Agricultural Credit and Banking in the Philippines: Efficiency and Access Issues

Gilberto M. Llanto

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AGRICULTURAL CREDIT AND BANKING IN THE PHILIPPINES: EFFICIENCY AND ACCESS ISSUES*

*Gilberto M. Llanto***

I. INTRODUCTION

Agricultural credit has an important role in the development of the agriculture sector. Agriculture accounts for close to 30 percent of gross domestic product (GDP), about 24 percent of foreign-exchange earnings and 46 percent of the labor force. It sustained the economy throughout economic and financial crisis of 1983-1986, growing by 3.1 percent in real terms while industrial growth declined by 7 percent. In 1987-1991, agriculture has been a steady source of growth for the economy. However, agriculture's relative use of formal credit is much lower than that of the non—agricultural sector which absorbed a much higher level of credit per peso value of output. Agriculture has had a small and, lately, declining share of total bank loans: 9.7 percent in 1985 and 5.2 percent in 1991 (Table 1). In 1985-1991, the average ratio of agricultural loan to gross value added (GVA) in agriculture was 23 percent, while it averaged around 34.3 percent in 1980-1983 (Table 2). The bulk of agricultural loans, which was supplied by the commercial banking system, was absorbed by commercial agriculture. Small-scale and subsistence agriculture sourced their loans mostly from informal lenders. With adequate financing the sector could have performed better. But, as the Asian Development Bank (1990) reports, the volume of institutional credit to the agriculture sector is considered inadequate and the sector has received a much smaller share of formal credit than the non-agricultural sector.

Credit is important because economic agents in the agricultural sector who suffer from a cash-flow problem and a liquidity constraint may produce sub-optimal inputs use and, therefore, output (Khandker and Binswanger 1989). This paper reviews past and present agricultural credit and banking policies in the Philippines. It identifies the principal issues in rural credit markets and discusses the present status of agriculture finance and the government's current role in rural credit markets.

It is organized into four sections. Section I introduces the issues. Section II discusses the status of agriculture finance and the institutional structure for credit delivery to agriculture. It explains the present agricultural credit policy in the context of the previous approach of

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**Research Fellow, Philippine Institute for Development Studies and the Social Weather Stations, Inc. Dr. Llanto is the former Executive Director of the Agricultural Credit Policy Council, Department of Agriculture.

TABLE 1
AGRICULTURAL PRODUCTION LOANS GRANTED, BY INSTITUTION
(In billion pesos)

	1985	1986	1987	1988	1989	1990	1991
(A) Gov't Banks	1.40	0.60	1.50	3.50	5.80	6.00	8.40
(B) Private Banks	26.10	24.50	25.90	31.80	25.40	35.30	37.70
(C) Total Agri Loans	27.50	25.10	27.40	35.30	31.20	41.30	46.10
(D) Total Loans	283.40	263.30	404.30	480.50	472.10	474.50	879.80
B/D (In %)	9.20	9.30	6.40	6.60	5.40	7.40	4.30
C/E (In %)	9.70	9.50	6.80	7.30	6.60	8.70	5.20

Source: Agricultural Credit Policy Council.

TABLE 2
RATIO OF AGRICULTURAL LOANS TO GROSS VALUE ADDED IN AGRICULTURE
(In billion pesos)

	1985	1986	1987	1988	1989	1990	1991
(A) Agri Loans	27.50	25.10	27.40	35.30	31.20	41.30	46.10
(B) Gross Value Added	104.50	104.40	119.50	135.70	162.40	185.90	206.90
A/B (In %)	26.30	24.00	22.90	26.00	19.20	22.20	22.30

Source: Agricultural Credit Policy Council.

providing subsidized credit to the agriculture sector and describes the role of government in the new agricultural credit framework. Section III is an impact assessment of the agricultural credit programs and discusses the main issues arising from the current agricultural credit policy, especially in relation to the new government approach of using non-bank financial institutions like credit cooperatives to deliver credit to the countryside. Section IV summarizes the findings and conclusions of the paper and provides some policy recommendations. The paper does not discuss lending to commercial agriculture which has easier access to bank resources; rather, it focuses on the credit problems affecting smallholder agriculture.

II. AGRICULTURE FINANCE AND THE ROLE OF GOVERNMENT

A. *The Institutional Structure for Credit Delivery*

The rural financial system has two broad components:
(1) the formal sector; and
(2) the informal sector (Figure 1).

The formal sector is composed of the commercial banks, thrift and development banks, the rural banks and the credit-guarantee institutions. The informal sector, composed of the informal moneylenders (such as traders, millers, large farmers, friends, relatives, landowners and, recently, overseas contract workers), the credit unions and credit cooperatives, rotating savings and loans associations, serves the financing requirements of small— scale and subsistence agriculture and the majority of small rural borrowers. Table 3 gives a summary of the main functions of the formal institutions, the types of ownership, their clientele and the sources of funds. Commercial agriculture, consisting of both medium and large-scale individual and corporate borrowers, is served by all types of banks in the formal sector. An emerging important institution is the credit guarantee institution.

The Comprehensive Agricultural Loan Fund (CALF), which was established in December 1986 by Executive Order 113, provides credit guarantee to the agricultural sector through three government agencies: the Philippine Crop Insurance Corporation (PCIC), which is used by CALF to guarantee the production credit of small farmers; the Quedan Rural Credit and Guarantee Corporation (Quedancor), which provides a guarantee cover to inventory financing and the Guarantee Fund for Small and Medium Enterprises (GFSME) which provides a credit guarantee to small and medium-sized firms/enterprises.

The CALF is managed by the Agricultural Credit Policy Council (ACPC) of the Department of Agriculture which oversees the credit-guarantee operations of these institutions and pays the guarantee calls submitted by banks through the PCIC, Quedancor and GFSME. The banks supply the loans to borrowers who have the option to seek guarantee cover from any of the three operating institutions of the CALF. The credit guarantee covers up to a maximum of 85 percent of the total loan amount. When the borrower defaults, the bank can claim from the CALF a reimbursement of the outstanding loan up to this maximum amount.

