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Rural Finance and Developments in Philippine Rural Financial Markets: Issues and Policy Research Challenges

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Rural Finance and Developments in Philippine Rural Financial Markets: Issues and Policy Research Challenges

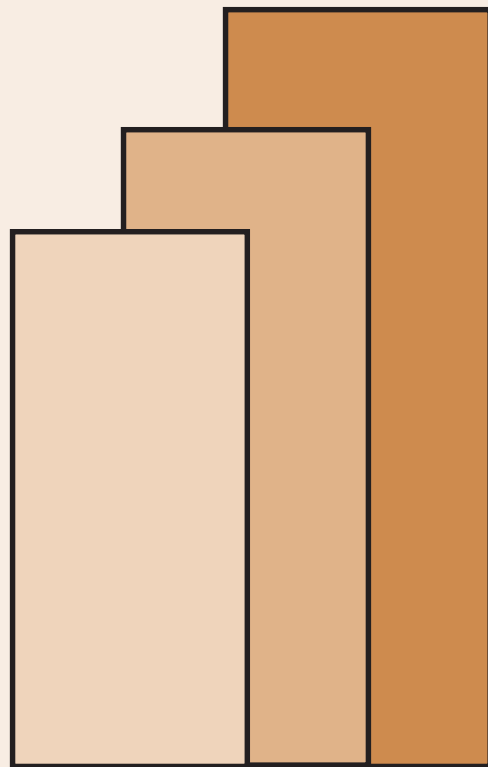
Gilberto M. Llanto

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June 2004

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RURAL FINANCE AND DEVELOPMENTS
IN PHILIPPINE RURAL FINANCIAL MARKETS:
ISSUES AND POLICY RESEARCH CHALLENGES

Gilberto M. Llanto

June 25, 2004

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ABSTRACT

The shift to a market-oriented credit and financial policy was expected to spur rural financing by the private sector that would help usher growth in the agriculture and rural areas. However, the rural areas have continued to suffer from the lack of access to financial services of banks. Despite government efforts to increase the flow of credit towards the rural sector, formal financial institutions have largely ignored the sector. Lack of financial depth and very limited access to financial services continue to hound the rural sector.

Mapping out efficient rural finance policies and implementing them remain as critical challenges for policy makers. Although it is impossible to consider in this brief review paper many other interesting papers and studies on rural finance, the literature survey and the rural finance experiences discussed in the paper can hopefully motivate a policy research agenda on rural finance in the immediate future. This paper, thus, discusses recent new research findings and information on rural finance and suggests thematic areas for policy research.

Keywords: collateral substitutes, credit bureaus, information asymmetry, innovations, transaction costs, risks and risk-mitigating instruments

RURAL FINANCE AND DEVELOPMENTS IN PHILIPPINE RURAL FINANCIAL MARKETS: ISSUES AND POLICY RESEARCH CHALLENGES

*Gilberto M. Llanto*¹

EXECUTIVE SUMMARY

In last two decades, the rural financial market in the Philippines has gone through various phases or stages of development and experience. The liberalization and deregulation of financial markets in the early 1980s led to a radical paradigm shift in rural financial markets in 1987. The government abandoned the subsidized credit policy framework that it had pursued in favor of a market-oriented approach and use of private financial institutions to provide small farmers and other small-scale borrowers in the countryside access to credit for their working capital and investment requirements.

The government's subsidized agricultural credit programs had failed to provide the intended beneficiaries, that is, the small farmers and other small-scale borrowers, access to bank credit. Thus, the government terminated around 42 subsidized credit programs in the agriculture sector, consolidated the remaining fund balances into a loan guarantee scheme for farmers, called the Comprehensive Agricultural Loan Fund (CALF) and announced that the CALF shall be used to encourage private bank lending to small farmers and other small-scale borrowers.

The shift to a market-oriented credit policy was expected to spur rural financing especially by the private sector that would help usher growth in the agriculture and rural areas. The financial and credit policy reforms led to an increase in the number of financial institutions, an improvement in bank density ratios as banking facilities and services became more accessible to various regions outside the National Capital Region, and the provision of new and innovative products to bank customers.

Meanwhile, other government agencies continued to implement their respective subsidized credit programs. It was only in the agriculture sector that subsidized credit programs were terminated. Because of the clamor by various interest groups for access to cheap credit, both politicians and government bureaucrats resurrected the subsidized credit programs in the agriculture sector. By the end of the Aquino administration, subsidized credit programs have once again mushroomed, undermining the government's own market-oriented credit and financial policy and the viability of formal rural financial markets.

Subsidized credit programs or the so-called directed credit programs (DCPs) remain a major source of credit for small farmers and fisher-folk after informal lenders. However, DCPs have created much duplication, segmentation and distortion in the rural financial markets. They have also created an enormous fiscal burden on the government. As of 2003, there are 27 agriculture lending programs, primarily for farm and farm-related improvements.

However, the rural areas have continued to suffer from the lack of access to financial services of banks. Despite government efforts to increase the flow of credit towards the rural sector, formal financial institutions have largely ignored the sector. Lack of financial depth and very limited access to financial services continue to hound the rural sector. Loans granted to the

¹ Vice-President, Philippine Institute for Development Studies and Research Fellow, Rural Development Research Consortium, University of California, Berkeley.

agriculture, fisheries and forestry sector barely increased throughout the years. Loans granted by banks specifically to agriculture-production throughout the years have been insignificant.

Distribution of loans is more concentrated on large farm owners who can present acceptable loan collaterals while small farmers or rural borrowers continue to depend on informal moneylenders. The symposium series of the ACPC in 1999 concluded that despite the financial reforms, agricultural and fisheries lending have remained unattractive to banks and the access of small farmers to formal loans did not improve. The 2002 Small Farmer and Fisherfolk Credit Accessibility Survey by the Agricultural Credit Policy Council (ACPC) reported that the majority of respondents indicate that access to credit has become more difficult in the past year (2001).

Given the foregoing, it is essential to investigate recent developments in the rural financial markets in view of the critical role of finance in the agricultural and rural sector. Well-functioning rural financial markets enhance the production and consumption possibilities of farm and nonfarm households in the rural areas. As pointed out by various researchers, efficient financial intermediation results to the transfer of deposits from surplus units (savers) with inferior investment opportunities to deficit units (borrowers) with high-yielding investments. The net result is efficient resource allocation, an increase in the yield to capital and higher output growth. On the other hand, as pointed out in a recent international conference on rural finance, weak rural financial markets can produce traps that worsen poverty over time, discourage the rate of rural growth and distort income distribution. Having efficient rural financial markets is important because of the combined (1) high incidence of poverty in rural areas and growing income inequality between urban and rural markets and (2) concerns for food security and population vulnerability in rural communities. The question is not whether to address these issues, but how².

Thus, the crucial challenge facing policy makers is how to frame efficient rural finance policies so that they may become a potent tool for development. To map out policy measures that respond to this challenge, it is important to first undertake a comprehensive study that will examine recent developments in rural finance in order to identify research and information gaps that should be addressed for efficient policy making. Thus, the motivation of this paper is straightforward: to find out what new research findings and information on rural finance can be used and what policy research areas should be tackled in order to equip policy makers in their quest for efficient rural finance policies.

It is impossible to consider in this brief review paper many of the other interesting and recent papers and studies on rural finance. However, the literature survey and the rural finance experiences discussed in the paper can hopefully motivate a policy research agenda on rural finance in the immediate future. To determine an agenda, it is important to bear in mind the vision and goal of rural finance policy reforms: to promote the provision of efficient, broadly-based and sustainable financial products and services to various rural economic agents. What can drive the proposed research agenda are the facts of life in the rural economy: imperfect information, high transactions cost and the risks inherent to an agriculture-agrarian setting. The policy research agenda should aim at producing research studies that will offer recommendations to policy makers on how to remove the constraints on the demand for and supply of financial services and products in the rural areas.

In the past, loan quotas, subsidized interest rates, directed credit programs among others, have been implemented by a well-intentioned government but to no avail. They deal with the symptoms and not the factors underlying the rural economy and which mold rural financial

² 'Executive Summary.' 2003. Paving the Way Forward for Rural Finance: An International Conference on Best Practices. International Trade Center, Washington, D.C., USA, June 2-3.

markets. As the paper has shown, economic agents have found a way to deal with those factors that constrain the provision of financial services to rural economic agents, e.g., informal lending techniques, microfinance, etc. It is important therefore to examine carefully the rural financial markets, understand the behavior of economic agents, and investigate the role played by institutions, e.g., property rights, among others. Given the complexity of rural financial markets, we can only point out thematic areas for research. The detailed research subjects can be carefully determined later by the research community.

In this respect, the following thematic areas are suggested:

- sectoral economic policy biases and barriers to increased productivity and higher incomes in the rural areas;
- appropriate legal and regulatory framework that deals with risks and cost of financial intermediation in the rural areas; regulatory barriers to rural finance;
- development of the capacity of financial institutions for rural financial services;
- financial innovations and services;
- identification and management of risks in rural finance;
- role of institutions and governance in rural financial markets.

RURAL FINANCE AND DEVELOPMENTS IN PHILIPPINE RURAL FINANCIAL MARKETS: ISSUES AND POLICY RESEARCH CHALLENGES³

Gilberto M. Llanto⁴

I. INTRODUCTION

A motivation

In last two decades, the rural financial market in the Philippines has gone through various phases or stages of development and experience. The government has pursued certain financial and credit policies and programs with a simple objective: create access to credit by small farmers and other small-scale borrowers in the countryside. The initial attempt at liberalization and deregulation of financial markets in the early 1980s led to the government's radical paradigm shift from a subsidized credit policy framework to a market-oriented approach and lesser government intervention in the mid-1980s, more exactly, in 1987. The government terminated around 42 subsidized credit programs in the agriculture sector and consolidated the remaining fund balances into the Comprehensive Agricultural Loan Fund (CALF) which was used to provide to guarantee small farmer loans from private and government banks.

In a comprehensive review, Lamberte and Lim (1987) identified the outstanding policy issues in Philippine rural finance and pointed out areas for policy research that is motivated by the shift to a new approach: market-oriented financial and credit policies in the rural financial market. In brief, these two researchers pointed out the importance of a stable macroeconomic regime for the development of the rural financial market, the need to remove the bias against rural development, e.g., re-examination of trade policies, and the review of monetary and banking policies that restrict the efficiency of the banking system, among others.

It is essential to investigate recent developments in the rural financial markets in view of the critical role of finance in the agricultural and rural sector. Well-functioning rural financial markets enhance the production and consumption possibilities of farm and nonfarm households in the rural areas. As pointed out in Esguerra (1996), Diamond (1984), Benston and Smith (1976), among others, efficient financial intermediation results to the transfer of deposits from surplus units (savers) with inferior investment opportunities to deficit units (borrowers) with high-yielding investments. The net result is efficient resource allocation, an increase in the yield to capital and higher output growth. On the other hand, as pointed out in a recent international conference, weak rural financial markets can produce traps that worsen poverty over time, discourage the rate of rural growth and distort income distribution.

³ Review paper prepared for the Agricultural Credit Policy Council. The author acknowledges the invaluable research assistance provided by Gabrielle Roanne B. Lavina, Adela B. Santos and Gregoria M. Guce.

⁴ Vice-President, Philippine Institute for Development Studies and Research Fellow, Rural Development Research Consortium, University of California, Berkeley.

Having efficient rural financial markets is important because of the combined (1) high incidence of poverty in rural areas and growing income inequality between urban and rural markets and (2) concerns for food security and population vulnerability in rural communities. The question is not whether to address these issues, but how.⁵

Thus, the crucial challenge facing policymakers is how to frame efficient rural finance policies so that they may become a potent tool for development. To map out policy measures that respond to this challenge, it is important to first undertake a comprehensive study that will examine recent developments in rural finance in order to identify research and information gaps that should be addressed for efficient policy making. Thus, the motivation of this paper is straightforward: to find out what new research findings and information on rural finance can be used and what policy research areas should be tackled in order to equip policy makers in their quest for efficient rural finance policies.

Objectives

The paper aims to provide a review of recent developments in rural finance in order to recommend future directions for policy research on rural finance in the Philippines. The specific objectives are, as follows:

1. Review the findings and policy implications of recent literature on rural finance;
2. Analyze the rural finance policies and programs of the government;
3. Draw lessons from the experiences of the Philippines and other less developed countries on rural finance;
4. Identify areas for future policy research studies on rural finance and draw up a research agenda on rural finance in the Philippines.

Scope and limitations

The paper is **not** an empirical evaluation or assessment of government's rural finance policies and programs. However, it makes a descriptive analysis of those policies and programs in order to help determine a future policy research agenda on rural finance in the country. Systematic policy research can provide policymakers with information for efficient policymaking. The take-off point is Lamberte and Lim's 1987 review of literature on Philippine rural finance. Thus, the paper covers the last fifteen years of rural finance development and experience in the Philippines. It makes no attempt to provide a comprehensive review of the theoretical developments in rural finance. Instead, it focuses on studies, articles and reports that can inform a policy research agenda that may be able to contribute toward efficient policy making.

⁵ 'Executive Summary.' 2003. Paving the Way Forward for Rural Finance: An International Conference on Best Practices. International Trade Center, Washington, D.C., USA, June 2-3.

Organization of the paper

Section I provides a brief introduction. Section II presents the current state of rural finance in the country and recent government efforts in rural financing. Section III discusses developments in Philippine rural financial markets and expounds on recent rural finance literature. Section IV presents a brief summary of some lessons drawn from the experience in rural finance development in selected countries. Section V weaves the lessons from the Philippine and other country experiences in rural finance and recent developments in rural finance literature into an array of future policy research issues or areas.

III. RURAL FINANCE SITUATION AND GOVERNMENT EFFORT IN RURAL FINANCING

The immediate goal of policy reforms in Philippine rural financial market in the late 1980s is to provide access to credit to small farmers and other small-scale borrowers for their working capital and investment requirements. The shift to a market-oriented credit policy was expected to spur rural financing especially by the private sector that would help usher economic growth in the agriculture and rural areas. The liberalization and deregulation of the financial sector initiated in the early 1980s and continued by the government throughout the subsequent decade led to an increase in the number of financial institutions (**Table 2**), an improvement in bank density ratios (**Table 3, Figure 1**)⁶ and the provision of new and innovative products to bank customers. The improvement in bank density ratios indicates that banking facilities and services have become more accessible to various regions outside the National Capital Region although the latter has maintained the highest bank density ratio because it is the center of the country's economic and business activities.

Financial Depth

A proxy indicator to measure financial depth is the ratio of liquid liabilities (M3) of the banking system to GDP⁷ since it reflects the size of financial intermediation although it does not give the entire picture of financial development. An increase in the ratio indicates an increase in financial deepening (**Table 1**). The ratio of M3 to GDP throughout the period 1998-2002 remained constant at 5, indicating that there had not been significant changes in the ability of the country's financial system to channel funds from surplus units of the economy (savers) to deficit units (borrowers).

	1998	1999	2000	2001	2002
Ratio of M2 to GDP	4.78	4.76	4.74	4.80	4.68
Ratio of M3 to GDP	4.83	4.78	4.77	4.81	4.69

Bank Density Ratios and Deposit Performance

There was a slowdown in the creation of new banking offices and branches after the 1997 Asian financial crisis as the banking industry complied with Bangko Sentral ng Pilipinas measures to strengthen the industry, e.g., increase in capitalization requirements, slowdown in the opening of new branches, etc.

⁶ See **Annex B** for details.

⁷ Researchers have shifted to using M3, a broader monetary measure, to overcome some shortcomings in M2, although as data show, the difference is not that large.

Item	1987	1990	1995	1996	1997	1998	1999	2000	2001	2002*
TOTAL	6,508	7,486	12,455	15,493	17,297	18,516	19,297	16,676	17,432	17,782
Commercial Banks	1,761	1,863	3,221	3,647	4,078	4,230	4,326	4,250	4,320	4,199
Thrift Banks	658	653	925	1,171	1,389	1,474	1,478	1,391	1,351	1,340
Specialized Government Banks ¹	76	76	77	-	-	-	-	-	-	-
Rural Banks	1,058	1,045	1,346	1,514	1,715	1,942	1,885	1,912	1,914	1,921
Non-Bank Financial Institutions	2,955	3,849	6,886	9,161	10,115	10,870	11,608	9,123	9,847	10,322

Source: BSP

¹ Specialized government bank consists of Al-Amanah Islamic Investment Bank of the Philippines (AAIIBP) only starting February 1996 and starting 1997, the remaining specialized government bank is consolidated with commercial banks

* Figures as of September 2002 only

The National Capital Region (NCR) has always had the highest bank density ratio in the country. However, the availability of bank facilities and services in other regions has hardly improved as indicated by a lack of growth in their bank density ratios. It was only the period 1997-1998 that showed growth at 6 percent. There was negative growth after the Asian financial crisis. The Central Luzon Region's average bank density ratio of 7 was a far second to NCR's 153 ratio. The lowest ratio of 0.5 was at the ARMM on a 5-year average.

	1997	1998	1999	2000	2001
Highest	144.4	153.6	157.5	154.7	155.6
Lowest	0.7	0.5	0.5	0.5	0.5
NCR-Metro Manila	144.4	153.6	157.5	154.7	155.6
I-Ilocos	2.8	3.1	3	2.9	3
II-Cagayan Valley	2.1	2.2	2.2	2.2	2.2
III-Central Luzon	6.3	6.7	6.7	6.5	6.5
IV-Southern Tagalog	5.5	5.8	5.8	5.8	5.9
V-Bicol	1.8	1.8	1.9	1.9	1.8
VI-Western Visayas	3.1	3.2	3.2	3.1	3
VII-Central Visayas	3.4	3.7	3.7	3.6	3.7
VIII-Eastern Visayas	0.9	0.9	0.9	0.9	0.9
IX-Western Mindanao	1.4	1.5	1.5	1.5	1.5
X-Northern Mindanao	2.8	3.1	3	3	3
XI-Southern Mindanao	4.5	4.9	4.9	4.7	4.6
XII-Central Mindanao	1.6	1.9	1.8	1.8	1.8
XIII-CAR	1.2	1.3	1.3	1.3	1.3
XIV-ARMM	0.7	0.5	0.5	0.5	0.5
XV-CARAGA	1.1	1.3	1.3	1.3	1.4

Source: The Philippine Financial System, BSP Fact Book

Note: The offices include head offices, branches, sub-branches, agencies, extension offices, savings agencies, money shops/sub-offices but exclude offices located in foreign countries

The higher bank density ratio in NCR as compared to other regions implies a concentration of banking facilities in the former region. Outside the NCR, urban clients compete for access to bank credit and other services with those in the rural areas who predictably lag behind in access. Given low bank density ratios outside NCR, access to bank facilities and services by the rural sectors appears constrained.

Bank density directly affects deposit contribution of a particular region. It therefore follows that in terms of contribution in total bank deposits (**Table 4**), NCR leads with 72% average share during the period 1997-2001. Central Luzon, which ranked second highest in bank density, contributed an average of 4% in total deposits. Southern Tagalog, which had a 6% average contribution, had an average bank density ratio of 6 within 1997-2001. ARMM, which had the lowest average density, had the lowest contribution also in total bank deposits with only 0.3% 5-year average.

There are noticeable increases in the deposits of other regions which could partly be attributed to the growth of urban centers in certain regions such as Cebu in Central Visayas and Davao in Southern Mindanao, although, the contribution of rural areas in bank deposits can not altogether be discounted because there is at least 40% ratio of rural population to total population in every region.

Table 4: TOTAL DEPOSIT OF THE BANKING SYSTEM (in Billion Pesos)					
	1997	1998	1999	2000	2001
NCR	1,202.61	1,319.65	1,411.22	1,430.95	1,493.65
Ilocos	27.51	31.69	30.82	39.16	45.52
Cagayan Valley	12.33	13.51	14.00	16.06	19.06
Central Luzon	68.78	74.17	75.71	90.66	106.96
Southern Tagalog	103.08	105.02	108.42	130.47	151.52
Bicol	15.38	17.53	17.60	21.19	23.24
Western Visayas	38.57	44.19	45.38	54.52	64.57
Central Visayas	67.20	76.28	92.14	104.91	116.73
Eastern Visayas	10.64	11.62	11.66	14.22	16.08
Western Mindanao	13.33	14.82	15.99	18.98	21.41
Northern Mindanao	15.42	17.58	18.56	21.14	23.98
Southern Mindanao	33.19	36.06	38.80	40.28	52.69
Central Mindanao	5.60	6.10	6.43	6.91	8.65
CAR	12.90	14.76	14.89	19.65	23.08
ARMM	5.25	5.59	5.58	6.06	7.45
CARAGA	5.92	6.24	6.76	8.18	8.91
GRAND TOTAL	1,637.69	1,794.81	1,913.96	2,023.34	2,183.50

Source: BSP Factbook

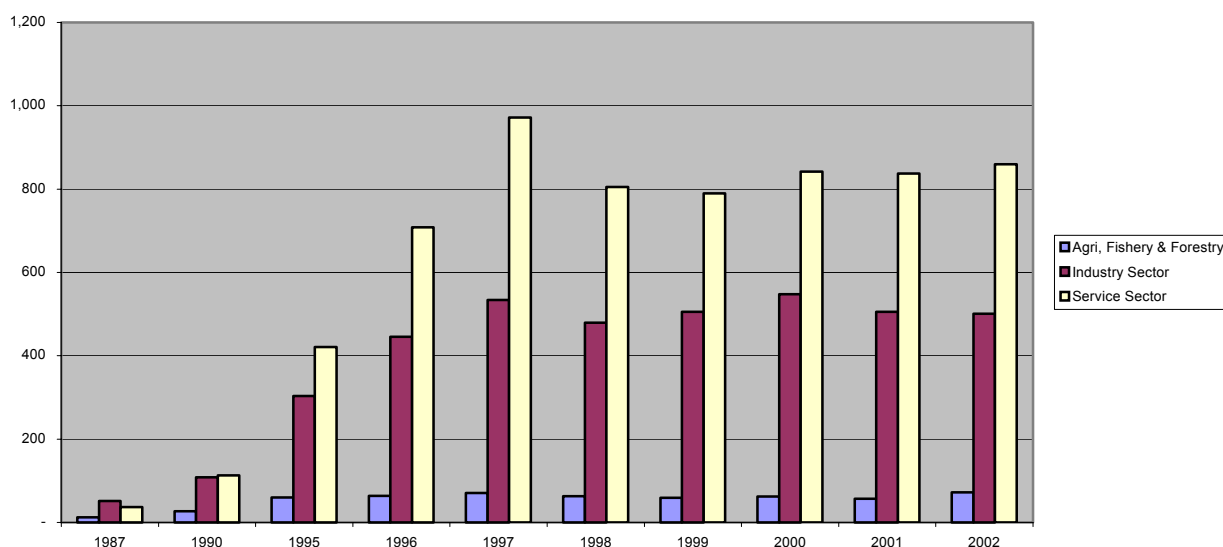
Loans Outstanding to Agriculture, Fishery and Forestry

Loans outstanding of commercial banks to the agriculture, fishery and forestry sector are on a decreasing trend over the years, with an average share of 5% of total

commercial bank loans outstanding from 1995 to 2002 (**Figure 2**).⁸ The biggest share ever enjoyed by the agriculture, fishery and forestry sector was at 12% in 1987. The service sector was the dominant recipient of commercial bank loans with an average share of 67% over the period 1995-2002. The industry sector followed with a 42% average share (see **Annex B** for details).

Despite the loan quota mandated under Presidential Decree 717 (the Agri-Agra Law) the agriculture sector has remained as the least priority sector of commercial lenders. Thus, in the period 1987-2002, loans outstanding to the agriculture, fishery and forestry sector barely increased while those for industry and the service sectors more than quadrupled since 1987 (**Figure 2**).

Figure 2: Industry Share of Loans Outstanding From Commercial Banks



Source: BSP Data

Loans Granted to Agriculture, Fishery and Forestry

The service sector had an 86% average share of total loans granted by all banks in the period 1998-2000 (**Table 5**). The industry sector had an average share of 11% for the same period. Total loans from all banks to the agriculture, fishery and forestry sector,⁹ however, averaged at 3 to 4% in the same period.

The share of loans to agriculture, fishery and forestry (AFF) sector to total loans granted had modest improvements throughout the years. The ratio of AFF loans to total loans granted was 3% in 1998. It increased to but remained at 4% in 1999 and 2000, but showed an improvement in 2001 and 2002 at 6% and 7%, respectively.

⁸There is no disaggregation of loan data published by the Bangko Sentral ng Pilipinas. It is safe to assume though that most of these loans are for agriculture.

⁹ Loans to AFF, as determined by the 1992 Inter-Agency Task Force on Agricultural Credit, cover loans classified by the PSIC system for production purposes under the following economic activities: agriculture, fisheries and forestry (excluding hunting). In addition, included also as determined by the Task Force, are selected agri-related loans classified under mining and quarrying, manufacturing, construction, and wholesale and retail trade.

