



15. Table 2 shows that relative to total loanable funds generated in 2012, only Rural and Cooperative Banks (RCBs) and Thrift Banks (TBs) surpassed the law's requirement, with almost 85% and 39% compliance, respectively. In contrast, Universal and Commercial Banks (UKBs) fell short at 21%.
16. Broken down into two components, all banks were able to comply with the 15% mandated allocation for agri. In fact, banks are over-complying with the agri component with PhP106.6 billion and PhP136.7 billion for direct and alternative compliance, respectively, or a total PhP243.3 billion versus the PhP169.5 billion minimum allocation for agri.
17. For agra, however, only RCBs met the 10% mandated allocation. There is severe under-compliance in the agra component, with direct total compliance of PhP21.9 billion and alternative compliance of PhP1.9 billion or a total of only PhP23.8 billion versus the PhP112.9 billion minimum allocation for agra.
18. The table also shows that UKBs have a higher alternative compliance than direct lending. Bankers Association of the Philippines (BAP) explained its members usually gravitate towards alternative modes of compliance, which represent less risk than direct lending, because most UKBs do not have the expertise to handle agri-agra financing. (Virtusio & Padronia, 2014)
19. Under the law, the Agricultural Credit Policy Council (ACPC), which is under the DA, is authorized to certify bonds or debt securities as eligible alternative modes of compliance and to accredit RFIs. UKBs can provide wholesale lending or invest preferred shares of stocks in these accredited RFIs, which can then relend funds to the target borrowers.
20. The law's IRR was released in 2011. The guidelines for the certification of debt securities and RFIs, have already been signed by the DA Secretary but is still under

review for the co-approval of the DAR Secretary. Banks have cited the delay in the release of said guidelines as a factor in their failure to meet the mandated allocation for agra through alternative compliance. (Corpuz, 2014)

21. Financial institutions still find agricultural lending very risky because the sector's productivity is very dependent on the unpredictable weather and profitability is hampered by a lack of rural infrastructure, such as farm-to-market roads, irrigation systems, and post-harvest and storage facilities.
22. For the BAP, alternative—and less risky—compliance mechanisms are the more prudent preferences for complying with the Agri-Agra Law. BAP also admitted that for many banks, paying fines to the BSP is a more prudent option than weakening their balance sheets. (Virtusio & Padronia, 2014)
23. Research and consultations with relevant government agencies and the private sector revealed that most of the mechanisms needed to address private banks' reluctance are already in place. However, these are either not being implemented or getting inadequate support from the government.

**(b) *Crop Insurance***

24. Banks are generally averse to agriculture lending because of the sector's inherent risks. To encourage banks to lend more to the countryside, the government created risk-mitigating mechanisms, one of which is the Philippine Crop Insurance Corporation (PCIC).
25. PCIC provides small farmers and farmer associations with insurance protection and guarantee coverage against crop losses, particularly for *palay*, corn, high-value commercial crops, livestock, fisheries, and non-crop agricultural assets (i.e.,

warehouses, rice mills, transport facilities, and other farm equipment due to perils like fire, theft, and earthquake).

26. In 2012, PCIC's penetration rate was only 4%, equivalent to 311,388 farmers, fisherfolk, livestock raisers and other stakeholders. In 2013, it improved to 8% as PCIC was able to provide agricultural insurance to 732,654 stakeholders.

27. Under the General Appropriations Act of 2014, the government gave PCIC around P1.2 billion for the full cost of insurance premium of subsistence farmers and fisherfolk registered in the government's Registry System for Basic Sectors in Agriculture (RSBSA). It covers rice, corn, high-value crops, coconut, livestock, and non-crop agricultural assets insurance within the 20 priority provinces.<sup>1</sup> Outside of these 20 provinces, however, only rice and corn crop insurance are subsidized by the government. Both are staples and top agricultural crops in the country.

28. PCIC paid a total PhP539 million in indemnities in 2013, higher than the PhP226 million in 2012. Banks have cited the often delayed payment of indemnities as a weakness of PCIC, even as the latter claims that its regional offices are able to settle claims within the prescribed 20 days. To accelerate the processing of insurance claims, PCIC has started work on specialized programs like the weather index-based insurance (WIBI) and the area-based yield index insurance (ARBY).