FIGURE 1. THE PHILIPPINE RURAL FINANCIAL SYSTEM

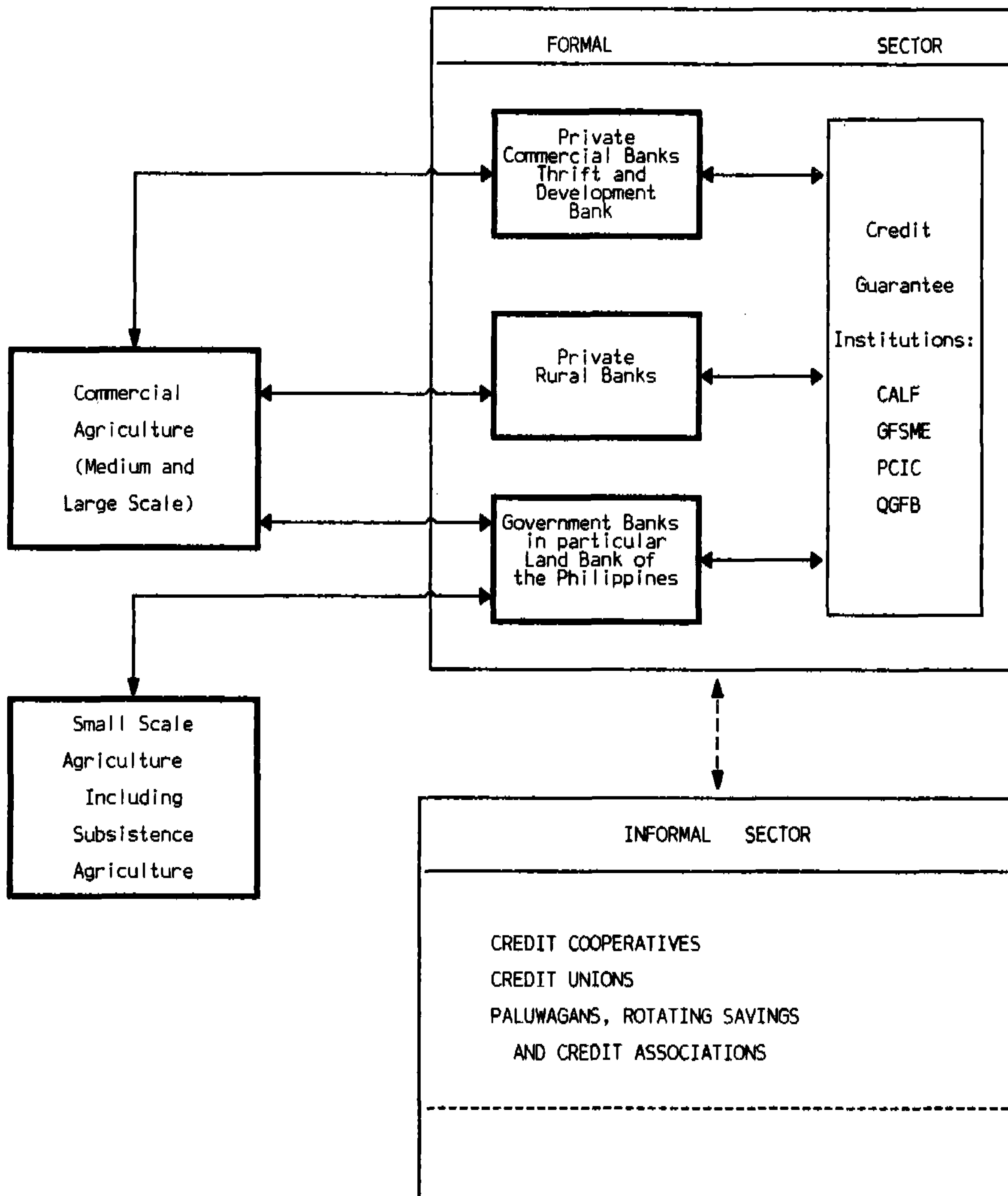

Table 3

FORMAL AND INFORMAL INSTITUTIONS, BY VARIOUS DIMENSIONS

INSTITUTIONS	OWNERSHIP	MAIN FUNCTIONS	CLIENTELE	SOURCES OF FUNDS
FORMAL SECTOR				
1. Commercial Banks	a. incorporators (5–15 persons) b. stockholders/ subscribers	accepting of drafts issuing letters of credits discounting and negotiating promisory notes, drafts, bills of exchange and evidences of draft receiving deposits (demand, time and savings) including negotiable order of withdra–wal accounts buying and selling foreign giver billions lending money against personal securities and against mort–gages on improved real estate (land and building) and insured improvements thereon managing trusts	traders merchants business firms / corporations producers consumers government agencies universities	Deposits Borrowings a. Central Bank – rediscounting – direct advance (loan) b. Government / private financial institutions (domestic) c. Foreign loans Capital accounts (capital stock / fund balances / surplus) Investments
2. Thrift and Development Banks	stockholders	grant loans, whether secured or unsecured accept savings and time deposits invest in readily marketable bonds and other debt securities, commercial papers and account receivables, drafts, bills of exchange, acceptance or notes arising out of commercial transactions issue domestic letters of credit engage in trust business perform quasi–banking functions (money market) accept checking accounts (demand deposits), NOW accounts, government deposits and foreign currency deposits under CB Circular No. 343	middle income groups school children small and medium scale producers involved in agriculture and in various industries	Deposits Borrowings a. Central Bank b. Government or any of its political subdivisions or instrumentalities c. Trust departments or managed funds of banks or investment houses d. Issuance of commercial papers e. Issuance and dealing in mortgage and chattel mortgage certificates f. Government / Private Financial institutions g. Foreign lands Investments Capital accounts (capital stock / fund balances / surplus)

Table 3
FORMAL AND INFORMAL INSTITUTIONS, BY VARIOUS DIMENSIONS

INSTITUTIONS	OWNERSHIP	MAIN FUNCTIONS	CLIENTELE	SOURCES OF FUNDS
FORMAL SECTOR				
3. Rural Banks	a. incorporators (5–15 persons) b. subscribers (in access of 15)	grant loans and make investment in accordance with existing rules and regulations accept savings and time deposits sell domestic drafts act as correspondent for other financial institutions receive in custody funds, documents and other valuable objects and rent safety deposit boxes for the safe–guarding of such objects act as financial agent, buy and sell by order of and for the account of its customers, shares, evidences of indebtedness and all types of securities make collection and payments for the account of others and perform such other services for its customers are not incompatible with banking business	agriculture – farmers including the poor producers (landless farmers and marginal fishermen) commercial – merchants – business firms consumers small scale industries	Deposits Borrowings a. governmenrt / private financial institutions (DBP, PNB, etc.) b. Central Bank – rediscounting – act as fund administrator of of special financing programs Investments Capital Accounts (capital stock / fund balances / surplus)
4. Credit Guarantee Institutions (PCIC, QGFB, GFSME, CALF)	government	provides a credit guarantee of up to 85% cover to the bank for the project financed by the bank for the ff: a. for small and medium–sized agricultural projects b. projects involving grains and other storable commodities c. for agricultural production projects of small farmers d. for rural–based projects of local government units	farmers / fishermen small and medium enterprises traders / millers cooperatives	Capital provided by government; for CALF, pool of funds from the initial integration of twenty out of forty six commodity programs implemented by DA