Total AFF loans to total loans granted was, on the average, 5% in the past 5 years. There has been no significant increase in the allocation of loans to the agriculture sector. There is a wide gap between the loans granted to the nonagriculture sector and those given to AFF. Financing support to AFF coming from formal financial institutions has been relatively small.

Table 5: LOANS GRANTED BY ALL BANKS ACCORDING TO SECTOR (In Billion Pesos)							
	1996	1997	1998	1999	2000	2001*	2002
AFF Sector (a)	n.a.	n.a.	299.04	401.88	335.31	414.28	487.73
Industry Sector (b)	1,385.04	1,063.26	1,034.73	984.51	874.13	n.a.	n.a.
Service Sector (b)	8,610.66	8,661.74	7,452.40	8,677.83	8,275.20	n.a.	n.a.
Total Loans Granted (a)	10,636.25	10,141.48	8,650.83	9,909.13	9,478.18	7,123.32	6,874.93

Source: BSP

(a) Data came from revised reports from ACPC based on BSP data; figures will not add up

(b) Data on PDB, SSLA & SB only until Oct of 2000; Data on SGB only until May 1994

(*) Except AFF sector, data is only from KBs

NOTE: Loan figures, except AFF, were based on reported loans granted to sub-sectors according to reports by each type of bank

Source: BSP Data

Agriculture Production Loans

Of the total loans granted to the AFF sector, only a portion of these actually went to agriculture-production; all the rest went to other agriculture-related activities. Agriculture-production loans made up 31% of the total agriculture-loans granted in 2002, which is equivalent to a mere 2% of the total loans granted to all sectors. On a 5-year average, only 35% of the total agriculture loans actually went to production.

Commercial banks held a significant share of total agricultural production loans granted by all banks (**Table 6**). In 2002, private commercial banks' share of total agriculture-production loans granted was 63%. Both private and government commercial banks provided 60% of the total agriculture-production loans granted. As the dominant provider of agriculture-production loans, private banks provided 94% of those loans in 2002. On the other hand, the share of combined government banks was only 6% for that same year. Rural banks' share of agriculture-production loans in 2002 was 18%, its highest by far, while thrift bank had 17%. In a 5-year average (1995-2002), rural banks' share was 14% while thrift banks had a 15% share of agriculture-production loans.

Table 6: AGRICULTURAL PRODUCTION LOANS GRANTED, BY TYPE OF BANK (in billion pesos)										
	1987	1990	1995	1996	1997	1998	1999	2000r	2001	2002P
Government Banks	1.49	5.93	6.46	8.05	8.38	9.09	9.39	8.39	7.62	8.55
PNB	0.70	1.68 P	a	a	a	a	a	a	a	
DBP	0.13	0.25 P	0.99	1.22	1.12	0.69 r	0.26 r	0.26	0.21	0.90
LBP	0.65	4.00 P	5.47	6.83	7.26	8.40	9.13	8.13	7.40	7.65
Private Banks	25.97	35.31	76.11	556.66	367.86	105.99	161.09	105.29	114.98	141.31
PKBs	21.01	27.25 P	43.27 P	519.75 r	335.24 r	73.03 r	123.01 r	68.63	77.98	89.37
TBs	1.51	3.12	20.37	20.61	22.94	15.31	18.76	20.75	21.04	25.28
PDBs	1.01	1.14	6.36	4.23	6.03	5.28	7.93	6.72	7.70	9.62
SMBs	0.09	1.34	7.04	4.35	4.74	4.17	5.28	8.65	6.30	6.78
SSLAs	0.41	0.64	6.96	12.03	12.17	5.86	5.55	5.38	7.04	8.88
RBs	3.46	4.94 r	12.47	16.30	9.69	17.66	19.32	15.92	15.96	26.65
ALL BANKS:										
Total Agri Prod'n Loans Granted	27.46	41.25	82.57	564.72 r	376.24 r	115.08 r	170.48 r	113.69	122.60	149.86
Total Agri Loans Granted	n.a.	n.a.	n.a.	n.a.	n.a.	299.04 r	401.88	335.31	414.28	487.73
Total Loans Granted to All Sectors	404.35	590.08	6,262.83	10,636.25 r	10,141.48 r	8,650.83 r	9,909.13	9,478.18	7,123.32	6,874.93

Source: BSP-DER, SRSO, Statistical Bulletin, RB System Annual Reports, LBP and DBP.

n.a./ Data not available

r/ Revised, based on actual reports from BSP

P/ Preliminary. Amounts were forecasted due to non-availability of actual data. For 2000 & 2001, LBP and DBP figures are actual Amounts

a/ Starting 1995, PNB was classified under PKBs

b/ For PKBs, estimated amount was based on actual data for first semester, 2000. For TBs, annual amount was estimated from actual data for first 3 quarters, 2000.

Food commodities receive approximately half of the total agricultural production loans while export and commercial crops receive about 20% of those loans. Among the food commodities, livestock and poultry gets the biggest share with 30-40% while cereals and the fruit, vegetable and root crops food group receive about 25% each. **Annex B** provides a detailed breakdown of loans granted to each commodity group.

Financing Support: Loan to Output Ratio

A rough indicator of formal financing support to the agriculture, fishery and forestry sector may be the ratio of loans granted to the sector to gross value added (GVA) of the sector. Overall loan to output ratio is highest in the service sector (**Table 7**), considering that it received the largest financing support from banks. In 1998-2002,

the agriculture, fisheries and forestry (AFF) sector received less than P1.00 in loans from the banks for every peso output in agriculture.

	1995	1996	1997	1998	1999	2000	2001	2002
AFF Sector	n.a.	n.a.	n.a.	66.21	78.72	63.76	75.41	82.33
Industry Sector	29.96	198.75	136.35	123.42	108.06	84.13*	n.a.	n.a.
Service Sector	134.81	838.23	728.51	541.97	557.94	474.65*	n.a.	n.a.

Source: BSP

(*) Data only up to Oct. 2000

The loan to output ratio for agriculture-production was 25% in 2002, a slight increase from 22% in 2001 (**Table 8**). This means a P0.25 financing support from banks for every peso output of the agriculture-production sector. Loan to output ratio in 1996 was quite a departure from the usual trend with 126%. Bangko Sentral ng Pilipinas reported on that particular year a significant increase in agriculture-production loans granted by all banks.¹⁰

Averaging the loan to output ratio of the last 5 years, the banks financed only P0.26 of every peso output of primary agriculture.

	1987	1990	1995	1996	1997	1998	1999	2000	2001	2002
Loan to Output Ratio	16.75	17.48	20.03	126.11	82.15	25.48	33.40	21.62	22.32	25.30

Diversification of Rural Income Source

Rural income still largely comes from farm production although income from nonfarm activities is becoming significant. Data show that in 1987 on-farm income dominated the total rural income with a 56% contribution while off-farm income had 7% which means that 63% of rural income came from farm production¹¹ (**Table 9**). However, by 1990, farm production income (on-farm and off-farm incomes) had declined to 57% while income from nonfarm and other sources increased to 43%. Income from nonfarm activities and other sources has become a significant source of rural incomes.

¹⁰ This seems an abnormal performance and perhaps, it may be necessary for ACPC or BSP to take a closer look at the reason or reasons behind this.

¹¹ On-farm income is income from the farmer's own farm; off-farm income is income of farmer for working on somebody else's farm.

	Total	On Farm	Off Farm	Non-Farm	Other Sources
1987	100%	56%	7%	25%	12%
1990	100%	47%	10%	31%	11%

Source: BAS

Note: An updated version of data will be available next year as BAS is currently processing the survey results

Remittances from overseas workers (OFWs) and family relatives based abroad have also become an increasing source of income for many Filipino families. (See **Annex B** for details.) It contributed 32% to total income within the period 1991-2000 and had largely helped in keeping the economy afloat (**Table 10**). With the decrease in incomes from agriculture and agriculture-related activities, remittances have figured as an alternative and significant source of income for the rural families. Although a large number of OFWs are from urbanized areas, such as NCR and Southern Tagalog, many of them also come from regions where poverty levels are high (**Table 11**).

Some families entirely depend on these remittances as their main source of income while others have used a portion of these funds to set up informal lending activities which provide external financing to farmers and entrepreneurs. Thus, these remittances either directly or indirectly provide the rural areas with necessary funds that formal institutions cannot supply. Either way, the increase in remittances has contributed to the growth of business and economic activities in the rural areas.

	1988	1991	1994	1997	2000
Total	100	100	100	100	100
Wage & salaries	43.3	41.7	44	45.6	52.1
Agricultural	5	4	4	3.2	3
non-agricultural	38.3	37.6	40	42.2	49.1
Entrepreneurial activities	29.8	30.5	27.7	26.2	25.1
crop farming and gardening	9.9	8.9	8.6	7	6.7
livestock and poultry raising	1.1	1.1	1.1	0.9	0.4
wholesale and retail trade	9.7	9.7	9.1	8.7	8.3
Manufacturing	2.1	1.8	2	2	1.5
other entrepreneurial activities	7	9	6.9	7.6	8.2
Other sources	26.9	27.8	28.3	28.2	22.8
net share of crops	1.5	1.5	1.1	0.9	0.5
receipts from abroad	7.5	8.4	8	6.8	11.1
rental value of occupied dwelling units	7.9	8.4	9.4	10.3	3.6
family sustenance activity	2.2	1.9	1.8	1.3	0.2
Others	7.8	7.6	8	8.9	7.4

Source: Philippine Statistical Yearbook

Table 11: 1997 Distribution of OFWs by Region		
	Distribution of OFWs	Rank
PHILIPPINES	100	
NCR	19.1	1
CAR	2	12
Ilocos	12.6	3
Cagayan	5	6
Central Luzon	12	4
Southern Tagalog	18.9	2
Bicol	2.7	9
Western Visayas	9.4	5
Central Visayas	4.2	7
Eastern Visayas	1.8	14
Western Mindanao	3	8
Northern Mindanao	1.3	15
Southern Mindanao	2.6	10
Central Mindanao	2.4	11
ARMM	1.9	13

Source: Go, 2002

Continuing Reliance on Informal Credit

Smallholder agriculture has continued to rely on informal sources of financing. The symposium series of the ACPC in 1999 concluded that despite the financial reforms, agricultural and fisheries lending have remained unattractive to banks and the access of small farmers to formal loans did not improve. Caneda and Badiola (1999) opined that agriculture has not become a profitable sector; rather, it has become riskier while banks became more selective in lending. It seems that those reforms neither led to the design and development of savings and credit products nor contributed to the simplification of lending procedures that would fit the requirements of the small farming and non-farming sector in the rural areas.

The 2002 Small Farmer and Fisherfolk Credit Accessibility Survey by the Agricultural Credit Policy Council (ACPC) reported that the majority of respondents indicate that access to credit has become more difficult in the past year (2001). These respondents expressed the opinion that obtaining loans from banks remain difficult and that government support on credit is inadequate. The main source of credit is still the informal lenders although there seems to be a shift toward formal sources in recent years (**Table 12**).

Table 12. Borrowing by Major Source of Loans: 1996-2002

source	1996-1997	1999-2000	2001-2002
	%	%	%
All borrowers	100.0	100.0	100.0
Formal institutions	24.0	38.6	34.4
Informal lenders	76.0	61.3	60.3
Both formal and informal			5.3

Source: ACPC Small Farmer and Fisherfolk Credit Accessibility Survey (2002)

Distribution of loans is more concentrated on large farm owners who can present acceptable loan collaterals while small farmers or rural borrowers continued to access the services of informal moneylenders. As pointed out by several studies, these borrowers were not so much as concerned with the rate of interest as with accessibility and timeliness of the loans. The costs involved in processing a formal loan application and the time spent to meet the loan requirements outweigh the low interest rates offered by government formal financial institutions. Informal credit markets, on the other hand, offer products that are specifically designed to the needs of the borrowers while alternative collateral, e.g., third party guarantees are widely accepted. However, these informal moneylenders operate on a very limited supply of funds which is not sufficient to service a large number of borrowers. They may have the ability to service those borrowers excluded by the formal banking system but they cannot expand their outreach and face the risk of covariant risks arising from the contiguity of areas and the relative homogeneity of borrowers they serve, thus, constraining their financing capacity.

Lack of Financial Depth and Limited Access

Despite government efforts to increase the flow of credit towards the rural sector, formal financial institutions have largely ignored the sector. There is lack of financial depth and very limited access to financial services continues to hound the rural sector. Loans granted to the agriculture, fisheries and forestry sector barely increased throughout the years. Loans granted by banks specifically to agriculture-production throughout the years have been insignificant. Rural economic agents have limited access to financial products and services and face high costs for the limited financial services they can avail themselves of. It seems that information problems, high transaction costs, the lack of instruments to mitigate and manage various risks affecting the sector, e.g., weather and price risks, and the general state of the rural economy with attendant problems associated with land ownership issues, lack of infrastructure, etc., have worked against the sector's ability to get more formal

financing support to the sector. The irony is that despite the lack of funding from banks, the agriculture sector has contributed 20% to overall GDP.¹²

With more efficient and longer-term financing, the agriculture and rural sector would have registered higher growth. The availability of formal and longer-term financing will be important in view of the growing importance of nonfarm activities as a source of rural incomes. Data show the decreasing share of incomes from on-farm production and off-farm activities to total rural incomes. Nonfarm activities now contribute an increasing share to total rural incomes. Thus, rural financing should be expanded to serve also the nonfarm, rural enterprises and not be mainly limited to agriculture-production alone. There is a need to develop innovative financial products and services other than short-term production credit. Financial products such as medium and long-term credit, deposits, insurance, leasing, inventory credit, among others that are demanded by nonfarm processing and manufacturing enterprises can boost the rural economy. The growth of overseas workers' remittances has provided a newly-found source of liquidity and funds for investments in the countryside. Those remittances should be harnessed to meet the huge savings-investment gap faced by the country.

The duality of economy in the rural sector is a serious gap that hinders sufficient financial services to be properly allocated to the rural-based borrowers. This implies that the rural financial market is seriously constrained by several factors: weak institutions, imperfect information-sharing networks, inadequate mechanisms for enforcing credit contracts and poorly developed systems for supervising rural financial entities, which explains why rural customers, especially small and medium-sized entrepreneurs and farmers are excluded by formal institutions as potential clients.¹³

Current Government Effort in Rural Financing

In the 1970s and till the mid-1980s, the government provided loans at highly subsidized rates to bring down the cost of borrowing of targeted sectors. The most famous example of subsidized credit was the supervised credit component of the Masagana 99 rice production program. Other subsidized credit programs were also created to bring about higher production of corn and other farm products, fish, etc.

Financial market reforms came in the 1980s. Interest rates were deregulated and a market-based interest rate policy was adopted. Subsidized rediscounting programs at the central bank were also terminated and the Central Bank of the Philippines started to move away from development financing leaving this function to the government financial institutions, the Development Bank of the Philippines and the Land Bank of the Philippines. In 1986, the Aquino administration abolished a number of subsidized credit programs in the agricultural sector. It consolidated 20 agricultural credit programs under the Comprehensive Agricultural Loan Fund (CALF) and established a credit guarantee fund for small farmer loans to encourage banks to lend to small

¹² In 1995, GDP contribution was 21% for agriculture, fishery and forestry; 35% for industry and 43% for the service sector.

¹³ See Agabin and Daly (1996).

farmers who do not possess the traditional collateral, that is, real estate, required by banks.

The credit guarantee schemes for the agriculture sector were found to be ineffective in increasing the flow of formal credit to small farmers based on evaluations both on the financial institutions' side (Llanto et al. 1991) and the end-borrowers' side (Llanto and Magno 1994). Banks continued to demand the traditional collateral, e.g., real estate in addition to the credit guarantees provided by the government. An hypothesis is that banks prefer to lend to their regular clientele (not the intended clients--the small farmers) believing that the government's guarantee facilities may not have adequate reserves to meet a sufficiently large claim (Esguerra 1996; Llanto et al. 1991).

Unfortunately, other government agencies continued to implement their respective subsidized credit programs. It was only in the agriculture sector that subsidized credit program were terminated. Because of the clamor by various groups, e.g., farmer groups, for access to cheap credit, it was easy for politicians and government bureaucrats to resurrect subsidized credit programs. By the end of the Aquino administration, subsidized credit programs have once again mushroomed, undermining the government's own market-oriented credit and financial policy and the viability of formal rural financial markets.

Subsidized credit programs or the so-called directed credit programs (DCP)s remain the major source of credit for small farmers and fisher-folk following informal lenders. However, DCPs have created much duplication, segmentation and distortion in the rural financial markets. The provision of credit subsidies has created an enormous fiscal burden. These undermine the development of viable and sustainable rural financial markets. The lack of adherence to market-based policies and principles does not ensure that access to financial services by small and marginalized borrowers will be met. Thus, the need to terminate direct subsidized lending by government agencies (Llanto et al. 1999).¹⁴

As of 2003, there are 27 agriculture lending programs, primarily for farm and farm-related improvements. The brief profiles of selected agriculture lending programs are presented below.

Development Assistance Program for Cooperatives and People's Organization (DAPCOPO)

DAPCOPO's main objective is to provide assistance to agriculture-based activities not serviced by banks. It does this through cooperative federations, people's organizations and nongovernmental organizations (NGOs). Eligible conduits of financial assistance coming from the Department of Agriculture-ACPC are national or regional federations of farmers' groups with management capabilities and satisfactory lending track record. Regional federations are expected to be sponsored by a national-based organization. Also eligible are agriculture-based organizations not financed by LBP or other banks.

¹⁴ Llanto and Geron 1999

A 1995, ACPC review of the program indicated high loan repayment rates but low utilization level. The program has underperformed in terms of utilization level and the explanation given was the inadequacy of the program design and faulty implementation. In addition, the institutional development component was also not properly implemented.

Program monitoring has been directed to primary organizations while activities of federations have not been monitored. The results are irregular submission of quarterly monitoring report and low utilization level of DAPCOPO loan.

The evaluation study recommended that the simplification of the objectives of the program. The program should also invest in institutional development and improve its monitoring. With regard to the design and implementation of the program, the study suggested the following:

- eliminate retention at the program level and capital contribution at the federation level;
- use financial institutions instead of cooperative federations;
- set up a central project management office with federations involved on a fee-for-service basis;
- maintain a revolving credit line for each federation;
- strengthen loans marketing capacities of federations;
- select one financial institution to approve loans and allocate program funds;
- require federations to share in the loan default risk;
- avoid making direct loans;
- pick winners and support them to the hilt; and
- revise program design.

Grameen Bank Replication Program (GBRP)

The Grameen Bank Replication Program seeks to extend loans to the poorest of the poor, eliminate exploitation of the moneylenders and create opportunities for self-employment. At the program level, the eligible conduits are development foundations, people's organizations and cooperative rural banks, while at the beneficiary level, eligible borrowers are the members of the group, particularly women, the landless or those cultivating land not exceeding 5 hectares and residents of depressed areas.

An ACPC evaluation showed that GBRP made a significant impact on the standard of living of its beneficiaries. It also reduced dependence on informal sources. The program exhibited high repayment rates, ranging from 94-98 percent. Those institutions replicating the Grameen Bank approach were able to avail themselves of low-cost funds for lending, to improve their staff capability through training conducted by ACPC and to realize their vision for their respective communities. Of those replicating the program, banks performed better financially while cooperatives had the highest profitability ratios mainly because they received more financial assistance from the government. The participants in the program demonstrated that they can be effective channels of affordable credit to the poor provided that incentives or subsidies are given to them.

To improve the program the following were recommended for institutions participating in the program:

- review loan ceilings periodically to account for changes in the general price level;
- allow institutions to charge market-oriented interest rates on loans and to offer market-based savings product;
- promote savings mobilization; and
- intensify efforts to develop entrepreneurship among borrowers.

The government, for its part, should focus on institution-building, staff training and act as broker of funds for lending by the participating institutions to beneficiaries. It should also limit assistance only during the initial years of the program. Guarantee funds for programs should also be eliminated.

Integrated Rural Financing (IRF)

The Integrated Rural Financing Program, an LBP-DA and ACPC-sponsored program, provides financing through rural financial institutions to enhance the production income and repayment capacity of organized small farmers and fishers. Eligible conduits for this program are rural financial institutions such as rural banks, cooperative rural banks, private development banks and cooperatives while end-borrowers are small farmers and fishermen.

A review of the program was conducted for ACPC. On the level of program management, LBP's loan portfolio targets largely influence program performance and led to provision of loans to cooperatives that do not have adequate social and institutional preparation. The institutional building component has no policy for graduation of cooperatives and lacks standardized tool for assessing training needs of cooperatives and measuring the impact of the training of cooperatives. The monitoring system is heavily oriented towards outreach and loan disbursements and very little attention is given to performance indicators that would reveal operational and structural problems.

The overall program performance shows that IRF was able to reach poor rural households. Loan repayment rate was high at the start of the program but this was not sustained over time. Overall savings to loans outstanding ratio is low, reflecting poor deposit mobilization effort among cooperatives. Most cooperatives exhibit either mediocre or low-level financial performance. The cost of implementation has been on the low side notwithstanding its nationwide coverage. The sustainability of IRF loan funds cannot be determined because those funds are co-mingled with other LBP funds.

The study suggested the following:

- review of program objectives
- ensure loan repayment by having zero tolerance for loan delinquency;
- revise the monitoring system;
- define the policy framework for graduation of cooperatives;
- develop standardized tool for assessing training needs of cooperatives;

- develop and promote savings and loan products that are suitable to client needs and preferences;
- review current administrative supervision by LBP;
- tap experienced service providers in view of limited capacity of current service providers or build the latter's capacity of through an incentive system;
- conduct internal review of caseloads of staff;
- track separately the loan funds of the program from those of other LBP loan funds;
- apply a standard system of cooperative performance and reports;
- focus on savings mobilization; and
- provide guidelines on how cooperative could perform efficiently

Fisheries Sector Program (FSP)

The Fisheries Sector Program, funded by the Asian Development Bank, seeks to alleviate poverty among fishermen through the diversification of their sources of livelihood. Targeted areas are several priority bay areas. Eligible conduits are rural financial institutions accredited by LBP, DBP, Philippine Crop Insurance Corporation and Quedan Rural Credit and Guarantee Corporation (Quedancor). The end borrowers are the marginal coastal fishermen's cooperatives and small aqua-culture operators.

The credit outreach of FSP is small and the program administrators have allowed credit provision even to non-priority areas. Survey results indicated that while utilization purposes for FSP loans might have improved in the priority bay areas, the program's impact in terms of promoting alternative livelihood was severely stifled by the limited outreach not only of the program's credit component, but its other interventions as well, and the fact that the credit component's scope was expanded to nonpriority areas.

According to ACPC, FSP could have improved its performance had information about the program been effectively disseminated, mechanisms to ensure sustainability installed and program intervention confined to priority areas.

Central Cordillera Agricultural Program II (CECAP)

CECAP funded by the European Union intends to increase rural incomes and living standards in targeted areas. Eligible credit conduits of this program are cooperatives, Annual Savings and Loans Assembly (ASLA) and agricultural savings organizations. Eligible borrowers are beneficiaries of CECAP-implemented micro-projects, members of accredited producer groups, savings and loans groups and those belonging to the poorer sector of the community.

In its review of the programs, Euronet Consulting pointed out that the first phase of the project, a direct lending program, failed. In the second phase, the project developed a parallel financial market by linking CECAP-established groups to municipal key cooperatives. The attempt was largely unsuccessful. Viability, especially in remote areas, has remained a serious concern. An effective and efficient loan tracking system was not introduced at all. CECAP has realized that its role as a wholesaler of loans is not sustainable and the program design needs a review which

should include emphasis on savings mobilization, collection of outstanding balances and appropriate institution-building.

Upland Development Program in Southern Mindanao (UPD)

Funded by the European Union, the project's primary objectives are to develop and test a replicable model for sustainable management of the natural resources in the uplands of 5 provinces in Region XI, and to enable upland communities to address their subsistence needs and to produce new marketable surpluses through sustainable market-led agricultural development. Eligible credit conduits for this program are rural banks, cooperatives and NGOs. Eligible borrowers are small farmer producers, small entrepreneurs within the program area and cooperatives.

The UDP microfinance approach is characterized as an institution building and strengthening exercise that is complementary to the existing formal financial market. At the grassroots, farmers are organized in groups called financial services center. Besides the support on a complementary institutional scheme, the project also tries to forge co-financing agreement with partner financial institutions. Thus, it goes beyond what most credit projects supported by the European Union have done.

Euronet Consulting's review of the program indicated that local government units should not be part of the lending scheme. This was stated in the Financing Memorandum between the government and the European Union but it was not observed during program implementation. The participating banks seem to follow a different credit strategy than the planned credit strategy of the program.

Aurora Integrated Area Development Project Phase (AIADP)

This project funded by the European Union aims to alleviate poverty, promote growth with equity and develop environmentally sustainable economic activities. Eligible borrowers are farmer owner-operators or share tenants with 0.5 to 2 hectares of land and the rural poor with viable projects within province of Aurora.