29. WIBI was developed based on 30 years' historical weather data from a weather station within 20 kilometers of a municipality, along with climate scenarios for 2020 and 2050. PCIC will be relying on the rainfall report of the Philippines Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) to implement WIBI, which will

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<sup>1</sup>The Registry System for Basic Sectors in Agriculture (RSBSA) covers the 20 poorest provinces: Abra, Agusan del Sur, Apayao, Camarines Sur, Davao Oriental, North Cotabato, Northern Samar, Romblon, Sarangani, Ifugao, Kalinga, Masbate, Mountain Province, Sultan Kudarat, Surigao del Norte, Surigao del Sur, Western Samar, Zamboanga del Norte, Siquijor, and Eastern Samar.

allow farmers to get compensation when there is very little or excessive rainfall to adversely affect crops during critical growth phases.

30. Crop data for ARBY, meanwhile, were obtained from DA, local government units and focus group discussions with farmers. Under ARBY, farmers will be compensated if their yield falls below the average, i.e., if on the average, a farmer in a certain area harvests 100 cavans per hectare and this falls to 60 cavans during one season, he would be promptly compensated.

31. Under these insurance schemes, indemnities are paid based on agreed weather indices or yield thresholds, and not on actual damages suffered by the producers. Therefore, pay-outs are released once a certain index is breached without the necessity of a farmer's filing a claim or of PCIC conducting field assessments.

32. In order to expand PCIC's crop insurance coverage and fund the roll-out of these new insurance schemes, the PCIC would first need to increase its capitalization. (Cajucom, 2014)

**(c) Credit Guarantee**

33. Guaranteeing agricultural credit is generally considered an effective government intervention to encourage banks to lend to a high-risk sector. In 2008, the Agricultural Guarantee Fund Pool (AGFP) was created to provide guarantees to unsecured loans made by lending institutions or their conduits to small farmers and fisherfolk who till no more than 7 hectares of land or engage in small-scale livestock, poultry or fisheries. AGFP covers up to 85% of the loan exposure of accredited lending institutions against all types of risks of non-repayment by farmer-borrowers, except fraud.

34. In 2013, AGFP was able to provide a guarantee cover to unsecured loans amounting to PhP5.4 billion involving 134,808 loan transactions with about 87,625 small farmers and fisherfolk. AGFP had a total of 243 partner-lending institutions last year. Starting with 19 banks in 2008, 67 banks now have guarantee lines with AGFP today.
35. While the BSP has already attested to AGFP's strength to serve its guarantee purpose in case of defaults, not all banks are responsive to AGFP's programs. It seems that credit guarantee still does not minimize the need for collateral required by big private banks. AGFP observed that even with the credit guarantee that it offers, big private banks still prefer to lend to less risky sectors.
36. Aside from the inherent risks of agriculture, credit guarantee is also subrogated, one factor that banks dislike. Unlike insurance, wherein the loan is extinguished upon payment, banks still have to collect payments from borrowers—which entails costs—and remit at least 30% of the guaranteed amount to AGFP. Otherwise, the bank will not be able to renew its guarantee line with AGFP. Given this reality, some banks choose not to avail of the government's credit guarantee at all. (Ruiz, 2014)
37. Both BAP and the Rural Bankers Association of the Philippines (RBAP), unfortunately, find these government-led risk-mitigants insufficient to encourage more direct lending on their part. For one, PCIC is underfunded with a capitalization of only P2 billion, often discouraging banks with larger loan portfolios from getting crop insurance.
38. Meanwhile, RBAP is proposing to increase AGFP's coverage from the present 85% to anywhere between 90-95%, consequently reducing banks' exposure from 15% to 5-10% only. (Almario & Mendoza, 2014) AGFP, however, believes lenders are already fairly covered at the present guarantee rate of 85%. If AGFP's guarantee is increased, the banks may no longer practice due diligence. (Ruiz, 2014)

**(d) *Agro-Industry Modernization Credit and Financing Program***

39. Subsidized or direct credit programs (DCPs) in agriculture were abolished in 1986 by the Cory Aquino government but later revived by the end of that administration due to the clamor for access to cheap credit. (Llanto, 2005) In 1997, Congress passed Republic Act 8435 or the Agriculture and Fisheries Modernization Act (AFMA),<sup>2</sup> which led to the phase-out of all agricultural DCPs.
40. The Agro-Industry Modernization Credit and Financing Program (AMCFP) was then created to widen and facilitate access to agricultural credit. The law allocated a total of PhP12 billion for AMCFP, of which PhP2 billion would be released on the initial year of implementation and P1.7 billion annually for the succeeding years.
41. AMCFP, now the DA's umbrella credit program for agriculture and fisheries, provides credit and financing for farm, off-farm and non-farm income-generating projects of farming and fisheries households, especially the small ones. AMCFP operates on a "wholesaler-retailer" approach, wherein funds are provided as loans to government financial institutions called "credit wholesalers," which, in turn, relend the funds to qualified "credit retailers" that include rural banks, cooperative banks, and other organizations engaged in lending to small farmers and fisherfolk. Credit funds under AMCFP use market-oriented interest rates. (Corpuz, 2014)
42. Given private banks' aversion to agri lending despite the existing risk-mitigating mechanisms, the government needs to continue to step-in and assist small farmers and fisherfolk in terms of financing. ACPC develops innovating financing schemes for small