Table 3
FORMAL AND INFORMAL INSTITUTIONS, BY VARIOUS DIMENSIONS

INSTITUTIONS	OWNERSHIP	MAIN FUNCTIONS	CLIENTELE	SOURCES OF FUNDS
INFORMAL SECTOR				
1. Credit Cooperatives / Credit Unions	groups (at least 25 persons)	mobilize the small, scattered resources of the member for capital formation develop the habit of thrift among its members for capital build–up provide loans to its members at reasonable rates of interest provide members with information and develop their skills in financial management provide social growth and economic independence of its members cooperate actively with other cooperatives	low income groups – small farmers – marginal fishermen – factory workers – ordinary employees	Share Capital Deposits Loans Subsidies / grants / donations
2. Money Lenders	individuals (traders, input suppliers, big landowners, warehouse owners, etc.)	provide short term loans	pretty traders small entrepreneurs e.g. market vendors factory workers employees poor consumers subsistence producers (farmers / fishermen)	Own funds Borrowings a. banks b. friends / relatives Income from regular jobs

Source: Compiled by the author.

Figure 1 distinguishes between two broad groups of informal lenders:

(1) the traditional moneylenders (traders, millers, landowners and big farmers); and
(2) organizations or groupings (credit unions, credit cooperatives, rotating savings and credit associations).

Their lending activities are motivated by different objectives. In many developing countries there are a number of complex reasons for the lending behavior of individual moneylenders: self-interest, interlinking of transactions involving credit, land use, marketing or labor arrangements or, as some observers claim, the exploitation of rural borrowers. The objectives of credit unions, credit cooperatives, rotating savings and loans associations, and other indigenous self-help organizations are much simpler and transparent. They profess to provide reasonably priced and timely credit to member-borrowers. Unlike informal moneylenders, credit unions and credit cooperatives provide patronage refunds or rebates to borrowing members. Credit unions and credit cooperatives are also voluntary associations of individuals who come together for a common goal and gain formal government recognition by registering with the Philippine Securities and Exchange Commission or the newly created Cooperative Development Authority under the Office of the President.

We must also point out that the formal and informal sectors do not act in isolation of each other. The informal lenders access bank credit which they in turn relend to small rural borrowers. The Land Bank of the Philippines, for example, uses cooperatives and some selected foundations and nongovernmental organizations (NGOs) as credit channels. The Land Bank wholesales the loans to these channels which retail the loans to member-borrowers. Moneylenders -- like traders, millers and big farmers -- also borrow their loanable funds from rural financial institutions for retail credit to their small farmer clients.

The government banks involved in agricultural and rural credit are the Land Bank and the Development Bank of the Philippines. The Philippine National Bank, formerly a wholly owned government bank, has been substantially privatised. It now has a more commercial orientation and will not be very much involved in smallholder agriculture.

The policymaking and regulatory bodies of the rural financial system are composed of several government agencies. The Central Bank of the Philippines provides the overall guidance for monetary and credit policies and supervises and regulates the financial institutions and the non-bank financial institutions. The Philippine Deposit Insurance Corporation insures individual deposits up to P40,000 and has taken over from the Central Bank the rehabilitation of rural banks. The ACPC provides policy advice on agricultural and rural credit and to manage the CALF.

B. *The Past and New View of Rural Finance*[1]

Supply-led Finance

For about 20 years, the Philippine government funded a number of rural sector credit programs which attempted to provide access to formal credit at concessional or subsidized rates. The programs were to encourage small farmers to adopt new technology to increase farm yields and to offset the policy biases against agriculture. Various incentives and regulatory schemes such as credit quotas, deposit retention schemes and highly subsidized loans from the rediscounting window of the Central Bank were part of this approach. Interest rates on deposits and loans were regulated. For loans, the ceiling was 12 percent for supervised credit and 14 percent for non-supervised credit. For deposits, the ceiling was 6 percent for savings and 6.5 to 8 percent for time. Agricultural activities enjoyed preferential rediscounting both in terms of loan value and interest rate. The rediscount rate for agricultural loans was 1 percent for supervised credit and 5 percent for non-supervised credit. Special time deposits for rural financial institutions were given at 3 percent interest rate. A loan quota under the Agri-Agra Law mandated banks to set aside 25 percent of net loanable funds to agriculture, of which 10 percent was for agrarian reform beneficiaries and 15 percent for agriculture. The deposit retention scheme required that at least 75 percent of total deposits mobilized by branches, extension offices and head offices of banks would be invested in the region where the deposits were generated. The private rural banks were used mainly as conduits of cheap loans from special time deposits and the rediscount window of the Central Bank.

The expected access to bank credit by small borrowers did not materialize except in cases that the government was willing to provide credit subsidies to banks. Even then, the supply of formal agricultural credit declined from a level of 18 percent of total bank loans in 1966 to only 5 percent in 1975 and less than 10 percent in 1985. Various surveys conducted by the Technical Board for Agricultural Credit (the forerunner of ACPC) also showed that the proportion of farmers who borrowed from banks decreased from 37 percent in 1967-1974 to 23 percent in 1981-1986. Worse, credit subsidies were largely captured by formal lenders and not by the farmer-borrowers (Esguerra 1981) while savings mobilization was neglected as rural banks depended on the Central Bank for over half of their loanable funds (Neri and Llanto 1985). The government's agricultural credit program was fragmented into 46 separate commodity-targeted programs which led to inefficient and wasteful use of credit resources and the subsequent impairment of the rural banking system because of high past dues and low repayments. 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.

The failure of the supply-led approach in the Philippines is not a unique experience. Braverman and Guasch (1989) observed that despite the expansion of targeted credit programs in developing countries, only a small fraction of the farmers seemed to have benefited. They estimated that only about 5 percent of farms in Africa and 15 percent in Asia and Latin America received such formal credit. Moreover, these targeted credit programs seemed to have worsened

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[1]This part draws from Llanto (1990).

already inequitable income distributions when only 5 percent of borrowers received 80 percent of the credit. One estimate of the Philippine experience showed high-income farmers receiving 68 percent of total credit from rural banks (Neri and Llanto 1985).