The Project has developed a parallel financial arrangement with the Cooperative Bank of Aurora but it was short-lived. There is an acute question regarding the viability of the credit component of the program. The Cooperative Bank of Aurora needs capital infusion for lending and institutional building measures.

Catanduanes Agricultural Support Programme (CATAG)

This project also funded by the European Union was established to assist rural communities to initiate and sustain increases in income for all economic activities hereby reducing poverty. Eligible borrowers in this program are the rural poor of the 11 municipalities of Catanduanes.

CATAG was instrumental in the establishment and strengthening of ARDCI, a local NGO operating on Catanduanes Island. There is still a need for further institution building. It is important to expand its services to a larger area of the Bicol region.

Economic Self-Reliance and Southern Cordillera Agriculture Development Programme

This program is aimed to help mainly indigenous rural people of the highland areas in promoting an agro-based local economy that will allow them a better and standard of living and will give them opportunity to remain settled where they reside. Targeted areas for implementation are Benguet, Nueva Viscaya and Nueva Ecija. Small farmer producers, small entrepreneurs within the program area and cooperatives are the eligible borrowers of this program.

The program strategy is to simultaneously upgrade grassroot level institutions and improve the accessibility of savings and credit services of microfinance institutions. However, the sustainability of credit projects in remote areas remains a concern.

Agriculture and Fisheries Modernization Act (AFMA)

The Agriculture and Fisheries Modernization Act (RA 8435), enacted into law in late 1997, is the government's response to help transform and modernize the agriculture sector. On paper, AFMA provides a vision and program for comprehensive rural development. It mandates public investments in rural infrastructure, irrigation systems, research and development as well as the reform of the government's agricultural credit programs. The Act declares it a policy of the state to vigorously promote the growth of the countryside economy through access to credit by small farmers, fisherfolk, particularly women, and the small and medium-scale enterprises involved in the production, process and trading of agriculture and fisheries products. It further encourages active participation of private banks and government financial institutions in the rural financial system.

AFMA mandated the termination of directed credit programs (the subsidized credit programs) and in its place, Congress created the AFMA-mandated Agro-industry Modernization Credit and Financing Program (AMCFP) which will use the government loan funds for agriculture sector for lending through private financial institutions. As designed by ACPC, the disbursement of funds for credit by the AMCFP will be determined by the market demand of its wholesalers and retailers and will be at market rates.

Landbank (LBP) is one of the most important institutions in agricultural credit. It was initially the main financing arm of the government's land reform program. However, upon conferment of a universal bank status, LBP put priority to commercial loans of government and corporate borrowers to the prejudice of agriculture and agrarian reform loans. Thus, it deviated from its original mandate to be the financing arm for rural development. AFMA reaffirmed LBP's role in agrarian reform and in the delivery of credit services to the agriculture sector. Under the AMFCP, another institution, Quedancor, is also envisaged to provide credit support for farmers, fishermen, rural workers, cooperatives, retailers, wholesalers and primary processors of agricultural and aquatic commodities.

Role of Foreign Donors

Donor-supported programs have not been able to sustain their activities on a long-term period primarily because once donor support is withdrawn, funds started dry up because of the lack of viability of those donor-designed credit programs. The implementing agencies are paralyzed because of the lack of funds and eventually, the programs are abandoned. When another batch of donors comes in, another round of negotiations will ensue and new programs designed basically by consultants hired by donors will be implemented. There is no continuity of programs and little interest in sustainability is exhibited. The ‘boom-bust’ cycle of donor funding and the lack of funding once the donor leaves the program, has not left a favorable impact on the rural sector. Instead, this has even discouraged efforts to have viable programs and vibrant rural financial market because of donor dependency on the part of the credit conduits and even the loan clients.

In fairness to the donor community, the government’s policy shift towards market-oriented credit and financial policy and sustainable credit programs has happened mainly because of pressure some donors after the realization of the futility of subsidized credit programs. For example, the World Bank’s new implementing guidelines for its projects recognized that the rural sector mobilize a substantial portion of deposits in the financial system. Commercial banks are deposit-takers in the rural areas but they are hesitant to lend to agriculture because they do not have the institutional capacity to reach small farmers and manage risks in agricultural lending,¹⁵ thus, resources are diverted away from the rural sector. Thus, the World Bank’s Operational Directive 8.30 shifted the bank’s policies from the fund transfer objectives of traditional agricultural credit projects to those of building viable financial institutions that operate within the paradigm of the rural financial markets. A preferred strategy is to develop the rural financial intermediaries by linking the formal with the informal credit systems. As long as the institutions are competitive and market-based, there would be no market segmentations (Yaron and others).¹⁶

The Consultative Groups Assistance to the Poorest (CGAP) reports the following problems that plague donors’ financial sector operations: (a) imperatives to move money overriding technical concerns; (b) lack of clarity of goals; (c) a narrow view based on objectives that resonate with citizens of the country providing the assistance rather than in response to local concerns in recipient countries; and (d) staff who are not well versed in institution building. The largest continuing threat posed by donors’ efforts to create a better world through credit projects and provision of other financial services is inconsistency in creating or selecting institutions that are capable of implementing donors’ visions within any given public policy milieu (Von Pischke 2003).¹⁷

It should be noted, though that donor support can play an important role in the progress of the rural sector in the Philippines. Developing innovative products and services, for example, could benefit from donors’ assistance, as the government is usually under budget-constrained while the private sector does not have the initiative to invest in such experimental ventures. The next round of donor assistance, therefore,

¹⁵ Sacay and Randhawa 1995

¹⁶ Design Issues in Rural Finance 1995

¹⁷ Von Pischke 2003

should focus on how to allow and support the emergence of a diverse system of financially sustainable institutions that would have the motivation to innovate and adapt their lending technologies to specific socioeconomic and agrarian context of the Philippine countryside (Llanto and Fukui 2003).¹⁸

¹⁸ Llanto and Fukui 2003

IV. RECENT DEVELOPMENTS IN RURAL FINANCE

Sound Macroeconomic Framework and Financial Sector Reforms

The Need for an Enabling Policy Environment. Unsound macroeconomic policies result in volatility and high real interest rates that can adversely affect all financial intermediaries, while misaligned exchange rates distort price signals and lead financial markets to channel excessive resources to inefficient sectors. In addition, inadequate regulatory oversight, inappropriate interventions in financial markets, and financial repression increase the risks and constrain the development of financial markets (Yaron et al. 1998). On the other hand, favorable macroeconomic and sector policies are necessary conditions for expanding the frontier of rural financial services (Gonzalez-Vega, 2003). Bad macroeconomic management, on the other hand, can thwart the gains brought about by financial market reforms (Lim, 1993).

Since the postwar period, agriculture and rural development has suffered from the policies that tended to favor industry and urban growth. The postwar protectionist policy environment in the country favored the import-substituting manufacturing sector. This protectionist bias has disadvantaged the agriculture sector and the rural sector, which eventually lagged far behind the urban sector. Esguerra (1996) noted that economic policies biased against the agriculture sector as a whole, or against the food crop sector where smallholder production dominates, necessarily lead profit-maximizing financial institutions to lend away from these unprofitable sectors. Negative real interest rates further induce banks to choose the safer and bigger urban-based borrowers instead of the risky and small rural farm producers. This obstructs the flow of funds into the rural sector, constraining the productivity and growth of the sector. However, trade reforms and liberalization in the 1990s, e.g., tariff reforms during the Aquino and Ramos administrations somewhat lifted the bias against the agriculture and rural sector. The economy's integration with global markets and accession to the World Trade Organization have increased contributed to the lessening of the policy bias.

The importance of removing the policy bias against certain sectors of the economy is highlighted, for example, by a recent study by Mundlak and others (1990) who showed the effects of macroeconomic and trade policies on the different sectors of the economy through the prices of inputs and the tradability of goods. Mundlak and others (1990) traced the influence of macroeconomic policy on the relative prices of exports, imports and home goods. The importance of trade in a sector's income and the influence of macroeconomic policy on the prices of the sector's goods, which both accounted for the sector's degree of tradability, determine the magnitude of the effect of policies on a particular sector. Mundlak and others (1990) suggested that economy-wide policies have substantial effects on both the real exchange rate and the incentives to agricultural exports. As most product groups have both traded and nontraded components they are, therefore, affected by the changes in the real exchange rate. Bautista, Robinson, Tarp and Wobst (2001) would later argue that biases against agriculture, namely (a) a direct bias wherein producer prices were suppressed by sector-specific policies in the form of agricultural export taxation, and (b) an indirect bias through the effects of policies on exchange rates affected agricultural incentives, and it may be added, agricultural and rural sector growth.

Financial sector development and growth. The study of Khan and Senhadji (2000) shows a positive link between financial development and economic growth. It is the more developed countries that have sophisticated and more developed financial markets. Their empirical results revealed a strong positive and statistically significant relationship between financial depth and growth. Their study also suggested a nonlinear relationship between financial depth and growth. Earlier, McKinnon and Shaw (1973) pointing out the close relationship between financial depth and growth, argued that hindering the development of financial markets would ultimately reduce growth. In this regard, King and Levine (1993) concluded that financial development has predictive powers for future growth as evidenced by the causal relationship running from financial development to growth.

Financial sector development is both a function and a determinant of economic growth. Promotion of economic development through creation of an enabling environment for the private sector, public enterprise reform and efficient and effective delivery of functions by the government, including maintenance of macroeconomic stability, will also promote financial sector development. At the same time, economic development depends on an efficient, competitive and responsive financial system, capable of mobilizing savings for the funding of investment projects (ADB, 2001).

Robust financial sector development is essential for growth and poverty reduction. Globalization creates new challenges to the design of the financial sector, potentially replacing domestic with international providers of some of the financial services, and recasting the role that government can efficiently play in the financial markets. It is to create the right policy mix or environment that will lead to efficient markets, and in the case of the financial and rural credit markets, to have the right financial and rural credit policies.

The importance of finance lies in its crucial role in the production and consumption opportunities of a household in an economy. An inefficient credit market, for example, would constrain the production and consumption possibilities of the affected households or economic agents, leading to a lower level of welfare. Esguerra (1996) indicated that a well-functioning financial market contributes to the development process by mobilizing deposits from savers with inferior investment opportunities and allocating these funds to borrowers with high-yielding investments. This process makes resource allocation efficient, increases the yield on capital and brings about a higher growth of output.

Financial sector reforms. Yaron and others (1998) believe that an assessment of the efficiency of markets, particularly rural financial markets is a useful starting point for the formulation of policies aimed at increasing rural incomes and reducing poverty. The assessment constitutes among others, an appreciation of the macroeconomic framework governing the functioning of markets, specific urban-biased policies that reduce the attractiveness of agriculture and nonfarm rural sector and policy distortions that devastate rural financial markets. Once factors impinging on the efficiency of those markets have been identified, key policy options could then be evaluated. One such key policy options is the promotion of financial sector reforms.

The liberalization and deregulation of the financial sector in the Philippines began in the 1980s. Lamberte and Lim (1987) provided an extensive review of rural finance in

the Philippines in 1987. The first major point made by these authors concerned the importance of maintaining a sound macroeconomic framework, including a market-based exchange rate policy. The overvaluation of the peso which hurt agriculture more than the other sectors and the urban-biased development of infrastructure supported the import-substitution policy pursued by the government in the postwar years that was continued many decades later. A re-examination of trade and exchange rate policies, the construction of more farm-to-market roads and other physical infrastructures that will promote agricultural productivity were recommended.

Some of the reform efforts in the 1980s were ironically biased against the growth and development of financial markets although the Central Bank of the Philippines justified those reforms as means to stabilize the financial system (Chan 1991). The establishment of branches in the early 1980s was according to the density of bank presence in service areas. Thus, the Central Banks had notions that a particular area is “over-banked” and hence, branching is a restricted activity in that area. Banks were also required to invest in government securities and comply with certain paid-in capital requirements before they could set up branches in other locations. According to Chan, the conditions for branching led to bank units being established mostly in the urban areas with the National Capital Region capturing 31 percent of total bank units in the country. As a result, the growth of banking facilities and services was concentrated in Metro Manila.

Central Bank Circular No. 1200 issued in 1989 provided for the reduction in bank entry restrictions. This barrier to entry shielded both the big and small banks from competition, allowing big banks to earn abnormal profits while leaving small banks to operate at high costs (Tan 1989). When closely examined, Circular No. 1200 proved to be restrictive since Central Bank also continued to increase the minimum capital requirement for banks (Lamberte and Llanto 1995). Mergers and consolidations were still encouraged, suggesting that Central Bank preferred few but large banks. Bigger and fewer banks were believed to promote the safety and soundness of the country’s financial system. The dominance of large banks resulted to a concentration in market power among these banks, giving them oligopolistic power over pricing. It was only in 1992 that these restrictions to bank entry began to be effectively relaxed. In 1995, they were further simplified and made uniform across banks. The geographical restrictions on domestic bank branching were lifted in 1993 (Milo 2001).

However, due to the 1997 Asian financial crisis, BSP imposed a moratorium in the establishment of new domestic banks and branch expansion of existing banks except for microfinance-oriented banks. Increases in the capital requirement were also mandated in a bid to restore the financial health of the banking industry that has been weakened by the plague by non-performing loans. The downside of the BSP requirement for increased bank capitalization and the moratorium on the establishment of new banks and branches was the erection of an effective barrier to entry to the banking industry. The cost of setting up a new rural bank, for example, became prohibitive for small investors. A negative effect is that the small banks like rural banks that would have been able to serve the rural areas cannot open for business because of the increase in minimum capital requirement. Milo (2001) noted that BSP mandated consecutive increases in the minimum capital requirement. The General Banking Act 2000 finally formalized a 3-year moratorium on new bank entry.

The passage of Republic Act 7721 in 1994 promoted competition in the banking industry. The Act partially liberalized the entry and scope of operations of foreign banks but tight branching restrictions remained. A survey by Hapitan (2001) showed that foreign banks initially catered more to wholesale banking thereby increasing the state of competition in that area. However, notwithstanding the reform efforts at liberalization and deregulation, access to credit is not necessarily made easier for certain borrowers, e.g., rural borrowers, small farmers, etc. In a paper on the effects of reforms in the agriculture sector, Kraft (1998) found out no positive impacts on bank lending to the agriculture sector over the past decade. By 1998, the share of agricultural loans from commercial banks fell to less than 1 percent from a range of 6 to 7 percent in the late 1980s. Agricultural loans from rural banks also fell from an average of 65 percent of their total loans in the late 1980s to around 47 percent in 1990-98. There was also a decline in the demand side as shown by the share of farm household-borrowers dropping to 34 percent in 1994-96 from 49 percent in the 1980s.

Lamberte and Llanto (1995) concluded that a deregulated environment does not necessarily make credit available to all types of borrowers if the macroeconomic environment constrains microeconomic behavior. Both structural, e.g., urban-biased development of infrastructure and policy reforms, e.g., financial liberalization are needed to enable rural economic agents to benefit from financial liberalization and deregulation. Llanto (1990) emphasized that there is no certainty that small farmers will gain access to bank credit in a liberalized financial environment. The financial reforms insofar as they address

Subsidized and directed credit was also heavily criticized because it discouraged deposit mobilization. The lack of this damaged the ability of the financial system to assist in allocating resources within the economy more efficiently. Access to cheap rediscounting facilities made financial intermediaries more dependent on the outside funds for on-lending and lessened their willingness to provide attractive deposit services for clients, especially those dealing in small amounts.¹⁹

Credit programs will only be effective in alleviating poverty if poor people capture most of the subsidies. However, despite the targeting of credit programs to particular groups and activities, the actions of both lenders and borrowers are beyond their control.²⁰ As such, those who can enjoy the subsidies more are those with greater access to credit loans. Small farmers who can only make small loans are disadvantaged by big landowners who have bigger loans, and thus, capturing bigger subsidies.

There had been changes to the approach in rural lending. The credit programs, although still heavily focused on agriculture, already provide financing for a comprehensive range of activities, instead of being confined to a specific commodity and activity as before. Group lending, rather than individual lending, is emphasized. Savings mobilization has been included as component, although still a minor part, in the programs.²¹

¹⁹ Adams and Lim 2000

²⁰ Ibid

²¹ Esguerra 1996

And yet, despite the huge amount of financial resources being poured into the sector, Llanto (2001) observed that many farm households still have no access to formal credit, therefore, they still rely on the informal sector for their consumption and investment, including working capital, requirements.

It could be that the failure of (subsidized) credit programs in reaching the rural borrowers, particularly the poor, is that they address the symptoms rather than the causes of inadequate rural financial intermediation (Sharma 2000).²²

The End of Subsidized Credit

In an attempt to stimulate growth and reduce poverty in the rural sector and perhaps to compensate for the policy biases against agriculture, the government provided farmers with cheap funds at highly subsidized rates. Targeted programs for rice, corn, and other commodities were implemented especially in the 1970s-1980s. Mandated credit quotas for agriculture and agrarian areas and a deposit retention scheme in favor of rural areas were imposed and special time deposits and a subsidized rediscounting facility were made available by the Central Bank of the Philippines.

Stiglitz (1993) contends that the rationale behind interventions in the market, such as targeted credit programs, is that without government's initiatives, the banks will not allocate funds to those projects for which the social returns are the highest. Directed credit, in contrast to subsidies, does not require the government to raise revenues. The effectiveness of directed credit is that controlling the quantity of credit is a surer way of providing for macroeconomic stability than controlling the price (or the interest rates) and is even more effective than controlling the price through subsidies (Stiglitz 1994).²³

However, as observed by several researchers (Esguerra 1981; Neri and Llanto, 1985; Lamberte and Lim, 1987, among others), these government interventions did not achieve the intended goal of providing small farmers and other small-scale borrowers access to credit. Rather, the results were sometimes perverse as unintended beneficiaries captured the subsidies and rural banks developed dependency on the Central Bank of the Philippines (Esguerra 1981; Neri and Llanto, 1985; Lamberte and Lim, 1987). The supply of formal agricultural credit declined from a level of 18 percent of total bank loans in 1966 to 5 percent in 1975 and less than 10 percent in 1985 (Abiad and Llanto 1989). Survey results also showed that the proportion of farmers who borrowed from banks decreased from 37.1 percent for the period 1967-1974 to 23 percent in 1981-1986 (Llanto 1990).

The Philippine experience manifested that directed credit programs (DCPs) were too costly for the government because the subsidized interest rates and the preferential treatments towards implementing financial institutions resulted in very low loan recovery. Financial discipline was weakened because of the distortions introduced in the financial markets by DCPs. The widespread nonperforming loans led to the dependence of financial institutions on government funding.

²² Sharma 2000 quoted in Llanto and Fukui 2003

²³ Stiglitz 1994

The government's subsidized agricultural credit programs were fragmented into 46 separate, commodity-oriented programs which led to inefficient and wasteful utilization of credit funds and the subsequent impairment of the rural banking system which was mainly used as credit conduits (Llanto 1990). Herdt and Rosegrant (1988) showed that as much as 65 to 90 percent of the credit subsidies accrued to financial intermediaries as incentives to lend to small farmers. Esguerra (1996) called attention to the "incentive effect of artificially cheap funds on financial intermediaries" that discouraged deposit mobilization, led to dependence on cheap funds from the state and made rural banks mere retailers of government funds.

Thus, Lamberte and Lim (1987) pointed out that subsidized credit was not at all cheap and the benefits of the subsidy were only captured by large farm-owners, thus frustrating the objective of subsidized credit programs. The subsidized credit programs introduced a costly distortion in the rural financial market and impaired its growth. To eliminate the distortion and have efficient rural financial markets, there was a need to shift to market-oriented, market-determined interest rates. To promote competitiveness in the banking industry, liberalization of the banking sector was advocated.

The Central Bank of the Philippines played a huge role in implementing special (subsidized) credit programs (Lamberte and Lim 1987). In the latter part of the 1980s, the World Bank provided a US\$100 million loan to the Philippines for the development of the agriculture sector. It was named the Agricultural Loan Fund and one of the loan's conditionalities was for the Central Bank to end its involvement in development finance. Many years later, in 1993, the New Central Bank Act that created the *Bangko Sentral ng Pilipinas* (BSP) in place of the bankrupt Central Bank of the Philippines, mandated that BSP should not undertake quasi-fiscal activities. Its main function is to conduct sound monetary policy and effective supervision over financial institutions under its jurisdiction.

Importance of savings mobilization

An important research issue tackled by researchers based at the Agricultural Credit Policy Council (ACPC) and the Philippine Institute for Development Studies is the crucial role of savings mobilization in strengthening rural financial institutions. Lamberte and Lim (1987) and the ACPC's rural savings mobilization project pointed out that rural financial institutions would be sustainable and viable with savings mobilization, thus weaning them away from state or donor fund infusion. Earlier, Neri and Llanto (1985) pointed out the negative impact of the dependence of rural banks on the Central Bank of the Philippines for on-lending funds. The special time deposits and the subsidized rediscount facility of the Central Bank of the Philippines that were used by the government to provide on-lending funds to the rural banks created the dependence and considerably led to a weakening of the financial structure of the rural banking industry in the mid-1980s.

The shift to financial intermediation highlighted the importance of financial intermediaries and their roles in providing financial services to the rural areas. This approach was borne out of the recognition that rural households do have savings and that they can be made more productive if only given the needed financing.

Savings mobilization is the anti-thesis of government's subsidized credit programs for by these programs, financial institutions, that is the rural banks that participated in those programs developed dependence and financial weakness. On the other hand, savings mobilization strengthens the balance sheet of banks. Blanco and Meyer (1989) showed that there is a large potential financial market to be tapped in rural areas due to its large share of population and GDP. Their study which covered the period 1977-1986 indicated a "considerable urban bias in the financial system."²⁴ The study also noted that rural loans and deposits were a fairly small share of total banking activity in the country and confirmed that past efforts to provide substantial subsidies and cheap funds to rural banks may have had a disincentive effect in deposit mobilization.

Rural Bank Rehabilitation Program

Lim (1998) believes rural banks are the correct conduits for financing and lending both to nonagricultural and agricultural microenterprises for they could provide cheaper credit than informal markets and at the same time, practice the market discipline and monitoring that usually evade nongovernment organizations. They also have a further advantage of being more approachable and having a more person-oriented atmosphere attractive to small clients which commercial banks lack. Thus, they are perceived to be the most conducive instrument for channeling funds to viable and sustainable microenterprises. However, rural banks have not always enjoyed this positive view because several years ago, the rural banking system was on the verge of total collapse. The nonrepayment of the (subsidized) Masagana 99 loans and other loans under the government's subsidized credit programs, mismanagement and other factors led to the closure of many rural banks as the 1980s drew to a close. Out of 1,167 rural banks in 1981, only 856 were operational by 1986 of which 82 percent were in arrears with the Central Bank of the Philippines (Abiad and Llanto 1989).

Lamberte and Lim (1987) drew attention to the need to rehabilitate the rural banks and to make them competitive. Loans to the agriculture sector dropped in real terms between 1981 and 1987 (Esguerra 1996, quoting Lim (1993). This is partly explained by the inability of many rural banks to continue lending as a result of insolvency (Esguerra 1996), a problem brought about by the government's policy to provide subsidized credit.

The Agricultural Credit Policy Council worked with the Land Bank of the Philippines and the Central Bank of the Philippines in formulating a rural bank rehabilitation program. Central Bank Circular No. 1143 was passed in 1987 aimed to rehabilitate the failing rural banks. The main instrument was the conversion of loan arrears of rural banks into government-preferred stocks. Central Bank Circular No. 1143 was amended twice on pressure from rural bankers to relax the requirement for fresh capital infusion and to extend the plan of payment from 10 to 15 years. There was much debate on the appropriate approach to rural bank rehabilitation until finally the Congress enacted the Rural Banks Act of 1992 that provided several incentives to rural banks to strengthen themselves. The rehabilitation scheme allowed the

²⁴ Blanco, Rhenee and Richard Meyer. 1989. "Rural Deposit Mobilization in the Philippines, 1977-1986." *Journal of Philippine Development*. Number 28, Volume XVI, No. 1. First Semester.

conversion of a rural bank's arrears with the Central Bank into government-preferred stocks in the bank. Owners were required to infuse an equal amount of capital over the period of 15 years (Llanto, 2001b).

Lim and Agabin (1993) conducted three case studies which yielded different conclusions on the effect of the rehabilitation program. In one case, the rehabilitation program was found out to be crucial to the turnaround of a particular rural bank from being a failing to becoming a healthy one. In the other two cases the rehabilitation program did not seem to affect rural bank performance. The two authors concluded that banks which benefited from the program were those that already have capable management and good performance in deposit and loan operations.

The rehabilitation program but perhaps, more appropriately, the ability of rural banks to learn from the lessons of the failed subsidized credit programs helped them to regain financial strength in recent times. A rural bank study by Lim (1998) showed that there had been a rapid increase in deposit and loan expansion in the period 1991-1996. There was also improvement in past due performance as the share of past due loans fell steadily which is partly a result of the transition of the country from recession, in 1990-1992, to growth in 1993-1996. At the onset of the Asian financial crisis and the El Niño and La Niña phenomena, rural banks experienced lower deposit mobilization and higher past due problems which made them more cautious in their lending. BSP regulations also compelled them to improve their banking practices in both deposit mobilization and credit allocations and to raise more capital. The latter seems to be a difficult hurdle for many rural banks.