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<sup>2</sup> AFMA was created to serve as the government's framework for the modernization of the farming and fishery sectors towards being more globally-competitive. AFMA mandated investments in rural infrastructure, research and development, information and marketing assistance, as well as reforms in the government's agricultural credit programs.

agricultural and fisheries households, especially for borrowers that have no access to formal financing and have limited assets, if any, to offer as collateral.

43. However, insufficient funding has limited AMCFP to only the following programs: the Agri-Microfinance Program for Small Farmers and Fisherfolk (AMP), which has disbursed PhP661.6 million of loans; Cooperative Banks Agri-lending Program (CBAP), which released PhP1.8 billion in loans; *SikatSaka* Program (SSP), which released P213 million loans; and Typhoon *Pablo* Special Agricultural Financing Facility, which disbursed PhP17.2 million loans. As of December 2013, these AMCFP programs have extended PhP2.7 billion to a combined 90,803 small farmers and fisherfolk.

44. Of the PhP12 billion total mandated allocation for AMCFP, only PhP1 billion has been released by the government and it has yet to give the balance of PhP11 billion. AMCFP currently operates on the remaining loanable funds and past due loans from the terminated DCPs being collected by ACPC.

45. Borrowers and lending institutions participating in the AMCFP also go through capacity-building programs to professionalize their management skills, enhance knowledge in technology, and strengthen borrowers' and retailers' capacity to access and manage credit.

**(e) Agrarian reform**

46. Earlier studies on rural finance have noted that lending to agriculture is unattractive because of the higher risks involved, particularly with agrarian reform beneficiaries (ARBs). Low productivity due to small-scale operations and natural risk factors, low value of collateral, and the costly administration of numerous small loans are just some of the reasons why banks remain averse to lending to the agra sector.

47. ARBs are the landless farm workers who benefited from the redistribution of public and private agricultural land assets under the Comprehensive Agrarian Reform Program (CARP) mandated by RA 6657 of 1988, which was later expanded in 2009 by RA 9700 or CARP Extension with Reform or (CARPER). The government's agrarian reform program was created in an effort to boost countryside development by allowing farmers to own, till and earn from their own land.
48. Studies have shown, however, that land ownership has not improved the economic welfare of ARBs. Llanto (2005) noted certain provisions of the CARP law that have hindered private investments in agriculture and the rural areas, such as ownership ceiling, transferability of lands and the holding period, and the land having no collateral value because it is not titled.
49. Fabella (2013) stressed two key flaws of agrarian reform: the prohibition on making transfers (through sale, lease, or other means) of CARP-distributed land until it is fully-paid, and the arbitrary five-hectare ceiling on land ownership.
50. Land has served as traditional collateral for loans but CARP weakened its capacity to command credit. Fabella wrote, "The legal creditor in case of foreclosure can neither own it (more than 5 hectares is illegal) nor sell it (no buyers) and so would rather not lend. Being an ARB does not improve access to formal credit...If a beneficiary of land reform cannot access production credit, he is condemned to destitution even while in possession of a potentially valuable asset."
51. Further, the parceled lands made the achievement of economies of scale in farm productivity difficult. Under the government's agrarian reform program, 5 million hectares of land were distributed among 2.6 million new landowners, which mean that on the average, each would only have 1.2 hectares, too small an area to be profitable.



52. These restrictions on the allowable size and beneficiaries' inability to transfer the assets have discouraged banks and other formal credit sources from offering loans to ARBs. Even rural banks, which primarily serve the agriculture and fisheries sector in the countryside, are not all able to meet the 10% loan allocation for ARBs. Like the UKBs, some rural banks opt to pay the fines rather than face the risks of lending to ARBs. (Almario & Mendoza, 2014)

## **Recommendations**

53. ACPC's commitment under the Philippine Development Plan (PDP) 2011-2016 is to increase formal borrowing from 52% in 2007 to 61% by 2016. This entails an increase in formal borrowing by 1% yearly until 2016. In this regard, the National Agriculture and Fisheries Credit Summit was held in 2011 to develop a strategic action plan for agricultural credit. Farmers groups, financing institutions, members of the academe, and other stakeholders from the government and the private sector participated in the summit. The action plan identified key strategies to make formal credit more accessible to small farmers and fisherfolk, some of which are included in the following recommendations:

### ***(a) Near-term (within Pres. Benigno S. Aquino's administration)***

54. **Approve guidelines on alternative compliance for Agri-Agra Law.** The ACPC is authorized to certify bonds/securities that are eligible as alternative compliance and to accredit RFIs which banks could provide wholesale lending to or invest preferred shares of stock in. The guidelines have been approved by the DA Secretary, but the document is still under review by the DAR Secretary for co-approval. DAR needs to give it the green light as soon as possible to provide banks with more options for their agra compliance, given that most of them remain averse to direct lending. Alternative modes of compliance will still benefit the target sector because the law already states that only agri- and agra-related activities will be declared eligible for compliance.

55. **Start operations of the Credit Information Corporation.** The cost of lending in the Philippines, which is currently among the highest in the Southeast Asian region, can be lowered if the cost of conducting credit investigations can be reduced. Big, commercial banks are usually not present in rural areas where most agri-agra borrowers live. Financial institutions incur costs in conducting background checks and in extending their services, which are usually passed on to end borrowers, thus the higher price of loans.
56. Banks would be better equipped to handle rural credit and be able to reduce their cost of lending if there is a repository of information on borrowers to make the evaluation of loan applications easier. The government's RSBSA, an electronic compilation of basic information on farmers, farm laborers and fishermen, can help identify and locate the beneficiaries of agriculture-related programs and services, including credit. However, RSBSA, for now, only covers the 20 poorest provinces in the country.
57. The best way to address information asymmetry is to make the Credit Information Corp. (CIC) operational as soon as possible. The CIC, created by the 6-year old RA 9510, is expected to aid in quicker credit evaluation and decisions, reduce the cost of processing loans, protect creditors from fraudulent borrowers, and benefit consumers in terms of lower borrowing cost. (Corpuz, 2014)
58. International experience with credit information systems, most recently in Japan, Malaysia, and Taiwan, have shown that the "availability of reliable credit information can increase credit access, lower banks' loan default rates, and even foster long-term responsible borrower behavior." (Bernardo, 2014)
59. **Strengthen crop insurance and credit guarantee.** The government can improve farmers' access to agricultural loans by strengthening the existing risk-reducing mechanisms, which can encourage banks to perform the required lending.

60. In August 2014, House Bill No. 469<sup>3</sup>, which aims to strengthen the PCIC by increasing its capitalization from the current PhP2 billion to PhP10 billion, was approved by the Committee on Appropriations. It needs to be passed into law, as soon as possible, to enable PCIC to roll-out index-based insurance programs and cover an estimated 3.7 million farmers, fisherfolk, livestock raisers and other stakeholders. This translates to a penetration rate of around 35-40%, higher than the current 8%, which is only equivalent to 732, 654 stakeholders.

61. We support the move to bundle crop insurance with credit guarantee in order to widen their coverage and to harmonize their benefits. Between 2009 and 2014, 85% of guarantee claim payments were due to insurable perils (i.e., natural disasters, plant diseases, and pest infestations) and only 15% were due to non-insurable causes (i.e., diversion, delayed harvest). Bundling crop insurance with credit guarantee will make it more attractive for farmers and banks to avail of such programs, and allow the government to save some money.

***(b) Medium- to long-term (within the next and subsequent administrations)***

62. **Gradually release the unremitted PhP11 billion to AMCFP.** ACPC currently uses a wholesaler-retailer approach for AMCFP. To help reduce costs, ACPC is recommending the special depository model of financing. Under this scheme, AMCFP provides credit to eligible RFIs in the form of deposits. These RFIs will then manage the funds and re-lend it to small farmers and fisherfolk. As a result, there is no longer a need for a wholesaler, effectively reducing the interest rates charged on borrowers.

63. We believe this is an effective way to reduce the pass-on rates to end-borrowers. Therefore, the AMCFP must be funded to allow the creation of more lending facilities

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<sup>3</sup>House Bill No. 469 or “An Act strengthening the Philippine Crop Insurance Corporation, amending for the purpose Presidential Decree No. 1467 as amended,” authored by Rep. Agapito Guanlao. It is the consolidated version of similar bills, namely, HB 2074 and HB 3226.

that use the special depository model of financing. To date, only the Cooperative Banks Agri-lending Program under AMCFP uses the said model.