Some critics comment that the past supply-led approach failed to consider the particular nuances of rural financial markets:

- the severe information asymmetries in rural credit markets;
- the huge transaction costs of small loans;
- the banks' preference for observable and hard collateral like land, and the weak incentive design which leads borrowers to shirk their loan-repayment obligations and induces banks to become less careful in screening borrowers or approving loans.

In addition, the banks depended on the government's subsidies for loanable funds and neglected savings mobilization, the "forgotten half of rural finance" (von Pischke 1991). Worsening the situation was the direct involvement of government line departments in the lending process which opened avenues for political interference and corruption in credit decision and allocation.

The New View of Rural Finance and the Role of Government

The Central Bank undertook financial reforms at the start of the 1980s as the financial system was not responding efficiently to the needs of a growing and modernizing economy. Lack of competition in the financial system and the absence of a long—term capital market hampered economic development. Reforms eliminated interest rate ceilings on all types of deposits and loans, stopped the Central Bank's subsidized rediscounting facilities and required banks to raise their minimum capital requirements.

With respect to the rural financial system, the government issued Executive Order 113 which terminated the direct lending programs by nonfinancial government agencies and consolidated 20 agricultural credit programs into the CALF. The credit subsidies were withdrawn and the government adopted a market-oriented rural credit policy. The private and government banks were urged to lend out of their loanable funds to agriculture and rural borrowers and were left to determine deposit and lending rates. Other important components of this new rural credit policy are as follows:

(1) the emphasis on savings mobilization and financial innovations to reduce transaction costs;
(2) the recognition of people's organizations as effective institutions for credit delivery;
(3) a more liberal bank branching policy; and
(4) the phase-out of the development banking function of the Central Bank and the transfer of special lending programs like the Agricultural Loan Fund (ALF) and the Integrated Rural Financing (IRF) to the Land Bank of the Philippines.

The CALF was created primarily as a credit guarantee fund to encourage banks to lend to agriculture, especially smallholder agriculture. Rather than give subsidized credit, the

government now intervenes in the rural credit markets indirectly through the CALF which acts as a risk-reducing mechanism for bank lending. The CALF provides a guarantee cover to the extent of 85 percent of the outstanding loan. In the event of a loan default, the bank calls on the CALF for reimbursement of 85 percent of the outstanding loan.

The liberalization of bank entry and branching policy is an important reform. Branching regulations in the 1970s promoted the physical expansion of banks in the country; the opposite, however, was undertaken in the 1980s which saw regulations biased against liberal bank entry and expansion. Many areas are still without banking facilities partly because of restrictive bank entry and branching policies of the Central Bank which are "expressed as a concern of the Central Bank Governor about proliferation of banks and the danger of entrusting banking responsibilities to new bankers" (Tan 1989). No new bank has been established since 1980. Instead, mergers, consolidation and investment in existing banks, including those in economic difficulty, are encouraged. Branching is also restricted to areas that are not "overbanked."

However, the Central Bank has recently taken steps to liberalize the licensing of new banks and the opening of new branches. Central Bank (CB) Circular 1200 (16 May 1989) allowed the establishment of new banks and lifted the requirement to purchase special five-year government securities as a condition to open new branches. All restrictions on opening new branches in rural areas classified under Categories IV and V were removed. The Central Bank, however, maintains its discretionary policy on branching in urban and particularly in metropolitan areas. It also allows a bank to open a new branch as long as it does not create market-concentration problems.

A key component of the new thrusts in agricultural credit and banking policies is the rehabilitation of the rural banks. It will be recalled that from the early 1950s to the 1970s the Central Bank and Development Bank promoted the growth of the rural banks through various subsidized schemes such as cheap and concessional credit through the rediscount window of the Central Bank and the equity participation by the Development Bank in many rural banks. However, those rural banks which greatly depended on the government's largesse and did not manage their respective institutions well were severely affected by the economic and financial crisis of 1983-1985 and the subsequent withdrawal of credit subsidies. As earlier stated, in December 1986 there were only 856 rural banks still operating of which 82 percent were in arrears with the Central Bank. The Central Bank made several attempts to resuscitate the moribund rural banking system, resulting in the 1987 Rural Bank Rehabilitation Program under CB Circular 1143 (24 April 1987) as amended by CB Circulars 1158 and 1172. This rehabilitation program intended to strengthen the rural banks through a combination of fresh capital infusion and the rescheduling of past due obligations with the Central Bank. Table 4 shows the principal features of CB Circular 1143, as amended.

TABLE 4
PRINCIPAL FEATURES OF THE RURAL BANK REHABILITATION PROGRAM

1. Fresh capital infusion to achieve the minimum 10 percent risk asset ratio
2. Option for conversion of supervised credit arrears into common stock in the name of the Land Bank of the Philippines and/or a plan of payment with the Central Bank not exceeding 15 years
3. First option to purchase the common shares held by the Land Bank under the conversion scheme, under certain conditions
4. Increase in authorized capitalization
5. Forgiveness of liquidated damages and/or penalties under certain conditions
6. Restoration of rediscounting privileges
7. Exemption from equity ceiling

Source: Central Bank Circular 1143, as amended.

Table 5 shows the status of the rehabilitation program for rural banks under CB Circulars 1143, 1158 and 1172 as of November 1992.

TABLE 5
STATUS OF APPLICATIONS UNDER CB CIRCULAR 1143, AS AMENDED

Total Applications Received	525
Applications Denied/Withdrawn/Disqualified	29
Applications Deferred	8
Approved Applications	488

Source: Central Bank

Despite the rehabilitation program under CB Circular 1143, as amended, the strengthening of the rural banks did not take place as decisively as policymakers expected. While rural banks participated in this rehabilitation program, some policymakers believed that a bolder approach to rural bank rehabilitation was needed to assure a stable and reliable credit-delivery mechanism in the countryside. Thus, the Central Bank, the Philippine Deposit Insurance Corporation and the Rural Bankers' Association put together a program to complement the existing rehabilitation program under CB Circular 1143, as amended. In this regard, the Central Bank issued CB Circular 1315 (29 October 1991) which created the Countryside Financial Institutions Enhancement Program (CFIEP) "to reduce the debt burden of eligible countryside financial institutions." Table 6 states the prominent features of the CFIEP.

TABLE 6
FEATURES OF THE CFIEP

Module I: Purchase of Rural Bank Arrears. This module seeks to retire some ₱2.8 billion of rural bank arrears with the Central Bank.