The Decline of Agricultural Credit

Numerous studies tell of the decline of agricultural credit. Rice (1993) observed that there had been marked declines in the international and domestic supplies of formal agricultural credit, in part related to reductions in the agricultural-credit portfolios of multilateral development banks and bilateral donors and in part related to reductions in domestic fiscal transfers for this purpose. In 1995, Gonzalez-Vega and Graham recognized the substantial losses and eventual decapitalization of most state-owned agricultural development banks and the failure of most targeted farm lending programs used as channels for government and donor funds. Baydas, Graham, and Valenzuela (1997) explained that the decline occurred because of the slow supply responses of private commercial banks, in expanding their operations toward the rural areas, following financial liberalization programs and/or the demise, closure, or privatization of state-owned agricultural development banks.

Most studies, such as by Stiglitz, Llanto and Fukui, Vogel, among others, agree that the primary reason for the failure of the traditional credit approach is that it failed to address the real problems. In effect, it created distortions in the market, defeating its purpose of bringing credit to the rural poor that would have improved agricultural productivity. Subsidies on interest rate of credit created excess demand that had to be rationed through transaction costs.²⁵ As a consequence, those who benefited were the large borrowers who can offset the cost of transactions with the subsidies. Borrowers of small amounts were the first ones to be rationed out.

²⁵ Vogel 2003

The fungibility of credit also explained why agricultural output did not increase despite the abundance of cheap credit.²⁶ This manifested the difficulty of controlling and monitoring of loans granted, and the presence of other nonfarm activities in the rural areas. As development experts began to recognize the behavior of rural borrowers and the importance of financial intermediation, and as credit programs proved to be too costly to sustain for the government and the donors, a new approach to rural finance emerged.

In the Philippines, it was hoped for, during the period of deregulation, that with the competition introduced among banks, credit would finally be made accessible to all sectors of the economy. However, as was earlier said, it does not necessarily follow that after the deregulation of interest rates, credit would be available to all types of borrowers.

Ratio of agricultural loans to total loans granted by the banking sector drastically declined from 22 percent in 1981 to 8 percent in 1983 and further down to less than 1 percent in the late 1990s, signaling a declining amount of financial resources going to the agriculture sector. The decline of financing for agriculture and the countryside was most evident among commercial banks. On the part of rural banks, the proportion of loans granted to agriculture has likewise decreased. Landbank, for its part, increased agriculture loans from 7 percent in 1987 to about 30 percent in late 1990s although this is still very small. Notwithstanding the supply-led financing strategy approach of the government, private banks have chosen to ignore the rural sector and instead focused on the urban sector.²⁷

Kraft (1998) identified the possible reasons that could have led to the decline. The factors in the supply side that prevented the credit market to adjust despite liberalization efforts were:

1. the agriculture and agrarian loan quotas which promoted inefficiency in funds allocation and increased banks' opportunity costs
2. the overly strict loan provision requirements of CB for reasons of greater prudence made most banks wary of the agriculture sector
3. the reduction in the number of banks due to merging weakened the impact of interest deregulation; big banks gained increased control in pricing that led to lower levels in real interest rates for savings and deposits which is believed to have discouraged savings in the rural areas
4. the Magna Carta for Small Farmers (RA 7607) in 1992, which provided that interest rates for small farmer loans should not be greater than 75 percent of prevailing commercial rates, and the RA 7900 in 1999, which stipulated that low-cost credit be made available to high-value crops, both drove away banks from these types of portfolio
5. the continued implementation of DCPs which promoted inefficient fund allocations prevent rural borrowers from venturing into other rural-based enterprises because these programs were usually commodity-specific

²⁶ Ibid

²⁷ Llanto 2001b

On the demand side, Kraft identified the lack of collateral value of land and the poor credit rating of the small farmers as reasons for the failure of formal institutions to provide credit access to rural areas. Furthermore, the financial liberalization on one side and the continued protectionist rural programs on the other side did not seem to work together.

Rural Finance: A New View

The Agricultural Credit Policy Council documented the problems of the government's subsidized credit programs: low repayment rates, the inability of the government to properly monitor program performance and the dependency of rural banks on state and the Central Bank for on-lending funds.

Rural finance, a more comprehensive approach to the problem of farmers' lack of access to credit, displaced the focus on traditional agricultural credit as governments the world over and donor alike became disenchanted with it. The new view is characterized by a paradigm shift from a subsidized credit regime to a market-oriented financial system's approach. The importance of financial intermediation was stressed as reforms to the financial system were pushed. Vogel (2003) emphasized that rural finance is not only about agricultural credit or credit, rather, it should also provide other financial services such as deposit or savings facilities, remittances, insurance and such. Rural finance is not also limited to agriculture as empirical studies have shown that there are other economic activities in the rural areas other than agriculture.

In the Philippines, the first feature of the subsidized credit program that had to go was the highly concessionary interest rates. Llanto (1990) pointed out that the Agricultural Credit Policy Council of the Department of Agriculture embarked on a credit strategy based on two guiding principles: (a) a greater reliance on the market mechanism in the allocation of financial resources and (b) the termination of direct lending programs by non-financial government institutions. The ACPC espoused three broad measures in this regard (Llanto 1990): (a) measures to increase government expenditures for rural infrastructure, marketing facilities, and technical assistance to the rural sector and to continue policy reforms; (b) measures to build farmer creditworthiness and bankability; and (c) measures to reduce the risks and transaction and monitoring costs faced by banks in lending to agriculture.

The core of the third measure is the Comprehensive Agriculture Loan Fund (CALF) that operated as a credit guarantee facility to cover small farmers' loans. The CALF guarantees up to 85 percent of the loan default of small farmer borrowers with 15% to be absorbed by the lending bank. Several studies on the credit guarantee programs (Llanto and others 1991; Llanto and Magno, 1994, Orbeta and Llanto) indicated that this intervention scheme that sought to reduce the relative credit risks of small farmers did not result to more access to formal credit by small farmers as envisaged by policy makers. Instead, banks stuck to their traditional clientele and continued to demand the usual (traditional) real estate mortgages or liquid financial instruments (e.g., government securities) as collateral. Sensing the failure of the new approach to rural finance, politicians and the government soon moved to reinstate credit subsidies (Llanto 1990; Esguerra 1996).

The window for the reinstatement of subsidized credit programs was provided by Cabinet Resolution No. 29 (November 1988) passed by the Aquino government to address the poverty alleviation concerns. The resolution provided a set of guidelines for funding to government-sponsored livelihood programs. Thus, credit was eventually extended by several nonfinancial government agencies, e.g., Department of Social Welfare and Development, Department of Trade and Industry, Department of Agrarian Reform, among others, through banks and nongovernmental organizations.

An important element of the new view of rural finance is the market-orientation of interest rates. The thinking in government circles, that is, the ACPC, Central Bank of the Philippines is that private and government banks should be allowed to charge market-oriented rates to enable them to recover the cost of lending and post a profit margin. At the same time, the credit risks would be partially covered up to 85 percent of the outstanding loan balance by the CALF. However, Republic Act 7607 in 1992, provided for interest rates of small farmer loans to be not greater than 75 percent of prevailing commercial rates, while RA 7900 in 1999 stipulated that low-cost credit be made available to high-value crops. These mandates created quite a pressure on the banks and, in effect, made agricultural portfolio unattractive. Ceilings on interest rates artificially cheapened cost of capital making the unprofitable seem otherwise, imposed undue cost burden on financial institutions and hindered their development, and further restricted small borrower access to institutional credit and worsened income distribution (Esguerra 1996).

The agricultural sector, perceived as an unprofitable activity, was all the more made unattractive by these Congress-imposed interest rate ceilings. Meanwhile, pioneering NGOs experimented with the provision of microcredits to urban-based, poor microenterprises in the Philippines. They drew inspiration from the success of Grameen Bank and the Latin American NGOs funded by Accion International. The advent of microfinance in the country in the late 1990s gave small-scale borrowers an alternative to the informal moneylenders which have catered to their borrowing needs.

Microfinance institutions were left free to charge market-oriented interest rates, enabling them to charge cost recovering interest rates; thus, making their operations sustainable in the long run. Control of interest rates had been proven to be ineffective and even detrimental to the agriculture and rural sector. Llanto (2001b) observed that the government's inconsistent interest rate policy threatens the growth and sustainability of rural financial markets. While BSP and other government agencies like NEDA and DOF have supported financial reforms, especially the adoption of market-based interest rates, this does not seem to be implemented at the operations level of government financial institutions – interest rate subsidies continue to be provided in some credit programs implemented by the government.

On the other hand, flexible, market-oriented interest rates helped the microfinance institutions expand their credit operations among borrowers that could not provide the traditional collateral demanded by formal financial institutions.

Esguerra (1996), although critical of the imposed ceiling, cautioned that removing interest rate restrictions should be weighed against concerns regarding high levels of interest rates and its negative effects on investment, financial stability and growth, thus, free floating interest rates become problematic when the macroeconomy itself is

unstable. Esguerra wanted to call attention to the macroeconomic situation of the country in which high and variable inflation rates, large fiscal deficits, overvalued peso and high nonperforming loans drive interest rates up.

The Agricultural Credit Policy Council is currently advocating the importance of market-oriented interest rates, the consolidation of all agriculture and fisheries directed credit programs per Republic Act 8435 (the Agriculture and Fisheries Modernization Act) and their transfer to government financial institutions for on-lending through private financial institutions, e.g., rural banks.²⁸

The misconception on the creditworthiness of rural borrowers in the past, which led to banks' preference for urban-based borrowers, is still very much felt in the Philippine countryside notwithstanding the reforms in the rural financial markets as earlier explained. Microcredit agencies, microfinance institutions still have to make their presence felt in rural areas. The result is a segmented financial market, a "dualistic financial sector where the formal exist together with the informal, and where the informal sector predominates."²⁹

Financial liberalization has not demonstrated its pivotal role in "pushing outwards" the frontiers of formal finance according to Agabin and Daly (1996). Private commercial banks still target their operations to a traditional urban clientele or a handful of large rural concerns devoted to the export of profitable crops. The majority of small and medium-sized rural enterprises have nowhere to go except to traditional moneylenders, input suppliers, marketing agents and other informal lenders.

Financial dualism occurs when agents with inexpensive access to information and monitoring mechanisms may not have enough resources or may be too risk averse to provide widespread financial services while those who do have the resources and the required attitudes towards risks have no access, at reasonable costs, to the required info and contract enforcements. If this problem is not properly addressed, the inequality, exclusion, high entry barriers and economic stagnation that shape the existence of large numbers of rural population will be perpetuated.³⁰

With the advancement in technology, another dimension to the financial gap arose between the rural and urban firms and households, which affect their access to financial services, termed as the digital divide. It separates those using modern computers and communication technologies from those that do not.³¹

Apart from the urban bias the inherent characteristics of the agriculture sector inhibit banks from making large exposures in the sector. The inherent features of the agriculture is that agriculture activities are location specific; there are varying terms of trade; the success of production depends a lot on natural conditions and requires time; production is seasonal, the sector has high incidence and depth of poverty, and has high volatility in prices (Gonzalez-Vega 1993). All these contribute to why financial institutions prefer to operate in the urban areas. Because of the specific characteristics

²⁸ Adela Santos of ACPC is acknowledged for this information.

²⁹ Abiad 1993

³⁰ Agabin and Daly 1996

³¹ Meyer and Nagarajan 2000

in agriculture, institutional and technological innovations and adaptation is crucial to reduce transaction costs.³²

A New Perspective of Government Intervention

Despite the general consensus that the financial market should be left to the market forces, development experts, lately, have appreciated the importance of the role of the government. According to Yaron (1992), full reliance on market forces is not always preferable. In the absence of intervention in the financial market, the supply response or the adoption of new technologies would be slow. This is further supported by Gonzalez-Vega (2003) who also believed that exclusive reliance on market forces may not result in the theoretically optimum rate of expansion; it must be accompanied by correctly designed political interventions.

Stiglitz (1994) pointed out that although it is not sufficient to conclude that the existence of market failures, by itself, justifies intervention, it is necessary to appreciate the limits, as well as the strengths, of government intervention. As market failures seem to be more pervasive in financial markets, there exist forms of government intervention that will not only make these markets function better but will also improve the performance of the economy. The government has powers, arising from its ability to compel and proscribe, that the private sector lacks however, it is also subject to constraints and limitations, including equity constraints and restricted ability to enter into commitments, which may make it less effective than private sector enterprises.

According to Stiglitz (1994) the principles of financial intermediation lie in the roles of transferring capital from savers to borrowers; agglomerating capital; selecting projects; monitoring; enforcing contracts; transferring, sharing and pooling risks; and recording transactions. In other words, it is concerned with the transfer of generalized purchasing power from economic units with surpluses to those with deficits (Esguerra 1996).

The allocative function of financial intermediation is carried out by mobilizing savings from savers with inferior investment opportunities and distributing these funds to borrowers with high-yielding investments will greatly contribute to the development of financial markets. Successful mobilization of funds would eliminate the need for soft loans from the government, thereby strengthening financial institutions. Financial institutions would, then, strive to lower transaction and risk costs associated with intermediation by giving importance to technological and institutional innovations.

The usual point of contention is when and to what extent the intervention of the government should be. The prevailing sentiment seems to be that the government should provide an enabling environment for economic agents to efficiently transact. It should ensure the proper functioning of markets by providing an appropriate legal and regulatory infrastructure for the financial system. Esguerra (1996) further defines the role of government in the rural sector to be primarily in the creation of an environment that is conducive to financial intermediation, which means effecting

³² Gonzalez-Vega 2003

policies that contribute to the reduction of transaction costs associated with lending and borrowing, thus increasing volume of financial market activity and the number of market participants. An environment conducive to financial intermediation means the provision of large-scale irrigation systems, major road networks, farm-to-market roads, ports, bridges, storage facilities and energy and power systems that will increase agricultural production and improve economic activity in the rural sector. Thus, a crucial part of a favorable policy environment where rural financial markets could function appropriately, reaching all segments of the population and particularly the poor, is the provision of infrastructure support to the agriculture and rural sector.

Public investment is also needed in instances where the required technological and institutional innovations needed to deepen the financial system and to serve poorer segments of the population can be readily copied by *for-profit* financial institutions, resulting in free-rider problems, therefore preventing and discouraging the private sector from sufficiently investing. However, the required public investment should be more labor and knowledge-intensive and far less capital-intensive (Zeller 2003).

In the macroeconomic scene, the government is responsible for its stability and for a sound financial infrastructure. It is also responsible for the deregulation of interest rates and the creation of a legal environment that sanctions the sanctity of loan contracts and protects the rights of lenders, savers, borrowers. It should encourage sound banking practices by drawing up appropriate incentive measures. The 1997 Asian financial crisis emphasized the need for the government to set up prudential regulations to promote stability in the financial system and viability among financial institutions.

Interventions in the rural financial markets, on the other hand, should always be designed to complement, facilitate and improve over a long-term period (Yaron and others 1998). Direct government interventions in the rural financial markets had long been proven to be detrimental to the sector. The prevailing problem in credit subsidies is that it is most often captured by rent-seekers and crowds out the small borrowers, while financial institutions receiving soft-loans and such support from the government never develop into sustainable and independent financial intermediaries.

Yaron and others (1998) stress the importance for cost-effective alternatives such as increased investment in rural infrastructure or in human development to increase incomes and reduce poverty. Rural financial institutions that provide a broad range of services to the targeted clientele in an efficient manner are likely to have the desired impact of expanding incomes and reducing poverty, thus, the evaluation of the performance of credit programs is based on outreach and self-sustainability. The willingness and ability to pay at market prices of farmers and entrepreneurs for savings, credit and insurance services are the primary premise in this paradigm. It is therefore implied that credit access has a significant impact on the output and revenues of rural borrowers, increasing their productivity and, in effect, improving their creditworthiness.

Information Asymmetry and Credit Rationing

As rural credit markets are peopled by very heterogenous rural economic agents whose attributes, characteristics and personal circumstances are not entirely

acceptable to banks while these banks and their operations may be totally alien to many of these rural economic agents, the rural borrower is denied effective access to financial resources and the bank loses the opportunity to intermediate the rural surplus.³³ This asymmetry in information is a major transaction cost that discourages private sector participation in rural financing.

Due to the problems faced by rural credit markets in screening loan applicants, ensuring that borrowers will make the repayments and in enforcement, a lender may employ indirect mechanisms to ensure that borrowers will undertake actions desired by the lender, such as interest rates that could act as a screen which regulates the risk composition of the loan portfolio. A lender could also use the threat of cutting off credit to induce desired borrower behavior (coined by Hoff and Stiglitz as the reputation effect) and a lender who are landlords or merchants could use contractual terms in other exchanges to affect the probability of repayment (market interlinkages). There are also direct screening mechanisms such as those used in informal credit markets, e.g., geography and kinship which makes info asymmetries negligible.³⁴

Hoff and Stiglitz also identified devices that could limit the consequences of information asymmetries and enforcement problems. These are collateral, usufruct loans wherein a lender occupies and uses the borrower's land until the principal is repaid (pawning), and ROSCAs.

The presence of moral hazards and adverse selection in asymmetric information could lead to a rationing of credit even when collateral is used to differentiate among borrowers with differing probabilities of default. Credit rationing occurs when there is residual uncertainty, when the adverse selection/adverse incentive effects of changing interest rate or the no-price terms of the contract must be sufficiently strong that it is not optimal for the lender to use these instruments fully to allocate credit, and when the supply of funds must be such that where demand equals supply, the expected returns to the lender are lower than for some other contract. Furthermore, credit rationing is observed when there are other factors, such as legal restraints on the level of interest rates.³⁵

Transactions cost

Transactions cost as a hindrance to credit accessibility and expansion of credit among formal financial institutions figured prominently in recent literature. It seems that the viability of a rural financial institution would depend on how well it can cope with or circumvent these costs and deliver efficiently bank services. Untalan and Cuevas (1989) defined transaction cost as the cost incurred as banks perform the role of intermediary among savers and users of funds. High transaction cost impedes the intermediary's efficiency in resource allocation and distribution according to these authors.

Abiad and others (1988), identified the two determinants of transaction costs: distance and type of bank. Distance would certainly be a major consideration for a borrower trying to process a loan application, as farmer-borrowers were found to be responding

³³ Llanto 1989

³⁴ Hoff and Stiglitz 1990

³⁵ Stiglitz and Weiss 1992

to cost of transaction in the same manner as in interest rates. Therefore, transaction costs play an important role in the demand for credit and in the rationing of credit among borrower classes.

Transaction cost also varies depending on the type of bank. Untalan and Cuevas (1989) examined the costs for each bank activity. Among their findings is that funds mobilization activities account for a greater part of total cost among all banks. Commercial banks (KBs) have a larger portion of cost contributed by funds mobilization than their lending operations; the opposite is true for rural banks. This emphasizes the thrust of their activities wherein KBs are funds-generating units while RBs are lending-oriented. Private development banks (PDBs) have a balanced operation on both funds mobilization and lending.

Lending transaction cost is also higher in KBs than in PDBs and RBs loan recovery cost is high among KBs and PDBs. In the cost for funds mobilization, a greater part is spent on deposit mobilization among KBs and PDBs; a greater portion of RBs funds mobilization cost come from mobilizing funds from the Central Bank's rediscount window. KBs and PDBs have relatively lower cost per peso of loan and cost per peso deposit mobilization than RBs indicating their comparative advantages.³⁶

One way of lowering transaction costs, according to Untalan and Cuevas, is through improvements in farm productivity which directly lowers the risk faced by banks because lower repaying capacity of rural borrowers would be eliminated. Serious constraints faced by rural markets due to weak institutions, such as info-sharing networks, mechanisms for enforcing credit contracts and adequate systems for supervising financial entities are poorly developed, thus driving up explicit and implicit costs of transaction.³⁷

They showed that commercial banks and private development banks serve as deposit-mobilizing units for their head offices. The larger portion of their transaction cost consists of cost of fund mobilization. Rural banks, on the other hand, with less incentive to raise funds and to depend instead on the Central Bank of the Philippines, have a larger portion of their transaction cost contributed by their lending operations. Untalan and Cuevas argued in favor of bigger capitalization for smaller banks to allow them to expand their operations and viability by exploiting economies of scale in their operations. They reasoned out that bigger operating capacity for smaller banks would lower transaction cost and effectively lower their average cost of delivery. Other recommendations to lower transaction cost are the following: (a) liberal bank entry to introduce more competition that forces banks to deliver services at the least cost possible; (b) improvements in farm productivity to lower the risk faced by the lending bank; and (c) improvements in rural infrastructure to improve farm productivity and increase household incomes.³⁸

On the other hand, high transaction and risk costs associated with rural lending could be addressed by interlocking market transactions so that costs associated with one market could be absorbed by the other market. Flexible lending arrangements enable

³⁶ Untalan and Cuevas 1989

³⁷ Agabin and Daly 1996

³⁸ Untalan, Teodoro and Carlos Cuevas. 1989. "Transaction cost and the viability of rural financial intermediaries." *Journal of Philippine Development*. Number 28, First Semester. Volume XVI, No. 1

agents to operate at efficiency.³⁹ Market interlocking is a common practice among informal lenders and microfinancial institutions, which explains why they can circumvent the both transaction and risk costs and why they are more successful than formal institutions.

The first-best solution, according to Geron, is to increase rural incomes. By increasing the incomes of farmer-borrowers and by making those fixed investments normally owned by trader-lenders available and accessible to the farmer, problems of market segmentation and high transaction and risk costs may be addressed.

In a case study of the transaction costs of lending to the poor, Llanto and Chua (1996) indicated that the bank-NGO-self-help group-poor linkage approach can reduce the cost of screening loan applications and borrowers. It can also create an incentive structure or mechanism for loan repayment, enforcing the loan contract and recovering the loan. However, successful reduction in transaction costs of lending to the poor depends a lot on the quality of the self-help group.

Interlinked Markets and Transactions

Lamberte and Lim (1987) pointed out that interlinked markets could lower the cost of transactions between lenders and borrowers and lead to the lending relationship. Lamberte and Lim (1987) documented empirical studies showing that informal lenders are more efficient in channeling funds to rural borrowers because they were able to reduce transaction costs and risk costs through the use of interlinked markets.

A great advantage of informal lenders is their ability to lower transaction costs of lending to small farmers and small-scale borrowers. One way to achieve this is to engage in interlinked deals defined by Geron (1989).⁴⁰ Interlinked deals lower the transaction costs informal lenders (Floro 1986; Bardhan and Rudra 1978). Geron observed that rural agents engage in interlocking market transactions to minimize costs due to underdevelopment of rural markets: the presence of incomplete and imperfect markets, asymmetry of information, high risks and the nature of agricultural loans. An important finding of Geron is that the existence of interlinked deals in the informal rural credit market addresses efficiency problems. Interlocking market transactions address the high transaction and risk costs in rural lending. She concluded that in an economy where income is low, where market is segmented and where high transaction and risk costs exist, informal lenders are useful on efficiency grounds. On equity grounds, she argued that this usefulness may not be true. If so, the first best policy is to increase rural incomes by overall agricultural policies favorable to the agriculture and rural sector, e.g., stronger support services like marketing services, timely credit information, etc. Increasing farm incomes and making assets and infrastructure available to trader-lenders also available to farmers will address problems of market segmentation and high transaction and risk costs.

³⁹ Geron 1989

⁴⁰ Geron, Ma. Piedad. 1989. "Microeconomic Behavior of Agents in a Credit-Output Market in an Agricultural Setting." *Journal of Philippine Development*, Number 28. Volume XVI. No. 1, First Semester.

The personalistic relationships that characterize the foundation of informal credit led to market interlinkage as an instrument for dealing with information asymmetry and for improving contract enforcement (Floro and Yotopoulos 1991). Interlinkages in the presence of asymmetric information had been stressed in past literature to reduce the cost of screening prospective borrowers and in controlling and monitoring the behavior of borrowers.

In interlinked contracts or transactions trader-lenders have information on the farmer-borrowers, and vice-versa, because of their numerous economic dealings with each other. Such is a strong motivating factor for the existence and prevalence of market interlinkages. Floro and Yotopoulos provided three possible reasons why interlinking lending and marketing may be advantageous to traders. First is due to local economies of scale wherein having a fixed cost that is greater than the variable cost presents an incentive to the trader to maximize his profit opportunities. The second is the seasonality of agriculture production, which also encouraged the proliferation of informal credit markets in rural areas. The liquidity of a trader is negatively correlated to that of the farmer thus getting into interlinkages will be beneficial to both parties. And thirdly, a trader can purchase crops at a discount price.