64. Aside from assisting small farmers and fisherfolk in terms of financing, credit programs under AMCFP also conduct capacity-building programs that help improve borrowers' ability to access and manage credit funds.

65. **Amend the Agri-Agra Law.** We support the position of the BSP, BAP and RBAP that the 25% mandated allocation is not a rational number to start-off. We also agree with DA that the mandated allocation of 25% should be gradually decreased and focused more on the agra component. The reduced mandated allocation should not undermine the welfare of the agri-agra sector nor compromise the rights of the banks to grow their capital.

66. This should be included in the periodic review of RA 10000, to be undertaken by the BSP, DA and DAR this year. Results of said review should be the basis for amendments to make the law more effective in mobilizing more funds to the agriculture sector, particularly the ARBs.

67. Instead of forcing banks to lend to the agri-agra sector, the government should also incentivize it as positive reinforcement for banks to lend. Some of the suggested incentives are: provision of higher guarantee coverage corresponding to a higher collection rate of payments, and granting a higher compliance rate if loans are extended directly to ARBs. The review of RA 10000 should also look into the provisions that banks consider as disincentives.

68. In addition, RA 10000 should be amended and transfer the mandate of certifying bonds and debt securities, as well as accrediting RFIs, to the BSP. As the country's central authority in the areas of money, banking and credit, the BSP has more

competence than the DA and the DAR to accredit financial instruments and institutions pertinent to Agri-Agra Law.

69. **Relax CARP restrictions.** The law presumes that ownership of land would instantly turn small farmers to agri-businessmen. Farming needs to be run like a business, and without capital or entrepreneurial know-how, there is only so much a farmer can get done on a small parcel of land.

70. Some agricultural entrepreneurs are willing to lease lands from ARBs but the current set-up is preventing them from doing it legally. We support RBAP's suggestion to amend the clause on restrictions and allow ARBs to lease their lands to agri-entrepreneurs who can make the land—or a consolidation of parceled lands—more productive.

71. As lessor, the ARB keeps ownership of the land and tills it at the same time. As lessee, the investor has access to land and compensates the lessor/laborer by paying part of his income directly to Land Bank, thereby facilitating the full payment of the CARP-distributed land. So while the CLOA is in the process of being transformed into a real land title, farmers' productivity can be improved with the help of entrepreneurs who are more likely to invest in modern farming methods.

72. **Explore public-private partnerships.** Big commercial and thrift banks' poor compliance in the agra component indicates that they are having more difficulty in lending to ARBs, particularly because of the size of land parcels and the restrictions on land transferability, as well as their limited presence in the countryside. Government-owned Land Bank, whose mandate includes ARBs, should work with private banks to arrive at a system that will help improve the latter's agra compliance while channeling more funds to ARBs. For instance, a pool of funds can be created and re-lent to ARBs by tapping Land Bank's countryside network. The risks should be equally borne by the banks that put up the fund. (Luzano & Angeles, 2014)

**73. Support contract-growing programs of agro-commercial firms.** Companies that extend financial support to their contract growers should be given access to rediscounting facilities and credit guarantees currently only extended to banks. The government should encourage tie-ups between these firms and banks that have commodity-specific lending products. In addition, these agro-commercial firms often provide development programs that help build farmers' capacity to manage credit funds and enhance their creditworthiness. This way, the private sector helps accelerate the capacity-building programs implemented by the ACPC, the Agricultural Training Institute, Cooperative Development Authority, and other similar agencies.

### **Contract-growing: Strength in Numbers**

As a result of agrarian reform, parceled farm lands made it difficult to achieve economies of scale in farm productivity. Banks hesitate to lend to agrarian reform beneficiaries (ARBs), often pushing the latter to borrow from informal lenders who charge high interest rates or dictate the buying price of crops during harvest season.

There is, however, a way around the unprofitable size of land parcels. Llanto (2005) notes how commercial farms in Mindanao that grow commercial and export crops were able to consolidate extensive lands for cultivation by entering into contract growing schemes and leaseback arrangements with ARBs to produce the export crop. "The contract growing schemes include support for quality inputs. Those agri business firms get financing from commercial banks which implies that direct financing is being given to small farmers with contract farming arrangements with those firms."

Another example is San Miguel Foods, Inc.'s (SMFI) contract growing programs, which source agri-based raw materials like cassava, sorghum, and sweet potato for the conglomerate's feeds business and food and beverage products. In particular, SMFI's flagship cassava program provides partners or "assemblers" with a guaranteed market, guaranteed floor price, and start-up technical assistance in production, post-harvest and logistics operations. An assembler can be an individual entrepreneur, a corporation, or farmers' cooperative that has the capacity to consolidate at least 20 hectares for cassava production.