Module II: Land Bank Counterpart Capital. Under this module an eligible rural bank is provided access to Land Bank's capital infusion program which involves the matching on a one-to-one basis of rural bank's fresh capital infusion. The Land Bank's matching equity shall be in preferred shares redeemable throughout a ten year period.

Module III: Merger and Consolidation Incentives. This module seeks to promote mergers and consolidations among banks as a means "to develop larger and stronger countryside financial institutions." The incentives include, among others, a counterpart capital infusion by the Land Bank by a ratio of more than one-to-one of the merged or consolidated bank's total fresh equity and a Philippine Deposit Insurance Corporation's Credit Facility to augment the capital infusion required to absorb the adverse impact of asset write-downs and other costs of merger and consolidation.

Source: CB Circular 1315, Series of 1991.

The CFIEP also provided a further set of the following incentives:

(1) exemption of voting stockholding of any person or persons related to each other within the third degree of consanguinity or affinity, cooperatives or corporations participating in the Program from the application of the prescribed equity ceilings as may be warranted; and

(2) waiver of penalties and other charges due on arrears covered by the Program.

The Rural Banks Act of 1990 was another important effort to address the problems of the ailing rural banking system in the country. It provided for the conversion of supervised credit past due and 50 percent of the non-supervised credit past due and restructured loans into preferred shares of those government banks. The law also gives the rural banks powers to do the following:

(1) open current or checking accounts, provided the rural bank has net assets of at least P5 million and subject to guidelines set by the Monetary Board;

(2) act as official depository of municipal, city and provincial funds where the bank is located;

(3) rediscount papers with the Philippine National Bank, the Land Bank or any other banking institution; and

(4) invest in equities of allied undertakings such as the following:

(a) banks, financial institutions and non-bank financial intermediaries;
(b) warehousing and other post-harvest facilities;
(c) fertilizer and agricultural chemical and pesticides distribution;

(d) farm equipment distribution;
(e) trucking and transportation of agricultural products;
(f) marketing of agricultural products and leasing.[2]

The Link Up with Non-bank Institutions

Another important feature of the new view of rural finance and role of government is the use of non-bank institutions such as nongovernmental organizations (NGOs), cooperatives and self—help groups as credit channels. From the Aquino government on, NGOs and private voluntary organizations (PVOs) have been recognized as credit conduits in the rural areas. The Land Bank and the Department of Trade and Industry have tried to use them as credit conduits. To reach rural borrowers and reduce its monitoring cost the Land Bank through the Integrated Financing Program of the ACPC/CALF also used rural banks as lending conduits. The Land Bank has become a wholesale banking institution and the rural banks, retail institutions. However, the slow rehabilitation of the rural banks and the restrictive branching policy of the Central Bank (at least prior to the recent branching policy reform discussed above) motivated the Land Bank to consider using credit cooperatives and some NGOs as credit channels.

These organizations have shown some capability as credit conduits and savings mobilizers. They have the advantage of having grass-root networks and peer pressure within the organization, allowing them to reduce transaction costs, more efficiently screen borrowers and assure loan repayment. Their link-up with the Land Bank allows the non-bank institutions to undertake both savings and credit activities for their members. These organizations screen or filter loan applications, instruct members on the rudiments of formal finance with a strong emphasis on savings mobilization and loan repayment, and act as collection agents of the Land Bank. A similar linking approach has been tried in Indonesia and has been reported to be a workable scheme to deliver credit to small borrowers (see Seibel 1989).

The cooperatives and similar organizations provide access to financial services at reasonable rates to members and to the small borrowers in general. However, there are limits to their ability to intermediate the rural surplus and mobilize huge amounts of funds. They cannot provide the far-ranging financial services that formal financial institutions offer. The more important issue, however, is whether they can sustain the effort at rural credit intermediation without the operating subsidies that they now enjoy from both government and external donors. Another issue is the extent to which the integrity of the credit link-up can be shielded from rent seeking by "instant" organizations that are established because of the availability of credit funds.

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[2]An objectionable feature of the Rural Banks Act of 1990 is the provision which mandates government financial institutions to extend credit at concessional terms to rural banks. This is a policy reversal because it runs counter to the market orientation of credit policy and discourages savings mobilization.

III. IMPACT ASSESSMENT OF CREDIT POLICIES AND PROGRAMS

The assessment of the impact of agricultural-credit policies and programs under the new approach in rural financial policies is a large undertaking and merits a serious and separate study. I present only a preliminary assessment with focus on some of the principal on-going credit programs to give an idea of the current state of agricultural credit and banking in the Philippines after the reforms. First, I discuss the general status of agricultural credit and banking in the Philippines. Secondly, I focus on the credit guarantees under the CALF, with emphasis on the Integrated Rural Financing Program (IRF), the Agricultural Loan Fund (ALF) and three special programs: the Livelihood Assistance for Agricultural Development (LEAD) of the Department of Agriculture and two experimental projects of the ACPC -- the Grameen Bank Replication and the Development Assistance Program for Cooperatives and Peoples' Organizations (DAPCOPO). Although over the past five years credit decisions and allocation were left to market forces operating in the financial system, the Grameen Replication and DAPCOPO were implemented to initiate non-bankable groups such as landless farmers and small fisherfolk into the formal credit system.

The projects were viewed as strategic interventions designed to address the access-to-credit issue in a period of policy transition. After getting prices right through financial liberalization, the issue of lack of access to credit by small rural borrowers remains. There was a huge clamor for a return to credit subsidies from both rural banks and some farmer organizations. There was also an enormous pressure on politicians to take the route presented by credit subsidies. These pressures motivated the creation of DAPCOPO and Grameen replication to show that even in a market-friendly credit environment, it is possible for small rural borrowers to be in the mainstream of formal rural credit markets.

The projects are, therefore, timebound and intended to complement rather than substitute for lending by formal financial institutions.[3] One of their special characteristics is their use of non-traditional and non-bank channels to provide credit to small rural borrowers. They focus on non-bankable groups, especially those without access to formal credit. One innovation they introduced is the conduct prior to loan availment of "social preparation" activities such as capability or institution—building among target borrowers. These features differentiate these programs in large measure from the credit program schemes during the 1970s and 1980s which had little regard for social preparation or institution-building.