Imperfections in the credit market rationalize these factors. A study by Teh (1994), on the other hand, presented two other possible explanations for the presence of interlinkages. One is that traders would be spared of costs in searching for low priced sources of output. Search costs are bound to be high due to poorly linked markets, underdeveloped infrastructure and communication facilities.

The other view was advanced by Fabella (1993) wherein unbundled and bundled credit and marketing contracts was a choice between cash for cash arrangements and kind for cash arrangements, respectively. A risk-averse farmer would naturally choose a bundled contract in order to hedge price risks. The trader would also benefit from the bundled contract by capturing the insurance premium the risk-averse farmer would be willing to pay. Apart from the premium, the trader would also enjoy market power. These two explanations for the presence of interlinkages point to the imperfections in the insurance markets rather than in the credit markets.

Interlinked contracts, whether they respond to imperfections in the credit market or the insurance market, certainly answers the issues on efficiency that formal financial institutions lack. The presence of traders increases the financial flows within the rural economy and effectively lowers transaction costs in credit access.

Banks, Self-help Groups, Cooperatives and Group Lending

Llanto (1989)⁴¹ pointed out an emerging phenomenon in the rural areas of interlinking transactions between banks and rural-based organizations called self-help groups that seem to provide a convenient mechanism to ensure access to bank credit and discipline among borrowers. The serious information problem in rural financial markets engenders a credit market structure that is complex and very information-dependent (ibid). Loan contracting becomes a formidable problem for those small

⁴¹ Llanto, Gilberto M. 1989. "Asymmetric Information in Rural Financial Markets and Interlinking of Transactions through Self-Help Groups." *Journal of Philippine Development*. Number 28, Vol. XVI, No. 1. First Semester.

borrowers who can not send the appropriate signals of creditworthiness to the banks. Asymmetric information denies the rural borrowers effective access to financial services and the bank loses the opportunity to intermediate the rural surplus (ibid.) However, as pointed out in the literature, interlinked transactions are an efficient economic response to unequally distributed information arising from the uncertainty in agriculture (Mitra 1983) and a significant device to reduce transaction costs since it is some sort of a screening device which prevents borrower default (Basu 1984).

The linkage between a bank and a self-help group may be the initiative of the group itself or the bank. The case documented by Morte and Llanto (1989) showed that the linkage is an active and mutually beneficial economic and financial exchange between two parties. The self-help group screens or filters loan applications, instructs farmers on the importance of financial discipline and acts as collection agents for the lending bank. The ability to process valuable inside information lead to the creation of a norm of contractual behavior which makes the members of the self-help group honor loan contracts. Willful default can lead to peer sanctions and even to eviction from the group (Llanto 1989).

The linkage strategy recognizes the roles played by the small local groups within the sector and the formal institutions. It focuses on self-help groups as grassroots financial intermediaries between banks and the vast numbers of microentrepreneurs and small farmers to cut down on transaction costs for both banks and customers.⁴² The self-help groups or organizations that work closely with the rural population can supply the necessary information to the bank so that information asymmetries would be eliminated.

After 1986, an important feature of credit programs has been the emphasis on group lending (Esguerra 1996). The lender extends a loan to a group which in turn on-lends to and collects loan repayments from members. A variant of the approach is for the group to act as “facilitator” in getting a loan for individual members who agree to guarantee repayment of each of the members’ loans. This has been popularized by the well-known Grameen bank approach. Esguerra (1996) cautioned on the issue of group size and composition. Homogeneity among group members underscores commonality of interest that must sustain the group. The informational advantage of the group may be dissipated beyond a certain group size.

Esguerra (1996) noted that the group may be a cooperative, a federation of cooperatives, and NGO or any collection of individuals organized for the purpose of accessing credit under some agreed set of rules, e.g., joint liability arrangement. The implication of this is the temptation on the part of policymakers to organize groups, e.g., cooperatives to channel credit to target sectors. This was precisely the approach taken by LandBank in the late 1980s giving rise to their slogan that “the cooperative is the only way.” Huppi and Fedder (1989) argue that the process of group formation must give due importance to the development of positive expectations about the group among its members. This is hardly achieved when groups are formed artificially merely to take advantage of reduced lending costs and it may be added, to be used as channels for cheap government funds.⁴³

⁴² Seibel 1998

⁴³ Cited in Esguerra (1996)

The cooperative movements in the country had been disastrous in contrast to the successful experience of other countries with cooperatives as reported in Lamberte and Lim (1987). The performance of cooperatives had not been very remarkable because government's excessive intervention bred dependence on the cheap credit subsidies which led to the cooperatives' financial weakening. Financial discipline was not stressed among members while the leaders were not trained to enforce the appropriate rules needed in sustaining the cooperative. Thus, it seems that a cooperative can only be successful when the government is not directly involved in its activities and its members are equipped with appropriate knowledge on funds mobilization and allocation and there is discipline in loan repayments and other such values needed to keep the organization viable (Llanto 1994).

The Rise of Microfinance

The NGOs pioneered in the use of lending techniques that draw inspiration from the informal moneylenders, e.g., use of third party guarantees, timely processing and quick release of loans, lending without requiring traditional collateral, etc. Through mechanisms, NGOs have successfully catered to the needs of small borrowers. Grameen Bank in Bangladesh and BancoSol in Bolivia, among others, have emerged from their NGO origins to provide microcredit to millions of poor borrowers.

Microfinance institutions operate often in densely populated urban-poor areas where microentrepreneurs demand financing for their working capital requirements and whose businesses are characterized by rapid turnover, e.g., petty trading, vending, etc. The challenge to microfinance institutions is whether they can also profitably operate in the rural areas whose main economic and business activities are farm-based and farm-related activities and off-farm activities such as minor processing and manufacturing, etc. with populations sometimes scattered over vast areas and whose economy is strongly dictated by the seasonality of crops and capricious weather conditions. Lim (1998) suggested that rural banks are the ideal institutions that could make use of microfinance techniques for they can provide credit that is cheaper than what is offered by informal lenders and at the same time, practice the discipline of formal banks.

The failure of the formal banking system to effectively respond to the credit demand of the small scale economic agents and the cost directed credit programs imposed on the government's fiscal position paved the way for the evolution of microfinancing techniques employed by various microfinance institutions. Private commercial banks confine their operations to traditional urban clientele while majority of small and medium-sized rural entrepreneurs have nowhere to go except to traditional moneylenders and other informal lenders.⁴⁴ Such demand paved the way for some institutions to provide microcredit to a specific group of clients. Credit-granting nongovernmental organizations, credit cooperatives and, to some extent, a few rural banks have utilized microfinance as a sustainable mechanism to provide basic financial services to small-scale borrowers.⁴⁵

⁴⁴ Agabin and Daly 1996

⁴⁵ Llanto 2001a

Faulty assumptions in the past about the willingness and ability of poor farmers and other entrepreneurs to pay for financial services led to faulty policy designs and implementation. These faulty perceptions about the clientele and its demand served as excuses for inaction or led to policy recipes that promoted ill-adapted services, institutions and market structures. However, it has been widely recognized, lately, by the government and the private sector, due to the success of the savings mobilization programs of microinstitutions serving the financial needs of the poor, that the poor save and that they also require savings facilities, if only given the right incentives. It has also been proven in microfinance that the poor make use of their loans in income-generating enterprises, therefore, they have repayment capabilities.

The Christian Aid Reports (1997) showed that over the last decade or so, pioneering efforts of NGOs and others across the developing countries have shown that the poor, women in particular, can successfully use small loans to earn income and are prompt and reliable repayers, implying that traditional collateral is unnecessary, procedures can be designed that make providing even small loans practical and cost effective, and that lending to the poor can be financially sustainable.

Microfinance institutions achieve high levels of sustainability with almost 100 percent loan recovery that is worth adapting into formal institutions serving the agricultural areas. The wide network of low-income clients of microfinance institutions proves that there is a great demand for credit by poor and that they can successfully use these small loans to earn income.⁴⁶

The key issues in building viable and sustainable microfinance institutions are having appropriate legal authority, having a strong equity and financial base and having sound internal policies, systems and procedures.⁴⁷ Regulations that most affect the operations of MFIs are the capital requirements, regulations on deposit-taking, the rates of interest and the loan security.⁴⁸ Seibel recommended that the strategic approaches to take in order to develop microfinance are the reforms in regulations such that the mandated capital requirement would not stand as a barrier in microfinance operations, institutional transformation which would make certain that institutions can be made viable, and finally, practice of sound policies.

The microfinance approach shows potential in answering the needs of the rural borrowers – its localized function has broken information asymmetries and monitoring problems. However, the sustainability and the capability of MFIs to provide long-term agricultural loans have yet to be established. MFIs rely on the quick turn-over of their working capital for funds while small farmers in agricultural production, on the other hand, need medium to long-term loans, in accordance to the seasonality of their crops. Microfinance is successful in densely populated urban areas where borrowers are concentrated and can be more easily reached and monitored.

According to Llanto and Sanchez (1998), the government has an important role to play in developing these microfinance institutions. Apart from creating a policy environment conducive to sustainable microfinance that would allow MFIs to flourish, the government should also provide technical assistance and support to

⁴⁶ Llanto 2001

⁴⁷ Llanto 1997

⁴⁸ Llanto and Sanchez 1998

capacity building. The government should also terminate its directed credit programs and consolidate the funds from these programs for re-lending to the poor.

Traditional prudential regulation and supervisory practices of the BSP can have prohibitive effects on banks engaged in microfinance (Fitzgerald et al. 1998). Llanto (2001) proposed a risk-based regulation and supervision of MFIs that would be more appropriate to their nature and lending activities. This approach focuses more on the risk profile of the MFI and its loan portfolio hold and requires a deep understanding of various risks faced by the lending institution, their risk management techniques, how they deal with loan delinquencies, etc.

The Issue on Missing Middle

Successful microfinance clients have credit demand that microfinance institutions may not be keen to provide because of the so-called mission drift, that is, the MFIs tending to gravitate toward nonpoor clients and move away from their original vision of serving poor clientele. On the other hand, there could be cases where the financial institution's capacity to provide loans grows in tandem with the increase in financing requirements of their most successful borrowers. However, microfinance clients who "graduate" from loans provided by the MFI, face a credit gap. The graduates' requirements are now too large to be met by the MFIs that gave them the early economic impetus, but they constitute a still-unattractive clientele for the formal financial sector.⁴⁹ The lack of an institution for middle-sized enterprises creates a gap which constrains an enterprise's growth. A major constraint that hinders these enterprises' access to the formal institution's services is the collateral requirements needed for loan applications. Thus, there is the emergence of a missing middle.

The missing middle concept is generally attributed to hidden and largely inadvertent biases in the economic policies of countries that militate against the gradual and organic growth of enterprises. The lack of coherent Small-Medium-Enterprise development strategies, which take into account the three dimensions of enterprise evolution (i.e., start-up, survival and growth) and the different needs of enterprises in their various stages of evolution, is another important contributory factor.⁵⁰

⁴⁹ Bastelaer undated

⁵⁰ UNCTAD undated

If policymakers want to deepen formal financial markets and wish to extend coverage to include the most productive and commercial actors in the local economy, which includes the poor whose productivity is high given access to needed credit, they must design lending institutions that can make far smaller loans more efficiently than any that currently exists. Formal institutions could approach the rural sector by borrowing from the techniques of the informal credit markets such as establishing close relationships with the clients, bringing the loans to the borrowers, providing timely credit, not supervising the loans, charging commercial rates of interests and being firm and strict in collecting loan repayments. Most important of all, formal institutions trying to break into the rural financial market should not rely on the methodologies of formal banking, as this would make their operations more expensive and unsustainable.⁵¹

According to Seibel (1998), the institutional adaptation or the downscaling of the operations of banks would involve the delivery system or bringing the bank to the people and adjusting the corporate culture of banks to the microeconomy's orientation. The business and product policies should be oriented towards savings and demand-driven sound banking. In terms of bank procedures, simplifications and modifications should be carried out to accommodate the requirements of microentrepreneurs and households. Banks should also have sufficient measures to avoid and/or manage risks.

The Continuing Importance of Informal Credit Markets

The existence of informal credit markets signifies that there is an excess demand for credit from a significant segment of the borrowing population that the formal institutions can not satisfy. Factors such as information asymmetry, transaction costs and risk costs make it impossible for formal institutions to serve the rural areas without incurring losses. Informal lenders, on the other hand, can easily cope with these barriers primarily because they are in close proximity with the borrowers and they are familiar with the activities in the rural countryside, such that they can offer diverse and flexible credit arrangements in order to accommodate the problems of market imperfections, thus, addressing efficiency issues.

In an economy where income is low, markets are segmented and high transaction and risk costs exist, the presence of informal lenders is useful on efficiency grounds. Their usefulness may not necessarily be true, however, when equity considerations are made.⁵² This is so because informal lenders are also constrained by their own financial limitations, thus the need to allocate available funds to borrowers, and their operations are also confined within a particular location.

The volume of informal financial transactions expands or shrinks in response to developments in the formal sector.⁵³ The persistence of the share of informal credit to total agricultural loans also indicates that credit absorption is a growth issue meaning,

⁵¹ Drawn from Christen 1992

⁵² Geron 1989

⁵³ Esguerra 1996

the rural economy has not grown to the extent that it will attract substantial financial resources from the banking system.⁵⁴

There are lessons, as identified by Adams (1992) that could be learned from these informal lenders, lessons that could benefit formal institutions.

1. deposits, small loans and short-term loans make up a majority of the services provided by informal lenders
2. services that are almost always absent from formal credit programs for the poor
3. informal finance almost always involves participants in orderly processes that result in increasingly disciplined behavior; on the lender's side, he must learn to judge creditworthiness and mobilize deposits, and in order to survive in the business, they need to develop this discipline; on the borrower's side, they must earn the privilege of borrowing through disciplined steps that may include saving before borrowing, repaying small loans to receive larger loans and always repaying obligations
4. the large amount of savings that surface in informal financial markets are an indication of substantial propensities to save voluntarily and also show the failure of most formal systems to provide attractive deposit services
5. many forms of informal finance involve reciprocity which implies a need for emergency credit in the future
6. informal finance is laced with innovations to reduce transaction costs
7. informal finance kept transaction cost low by bringing financial services to places and at times that are convenient to clients; in contrast, formal finance focuses mainly on reducing the transaction cost of the financial intermediary with little concern given to how this would affect depositors and borrowers

A problem with informal finance is its inability to sustain the credit needs of a growing rural economy and to intermediate the rural surplus.⁵⁵ Furthermore, it is limited by the wealth constraints and the covariant risks of the local economy, thus it is shallow. Its services are valuable but not deep enough. However, the government should not repress the informal markets as rural welfare would decline, rather, it should provide new financial services that can complement the valuable contributions of these informal sources.⁵⁶

Regulatory Avoidance in Informal Financial Markets⁵⁷

Regulatory avoidance in informal financial markets is often the result of the repression of financial transactions for which there is considerable demand. Such repression is typically the result of economic regulation of the financial sector, for example, when interest rate restrictions are a binding constraint for financial intermediaries. Disequilibrium in the financial market arises and when this

⁵⁴ Llanto 2001b

⁵⁵ Llanto 1989

⁵⁶ Gonzalez-Vega 2003

⁵⁷ Primarily drawn from Vogel and Weiland's Regulatory Avoidance in Informal Financial Markets 1992

disequilibrium is big enough, alternatives arise such as the informal financial markets which operate independently of the formal sector regulations.

Informal markets, as they are unregulated, are not required to meet the reserve requirement of the financial sector. However, this is only a second-best response to the policy-induced constraints. The government, for its part, should attempt to understand the factors that lead to the rationing of finance in the formal sector (which gives rise to regulatory avoidance) and work to remove them.

Regulatory policies are meant for the proper functioning of markets but the emergence of unregulated entities in the financial sector implies that some of the existing policies are constricting the market. Although these informal markets may be a convenient response to rural financial demands, the lack of supervision and regulation exposes the practice to exploitations and widens the financial segmentation.

Lending Behavior in Informal Credit Markets⁵⁸

The lending behavior of informal lenders reflects the demand of borrowers as well as the supply, or lack of it, of formal institutions.

The larger the likelihood that the residual output is accessed by the trader-lender, the smaller is the interest rate charged, thus, the more encompassing the linked arrangement, such as to include the sale of the residual output, the more interest discount the farmer can hope to enjoy.

Interest rate falls with the higher likelihood of repayment or the easier is the enforcement of the debt service if the farmer's loan is elastic. If it is inelastic, the trader will likely exploit his monopoly position.

The study concluded that the significant factors influencing the behavior of rural lenders are the supply of marketable surplus, such as farm area, the enforceability of repayment, and the extension of the linked contract to include residual output purchase. Found insignificant in the behavior of lenders are the borrower information, determined by the duration of stay, and labor linkage.

Financial Infrastructure, Legal and Regulatory Systems

Development of the financial infrastructure is more important than supporting a specific institution because an improved infrastructure contributes, not only to the particular institution but, more importantly, to the entire financial sector,⁵⁹ as it represents the system through which all transactions within the sector goes through. A well-structured system will have less externality and will not entail unnecessary transaction costs, as there would be transparency between transacting agents.

⁵⁸ Drawn from Esguerra and Fabella's *Trader-Lender in the Rural LDC Credit Market* 1990

⁵⁹ Meyer and Nagarajan 1999

Proper policy instruments can correct the presence of structural barriers, which affects the flow of transactions through the sector. The financial sector needs a clear set of supervising guidelines and regulatory systems for the purposes of distributing growth equitably and protecting the players of the sector, both the lenders and borrowers, while allowing for the financial markets to function competitively. Lenders need a system that provides formal procedures for claims against property and enforcement of financial contracts.⁶⁰ Borrowers and depositors, on the other hand, need protective measures for their investments and from unfair dealings.

Within the financial infrastructure, there should be an efficient information system in order to overcome the information asymmetries in the markets. There is also a need for an appropriate legal and regulatory system that is consistently enforced in order to strengthen the financial institutions as well as to protect the clients of the institutions. Finally, the need for a well-defined system of property rights would be of most benefit to the rural sector.

An inadequate financial infrastructure leads to a gap termed by Gonzalez-Vega (2003) as inefficiency gap. This gap separates current achievement from the potential supply, which means that resources are not being used efficiently.⁶¹ The frontier of production possibilities is not fully reached because of technical inefficiencies due to the absence of correct regulatory structures that determine property rights and appropriate governance.

The legal and regulatory systems provide the rules and guidelines on how agents in the financial markets should conduct themselves. An appropriate system levels the playing field for all participants in the market, promoting competitiveness and, at the same time, imposing measures to prevent or avert crisis in the market. The susceptibility of financial markets to shocks is measured by the effectiveness of its legal and regulatory framework.

According to Gonzalez-Vega (2003), regulations should attempt to establish a competitive environment for all types of financial organizations, at the same time, regulatory framework should also be flexible enough to allow the regulation of different intermediaries that take on different types of risks in different manners. A regulatory policy should not, therefore, be a stumbling block towards the development of the financial sector. At the same time, however, prudential regulations are important in building the strength and stability of the financial markets. The three major principles behind sound regulations are to maintain high net worth and capital requirement, to restrict interest rates on insured deposits and to restrict ownership and transactions where fiduciary standards are more likely to be violated.⁶²

The lack of regulatory framework gives rise to the absence or lack of the following: (1) performance standards, (2) uniformity and dilution standards of credit evaluation, and (3) portfolio supervision which leads to poor loan recovery and deterioration of loan quality. It also gives rise to moral hazards and incentive problems.⁶³

⁶⁰ Yaron and others 1998

⁶¹ Gonzalez-Vega 2003

⁶² Stiglitz 1994

⁶³ Llanto 1997

In this regard, there is a need to review Republic Act 6938 and Republic Act 6939 (Cooperative Code of the Philippines and the Cooperative Development Authority, respectively) enacted into law in 1990 which aimed to promote and develop cooperatives as a vehicle for the delivery of basic economic and financial services to the rural poor and to encourage private sector involvement in the actual formation and organization of cooperatives, to find out the impact these laws have made on cooperatives. The importance of the cooperative sector in granting financial access to the poor justifies the need for formal regulation of the sector.

The Cooperative Development Authority (CDA) is the supervising and regulating body of cooperatives. However, CDA maintains only a very limited “regulatory” role confined only to the registration and, to some extent, monitoring of cooperatives.⁶⁴ It has yet to impose a minimum capital requirement, reserve requirement, mandatory credit allocation and has yet to conduct a financial audit of cooperatives. Unlike deposits in banks, however, deposits in cooperative groups and credit unions are not covered by any insurance. Although, there has been no case yet in the country where a collapse of one cooperative created a ripple effect in the cooperative system,⁶⁵ effective regulation and supervision are necessary to protect the deposits of millions of small depositors in cooperatives.

Vogel (2002) emphasized that to implement an effective regulatory environment for credit cooperatives, an essential first step is to ensure there is a standard chart of accounts with standard definitions for all credit cooperatives and then to secure agreement on key indicators of condition and performance. The environment for non-deposit-taking credit cooperatives should encourage the provision of transparent information so that potential donors, lenders and investors can make well-informed market-based decisions. Improved internal auditing and external audits by qualified auditors following a prescribed format can also contribute to the transparency of non-regulated credit cooperatives, and with audit cost reduced by the increased efficiency stemming from standardized accounting.⁶⁶

A well-functioning credit cooperative, meaning it effectively delivers the financial services needed in the community where it is based using its own funds in its operations, reflects the degree of development of the sector as well as the maturity of the government as a regulatory body of the financial sector.

Information Systems and Credit Bureaus

In a market abounding with asymmetry in information, lenders should have a way of appraising prospective borrowers to avoid loan defaults while depositors, as well as shareholders, should have a way of knowing the profitability of their investments. In response to this need, a database of information attempts to overcome information asymmetries, using statistics to make the predictions, by linking default behavior of past clients to a range of objective indicators.⁶⁷

⁶⁴ Arbuckle, Llanto and Bhagwani (undated)

⁶⁵ Lamberte 1995

⁶⁶ Vogel 2002

⁶⁷ Rhyne and Christen 1999

These credit bureaus provide detailed information that allows financial institutions, including microfinancial institutions, to evaluate a borrower's ability and willingness to pay; they operate on a principle of reciprocity among members which addresses a fundamental tension between the parties involved in a credit transaction. Through these institutions, transaction costs are lowered, risks are reduced, there is greater transparency, competition is promoted and better incentives for repayment are encouraged.⁶⁸

According to Haider, the government should initiate the establishment of such institutions because, primarily, it is a public good and, secondly, there are fixed costs involved. Private entities will only enter the market after a public credit registry has made a head way through the market. Privately managed bureaus will, then, complement the records of the public credit register by expanding the breadth, quality and accessibility of information. A problem, however, arises in the linkage of credit bureaus among financial institutions. Usually, due to bank secrecy laws, which stipulate that only regulated entities can have access to these facilities, microfinance institutions are automatically excluded.⁶⁹ Another issue is the cost, particularly for small banks and microfinance institutions with few transactions. Integration of microfinance into the credit information system would need (1) national initiatives to promote linkages of large unregulated MFIs with public credit bureaus; (2) willingness on the part of MFIs to share information and develop standard reporting systems; (3) technical assistance providers that can help to set up information systems and develop MFI capacity to fulfill information reporting requirements, and (4) where credit bureaus do not exist or are underdeveloped, donor support to encourage legal framework for public and/or private credit bureaus.⁷⁰

Bangko Sentral ng Pilipinas has a role to play to facilitate the proper and valuable development of the use of credit references in commercial and financial transactions. BSP should motivate financial institutions to exchange references with credit bureaus.⁷¹

The Emergence Of Credit Bureaus In The Philippines⁷²

While the use of credit bureaus has long been implemented in many developed countries, this information system has barely been adopted in the Philippine banking sector. The main reason for this is that the personal credit history available to lenders for assessing risk is typically limited by custom or law. Historically, credit reporting began with the sharing only of so-called *negative information*, or reports on bad experiences from borrowers such as delinquencies, charge offs, bankruptcies and other similar types of information.

Only gradually and recently has information about the successful handling of accounts (prior and current) been added to the data repository of some Philippine banks. These, on the other hand, are the *positive data* that include such information as account type, account age, current balance, credit limit, and others.

⁶⁸ Haider 2000

⁶⁹ Haider 2000

⁷⁰ Campion and Venezuela 2001

⁷¹ Bolaños 2000

⁷² The discussion on credit bureaus drew on information supplied by the ACPC.

Majority of the banks that presently practice the sharing of positive information are commercial banks situated in the urban areas. These banks have organized a common screening system and a depot of information primarily to keep records of corporate as well as personal accounts.⁷³ Among other things, this system can provide banks with information on how much a borrower owes other banks. With the ready availability of this type of information, the risks to the entire banking system can be minimized.

The management of data on good and bad bank borrowers started with the founding of the Credit Information Bureau, Inc. (CIBI) and the Bankers Association of the Philippines (BAP)-Credit Bureau in the mid-80s to early 90s. However, these credit bureaus mainly serve the information requirements of banks in Metro Manila. Although, now, both the CIBI and BAP are planning to expand the area coverage of their credit bureaus to the countryside by encouraging the cooperatives and rural banks to participate in their respective credit bureau systems.