The program can also assist farmers in accessing financing. SMFI has referred assemblers to financial institutions like Land Bank, Development Bank of the Philippines, Bank of Commerce, Small Business Corporation, and United Coconut Planters Bank. In addition to the contract as proof of partnership between SMFI and the prospective borrower, SMFI can also provide the lender with Certificate of Volume Delivery Performance as part of the latter's background investigation for Purchase Order (PO) Financing. These help facilitate farmers or cooperatives' application for bank loans. (San Miguel Foods, Inc., 2014)

**(c) New Strategies**

74. **Creation of CCT for farmers.** The government should seriously consider a more direct form of helping the small stakeholders in agriculture. Most of the Conditional Cash Transfer (CCT) beneficiaries of the DSWD's *Pantawid Pamilyang Pilipino Program* are engaged in farming, fishing, and/or forestry, yet there is no nationwide program to enhance their livelihood activities.
75. As a policy measure, the government should provide farmers with incentives for being more productive, just like how members of CCT households are given an allowance for getting regular health check-ups and for staying in school. Farmer-CCT beneficiaries can later organize themselves into associations, which make them easier to train to access credit. This can be a sustainable exit strategy for more than half of the households under the CCT program today.
76. The government should also focus more of its assistance on lowering the cost of critical inputs like seeds and fertilizers, which would then complement the availability of credit.
77. **Fast-track rural infrastructure through co-financing.** A conducive lending environment also requires the provision of irrigation systems, farm-to-market roads, ports and bridges, and other infrastructure support that will help farmers increase their productivity and profitability, which will then improve their bankability.
78. The government's budget allocation for agriculture has been gradually increasing from 0.26% of the total budget in 2009 to 3.13% in 2014. The budget for farm-to-market roads (FMR), in particular, increased from PhP5.2 billion in 2013 to PhP12 billion in 2014. However, PhP12 billion is only estimated to build 1,000 kilometers when, as of 2013, there is a deficit of 13,873 kilometers of rural roads. If DA wants to complete its targeted 13,999 kilometers of FMRs by 2017, it will have to spend PhP154.5 billion to

build the remaining 12,873 kilometers. Therefore, the government should quadruple its 2014 budget for FMRs and sustain it for the next three years.

79. To accelerate the construction of agri-related infrastructure, we propose that the national government enter into co-financing agreements with local government units (LGUs). Under this system, part of the LGU's internal revenue allotment (IRA)—if used to finance rural infrastructure like FMRs and irrigation systems—can be an incentive for the LGU to receive more support from the national government. For instance, for every PhP1 the LGU allots to FMRs, the government can give the LGU another PhP1-PhP3 to enable it to continue implementing its health- and education-related projects.

80. **Develop a credible *quedan* system.**<sup>4</sup> Under the “*quedan*” system, a farmer is allowed to deposit his produce in a warehouse in exchange for a receipt certifying the storage of goods of a particular quantity and quality. The farmer can then use the *quedan* receipt as collateral for a bank loan while waiting for prices of his stored commodity to go up.

81. Most sugar in the country is already produced and marketed under the industry's long-established *quedan* system. The government needs to develop the *quedan* system for other crops that can be stored for a period of time. A *quedan* system will particularly help collateral-short farmers to access loans that will finance their next cropping season while waiting for better prices to sell their stored produce. The Philippines had a growing *quedan* system, but the agency mandated to implement it has been hounded with anomalies, dragging the *quedan* system with it. Without credibility, the *quedan* system cannot work well.

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<sup>4</sup> See related sidebar on *quedan* system in the Philippines.



82. The government needs to review legislation relating to warehouse deposits, and amend these laws if necessary, to create an efficient and secure *quedan* system. Measures should be implemented properly to rebuild trust and confidence among farmers, traders, and financial institutions until it becomes the norm in the food and agriculture sector.
83. The government can learn from other countries that already have good *quedan* systems in place. Several Latin American and African developing countries, as well as India, currently use the warehouse receipt system to increase farmers' access to financing.
84. One of the more successful models is in Ethiopia, where IFC's Warehouse Receipts Financing Initiative has helped lend US\$1.5 billion to 42 borrowers during the program's first 12 months in the country. In keeping up with the times, Ethiopia's *quedan* system even employs an electronic copy of receipts, which is sent to a central database for better security and convenience.