A. *General Status of Agricultural Credit and Banking*

Table 7 shows the volume of agricultural and non-agricultural loans provided by financial institutions in 1986-1989. It is significant that the share of private banks in total agricultural loans is relatively high. These private banks provided loans mostly to large corporations with agribusiness activities and medium-size enterprises. Small-scale agricultural activities, especially those of small rural borrowers, are served by government banks and the rural banks.

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[3]Llanto (1990) and Alip et al. (1990) provide a detailed description of the motivation and respective program designs of DAPCOPO and Grameen Replication.

TABLE 7
LOANS OUTSTANDING OF FINANCIAL INSTITUTION BY INDUSTRY
Average of 1986–1989
(In million pesos)

Industry	Commercial Banks		Thrift Banks		Rural Banks		Specialized Government Banks		Non–Bank Financial Institutions	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Agriculture	44,641.90	38.60	2,374.30	17.60	5,697.00	74.70	1,439.40	21.90	2.60	0.10
Commercial	19,038.3 a/	16.50	1,902.20	14.10	788.00	10.30	(8.6)	(0.1)	44.80	2.20
Industrial	–	–	917.50	6.80	237.20	3.10	2,596.50	39.60	0.60	c/
Real Estate	3,215.2 b/	2.80	3,314.00	24.60	–	–	574.20	8.80	128.70	6.20
Consumption	3,303.60	2.80	1,031.80	7.60	–	–	2.10	c/	1,548.00	74.60
Others	45,399.70	39.30	3,938.50	29.20	905.10	11.90	1,955.00	29.80	350.00	16.90
Total	115,598.70	100.00	13,478.30	99.90	7,627.30	100.00	6,558.60	100.00	2,074.70	100.00

a/ data classified as trade
b/ data classified as contract construction
c/ less than 0.1 percent

* KBs, SGBs, NBFIs – based on yearend data

Source: Central Bank Annual Report, 1986–1989

Rural banks, which on average accounted for 10-13 percent of the total volume of loans granted by the banking system as production loans to agriculture, has traditionally lent to small-scale agriculture.

Agricultural loans in 1986-1990 classified by commodity are shown in Table 8. The larger share (51 percent) of agricultural loans was shared by several food commodities: fruits and vegetables, rice, fish and livestock. Export crops got 34.1 percent of total agricultural loans; forestry and others received the balance. Floro and Yotopoulos (1991) call this phenomenon the "asymmetry in agricultural credit allocation" which is determined by the size of the farm and the market orientation of output, i.e., the export and commercial markets. Of the export and commercial crops, sugar had a sizable share of total agricultural loans. Most of the financing is absorbed by sugar and coconut/copra, both export crops.

A summary of the performance of the CALF Credit Guarantee Program in 1986-1990 shows the average volume of agricultural and agriculture-related and non-agricultural loans covered by the CALF credit guarantee (Table 9). Quedancor (QGFB) covered ₱1.8 billion or 68 percent of total agricultural loans in 1986-1990. It also covered a huge amount of non-agricultural loans over the same period. Table 10 shows as of 31 December 1991 the cumulative total of guaranteed loans, the number of direct and indirect beneficiaries and the participating institutions and guarantee payments made since the CALF credit-guarantee program started.

The recent countryside credit performance of the Land Bank of the Philippines must be mentioned. Because of the strategic shift and expansion in 1987 of the Land Bank's credit delivery approach, the Bank's agricultural loans increased 10-fold from ₱105.06 million in 1987 to ₱2.8 billion in 1990 and to an estimated ₱5 billion agricultural loan portfolio by the end of 1991. The Land Bank achieved its phenomenal growth in agricultural lending (principally to small agrarian reform beneficiaries) by using cooperatives as loan conduits. It worked with private groups to help organize these cooperatives which, according to its latest report, total some 5,000. The growth in Land Bank's agricultural credit was also due to its mandate to lend to agrarian reform beneficiaries. By the end of 1990 the Land Bank delivered credit to 305,156 farmers through 2,879 cooperatives.[4]

Despite the recent growth in formal credit to agriculture, the informal sector continues to be a critical feature of rural credit markets. The majority of rural borrowers in the Philippines as in many developing countries has always depended on informal lenders. Unfortunately there are no organized and systematic data on the informal lenders to help us assess their relative importance to the agricultural sector. However, anecdotal evidence and several local surveys point to their ability to operate in certain areas and for specific clientele that banks fail to serve (Llanto 1990). The available evidence seems to show that informal lenders serve a significant segment of the rural sector. The 1981-1982 TBAC Survey revealed

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[4]The ACPC cautioned Land Bank about the sudden increase in the number of cooperatives used as credit conduits. Moral hazard problems exist in situations where access to credit is used to motivate the formation of certain groups such as cooperatives.

TABLE 8
AGRICULTURAL LOANS BY COMMODITY, 1986–1990
(In million pesos at current prices)

Commodity	Total Agricultural Loans		
	Amount	Average Distribution (Percent)	Compounded Annual Growth Rate (Percent)
Food	78,878.00	50.78	17.41
Rice	15,701.00	10.11	40.40
Corn	2,502.00	1.61	27.70
Sorghum	110.00	0.07	19.30
Soybeans	170.00	0.11	123.80
Fruits and Vegetables	19,902.00	12.81	(12.2)
Livestock	20,777.00	13.38	34.90
Fisheries	19,716.00	12.69	22.40
Export Crops	51,786.00	34.13	2.80
Abaca	5,038.00	3.24	(16.4)
Coconut	14,328.00	9.22	0.80
Coffee	2,905.00	1.87	(25.8)
Cotton	701.00	0.45	41.20
Rubber	421.00	0.27	(0.6)
Sugar	28,393.00	18.28	10.80
Tobacco	1,230.00	0.79	28.20
Forestry	8,055.00	5.18	4.60
Others	15,389.00	9.91	43.70
Total	155,339.00	100.00	13.50

Source: CB–DER, CB–SRCAD and LBP

TABLE 9
AVERAGE VOLUME OF AGRICULTURAL/AGRICULTURE-RELATED AND NON-AGRICULTURAL LOANS COVERED BY GUARANTEE, 1986-1990

	Agri (PM)	% Share	Non-Agri (PM)	% Share	Total (PM)	% Share
PCIC	680.60	25.50	–	–	680.68	24.50
GFSME a/	184.27	6.90	–	–	184.27	6.60
QGFB c/	1,804.34	67.60	109.37 b/	100.00	1,913.71	68.90
TOTAL	2,669.29	100.00	109.37	100.00	2,778.66	100.00

a/ Loans under GFSME-CALF excludes inactive or accounts withdrawn.
b/ Quedan Financing fro Food Market Retailers and Livelihood Financing for Employees (LIFE)
c/ Includes programs which have stopped lending operations

* Both for regular programs and CALF

Source: ACPC monitoring report on Summary Performance of Agri Credit/ Guarantee/Insurance Programs, 1986-1990.