Presently, the existence of a credit bureau is already part of the prerequisites to the implementation of the Basle Capital Accord II by the Bank for International Settlement (BIS) in 2005.⁷⁴ The Philippines recently became a member of the BIS, which is among the stronger and more prestigious advocates in international fora on bank supervision (Malaya, November 3, 2003).

As a leading institution in credit policies, ACPC has taken initial steps towards the establishment of credit bureaus in the countryside. It plans to pilot a rural credit bureau next year which is chiefly geared at promoting a sustainable and effective delivery of financial services to the countryside through information dissemination, strengthening the market base of the rural and cooperative banks in the countryside by fusing its technical resources to the existing credit bureau operating in Metro Manila and instilling discipline and diligence in making payments especially to the small borrowers like farmers and fisherfolk.

Also, the Bangko Sentral ng Pilipinas (BSP) is currently working with the National Credit Council (DOF-NCC) to study and develop a viable business option for effective credit bureau operation given current Philippine policy and regulatory environment.

Some Issues That Hinder the Development of Credit Bureaus in the Country

A well-established bureau hinges on certain test-components such as its *market reach*, *sphere of operation*, *number of subscribers*, *social responsibility* and *impact* on the lives of the people that can significantly tell the depth of its experience in the business. Fitting models of this kind are the BAP-Credit Bureau and the CIBI that can be both considered as the prime-movers in the development of commercial credit

⁷³ Particularly those holding credit cards.

⁷⁴ Also known as the Basle Committee which is composed of senior representatives of bank supervisory authorities and central banks. Among the original member-states are Belgium, Canada, France, Germany, Italy, Japan, United Kingdom, Netherlands, Sweden, Switzerland and The United States. To obtain public policy benefits, the New Basle Capital Accord focuses on improved capital adequacy framework zeroing in on developing capital regulation and increasing substantially the risk sensitivity of minimum capital requirements.

information system in the country. Akin to a budding organization, nonetheless, problems and issues are always there that hinder their efforts to further develop their systems and increase their reach.

Credit bureaus could not take-off in the countryside because rural and cooperative banks are *unwilling to share information*. Little appreciation for new technology, additional overhead cost to the maintenance of database (e.g., training and hiring of new staff), and perceptions that their current and prospective clients are open to piracy are among other reasons why the setting up of an information depot is difficult to launch.

The current set up of BAP Credit Bureau and CIBI are mainly catering to the needs of commercial banks. Viability of the business is their primary consideration at this time and, hence, hesitant to venture to the rural financial market which they believe could not sustain the financial requirements of maintaining the services of a credit bureau.

Credit bureau as a disciplinary tool to those who are delinquent in repaying their loan obligations may further steer away the small borrowers such as the small farmers and fisherfolk in obtaining credit from the formal institutions like banks. The instability and seasonality of the nature of the incomes of the rural borrowers make it difficult for them to repay their obligations on the agreed time which, consequently, prohibits them from obtaining any subsequent loans because of their bad records. As recourse, they have oftentimes the tendency to borrow from the informal lenders. Unfortunately, this is contrary to the objective of the government in encouraging the private sector to actively participate in agricultural lending.

Making it mandatory through legislation for banks to participate in the credit bureau is *unnecessary*. The **Bangko Sentral ng Pilipinas (BSP)** may elect to indirectly require these banks by giving incentives such as additional points in their respective performance ratings should they join in the said bureau. The **BSP** that pushes for the establishment of credit bureaus, under the existing laws, is in itself legally constrained from financing a subsidiary or undertaking for private or commercial purposes such as this. Recently, the BSP through a news release urged anew the banks to form their credit bureaus to allow sharing of vital credit information and blacklist notorious borrowers. It also encouraged the participation of other government agencies in this undertaking. On the one hand, banks can form an independent organization where each of them is represented and has a voice in the administration of the credit information system. The sharing of authority and responsibility gives the formed body a level of independence and neutrality in as much as the whole operation is concerned.

The loan portfolios of rural and cooperative banks mostly benefit the big borrowers than the small ones. This is a clear example of small borrowers being slighted in the process because the current trend in the banking sector is to go main-stream in order to achieve business and financial viability. The banking sector is unanimous and unequivocal in saying that countryside lending is too high a risk because rural farmers and fisherfolk have no stable source of income and subsist only on seasonal harvests thereby compromising their ability to pay their loan obligations.

There is no clear distinction between the big and small borrowers in terms of loan amounts. This poses a problem when you treat them as both delinquents with a large rift in the amounts of their respective loans. More leeway should be given to small borrowers since the amounts they borrow are relatively easier to pay. Separate criteria for this group should be formulated in order not to discourage them from borrowing from the formal sector.

Property Rights, Agrarian Reform and Financial Intermediation⁷⁵

The system of property rights has a profound effect on incentives and on the scope of market transactions in land and credit. For one, property rights provide agents with the incentives to use land efficiently and to invest in land conservation and improvement. Also, it has been determined that information is positively correlated with property rights, which means that a clear and well-enforced property rights will produce symmetric information. Land's usefulness as collateral is dependent on the absence of uncertainty and asymmetric information with regard to the rights, such as transfer rights (Feder and Feeny 1991).

The absence of clearly defined owners and other attenuations of property rights usually lead to technical inefficiencies and yet, most organizational structures of rural financial institutions are characterized by this weakened property rights and do not generate optimal levels of internal control.

In the Philippines, the Comprehensive Agrarian Reform Program (CARP) of 1988 was aimed to address the highly unequal distribution of rural incomes caused mainly by the inequitable distribution of lands. However, what it failed to foresee was the externalities it brought that adversely affected the value or collateralability of land. Several authors criticized the CARP's slow implementation, some of which were David (1998) and Kraft (1998), as the delay increased the distortions and uncertainties in the land market.

The inequitable distribution of agricultural lands and the high levels of poverty in the countryside prompted the Philippine government to address these problems. In 1972, Marcos instituted Presidential Decree 27 which granted the liberation of the tiller from the bondage of the soil. Through this proclamation, tenants in rice and corn became deemed owners of the land they were tilling. A mechanism was also established where tenants can purchase lands on installment, while others could be shifted from share to fixed-rent leasehold tenancy.

However, PD 27 was confined only to tenant-farmers and private agricultural lands in rice and corn. It also suffered from implementation problems where, in the 15 years of its implementation, Operation Land Transfer achieved only 15 percent of its original target for emancipation patents. This low completion rate was due to lack of funds, lack of strong political will, inadequate agrarian reform policies and various technical and documentation difficulties.⁷⁶ Alongside these difficulties was the unfavorable macroeconomic environment, characterized by an overvalued exchange rate, monopolies, price controls, an abundance of cheap credit which worsened income

⁷⁵ Heavily drawn from *Financial Intermediation in an Agrarian Reform Regime* 1994, edited by Llanto and Dincong

⁷⁶ DAR, *Cornista* 1987 as quoted by Llanto and others, 1994

distribution and weakened RFIs, and constricting regulations in the financial system, that discouraged growth of the sector.

In 1988, the Comprehensive Agrarian Reform Program was signed into law by Aquino. Its primary objectives were to improve land tenure systems and enhance the socio-economic status of beneficiaries through the delivery of support services. Unlike PD 27, the program has more expected beneficiaries and is compensatory rather than confiscatory.

Structural adjustments were expected to likely occur, such as changes in the size distributions of farms which would either increase or decrease production levels according to whether there are economies or diseconomies of scale, and changes in the tenancy arrangements which would alter the rewards of investing capital and allocating labor to agriculture. It was also expected that with the implementation of the program, an increase in the number of beneficiaries would bring about an increased demand for credit. Landbank had been directed to service the needs of these rural borrowers.

Due to the structural changes, however, the supply of finance would have to depend on the financial system's willingness to accommodate the credit demand of the rural sector. The increase in number of smaller-scale farms and individual farmers, the change in the collateral value of land, the shift in the assets of former landowners from land in the rural areas to financial assets, and the increase in lender transaction costs resulting from the changed size distribution of farms will be important factor to be considered in the granting of credit to the rural sector. Government policies will also greatly affect the ability of beneficiaries to access the financial services and the capacity of financial institutions to provide these services.

The uncertainties unintentionally brought by CARL adversely affected the willingness of banks to provide financial services to the rural areas. Based on the surveys undertaken by Llanto and Dingcong (1994), marketability of collateral and reputation of borrowers are considered the most important factors in the evaluation of loan applications by banks.

Farm lands are not accepted as collaterals by some banks due to uncertainties in their ownership while, on the other hand, Emancipation Patents, which are nontransferable, and Certificate of Stewardship Contracts, which remain public properties, are not accepted at all. Most banks only service large, commercial clients because agrarian reform beneficiaries are perceived as greater credit risks. A bias against agricultural activities was identified as evidenced by the higher proportion of rationed borrowers engaged in agricultural activities as compared to the proportion of borrowers engaged in nonagricultural activities. This therefore implies that agrarian reform beneficiaries have difficulty accessing loans from financial institutions. The program unintentionally intensified the bias of private banks against the rural sector, particularly in agriculture.

Financial liberalization and a market-oriented credit policy will not sufficiently address the lack of credit access of these rural borrowers. Although Landbank and the rural banks were mandated to deliver credit to the agrarian reform beneficiaries, the magnitude of credit requirements and the number of borrowers cannot be

accommodated by the available resources of these banks. And because of extreme competition in loan applications, only the most bankable will likely avail of credit.

Enhancing the creditworthiness of the farmer-borrowers will definitely take some time, therefore, in the interim, interventions that would support the viability of the activities undertaken by rural borrowers is necessary.

What is emerging as a short-term policy tool to address the problem of credit is the use of cooperatives and people's organizations as channels for credit delivery. The basic idea is to use the low cost funds in the formal financial sector while at the same time, taking advantage of the monitoring, information and enforcement technologies of cooperatives and people's organizations. The joint liability among cooperative members in a particular loan contract serves as a relatively efficient risk-sharing device and as a collateral substitute for loan availments. If efficiency considerations are adhered to by these programs, there is the possibility that the bank-cooperative/people's organization linkage can address the access to credit problems of agrarian reform beneficiaries.

The shift in resource-ownership brought by CARL also increased the transaction costs between the lender and borrower, which in turn increased the total borrowing costs of farmers. In effect, banks shifted away from agricultural lending. Based on a sample of banks, Casuga (1994) reported an advantage in using nonbank financial institutions (NBFIs) over banks in servicing small farmer credit needs in terms of transaction costs. The survey also showed that banks have considerably higher lending transaction cost than NBFIs. Furthermore, the total transaction cost incurred by borrowers of these banks in availing themselves of loans was found to be twice as much as the expenses incurred when transacting in NBFIs.

Support interventions required in promoting the operations of NBFIs should not only be limited to funding, as this may adversely result to laxity, rather, encouraging mobilization of savings and entrepreneurship will be more beneficial. The linking of formal financial institutions and NBFIs/credit cooperatives would also reduce lender and borrower transaction costs.

Existing bank policies and regulations discourages their operations in rural areas and makes the urban areas more attractive. The inherent characteristics of the countryside also aggravate the bias of banks against it. Improving the transport infrastructure and supporting the development of technology will decrease travel costs involved in transactions between formal banks and rural borrowers. Given the asymmetry in information, information systems should be properly laid down. Support groups and other techniques could be promoted to eliminate the moral hazard problems.

As the delivery of support system is a part of CARL's component, Landbank, being the principal institution mandated to provide support services, should have the institutional capability to accommodate both the landowners' and beneficiaries' financial needs. A primary factor, which restrains Landbank from fully servicing the agrarian reform beneficiaries, is the difficulty in being a unibank as well as an apex bank for agrarian reform at the same time. While there is a need to provide access to credit for agrarian reform beneficiaries, the subsidies that the government provides through Landbank should be evaluated in terms of cost-effectiveness and equity

impact. Furthermore, Landbank must stay viable and profitable to discharge its functions. The arrangements for buying land under CARL pose potential problems because of the mismatch between payments to landowners and receipts from small farmer mortgages. In case the Agrarian Reform Fund is not fully funded, Landbank would still have the legal responsibility to finance future liabilities on land purchases. This has severe implications on the integrity of its balance sheet.

Banks, thus, should be equipped to deal with agrarian reform beneficiaries. This implies that government should initiate activities that would equip banks in dealing with these beneficiaries. Banks should also be given incentives to induce them to lend to the rural sector. This means that their risks to lending be reduced to a reasonable level. The credit guarantee and insurance programs seem to be appropriate interventions. Also, the overall condition for lending should be improved such as the removal of intermediate taxes and the promotion of policies that would increase efficiency in financial intermediation. No amount of effort at the micro level will increase the level of efficiency of financial intermediation in the agrarian sector unless a suitable policy environment is created.

Current Issues on the Collateral Value of Farmlands

As of December 2002, 68.6 percent of agricultural lands for distribution under the agrarian reform have been distributed. To a certain extent, rural incomes had been equalized and poverty had been alleviated. However, an unintended cost arose: the demise of land markets in the rural areas because of certain provisions of the agrarian reform law passed by Congress (Llanto and Estanislao 1995). Among the law's provision are:

1. prohibition on mortgaging/selling of land within 10 years of its award and upon full payment by farmer beneficiaries to Landbank
2. ceiling on ownership of agricultural lands at 5 hectares
3. government as sole buyer of awarded lands
4. prohibition of share-tenancy arrangements

Llanto and Estanislao (1995) and more recently, David and others (2003) explained that those provisions of law eroded the collateral value of land which hampers a farmer's access to credit, particularly in the formal financial markets. The distortion of land markets had negative impact on resource allocation. These provisions constrained the transferability of land from less productive to more productive uses and better farmers. It also limited the choice of more efficient contractual arrangement and prevented landless workers from rising up the agricultural ladder, from tenants to owner operators.

Despite the prohibition on pawning and selling, several studies in the past had accounted for such activities, particularly in informal financial markets, and although land regulations did not prevent land market transactions, the benefits to farmers of land reforms had been lowered because the price of land to farmers is discounted by the high transaction cost of selling, at least by the amount necessary to pay-off officials for legalizing the transaction sale. Farmers also lack legal protection in cases of failures in sale or pawning transactions. The mortgaging of land to formal institutions is also severely limited.

The deregulation of the land markets is now being considered by policy makers. A possible implication of this is a widening in the land ownership distribution which will systematize changes in land ownership and increase land prices to a certain extent. It will also accelerate land conversion and facilitate access to credit if banks are convinced they can foreclose the land following a loan default and dispose of this in a functioning land market.

House Bill 5511, known as Farmland as Collateral, was filed in 2002. It seeks to provide measures to enhance the acceptability of agricultural lands as security for loans obtained from lenders, banks and other financial institutions to promote access to rural credit by setting up a guarantee fund which will be used to guarantee the mortgage. The senate version of this, the Senate Bill 2553, on the other hand, disregards the guarantee provision of HB 5511 and instead focuses on restoring the legal rural land market by allowing the mortgaging of awarded lands to any person. In the event of default, the mortgagee may foreclose the land provided that the farmer-beneficiary shall have two years to redeem the land. The 5-hectare ceiling will also be removed. This would result, according to Fabella, in land prices being revealed, thus, improving land marketability. It would also correct the pricing of EPs and CLOAs, thus, improving the capacity of collateral to sufficiently repay the lender's exposure. Banks would also be allowed to foreclose and own more land than the CARL limit.⁷⁷

Institutional Development

As Yaron (1992) put it, targeted credit without institution-building in rural financial institutions is almost a recipe for prolonged dependence on donor or state funds and bailouts. In another perspective, it can, thus, be said that institutional development is the first step towards strengthening rural financial markets.

A financial institution has to achieve the self-sufficiency required to become sustainable and viable. According to Von Pischke (2003) sustainability requires self-correcting mechanisms and dynamism through innovations wherein which competitive markets are probably the most subtle and sensitive self-correcting mechanism because every transaction has the power to make some change, however small it is. The lack of institutional development creates a gap, dubbed by Gonzalez-Vega (2003) as insufficiency gap, that separates the potential supply from the willingness and capability of the rural population to demand different types of financial services at prices and terms that are offered under competitive conditions.

Poor performance of government and donor assisted credit programs can be traced to their inability to sustain their operations, which, in effect, heavily taxes the government. Development experts have been saying, since the time of Lamberte and Lim until the recent literatures, that this can be achieved through savings mobilization. Meyer and Nagarajan (2000) further recommended that in order to achieve high levels of outreach and sustainability, rural financial institutions also need appropriate governance, loan recovery and proper design of products and services.

⁷⁷ ACPC Monitor, Issue No. 5 Series of 2003

Savings mobilization had long been advocated in literature and, based on the evaluation reports of selected current programs this study has obtained, although not all agri-credit programs have savings mobilization as one of their major components, several programs are already implementing this.

Lim (1998) documented that before the Asian Crisis, many rural banks had successfully mobilized deposits from small savers by implementing incentive schemes, advertisement of products, competitive interest rates on savings and time deposits and establishment of credit links to attract clients. When the crisis and El Niño hit, large and medium depositors preferred large established commercial banks. The stricter prudential regulations implemented by BSP after the crisis should improve rural banks' practices in credit allocation and savings mobilization.

Miller (2003) related poor savings mobilization to the abundance of "easy" or "cold" money from donors. The regulatory environment could also act as hindrance to the deposit-taking among the poor in the rural areas. Finally, microfinance institutions do not exhibit an image of solvent and reliable deposit-taking institutions. In response, Miller recommended that government should loosen the reserve and reporting requirements in rural areas of branches that maintain total deposits below a pre-determined threshold and support strategic alliances between regulated and non-regulated entities. Donors, on the other hand, should direct any subsidy towards human resource development, financial management, market intelligence, MIS systems development and well-priced funds for loan portfolios.

Meyer and Nagarajan (2000), in their study of the different rural systems among different countries, noted that all successful rural credit institutions in other countries have highly professional management and enjoy an autonomous operation. This implies that maturity is needed among the staff that would, in turn, through the firm implementation of loan repayments and other such transactions, be reflected in the institution's clients.

The proper management of an institution would keep it along its core objectives and would efficiently and continuously find ways and means to attain these goals. A dynamic management would also encourage innovations in banking practices. A continuous improvement in the design of products and services would fine-tune institutions serving in rural areas and would effectively capture the demands of the rural community. Meyer and Nagarajan recommended that financial institutions must design their products and services according to the expected demand in rural areas, taking into consideration the presence of informal credit sources, and according to how costs could be recovered and profits could be generated. Such would, then, lead to a widened outreach.

Loan recovery is a major consideration which discourages most formal institutions to serve the rural areas. The three factors, according to Meyer and Nagarajan, that affect repayment are the design of products which can enhance a borrower's ability to pay, the length of relationship between the institution and the client and the timely information about the clients.

Risk-mitigating Instruments – risk management and risk coping

As all portfolio investments normally practice, risks should be diversified as well as assets. In an environment where risks are correlated, rural financial markets should avoid concentration on a particular crop or agricultural activity. The funds transfer operations⁷⁸ of commercial banks with rural branches, where funds could be circulated among several of the bank's branches, depending on the demand of funds to circumvent negative effects of seasonality in rural areas, is one way to address the risk in rural financing.

Skees (2003) differentiated strategies in risk management from that of risk coping. Risk management strategies attempt to address risk problems *ex ante* while risk coping strategies address problems *ex post*. Diversification or the fund transfer operations is among the common risk management strategies. Building savings is the common risk coping strategy. Since rural financial markets are limited, accumulation of assets that can be liquidated to smooth consumption during adverse events is a common form of savings. However, problems arise when the accumulated asset cannot be easily liquidated and the value of the asset may be affected by the shock.

Symmetric information in the rural markets is another way of managing risks among the rural borrowers. Moral hazards and other such distortions that could affect the allocation of credit and the ability to recover loans would be effectively reduced in the presence of reliable credit systems.

Innovations in Rural Financial Markets

Financial innovation is the creation by financial intermediaries of new products, instruments or processes, intended to improve their liquidity position, decrease risks and increase the flow of credit and/or the level of deposits. It has been shown, through the examples of rural financial markets in other Asian countries such as Bangladesh, that innovations can reduce intermediation costs and risks, resulting in the widening, deepening and integration of capital markets.⁷⁹

Because of the differences in the degree of maturity of the financial markets and the regulatory framework within which the markets operate and the openness of the economy, the innovations in developed countries differ from those in underdeveloped countries. The catalysts for innovations in developed countries are usually inflation, interest rate variability, internationalization, technological advancements and legislative initiatives. Due to the presence of structural elements such as an oligopolistic financial market, and inconsistent and ineffective regulatory enforcements, innovations in the underdeveloped countries are usually spurred by external forces like the policy environment. Catalysts of developed countries, on the other hand, are market forces.⁸⁰

Buchenau (2003) views innovations quite differently, however. For him, innovations are by-products of a competitive market. An indicator that financial institutions are

⁷⁸ Relampagos and Lamberte 1989

⁷⁹ Bhatt 1988 quoted by Abiad 1993

⁸⁰ Abiad 1993

competitive is when they are continuously improving their quality and pricing of services in order to protect and expand their market shares.

Therefore, innovations occur either as by-products of a competitive environment or as improvisations in the face of imperfect structures. Either way, the primary objectives in the emergence of innovative products and processes are to make formal institutions available to those groups which did not previously have access, to reduce the transaction and risk costs in both the lender and the borrower's side, to increase loan amounts and loan terms to accommodate the needs of the rural borrowers while, at the same time, maintain the profitability of financial institutions.

The government has a bigger role in underdeveloped countries such as the Philippines in creating a conducive policy environment that would encourage competitive financial markets where innovations can flourish. Furthermore, the government should also support institutional innovations as opposed to product and process innovations, which the private sector can handle.⁸¹

Innovations, particularly in the technological area, require investments that the government, given its perpetual budget constraints, cannot finance while the private sector cannot fully respond to because of externalities and free-rider problems. These projects can be initiated with the assistance of donors.

Collateral Substitution

One way for financial institutions to reach the rural poor borrowers is by studying and adapting mechanisms used in informal credit markets such as collateral substitution, to secure loans to the small borrowers. Collateral substitutes are used to enforce repayment in the informal credit markets in the absence of collateral. Some of these are pawning of cultivation rights and required sale of output to trader-lender. The employment of collateral substitutes, however, requires more intensive human capital involvement.

The use of various forms of collateral substitutes in the informal credit markets derives from the fact that the different types of informal lenders lend for diverse reasons. Lenders tend to specialize in lending to certain borrower classes according to the collateral substitute used. Specialization according to collateral substitute used implies that certain types of lenders have an advantage over others in lending to particular types of borrowers.

In the case studies of Casuga and Hernandez (1996), other forms of collateral substitutes came up, such as the joint liability or having a guarantor to back up the loan, mutual guarantee by group members, interlinked contracts and government guarantees. Their study also showed that collateral substitutes are used as tools to reach mandated or targeted clients, broaden clientele, enforce loan repayment and source additional funds or external funding. Collateral substitution also exhibited portfolio expansions and higher loan recovery rates.

⁸¹ Llanto and Fukui 2003

IV. RURAL FINANCE DEVELOPMENT IN SELECTED ASIAN COUNTRIES⁸²

Poverty, unsound policy framework and heavily constrained financial markets often characterize rural economies in less developed Asian countries. Most Asian countries, such as the Philippines, pursued a supply-led development policy to promote credit access to the rural sector. This strategy, however, created a pressure on the limited resources of their governments, which led to the emergence of financial services and techniques that attempted to respond to the needs of the rural sector. Some of these institutions succeeded.

This study decided to look into the profiles of four Asian countries not too different from the Philippines: India, Bangladesh, Indonesia and Thailand. India and Bangladesh are poor and densely populated countries which experienced heavy interventions from their governments, while Indonesia and Thailand are two rapidly-growing economies that were severely affected by the 1997 crisis. From three of these sample countries emerged financial institutions that received international attention for their success in providing credit and other financial services to the rural poor. These are the Grameen Bank of Bangladesh, which the Philippines is trying to adapt, the BRI-UD of Indonesia and BAAC of Thailand.

Bangladesh

The formal financial system of Bangladesh consists of a central bank (the Bangladesh Bank), four nationalized commercial banks, eighteen private commercial banks, twelve foreign commercial banks, four nationalized special banks and four specialized development financial institutions, two of which serve the agri-development. Two cooperative networks serve the rural sector.

During Pakistan occupation, financial institutions were used as cheap sources of credit for priority sectors, thus, upon the country's independence, it inherited a repressive financial system. The state prioritized nationalized industries which led to the rationing of loan supply to private sector demand. In response to this, principal donors to Bangladesh provided sizeable lines of credit to the private sector and entrepreneurs without proper screening. The country's aid-based development strategy was alleged to contribute to the bad-debt problem.