## Quedan system in the Philippines

The word “quedan” is derived from the Spanish “quedar,” which means “to deposit or to leave behind.” *Quedan* is an old system of recording commodity deposits and was practiced during the Spanish colonization of the Philippines. Farmers trading in copra, hemp, palay, sugar, and tobacco deposited their harvest in warehouses in exchange for warehouse certificates or “quedan.” These *quedans* served as instruments for trading the commodity and as collateral for obtaining a loan.

The Philippines has Republic Act (RA) No. 2137 or the Warehouse Receipts Law of 1912. Unfortunately, there is not much information on what happened to the said law, or if it was ever implemented.

In 1978, amidst the rice surplus brought about by the successful implementation of the Masagana '99 program, then President Ferdinand Marcos created the Quedan Guarantee Fund Board (QGFB), which implemented the Grains Quedan Financing Program.

Under the said program, farmers stored their produce in a government-bonded warehouse and received a corresponding *quedan* receipt as evidence of the stored commodity. Using the *quedan* receipt as collateral, the farmers can go to QGFB-accredited bank to borrow working capital for the next planting season. When the price of palay goes up, the farmer can sell the stored commodity, attain a better income, and pay their loan.

In 1980, after said program was proven effective in palay, QGFB was mandated to include other grains and food commodities, such as corn, sorghum, soybean, mungo, and peanuts.

In 1992, RA No. 7393 reorganized the QGFB into Quedan and Rural Credit Guarantee Corporation (Quedancor), which was mandated to “institutionalize the *quedan* or warehouse receipt and other negotiable instruments, evidencing stored agri-aqua produce in bonded warehouses, as the more convenient collateral for obtaining credit financing.”

Quedancor, however, has been hounded by anomalies. As of today, it does not implement the warehouse receipt system. Based on a Commission of Audit (COA) report in 2013, “the financial condition of Quedancor is adversely affected by the continuous incurrence of huge losses from its operations since 2006...thus, casting doubt on its capability to continue providing guarantee on loan programs.” COA recommended either Quedancor’s rehabilitation to enable it to carry out its mandate or fold up in order not to further hurt the government’s finances.

## Summary and Conclusion

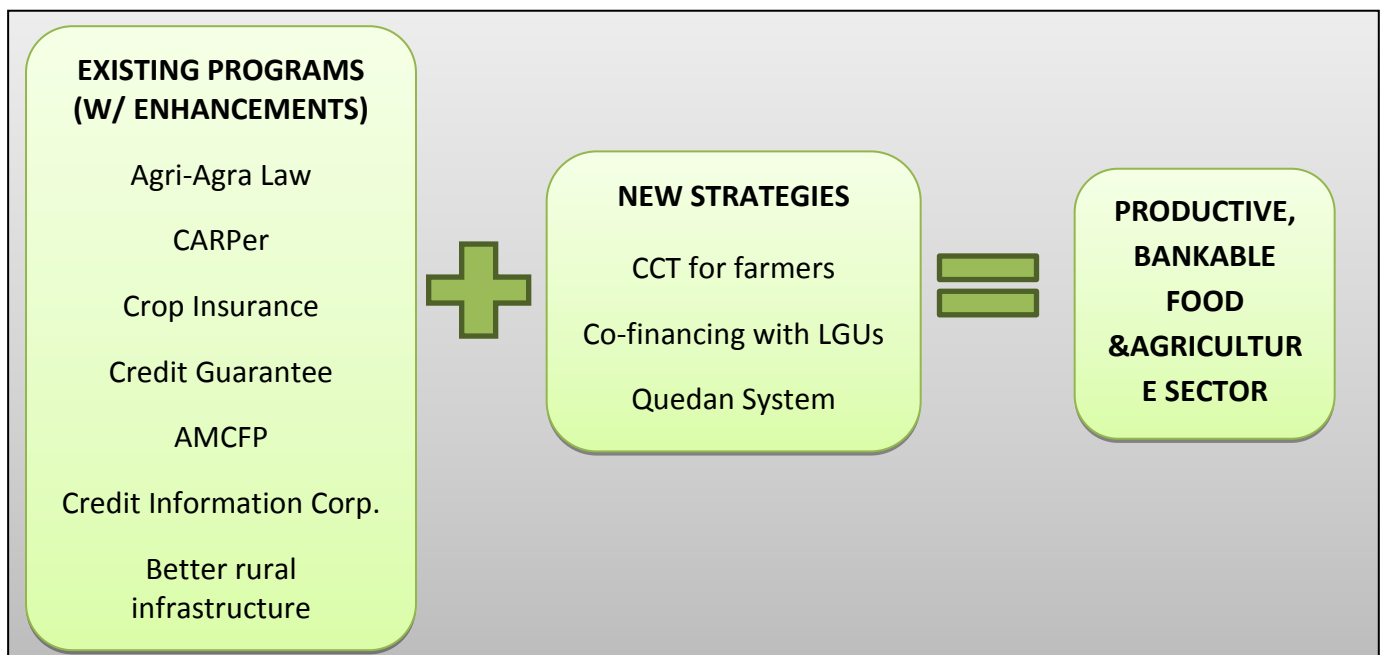
85. Agriculture remains a main generator of employment in the country but its slow growth has resulted in a declining GDP share and high poverty incidence among farmers and fisherfolk.
86. The government recognizes the provision of sufficient and affordable credit as a key intervention in boosting the agriculture sector. Through the years, various policies have been introduced to mobilize more funds for the agri-agra sector, with the help of private banks. For instance, market-oriented interest rates were adopted and RA 10000 rationalized alternative modes of compliance to those that directly benefit the agri-agra sector (but guidelines on certification are still pending for approval).
87. RA 10000 helps in the development of the food and agriculture industry but it has not been effective in channeling more funds to the agrarian reform sector. CARP restrictions have kept investors from putting their money in CARP-distributed lands and hinder banks from lending to ARBs. CARPER's deadline for acquiring land for distribution was originally on June 30, 2014 but Pres. Aquino has asked Congress to prioritize House Bill 4296, which extends the ability of DAR to issue notices of coverage (NOCs) and distribute them to tenant farmers until June 30, 2016. We believe that such an extension will only prolong financial institutions' hesitation to lend to ARBs.
88. Government-funded lending programs under AMCFP help increase credit access of small farming and fishing households. However, resource constraints limit the number of farmers and fisherfolk that AMCFP can assist. The government must fully implement agriculture-related legislation that have been left out by previous administrations, such as AFMA. In particular, the AFMA-mandated budget for AMCFP should be released to create more innovative financing schemes that target the most marginalized agriculture groups.