TABLE 10
CUMULATIVE LOANS AND GUARANTEE PAYMENTS UNDER THE CALF
As of December 31,1991
(Amount in million pesos)

	Years in Operation	Loans Generated	Beneficiaries Direct	Beneficiaries Indirect	Participating RFIs	Guarantee Payments	% to Loans Granted
PCIC-CALF	4 yrs/ 2 mos.	1,324.00	127,081.00	–	512.00	13.45	1.20
QGFB-CALF	3 yrs/ 10 mos.	2,113.00	510.00	148,714.00	70.00	51.40	3.00
GFSME-CALF	4 yrs/ 7 mos.	307.00	349.00	61,975.00	20.00	7.20	2.80

Source: Agricultural Credit Policy Council

that about 59 percent of farmers who ever borrowed, sourced credit from informal lenders; 34 percent from formal institutions and about 4 percent from both formal and informal sources.

Even at the height of the government-sponsored credit programs before 1986, the great bulk of farmers relied on informal loans (Llanto 1990). Table 11 is a summary of recent information on the extent of borrowing from formal and informal sources as reported by several researchers. In a 1987-1988 survey of farms, non-farms and landless households in Nueva Ecija, Laguna, Quezon and Batangas provinces, the ACPC documented that as many as 94.4 percent of borrowers obtained informal loans.[5] Floro and Yotopoulos (1991) observed that the limited ability of the formal financial institutions to perform their major function of financial intermediation in the rural areas and the endemic asymmetry in formal loan distribution in both the agricultural and non-agricultural sectors leave a large vacuum in the rural credit markets which is filled by informal lenders. The comparative advantage of informal lenders in the rural areas has long been recognized in many countries. A survey done in 1978-1979 by the Technical Board for Agricultural Credit (later reorganized as the ACPC) on informal rural financial markets showed that moneylenders lent principally because of the borrowers' good credit standing and promise to pay. The high interest charges were viewed as premia for risks and uncertainty. Compared to formal lenders the informal lenders are able to maintain high loan repayment or lower loan default and low transaction cost. Recognizing this advantage, government attempts to use informal lenders in rural credit delivery. The Quedancor, for instance, has used the traders and millers with access to traditional banking as credit conduits. The Quedancor provided a guarantee to these traders/millers who, after getting a bank loan, provided credit to their small farmer-clientele. The results motivated the Land Bank to use NGOs and cooperatives as credit conduits to deliver credit to numerous small borrowers.

B. *Assessment of Specific Programs*

1. CALF-Guarantee Program

PCIC-CALF Program

In September 1987, PCIC and the Department of Agriculture signed a Memorandum of Agreement putting the PCIC-CALF Guarantee Program into effect. The PCIC-CALF guarantee aims to encourage banks to extend small-farmer credit by protecting the lenders from loan-default risks. The Program guarantees a maximum of 85 percent of small- and medium-scale agricultural loans. The PCIC administers the Program through its regional offices.

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[5]See the Rural Savings Mobilization Survey (1986) and the Informal Credit Survey (1987-1988) of the Agricultural Credit Policy Council.

TABLE 11
EXTENT OF BORROWING FROM FORMAL AND INFORMAL SOURCES IN THE PHILIPPINES

Period Covered	Author/Year of Publication or Release	Number of loans/ farmer-Borrowers	Credit Source Formal (Percent)	Informal
1954-55	de Guzman (1957)	2411 loans	12.00	88.00
1957-58	Gapud (1958)	256 loans	10.00	90.00
1957-58	Sacay (1961)	916 loans	13.00	87.00
1960-61	BCS (1963)	1679000 loans	7.80	92.20
1967-70	Mangahas (1975)	151 borrowers	11.90	88.10
1970-71	Mangahas (1975)	297 borrowers	20.90	79.10
1969-70	Almario (1970)	138 loans	37.70	62.30
1969-70	Balagot (1974)	134 borrowers	21.60	78.40
1973	DA (1974)	620 loans	51.30	48.70
1973-74	PCARR-Baecon (1974)	3304 loans	92.20	7.80
1974	Cigaral (1977)	421 borrowers	94.00	6.00
1975-76	DA			
	Iloilo (Feb 1977)	341 loans	82.70	17.30
	Iloilo (Jan 1977)	703 loans	97.60	32.40
	Zamboanga (Apr 1977)	551 loans	74.60	25.40
1976	DA (1976)	268 farmers	17.20	82.80
1977	UPBRF (1977)	1079 loans	36.90	63.10
1977	DA (1977)	405 farmers	5.20	94.80
1977	TBAC (1978)	656 borrowers	25.80	74.20
1978	DA (1987)	338 farmers	3.80	96.20
1978	TBAC (1981)	2110 borrowers	17.40	82.60
1979-80	NIA-SGV (1980)	299 farmers	20.00	80.00
1981-82	TBAC (1984)	817600 loans	40.20	59.80
1986	SWS (1986)	1200 respondents	33.00	67.00
1986	ACPC (1988)*	1000 household	16.00	72.00

Data comparability is limited by differences in sampling

BCS – Bureau of Census and Statistics.
DA – Department of Agriculture
PCARR – Philippine Council for Agriculture Resources Research
BAECON – Bureau of Agricultural Economics
UPBRF – University of the Philippines Business Research Foundation
TBAC – Technical Board for Agricultural Credit
NIA – National Irrigation Administration
SGV – Sycip, Gorres and Velayo
SWS – Social Weather Stations
ACPC – Agricultural Credit Policy Council

* Proportions for formal and informal will not add up to 100%.
The remaining 12% borrowers from both formal and informal sources.

Source: Agricultural Credit Policy Council

In 1991, the PCIC-CALF guarantee scheme underwent some changes to expand services:

(1) a shift from multi-risk to credit guarantee;
(2) expansion of coverage to include production-related activities;
(3) increase in guarantee fee from 1.5 percent to 2 percent per annum of the outstanding loan submitted for guarantee;
(4) increase in loan ceiling from ₱50,000 for individual borrowers to ₱150,000;
(5) ceiling of ₱3 million for institutional borrowers when loan is not intended for relending; and
(6) decentralization of claims settlement activities to the regional offices.