By late 1980s and in 1990s, attempts were made to implement financial sector reforms. The accomplishments include significant deregulation of interest rates, decreased directed credit, recapitalization of and greater autonomy of nationalized commercial banks, and introduction of loan provisions. However, political interferences continue to be great. In fact, in 1996, the government permitted a blanket rescheduling of all bank loans on the basis of a 10 percent down payment. This aggravated the bad-debt culture and an unsound banking system.

Provision of financial services in the rural sector has been subjected to similar government and political interventions that led to disastrous results. An important

⁸² Profile of countries were taken from Meyer and Nagarajan 1999: Rural Financial Markets in Asia: Policies, Paradigms and Performance, ADB. This chapter is based on several studies of both authors.

feature of Bangladesh, however, is that it has a strong NGO financial system that, along with the Grameen Bank, serve small towns and peri-urban areas whose activities are not necessarily limited to agriculture.

There were efforts to push financial services especially loans to the rural sector. From 1978-1981, banks were required to put up rural branches which led to a large commercial share of rural loans and deposits. Lending rates were controlled and banks were encouraged to make agri-loans that the Bangladesh Bank would refinance at subsidized rates. Five interest exemption programs were implemented during 1982-1991. Agri-loan repayments did increase but at a huge cost.

Nationalized commercial loans, development financial institutions and cooperatives play dominant roles in agri-lending. They provide loans to individual farmers and focus on crop lending, however they do not serve the wider demands for rural finance. An important development has been the emergence of member-based institutions such as Grameen Bank and hundreds of microfinance organizations that make loans, often to group of borrowers.

The concept of Grameen Bank is adopted on the idea of joint-liability. Clients are mostly women. Membership is limited to people who own less than one-half of land, are not of the same household, have similar economic resources and live within the same village. Loans are given to borrowing groups so peer pressure for repayment is created. Each member is obligated to make a weekly savings, is required to make a 5% contribution from each loan received and a 25% contribution of the total interest due on the loan principal to an emergency fund for use as insurance against potential default.

There are about 1,000 NGOs that are also MFOs in Bangladesh. All provide loans, some mobilize savings and many provide non-financial services. Most use the group lending technology popularized by the GB but some also work with much larger groups.

The most important factor affecting the sustainability of FIs is loan recovery. GB disbursements for general crop loans, which comprise 25% of its portfolio, had a 99% loan recovery rate. Other NGOs that lend to agriculture showed good recovery. However, Murdoch estimated that since GB's report is based on the amount overdue as a fraction of loans due, there is a declining trend in loan repayment at the latter part of the period. The second most important factor to sustainability is net income. GB and the NGOs are dependent on foreign funds and domestic subsidies which help keep interest rates low.

The GB and the financial NGOs have surpassed the banks in providing loans to rural areas and have avoided serious default problems. They have succeeded in developing systems to deliver highly standardized small loans to poor people. They have been more successful at serving female clients.

The chief weakness, however, is that many are dependent on government and donor funding, thus, they are not self-sustaining in spite of good loan recovery. The inescapable conclusion is that the rural financial system in Bangladesh is fragile.

Important reforms are required before the country can be assured of an efficient and sustainable rural financial system.

India

Government has intervened heavily in the banking sector with policies for bank branching, mandatory quotas and below-market interest rates. The infamous loan *melas* in the 1980s, in which large volumes of funds were imprudently issued as subsidized loans to the supposedly weaker segments of society and loan waivers offered until 1991, are such examples.

State mandated branch banking might have contributed to the expansion of commercial banks in the rural areas and to their lending to the rural population. Policies such as directed credit, loan waivers, subsidies and the bailing out of nonperforming institutions contributed to a decline in borrower discipline and weakened the financial sector. The performance of loans made to the priority sector under the directed credit program has been especially dismal.

In the 1990s, the country embarked on a paradigm shift in its approach to the financial sector however, the political hold on the banking sector is still significant. By mid-1996, the country's banking regulatory framework was considered satisfactory while supervisory quality and transparency were improving. State interference is still substantial, though.

Overall structure, conduct and performance of the financial system have a profound impact on the rural sector. The increase in rural poverty has become a great concern for the government, leading to the formulation of several policies for poverty alleviation.

Rural finance was such the program for the rural poor. Thus, a supply-led approach was employed for rural and agricultural finance to cater to the rural population. Majority of state interventions were done with the rural sector as primary focus.

The government launched the Integrated Rural Development Program. Loans were made through the banking system at subsidized rates to those who belong to a particularly low-income group. Besides the loan, a cash subsidy is paid to borrowers and is set at 25% of the total cost for projects financed for small farmers, 33% for projects for agricultural laborers and 50% for lower-caste persons.

Microfinance has been attempted on a large scale since the early 1990s. The importance of self-help groups was also recognized in the late 1980s. In 1992, a pilot linkage program was initiated under the directive of the government to link SHGs with banks either directly or through NGOs as guarantors or intermediaries. The KBs have also introduced several innovative schemes to finance the rural sector such as the green-card scheme which allows established farmer clients to access credit on demand without lengthy paperwork, agricultural overdraft schemes that provide credit throughout the year for farming and installment schemes for the purchase of machinery and equipment for small businesses.

As of 1998, the country had 32,662 rural and semi-urban branches of KBs, a cooperative network with 92,682 primary agricultural credit societies, over 2,000 branches of land development banks that primarily provide term loans for the purchase of land and land improvements, and about 14,136 branches of regional rural banks. The Reserve Bank of India is responsible for broad financial sector policies and is the general regulatory authority for KBs and urban credit cooperatives. The National Bank for Agricultural and Rural Development (1982) is an apex refinancing institution for coops, RRBs and KBs engaged in rural lending.

During 1950-1969, the role of privately owned KBs in rural finance was minimal and indirect. There were few KB branches in rural areas despite the RBI directive in 1954 to have at least one branch in unbanked rural and semi-rural areas for every branch opened in previously banked areas. Thus, 14 major KBs were nationalized in 1969 in order to improve services in rural areas. After nationalization, the share of bank loans in rural areas increased. The lead bank scheme was also introduced in which all districts were allocated to the nationalized banks and a few private banks to initiate and lead development in each area. Differential rates of interest were introduced in early 1972 wherein public banks faced a ceiling of 4% nominal rate per annum for loans made to sectors identified as weak in the rural society.

Estimates of the effect of bank expansion on agri-investment and output indicated that an increase in the number of KB branches increased investment in animals and pumpsets. The expansion in bank outlets had a direct impact on crop output and a larger increase on the demand for fertilizers.

However, the impressive expansion was not matched by outreach, in fact, there had been a decline in real volume of credit to the agri-sector in 1996.

None of the rural FFIs in India can be considered sustainable. Most of the institutions are plagued with huge arrears and incurred high transaction costs in providing financial services. Loan losses and transaction costs are invariably higher than earnings such that they require constant refinancing and recapitalization by the apex institutions.

The most serious problem is poor loan recovery. Repayment problems have become pervasive and are eroding the discipline among borrowers. Besides the alarming problem of low loan recovery, transaction costs are high for both lenders and borrowers.

The financial sector has significantly expanded over the years, especially in the rural areas. The country has an excellent infrastructure with its wide networks of financial institutions. Interventionist policies had positive impacts in terms of absolute credit volume and high levels of rural bank branch penetration. Rural deposit mobilization has been vigorous, especially by KBs.

There has been a gradual policy shift in the 1990s towards a market-based financial system. The 1992 reforms placed greater emphasis on the viability and sustainability of institutions, transparency of operations, competition, quality of services and reduction in state interference.

Several factors constrain the effective functioning of RFMs. (1) The state still plays a dominant role, (2) FIs have limited freedom to collect loans because of political pressure, (3) KBs still face an interest rate ceiling, (4) mandatory lending for priority sectors still exist, (5) despite the low viability of many rural branches, urban coops are still permitted to establish their operations in rural areas, and (6) the skill level of banking sector employees are still low.

Indonesia

Indonesia has a long history of deregulation of its economy and the financial sector, mixed with a high degree of state intervention designed to allocate credit on the basis of preferential programs. This mixed policy environment is attributed to the country's more than 30 years of authoritarian rule.

The first major financial deregulation occurred in 1970 with the adoption of a unified exchange rate and the opening of the capital account to free inflow and outflow of funds. To strengthen indigenous Indonesians, programs for short-term and long-term loans were created, while medium-term investment program was reserved for firms with indigenous majority ownership. Credit ceilings for each bank were introduced in response to inflationary pressures.

1983 reforms introduced private savings mobilization and the measures for credit allocation were altered. (1) Credit ceilings were abolished, (2) deregulation of state bank deposit and loan rates, (3) central bank preferential financing was curtailed, and (4) central bank's subsidized direct lending was also curtailed.

In 1988, regulations on bank branching and licensing of new private domestic and foreign banks were relaxed. In 1989, controls were removed for offshore borrowing by banks. In 1990, there was a further reduction in the subsidized loan programs and an upward adjustment in refinance rates. However, banks were required to extend at least 20% of their total loans to small and medium enterprises. A new banking law in 1992 removed the distinction between development and savings banks.

Deregulation effectively ended in 1991, when liquidity loans to FIs began to expand and controls were reimposed on overseas borrowing by banks. The near collapse of some private banks in 1994 prompted a wave of prudential regulations to prevent banking abuses. Credit controls were reimposed in an attempt to control inflation and in December 1995, the central bank moved to exercise control over non-bank FIs. In 1996, the government adopted the policy of being more selective in the licensing of new bank branches out of fear that excessive competition would emerge between banks.

The devaluation of the Baht in 1997 resulted to tightening in prudential regulations. The political and economic crisis that followed continues to this day and has inspired several subsidized credit programs as part of the government and donor response to the economic and social problems.

Indonesia has employed a variety of agricultural and rural development strategies that have influenced the evolution of financial markets. Rice sufficiency was the priority in the 1960s and early 1970s. Infrastructure investments were made and direct cash

grants were given by the central government to individual villages. Self-help groups and cooperatives were given special roles to support food self-sufficiency and small-scale rural enterprises. Programs were implemented to intensify agriculture, to stimulate rural nonfarm enterprises and to increase rural employment. Transmigration projects were implemented to create employment and reduce population density. The country has developed unusually rich and complex formal and informal financial organizations.

In the 1970s and 1980s, the government actively intervened in financial markets by creating a special program with regulated terms and conditions. In 1982, 19 categories of short-term credit were specified with 7 different lending rates, 3 discount rates, and 8 rediscount percentages. This approach may have made a contribution to economic growth but the price was high transaction costs. Secondly, both the national and provincial governments have employed a variety of grants, capital transfers and subsidies to start and strengthen financial institutions.

Two nationwide programs were specifically created to benefit the rural economy: the Bimas rice intensification scheme, and the small investment and permanent working capital schemes. The green revolution offered new production opportunities but required huge investments in irrigation. To accelerate the green revolution, the Bimas rice intensification program was established in 1969. The BRI unit desas were selected to channel subsidized credit to rice farmers.

In 1974, a loan window was created primarily for nonfarm activities. In 1976, the unit desas were authorized to mobilize rural savings through the national saving program. In 1980, a program was introduced for making large nonagri-loans. All these loans carried an annual 12% nominal interest rate.

The second nationwide credit program was introduced in 1974 to improve credit access for small businesses, especially for indigenous Indonesians. The banks lent at a 12% nominal annual rate and BI refinanced the loans at 3%. In addition, the state-owned loan insurance company insured 75% of loan losses. However, like Bimas, these programs encountered heavy losses, widespread fraud and high default rates, thus, in 1990, these programs were terminated.

Several other government and donor programs were initiated to expand banking services to the poor. Following the collapse of Bimas, three key policy changes were introduced in 1983-1984 to reform the unit desa system. (1) the units were transformed into full service rural banks, (2) each unit would be treated as a discrete profit or loss center within BRI, and (3) they would be evaluated on profitability rather than on hectares covered or money lent.

One of the unique features of the unit desas as compared with other MFOs is that they make individual loans based on collateral, usually in the form of land, and loans are made for one to three years. Local village officials are involved in the screening by acting as character references for the borrowers. As such, the unit desa system ranks as one of the most effective rural financial institutions in a developing country.

Another major financial institution is the provincial BKK system which provides short-term loans to rural families primarily for nonfarm productive purposes. The

BKK units create over 3,000 village posts (from a total of about 8,200) that are staffed once a week, usually on local market days. The BKKs are locally administered and are financially autonomous which has a political accountability because it is incorporated into the local government structure.

The transformation of the BRI unit desa system in 1983-84 produced spectacular results in outreach and financial performance. Because of this positive experience, unit desas were opened in selected urban neighborhoods. In the 1970s and 1980s, the government actively intervened in financial markets by creating a special program with regulated terms and conditions. In 1982, 19 categories of short-term credit were specified with 7 different lending rates, 3 discount rates, and 8 rediscount percentages. This approach may have made a contribution to economic growth but the price was high transaction costs. Secondly, both the national and provincial governments have employed a variety of grants, capital transfers and subsidies to start and strengthen financial institutions.

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Access to formal loans appears to be widespread in rural Indonesia. Borrowers without sufficient loan collateral face problems in getting loans from BRI and the other lenders that require physical collateral. Seeking loans from joint liability group lenders is one way for rationed borrowers to solve this problem. However, Indonesia has several organizations, which successfully provide loans without requiring collateral.

The sustainability of RFIs in Indonesia varies. Unit desas are self-reliant and subsidy independent, since they have a high interest rate policy and level of efficiency, while several weaknesses were identified in the Central Java BKK. BRI also has attractive savings products even though very small deposits earn no interest. Many of the other financial organizations, however, rely on subsidies.

The relative success of BRI and some other rural financial institutions is due in part to Indonesia's dynamic economy and political environment until mid-1997. A strong demand for credit and the generally good repayment performance of borrowers stimulated the emergence of RFIs. Several key features of institutional design also explain the successful performance of financial intermediaries. (1) Important information problems in lending have been resolved by establishing a network of semi-independent locally operated FIs with a comparative advantage in gathering necessary information, (2) performance-based incentives and efficiency wages are given to managers, (3) managers of FIs were given autonomy over interest rates and other key performance variables, (4) one-time subsidies in the form of start-up loans and grants nurtured the organization without creating dependency, and (5) clients value their banking relationship due to rapid loan disbursement, low transaction costs, and the possibility of pledging nontraditional forms of collateral.

Indonesia has explicitly included savings mobilization in its policies to expand financial services. Microfinance does not play as visible a role in Indonesia as in some other Asian countries.

The Indonesian experience provides important lessons for rural Asia in developing a sound and efficient rural financial system, and these are: (1) technocrats and the foreign technical assistance have important roles in creating effective systems, (2) favorable policy environment, (3) the massive mobilization of savings proved that rural people do save given attractive savings products, (4) policies and institutions can be designed to achieve high levels of outreach, serve the very poor and attain financial and institutional sustainability using an individual lending technology.

Thailand

State officials in Thailand have intervened in the economy and the financial sector to a lesser degree than in most other SE Asian countries. Until the late 1980s, the central bank's policy focused largely on the stability and solvency of financial institutions and the use of credit instruments to promote agriculture and exports. Financial operations in Thailand were subject to interest rate ceilings on both deposits and loans, to regulations on portfolio and branching, and to various types of compulsory credits. Deregulation was first undertaken in a gradual way, beginning with IR reform. The Bank of Thailand (central bank) implemented a reform plan in the 1990-92 period that further deregulated IR, relaxed portfolio requirements and foreign exchange controls, improved the supervision and examination system, adjusted capital requirements, promoted financial innovations and improved the payment system. The second BOT plan focused on savings mobilization, development of a country into a regional financial center and improvement of the central bank's operations. Liberalization of the financial system without appropriate regulatory safeguards, however, contributed to the country's currency and financial crisis in 1997.

An important feature of Thailand's financial history has been the relative autonomy of the BOT and its ability to restrain the growth of preferential or directed credit, with agriculture being the primary exception.

Thailand has traditionally been a food-surplus country and has never implemented major, highly subsidized agri-credit programs such as the Bimas program in Indonesia or the Masagana 99 program in the Philippines. Since 1916, the government has experimented with different institutional frameworks to provide cheap credit to the rural sector. Targeted financial support through the banking sector began with the rediscount facility, first introduced in 1958 to support exports, which were essentially agricultural.

The creation in 1966 of the Bank for Agriculture and Agricultural Cooperatives (BAAC) as a specialized institution under the Ministry of Finance to provide loans to farm households, and its subsequent funding and regulation, represent the country's most important effort to support small and medium-sized farmers. An interesting aspect of financial development in Thailand is how the country has managed to avoid the errors of other countries that also created specialized agricultural finance institutions. The rapid growth of agriculture and the rural economy provided a strong demand for rural financial services, but several problems, including the land tenure system, have constrained the development of competitive FIs.

The country's land tenure system has been a constraint for commercial banks and other FIs that use traditional collateral-based lending to screen borrowers and enforce loan contracts. Many farmers on private lands and squatters on public lands do not have legal documents that lenders will accept as collateral. Collateral substitutes are needed in this situation.

KBs, BAAC and cooperatives are the most important rural financial institutions. The number and distribution of banking outlets have a strong influence on access to

banking services in rural areas. Transaction cost for savers and borrowers fall when banking outlets expand and move closer to rural businesses and residences.

The best insights on access to formal rural finance are obtained by analyzing BAAC. It has recently received a great deal of international attention because of its impressive performance in outreach, lending portfolio, savings mobilization, efficiency, profitability and subsidy independence.

The problem of access to loans by persons without loan collateral has been resolved by BAAC for working capital loans by making joint liability group loans, in which the farmer-members guarantee each other's loan repayment.

The issue of sustainability of RFIs largely concerns BAAC and the agricultural cooperatives. BAAC is dependent on subsidies, although not as heavily as many specialized agricultural lending institutions in developing countries. Also, Thai government requires their offices to hold their deposits in government-held FIs which implies an additional subsidy of unknown magnitude. Meanwhile, BAAC's need for subsidies cannot be attributed to low levels of efficiency. In fact, it is noted for its high productivity and efficiency, rather, it can be attributed to the relatively poor financial results, partly due to its five pricing policies. (1) It tries to maintain low interest rates, (2) it charges higher rates for larger loans and cross-subsidizes its small clients, (3) interest rates were not adjusted to cover the rise in inflation, (4) in 1995, nominal IR was reduced from 11% to 9% for loans less than B30,000, and (5) BAAC charges 3% less on wholesale loans made to cooperatives and associations than on retail loans to individual borrowers.

Rural savings mobilization has not been a particularly strong feature of financial policy in Thailand. Also, specialized microfinance services are not important in Thailand. One reason is that BAAC has already achieved a large outreach. A second reason is that poverty is not as serious in this country as in some other Asian countries.

Until the 1990s, Thailand was a good example for the developing world in financial sector development. State intervention was moderate and authorities proceeded slowly with deregulation. A desire to support agriculture led to the creation of BAAC in 1966 and to establish loan quotas for the KBs in 1975. Presently, BAAC represents about half of total agri-lending and its outreach is reported to be about 90% of farm households. Depth of outreach is also impressive. During the 1990s, BAAC began to mobilize savings more aggressively and rely less on KB deposits.

BAAC has largely avoided the usual problems that undermine agri-development banks because of the following: (1) the Ministry of Finance has the technical competence which contributed to the maintenance of the banking vision for BAAC, (2) it has strong leadership geared towards professionalism, efficiency and long-term sustainability, and (3) the interest of the workers' union is tied to BAAC performance through annual bonuses. There are a number of weaknesses, though, in the financial system, such as the lack of priority in rural savings mobilization.

Common Problems of Asian Countries

Rural financial markets in the countries discussed are still largely dependent on government and donor subsidies. The political environment as well as the institutional capability of these markets is still inappropriate and inadequate. Also found lacking is the training and development of personnel for financial institutions.

A most evident similarity between the sample countries and the Philippines is the failure of formal financial institutions to reach the small borrowers in the rural sector and provide services that could have improved these small farmers' production and consumption possibilities. The common weakness of these countries is their financial system which is seriously hampered by inappropriate policies that hinder the delivery of financial services to all types of borrowers, although Thailand's case started in the late 1990s and involved regulatory issues.

A common direction these countries took towards rural development is through institutions with alternative banking practices that could accommodate the inherent characteristics of rural borrowers. Through these innovative techniques, the Grameen Bank of Bangladesh, the Bank for Agriculture and Agricultural Cooperatives in Thailand and the Bimas Rice Intensification-Unit Desas of Indonesia successfully reached the poor borrowers of the rural countryside. These institutions serve as useful models that demonstrate the potential for sustainability and outreach given appropriate policies and proper implementation of financial infrastructure and institutional design.

V. TOWARDS A POLICY RESEARCH AGENDA

It is impossible to consider in this brief review paper many of the other interesting and recent papers and studies on rural finance. However, the literature and the actual experiences dealt with in the preceding discussions can hopefully motivate a policy research agenda on rural finance in the next future. To determine an agenda, it is important to bear in mind the vision and goal: to promote the provision of efficient, broadly-based and sustainable financial products and services to various rural economic agents. The policy research agenda should aim at producing research studies that will offer recommendations to policy makers on how to remove the constraints on both the demand for and supply of financial services and products in the rural areas. What drives the proposed agenda will be the facts of life in the rural economy: imperfect information, high transactions cost and the risk profile.

In the past, loan quotas, subsidized interest rates, directed credit programs among others, have been implemented by a well-intentioned government but to no avail. They deal with the symptoms and not the factors underlying the rural economy and which mold rural financial markets. As the paper has shown, economic agents have found a way to deal with various constraints to financial services, e.g., informal lending techniques, microfinance, etc. It is important therefore to examine carefully the rural financial markets, understand the behavior of economic agents, and investigate the role played by institutions, e.g., property rights, among others. Given the complexity of rural financial markets, we can only point out thematic areas for research. The detailed research subjects should be carefully determined later in view of scarcity of resources in the research community.

In this respect, there is a need to engage into an investigation or study of the following thematic areas:

- sectoral economic policy biases and barriers to increased productivity and higher incomes in the rural areas;
- appropriate legal and regulatory framework that deals with risks and cost of financial intermediation in the rural areas; regulatory barriers to rural finance;
- development of the capacity of financial institutions for rural financial services;
- financial innovations and services;
- identification and management of risks in rural finance;
- role of institutions and governance in rural financial markets.