89. In terms of critical mass, the government still needs private financial institutions to lend to the food and agriculture sector. To encourage more private banks to lend to the high-risk sector, the government has been increasingly strengthening risk-mitigating mechanisms like crop insurance and credit guarantee.
90. Crop insurance protects farmers and fisherfolk from natural calamities and other risks, but PCIC can only cover a small portion of the agriculture sector because of its financial constraints. In August, the Lower House Committee on Appropriations approved HB 469, which seeks to increase PCIC's capitalization from PhP2 billion to PhP10 billion. Legislators must fast-track its passing into law to give the agriculture sector a much-needed boost.
91. Just as crop insurance protects the borrowers, credit guarantee protects lenders in the case of defaults in unsecured loans. However, AGFP has yet to convince more banks, especially the biggest ones, to avail of its credit guarantee programs. For these banks, the penalty for non-compliance is still less than the risks associated with agri-agra lending. The bundling of credit guarantee with crop insurance in order to harmonize their benefits is a welcome development in encouraging more banks to lend to the agri-agra sector.
92. The private sector must also take the initiative to do more. While the need to protect their business is reasonable, those who have benefited the most from our nation's economic system also have a social responsibility to make a positive contribution to society, especially in helping the country's poorest sectors. Banks need to be more proactive in finding ways to help the agriculture sector and not just wait on the government to improve the lending environment or to give more incentives. Pursuing public-private partnerships will be helpful in this matter.
93. While credit access is important, agricultural policies in the Philippines have more pressing challenges beyond the availability of funds. Just as the government mandates

private banks to lend more to the agriculture sector, it must also boost its own efforts to address the underlying issues that have kept farmers and fisherfolk from being more productive. The government needs to fast-track efforts in rural infrastructure like farm-to-market roads and irrigation; invest in the modernization of farming methods and equipment; and continuously build farmers and fisherfolk's capacity to access and manage credit funds.

94. We emphasize the need to implement and improve on the government's existing programs and combine these with policy reforms and new strategies that will help small farmers and fisherfolk become more productive. A productive food and agriculture sector will be more bankable, which will then prompt formal lenders to extend credit to the sector, with or without a mandated allocation.

95. The agriculture sector's share in the country's output is declining, but demand for food and other products will continue, and even increase, as the population grows and as the Philippine economy develops. We hope the Aquino administration and the succeeding presidents find some of our recommendations useful in developing a strategy that would accelerate agricultural development, improve incomes, and effectively reduce poverty in the country.



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