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ANNEX A

PROFILE OF AGRI-LENDING PROGRAMS														
Program	Objectives	Target	Eligible Conduits, borrowers	Funds (in million pesos)				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
DA-ACPC														
Dev't Assistance Program for Cooperatives and People's Orgn DAPCOPO DCP 1990-96	To provide assistance to agri-based activities not serviced by banks through existing coop federations, POs & NGOs; to develop & strengthen viable rural community-based orgs	Nationwide	Nat'l/reg'l-based federations of farmers' groups & coop; w/ management capability & satisfactory lending track record; Reg'l federations should be sponsored by a nat'l-based org; Agri-based orgs not financed by LBP or other bank	ACPC CALF	41.3	68.5	NA	For relending to primary-affiliate/chapters	Varied based on credit need of target primaries & repayment capacity of applicant	Joint & several signatures of at least 3 officers &/or Board Members; Counter-guarantee by nat'l-based federation; &/or other forms of acceptable collateral	Maximum of 5 years	LBP to fedns-6% (reg'l/nat'l) 8% (prov'l); From fedns/POs to primary coops-negotiated rate (IR caps & subsidy)	100% fed'n	Later required (at 15 - 20% loan retention)
Agri-Mechanization Financing for Farmer Coops 05-25-75 1994-	To promote farm mechanization	Nationwide	LBP accredited coops within priority areas endorsed by ACPC	GAA/CALF	48.7 as of Dec 00	47.8	82.94	Fixed assets acquisition	95% of total project cost	Depends on the project type	Depends on the project type	16%	25% ACPC; 70% LBP	None
The Grameen Bank Replication Program 1990-	To extend banking facility to the poorest of the poor; eliminate exploitation	Nationwide	Program level-Development foundations, POs and cooperative rural banks.	-	-	-	-	Program level-Operating support fund Beneficiary level-	Program level-P100,000 per NGO per year for a max. of 3 yrs (grant	-	50 weeks	Free market rate	-	-

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
	by money-lenders; create opportunity for self-employment for utilized & underutilized manpower		Beneficiary level-members of a group, preferably women, landless or cultivating land not exceeding 5 has; residing in a depressed areas; with income of P3,900 and total asset of not exceeding P10,000.	-	-	-	-	Micro-enterprise	amt does not exceed 50% of total project operating cost) Beneficiary level - 1st loan - P1,000; 2 nd loan - P2,000; 3 rd loan P3,000	-			-	-
DA Prog.														
BAI-Multi-Livestock Dispersal Loan Program DCP 1989-	To increase the country's breeder base; To upgrade genetic make-up of local stock To provide additional income to farmers; and to improve nutritional status of people	nationwide	<u>Retailers:</u> RBs/ CRBs <u>End-borrowers:</u> A good standing member of coop/ farmers' org'n for at least 1 year; must not be an owner of 2 or more heads of cattle/carabao	Agency Fund: DA-BAI	219.8	231.8	219.8	Cattle breeding or fattening	P14,000 per farmer (<i>represents cost per stock</i>)	Chattel mortgage	5 years for breeding; 1 year for fattening	10%	100% BAI	None

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Lending Terms/Conditions					Credit Risks	Savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
DA – Central Cordillera Agricultural Program II (CECAP) DCP 1996-2004	To increase rural incomes & living standards in the project area; support ecologically stable & diversified farming systems; & strengthen local capabilities in planning, implementation, operation, maintaining, monitoring & evaluating development efforts.		<u>Retailers:</u> Coops, Annual Savings & Loans Assembly (ASLA); Agricultural Development Organizations (ADO) <u>End-Borrowers:</u> beneficiaries of CECAP-implemented micro-projects; members of accredited producers groups (PG); savings and loans group (SLG) or ADO; belong to the poorer sector of the community.	EU grant	49.31*	24.77*	49.31*	Production & acquisition of agri-support facilities; Providential & emergency loans for SLG members only.	P15,000	Group guarantee & depending on the conduits policy	1 year	15%	100% DA	Required
DA-Upland Development Program in Southern Mindanao (UDP) 1998-2002	To develop & test a replicable model for sustainable management of the natural resources in the uplands of	Five (5) provinces of Southern Mindanao	<u>Retailers:</u> RBs, Coops, NGOs <u>End-borrowers:</u> small farmers producers, small	EU grant	1.45	0.81	1.45	Dev't or expansion of rice/corn mills, shellers, threshers, coffee depulpers	Actual credit needed by the target group	-	-	-	-	-

* Up to June 2001 only

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
	5 provinces in Region XI; & to enable upland communities to address their subsistence needs & to produce new marketable surpluses through sustainable market-led agricultural development		entrepreneurs within the program area; coops					& storage, drying facilities etc., working capital for micro projects and agri business; Industrial, tree and fruit tree projects, livestock, fattening/ breeding projects						
DA-Aurora Integrated Area Development Project Phase (AIADP) DCP 1988-2002	To alleviate poverty; To promote growth with equity; and To develop environmental ly sustainable economic activity	Aurora Province	Farmer owner-operator or a share tenant with 0.5 to 2 has. of land; rural poor with viable projects.	EU grant	27.8 (or 58.02 thru conduits)	29.48	32.68	Crop prod'n, Improvement of irrigation facilities, Livestock prod'n Fishery, Coop projects, Post-harvest facilities, Marketing, Other agri-related or livelihood	P100,000	Mortgage-able items	Crops – 6 mos. to 4 years Livestock - 2 years	15%	-	-
DA-Catanduanes Agricultural Support Programme	To assist rural communities, to initiate and sustains increases in	11 municipalities of Catanduanes	Rural poor	EU grant	40.0	40.0	40.0	Short-term loans for crops, livestock, fisheries,	P20,000	none	Six months to 1 year	36%	-	-

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n	
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates			
(CatAg) DCP 1994-99	income for all economic activities hereby reducing poverty.							agro-processing, trading, services and machinery							
DA-Economic Self-Reliance & Southern Cordillera Agri Dev't Programme CASCADE DCP 1992-	To help mainly indigenous rural people of the highland areas in promoting agro-based local economy that will allow them a better and standard of living & will give them opportunity to remain settled where they reside.	Benguet, Nueva Viscaya and Nueva Ecija	<u>Retailers:</u> <i>still to be identified</i> <u>End-Borrowers:</u> small farmer producers, small entrepreneurs within the program area; coops	EU grant	4.35	4.55	4.55	Financing of agricultural crops and livestock production activities include off farm and non-farm micro enterprises of out of school youth women and artisans	Prod. Loan - P10,000 Commodity Loan – P30,000 Facility Loan – P200,000 and above	Savings – equity and fixed assets	Prod. Loan: 6 to 12 months Commodity Loan: 6 – 12 months Facility Loan: 24 – 36 months	-	-	-	-
LBP-DA/ACPC-Integrated Rural Financing Program (IRF) DCP 1989-	To provide financing through rural financial institutions to enhance the prod'n, income & repayment capacity of organized small farmers and fishers.	nationwide	<u>Retailers:</u> RFIs (RBs, CRBs, PDBs, Coops) <u>End-borrowers:</u> Small farmers and fishermen	Special fund	233.09	1,078.0	233.09	Crop prod'n Fishery Poultry, Livestock-raising	Depends on the project type	Real estate/ chattel mortgage of the object of financing	Max. of 1 year	12% for coop members 14% for individual farmers	-	-	-

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
LBP-DBP-DA/ACPC - Fisheries Sector Program (FSP) DCP 1990-	Alleviation of poverty among fishermen through diversification of their sources of livelihood.	Priority bay provinces	<u>Retailers:</u> Accredited RFIs of LBP, DBP and accredited FIs of PCIC and QuedanCor <u>End-borrowers:</u> Marginal coastal fishermen's coops & small aqua-culture operators	ACPC -GAA	330.45 M (LBP) 260M (DBP) 73.6 (Quedan cor) 54.35 (PCIC)	754.07 LBP 549.70 DBP 165.48 Quedan cor	330.00 LBP 260 DBP	Agricultural production loan, Working capital, Fixed assets acquisition	Depends on the project type	Depends on the project type	Depends on the project type	Agri Prod'n/ Working Capital - 12% FA-16%	-	-
Agricultural Competitiveness Enhancement Fund (ACEF) DCP 2000-	A more equitable distribution of opportunities, income and wealth; a sustained increase in the amount of goods and	nationwide	Farmers/ fisherfolk and agribusiness enterprises	GAA	62.48	38.85	62.18	Eligible projects & activities for ACEF support are limited to those which are directly related to	Minimum of P 500T	Collateral free	Depends on the project type	Interest free	-	-

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
	services produced by the nation for the benefit of the people; and an expanding productivity as the key to raising their quality of life, esp. the underprivileged							a) enhancing the global competitiveness of the agri products; b) establishment of enabling mechanism for eligible proponents						
NFA														
Farm Level Grains Center II (FLGC II) DCP 1995-	To establish farm-level infra-structure that provide coops with mktg. capability to obtain max. return for their harvest; To accelerate the provision of low-cost credit to uplift income opportunities and livelihood of small farmers.	nationwide	Primary coops located in irrigated palay/corn producing province listed under DA Key Grain Areas.	Proceeds from importing Thai rice	86.9	153.6	100.7	Lot acquisition (LA); Warehouse Construction (WhsC); Marketing loan (ML)	(LA) - P100T WhsC - P750T ML - P500T	Real estate mortgage on the lot and warehouse; Built-in on the warehouse loan for ML	5 years and 3 years for ML	14%	-	-
Japan Internat'l Cooperation Agency Postharvest Facilities Assistance Program JICA-PAP	The project aims to provide farmers orgn's with post harvest facilities to reduce grains losses lessen	nationwide	Primary coops located in irrigated palay/corn producing province	Proceeds from RP-Japan Project	17.19	25.52	17.19	Construct'n of post harvest facilities	-	Real estate mortgage on the lot and warehouse; Built-in on the warehouse loan for ML	-	-	-	-

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
DCP 1987-	post harvest cost and shorten the time period for the various in farm operations.													
Quedanc or														
Agrikultura ng MAKAMAS A for Local Gov't Units (AM-LGU) DCP 1997-2002	The program seeks to enable LGUs to extend financial assistance that would support the social upliftment of their constituents in accordance with the approved local development plan and public investment program	nationwide	Individual farmers/ fisherfolk or association of farmers/ fisherfolk Wholesale: LGUs	DA-GAA	75.0	112.75	Not available	Relending for agri-fishery projects	P 50,000 and above	LGU must secure the loan by the assignmt of Internal Revenue Allotment (IRA) covering total project cost ; shall properly be supported by a local Sangunian resolution	Max of three (3) years	8% p.a. to LGU (pass-on rate to indiv farmers/ fisherfolk or association shall be 14%)	-	-
Agrikultura ng MAKAMASA for Rice and Corn-Based Farming System (RCBFS) DCP 1997-2014	To finance projects on production of palay and corn and its inter/rotation/relay crops.	nationwide	Farmers/Sole Proprietors/ Cooperatives/ Partnerships/ Corp./ LGUs/FPOs/POs/ RFIs	DA-GAA	557.0	756.56	Not available	Production of palay and corn and its inter/relay/rotation crops, Processing/ marketing Acquisition/ construction of prod'n and post-prod'n	For conduit P500T and above Lending to farmers P100T and above	REM/CM/Assignment of gov't bonds/ securities/ comm'l shares of stock or bank dep./ placements/ co-makers/ hold-out/ JSS/IRA	Prod'n: Max of 1 yr. Marketing/ Processing - Max 3yrs Acquisition of facilities & equip't: Max 3yrs	-	-	-

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
								facilities, machineries and equipments.						
Agriculturing MAKAMA SA For High Value Commercial Crops (AM- HVCC) DCP 1998-2013	To provide support to hasten development of the HVCC industry	nationwide	Farmers/Sole Proprietors/ Cooperatives/ Partnerships/ Corp./ LGUs/FPOs	DA-GAA	208.57	298.28	Not available	To finance projects on agri production, processing, marketing, acquisition of prod. And post-harvest prod. , facilities or joint venture involving high value crops	For conduits: P500T & above <u>Lending to farmers</u> : P100T and above	REM/CM/ Assignment of gov't bonds/ securities/ comm'l shares of stock or bank deposits/ placements/ co-makers/ hold-out/ JSS/IRA	<u>Production</u> : 2-12 years depending on cash flow & crop gestation <u>Marketing/P</u> rocessing – Max of 5 years; <u>Add'l working capital</u> : Max. 3yrs	SGM: Bank rate GCFM/ SWM - for conduit 8% - to farmers 12% (based on present value of annuity)	-	-
Agrikultura ng MAKAMA SA for Sugar Modernizati on (AM- SM) DCP 1999-2014	To revitalize the sugar industry through mechanized farming; and to promote the bankability and access of sugar farmers/ planters to formal credit institutions	nationwide	Sugar farmers/ planters endorsed by SRA	DA-GAA	60.0	31.06	Not available	To finance and guarantee the purchase of tractor/ implements	P250,000 and above	10%- farmer's cash equity; 50% CM on purchased tractor/ implement 40%-any or combn of REM, CM, assgnmt of gov't bonds/ sec., commercial shares of stock or bankdeposit/ placement	1-5 years to be determined by the lending bank	Bank rate	-	-
Integrated Livelihood Program	To improve the living conditions of	nationwide	Small-scale fisherfolk engaged in	ACPC -GAA	73.6	165.48	Not available	Small-scale agri and non-	P50,000	Real estate/chattel mortgage	Max. of 5 years	coop - 8%	-	-

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
for Fisherfolk (ILPF) DCP-FSP? 1997-	small-scale fisherfolk; and To increase income of fisherfolk thru the provision of alternative livelihood projects.		aquaculture, marine based, agri-based and non-agri-based project.					agri based projects		Loan co-makers		indiv. - 10%		
Poverty Alleviation Fund for Direct Assistance to Farmers (PAF-DAF) 1997-2002 1. Special Credit Window for Individual Farmers DCP 1998-	To provide credit assistance to individual farmers who are not eligible for financing under regular programs of banks.	Selected areas only	Creditworthy farmers/farm-households in the identified priority areas whose per capita income does not exceed the poverty threshold					For relending to eligible farmers/farm households to finance agri production, marketing and/or other livelihood projects	<u>To lending conduits:</u> Loan exposure not to exceed the total fund allocation of a particular prov. and shall not exceed 10 times the conduit's equity. <u>To end-borrower:</u> Not specified.	none	To lending conduits: max. of 10 years for term loans and 15 months for credit line. To end-borrowers: not specified.	Shall be set by the ACPC in consideration of Sec. 21 of the Magna Carta for Small Farmers	-	-
2. Calamity Housing Loan Window DCP 1998-	To provide interest-free credit for the construction/repair of houses of farmer-victims in calamity-stricken areas.	Selected areas only	Farm households who belong to the poverty threshold line and whose dwellings were damaged by					For relending to eligible farmers/farm households to finance construction/repair of houses damaged by	Max. of P20,000 per household	none	Max of 2 years	0%		

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n	
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates			
			calamities such as typhoon, flood, fire and other natural calamities					calamities in the priority areas.							
Quedancor -NFA – Farm Level Grains Center (FLGC I) DCP 1995	To establish farm-level infrastructure that provide coops with marketing capability to obtain max. return for their harvest; To accelerate the provision of low-cost credit to uplift income opportunities and livelihood of small farmers.	nationwide	Primary coops located in irrigated palay/corn producing province listed under DA key Grain Areas	NFA-Japan	43.7	2.08	Not available	Lot acquisition (LA); Warehouse Construction (WHsC); Marketing loan (ML)	LA-P100T WhsC-P750T ML-P500T	Real estate mortgage on the lot and warehouse; Built-in on the warehouse loan for ML	5 years and 3 years for ML	14%	100% LBP	required	
Non-DA Prog TLRC															
Agro-Industrial Technology Transfer Program (AITTP) DCP 1984-	To facilitate the transfer of production and processing technology; To develop domestic and export markets; and To generate livelihood	nationwide	Corporations, individuals or registered farmers' coops/ associations	OECF	447.41	680.17	255.3	Fixed assets (excluding land) acquisition, Working capital, Anchor projects, Relending to small farmers Pioneer	P40 M (depending on loan type)	Short-term-max. of 1 yr Medium to Long Term-based on project cash flow and borrower's overall repayment capacity	Short term working capital loans mature in 12 mos. Medium to Long term repayable in 5 yrs with grace period of 15 yrs.	Short-term-12% Med/Long Term - 13% Front-end fee Short term-3% Long term 4% p.a.of	-	-	

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
	opportunities for the rural sector							technology, Commercialization				approved loan		
Non-DA prog DAR														
Credit Assistance Program for Program Beneficiaries Development (CAP-PBD) 1996	To provide financial assistance to ARBs particularly for agri-related livelihood	nationwide	Retailers: LBP End-Borrowers: ARBs coops/organizations in identified ARCs accredited by DAR					Agricultural production loan, Working Capital (WC), Fixed assets acquisition	Depends on the project type	Depends on the project type	Depends on the project type	AP/WC-14% FA-16%	-	-
DAR-LBP:5:25:70 Countryside Partnership Scheme (DAR-CPS) DCP 1993-2003	To enable deserving small farmer cooperatives to own affordable pre-and post-harvest facilities and other fixed assets in order to improve their productivity & increase their income	nationwide	Retailers: LBP End-Borrowers: ARB coops endorsed by DAR					Agricultural production loan, Working capital, Fixed assets acquisition	Depends on the project type	Depends on the project type	Depends on the project type	AP/WC-14% FA-16%	25% DAR, 70% LBP	required
DAR-Quedancor Program for CARP-Barangay Marketing Center	To establish farm-level infrastructure that provide coops with the marketing capability to	nationwide	Retailers: Quedancor End-Borrowers: Primary coops located in	ARF	171.82	121.41	171.82	Warehouse Construction Marketing Loan Rice Mill Loan	P750T (more or less) P1M P200T (more or less)	REM on the lot & waterhouse ; Built-in on the warehouse loan; Chattel Mortg	8 years 4 years 5 years	12% 12% 12%	100% Quedancor	without

Program	Objectives	Target	Eligible Conduits, borrowers	Funds				Terms/conditions					Credit Risks	savings mob'n
				Fund source	Total credit seed fund	Total loan releases	Total available credit fund	Loan purpose	Loan ceiling	Collateral requirement	Loan maturity	Interest rates		
(CARP-BMC) DCP 1992	obtain maximum return for their harvest; To accelerate the provision of low-cost credit to uplift the inc. opportunities and livelihood of agrarian reform beneficiaries		irrigated palay/corn producing province listed under DAR SOPs/ARCs and/or DA's KGAs					Trucking Loan	P300T (more or less)	on ricemill, truck				
Non-DA prog NLSF														
LCAP, Livelihood Credit Assistance Program for ARC's, Special Tie-up, BSK DCP				Agency fund	313.85	313.85	313.85							
DBP														
Cattle Financing Program (CFP) 1991-	To increase the country's breeder base.	nationwide	Individual or corporate cattle raisers with good track record for the last 5 years and with a minimum of 20 existing breeding cows					Purchase of breeding stock, Pasture development and/or maintenance; Other purposes that contribute directly in increasing productivity	Based on actual needs of the project	REM/CM, Assignment of leasehold rights over the land covered by Pasture Lease, Agreement Livestock Ins.	Maximum of 15 years inclusive of 3 years grace period	Fully secured: 15% Not secured: 17%	100% DAR	-

Source:ACPC

ANNEX B

BANK DENSITY RATIOS BY TYPE OF BANK															
	COMMERCIAL BANKS					THRIFT BANKS					RURAL BANKS				
	1997	1998	1999	2000	2001	1997	1998	1999	2000	2001	1997	1998	1999	2000	2001
Highest	112.4	117.4	120.6	119.2	120.5	29.2	32.4	32.9	31.2	30.8	2.8	3.8	4.1	4.3	4.4
Lowest	0.4	0.4	0.4	0.4	0.4	0	0.1	0	0.1	0.1	0.2	0.1	0.1	0.1	0.1
NCR	112.4	117.4	120.6	119.2	120.5	29.2	32.4	32.9	31.2	30.8	2.8	3.8	4.1	4.3	4.4
Ilocos	1.1	1.1	1.1	1.1	1.1	0.4	0.5	0.4	0.4	0.3	1.3	1.5	1.4	1.5	1.5
Cagayan Valley	0.8	0.8	0.8	0.8	0.8	0.2	0.1	0.1	0.1	0.1	1.1	1.3	1.3	1.3	1.3
Central Luzon	2.5	2.6	2.7	2.6	2.7	1.5	1.5	1.6	1.4	1.4	2.3	2.6	2.5	2.4	2.5
Southern Tagalog	1.9	2	2.1	2.1	2.2	1.5	1.4	1.5	1.4	1.4	2.1	2.4	2.3	2.3	2.3
Bicol	0.8	0.8	0.8	0.8	0.8	0.2	0.3	0.3	0.2	0.2	0.7	0.8	0.8	0.9	0.8
Western Visayas	1.7	1.8	1.8	1.8	1.7	0.4	0.4	0.4	0.4	0.4	1	1	0.9	0.9	0.9
Central Visayas	1.9	2	2	2	2	0.7	0.8	0.8	0.8	0.8	0.8	0.9	0.9	0.9	0.9
Eastern Visayas	0.5	0.5	0.5	0.5	0.5	0.1	0	0.1	0	0	0.4	0.4	0.4	0.4	0.4
Western Mindanao	1	1	1	1	1	0.1	0.2	0.2	0.1	0.1	0.3	0.3	0.3	0.3	0.4
Northern Mindanao	1.5	1.4	1.4	1.4	1.4	0.5	0.6	0.6	0.6	0.5	0.8	1.1	1.1	1.1	1.1
Southern Mindanao	2.5	2.6	2.6	2.6	2.6	0.7	0.8	0.8	0.7	0.6	1.3	1.5	1.5	1.5	1.4
Central Mindanao	0.9	1	1	1	0.9	0.1	0.1	0.1	0.1	0.1	0.6	0.8	0.7	0.8	0.8
CAR	0.7	0.7	0.7	0.7	0.7	0.1	0.1	0.1	0.1	0.1	0.4	0.5	0.5	0.5	0.5
ARMM	0.4	0.4	0.4	0.4	0.4	-	-	0	-	-	0.2	0.1	0.1	0.1	0.1
CARAGA	0.5	0.5	0.5	0.5	0.5	0.1	0.1	0.1	0.1	0.1	0.5	0.7	0.7	0.7	0.8

Source: The Philippine Financial System, BSP Fact Book

Note: The offices include head offices, branches, sub-branches, agencies, extension offices, savings agencies, money shops/ sub-offices but exclude offices located in foreign countries

LOANS OUTSTANDING OF COMMERCIAL BANKS BY SECTORS (in million Pesos)										
	1987	1990	1995	1996	1997	1998	1999	2000	2001	2002
TOTAL	101.11	248.18	783.81	1,216.97	1,576.93	1,348.19	1,354.23	1,451.50	1,399.24	1,432.66
Agri, Fishery & Forestry	12.43	26.92	59.60	63.43	70.71	62.93	58.86	62.10	56.82	72.43
Industry Sector	51.75	108.30	303.57	445.59	534.10	479.76	505.39	547.74	505.31	500.61
Service Sector	36.94	112.96	420.64	707.95	972.12	805.50	789.98	841.67	837.11	859.62

Source: BSP

Note: Data on Loans Outstanding of KBs by Industry from 1981 to 1989 was based on credit reports while data from 1990-onwards was based on consolidated statement of conditions.

Starting 1986, transfer of non-performing assets/liabilities of two gov't banks to the National Government is already reflected.

AGRICULTURAL PRODUCTION LOANS GRANTED, BY COMMODITY (Amounts in Billion Pesos)										
	1987	1990	1995	1996	1997	1998	1999	2000	2001	2002
FOOD COMMODITIES	12.38	22.80	39.24	364.83	233.95	65.04	99.89	54.05	61.09	76.55
Cereals	2.72	6.07	12.49	67.74	46.22	15.17	23.12	14.38	14.25	17.28
Palay	2.13	5.42	11.21	62.81	42.82	13.99	20.95	12.43	12.89	16.14
Corn	0.55	0.60	1.19	4.72	2.83	1.02	2.07	1.80	1.24	0.99
Sorghum	0.02	0.01	0.04	0.01	0.11	0.01	0.02	0.00	0.01	0.04
Soybeans & Feedgrains	0.02	0.04	0.05	0.19	0.45	0.14	0.09	0.15	0.11	0.11
Fruits, Veg. & Rootcrops	4.54	3.25	6.21	21.44	34.43	9.96	12.30	7.20	14.48	20.47
Livestock & Poultry	2.42	7.81	12.76	222.51	125.76	21.12	40.43	22.12	21.88	30.08
Fisheries	2.70	5.68	7.78	53.14	27.54	18.79	24.04	10.35	10.48	8.73
EXPORT & COMM'L CROPS	10.98	10.77	21.04	93.25	43.50	20.24	30.65	21.64	20.74	21.24
Abaca & other Fibers	1.51	0.44	1.11	4.58	7.41	0.99	1.84	0.37	0.34	0.32
Coconut	3.06	3.10	7.02	28.03	10.64	4.88	9.77	6.04	3.43	4.83
Coffee & Cacao	0.45	0.40	1.33	5.06	1.68	0.85	1.49	0.60	0.96	1.36
Cotton	0.12	0.14	0.23	4.04	0.68	0.04	0.63	0.07	0.09	0.14
Rubber	0.06	0.08	0.12	0.92	0.79	0.06	0.17	0.23	0.08	0.08
Sugarcane	5.51	6.23	10.78	49.98	17.79	13.09	16.04	14.25	15.81	14.47
Tobacco	0.28	0.37	0.44	0.65	4.51	0.33	0.71	0.07	0.04	0.04
FORESTRY	1.20	1.99	2.08	1.09	9.69	1.92	2.11	4.32	1.48	1.79
OTHERS	2.49	5.05	13.25	93.52	76.93	12.56	19.08	12.93	18.25	24.99
Sub-Total	27.05	40.60	75.61	552.69	364.08	99.77	151.72	92.94	101.56	124.58
PDB Loans a						5.28	7.93	6.72	7.70	9.62
SMB Loans a						4.17	5.28	8.65	6.30	6.78
SSLA Loans a	0.41	0.64	6.96	12.03	12.17	5.86	5.55	5.38	7.04	8.88
TOTAL	27.46	41.25	82.57	564.72	376.24	115.08	170.48	113.69	122.60	149.86

Sources of data: BSP-DER/SRSO, LBP and DBP

r/ Revised based on actual data for all bank types, except for distribution of RBs by commodity, which was estimated

P/ Preliminary; basic data was based on average shares in past years

a/ A breakdown of loans of thrift banks by commodity is not available. Caution should be exercised in using the figures in this table if we are to account the loans granted by thrift bank

TOTAL OVERSEAS FILIPINO WORKERS' REMITTANCES

In Billions of (US) Dollars

YEAR	Total		
	Remittances	Landbased	Seabased
1988	0.86	0.68	0.17
1989	0.97	0.76	0.21
1990	1.18	0.89	0.29
1991	1.50	1.13	0.38
1992	2.22	1.76	0.45
1993	2.28	1.84	0.39
1994	3.01	2.56	0.38
1995	3.87	3.66	0.21
1996	4.31	4.06	0.25
1997	5.74	5.48	0.26
1998	4.93	4.65	0.27
1999	6.79	5.95	0.85
2000	6.05	5.12	0.93
2001	6.03	4.94	1.09
2002	7.19	5.96	1.23

Notes :

a Earnings from resident aliens refer to salaries/allowances of foreigners employed in foreign banks and other entities inwardly remitted to the Philippines.

Source: Bangko Sentral ng Pilipinas