Table 10 shows that in 1987-1991, the PCIC-CALF was able to generate a total of ₱1.3 billion in loans under guarantee, benefiting 127,081 direct beneficiaries. Guarantee payments for the same period amounted to only ₱13.4 million or 1 percent of the total amount guaranteed. The PCIC works with 512 participating rural financial institutions.

Quedan-CALF Program

The Quedancor-CALF guarantee enables local traders, millers, cooperatives and small farmers to deposit grain in franchised bonded warehouses against which a negotiable warehouse receipt called the quedan is issued. The quedan can be used as collateral to bank loans. The CALF guarantees up to 80 percent of the outstanding loan extended by the bank.

In 1987-1991 Quedancor-CALF guaranteed loans amounting to a cumulative total of ₱2.1 billion, benefiting directly 510 groups and, indirectly, 148,714 individuals. Guarantee claims amounting to ₱51.4 million or only 3 percent of total loans guaranteed were paid as of 31 December 1991. The Quedancor works with 70 rural financial institutions (Table 10).

GFSME-CALF Program

The GFSME was established in 1983 to stimulate credit flows to small and medium enterprises by providing credit guarantee to bank loans. The CALF uses the GFSME to provide guarantee to rural-based entrepreneurs. The guarantee is up to 85 percent of the outstanding loan. Total cumulative loans generated by GFSME—CALF amount to ₱307 million, benefiting directly 349 groups and indirectly 61,975 individuals. It works with 20 participating rural financial institutions. Guarantee payments in 1987-1991 amounted to P7.2 million or 3 percent of total loans granted (Table 10).

2. Integrated Rural Financing (IRF) Program

Introduced as a pilot financing project in 1983, IRF uses the credit-line approach to financing smallholder agriculture. It is jointly managed by the ACPC and the Land Bank of the Philippines and has two distinct features:

(1) a comprehensive credit-line type of financing open to rural banks and cooperatives through the Land Bank's rediscounting window; and

(2) an institutional-development component focused on organizing and strengthening small farmers' groups.

The latter component is implemented through NGOs. The farmers are trained in basic enterprise management and bookkeeping skills and, more important, value formation, prior to actual availment of bank credit.

The IRF's objectives are as follows:

(1) to support multiple and diversified farming systems and integrated farm financing to spread risks in lending;
(2) to encourage development of viable small home or rural industries linked to the main livelihood of the community or farm household; and
(3) to simplify and systematize the lending process between banks and borrowers.

Following the transfer of supervision of IRF from Central Bank to Land Bank in 1989, some changes were made. Instead of the old strategy of granting special time deposits (STDs) to rural financial institutions (RFIs), the modified IRF uses the Land Bank's rediscounting window to provide loans. This means that the rural banks and cooperatives have to originate promissory notes which they then rediscount with the Land Bank. The old approach placed STDs at the disposal of the banks which they in turn lent to small borrowers. Another significant modification in the IRF is the institution-building component. Farmers are organized into groups and cooperatives in order to facilitate credit delivery by the Land Bank. While the old IRF lent to individual farmer-borrowers, the modified IRF recognizes the role of NGOs in preparing and training farmers in credit management and uses group lending as a strategy to deliver credit to farmers.

A recent evaluation done by the ACPC (1992) revealed that the rural financial institutions (RFIs) participating in the IRF increased their client outreach as evidenced by a significant growth in the number of agricultural borrowers. Also, compared to other lending schemes, IRF lending is more cost-effective. A summary report of the program as of end 1991 follows:

- lent a total of ₱1.8 billion since the new program started;
- approved a total of almost ₱1.5 billion in credit lines;
- served 119,546 farmer beneficiaries through 330 RFIs; and
- consistently exhibited a near 100-percent repayment rate.

3. Agricultural Loan Fund (ALF) Countryside Loan Fund

Established in 1985, the Agricultural Loan Fund (now known as the Countryside Loan Fund) was administered by the Central Bank prior to its transfer to the Land Bank by virtue of Monetary Board Resolution No. 246 (27 March 1989). The transfer was mainly due to the

decision to steer the Central Bank away from providing development finance and to focus it on its primary tasks of monetary management and stabilization. The Land Bank was selected to administer the fund because it is oriented towards development finance.

The ALF was to provide credit to finance seasonal production credit and private-sector investments in fixed assets and working capital. In keeping with current policy directions, interest rates were market-determined. Moreover, no specific allocation of funds by crop or type of investment or to any targeted group of borrowers was made. The ALF used commercial banks, unibanks, rural banks, thrift banks and non-bank financial institutions to deliver credit. The accreditation of participating private financial institutions was based on the following:

(1) absorptive capacity;
(2) financial capability;
(3) performance based on previous availments;
(4) management capability; and
(5) the results of Central Bank audit.

A limitation on each bank's credit line was also imposed. Banks are further required to open an account (with no minimum balance requirement) with the Land Bank.

According to a study made by SGV in 1991, the program was relatively successful in meeting its principal objectives and that the Central Bank was generally efficient in releasing the funds. The other indicators of the relative success of the program are the following:

- Ninety-three percent of all rural credit was extended at market-determined rates.
- The project helped facilitate the on-going rehabilitation of the rural banking system.
- The program initiated the elimination of subsidies even in the crop insurance program of the government.
- Rediscounting rates became positive in real terms exceeding the average cost of money to banks thus benefiting the private financial institutions. This benefit, however, was found to be at the expense of the Central Bank, which set the rediscounting rate on the basis of an underestimated exchange rate.
- As of 31 March 1992, about ₱397 million was lent under the ALF program benefiting 231 borrowers with main investments in agro-processing (37 percent), poultry and livestock (39 percent), fisheries (14 percent), plantation crop development and farm mechanization and machinery (10 percent).

The ALF was instrumental in providing agricultural credit for rural development. In 1989, the peak year of ALF lending, loan disbursements went as high as 7 percent of loans provided by the banking sector to agriculture. A follow-up project -- the Countryside Loan Fund (CLF) -- has just been made possible through a US$200-million loan from the World Bank. The Land Bank will channel loans through participating financial institutions. The main focus will be loans for agricultural and non-farm rural investments. Loans will also be made for seasonal production and for investments in fixed assets and incremental working capital.

4. Livelihood Enhancement for Agricultural Development (LEAD)

The LEAD program was launched by the DA in May 1988 mainly to improve the bankability of organized rural groups whose access to formal credit is constrained by lack of track record, absence of collateral and lack of project management capability, among others. It extends services and assistance to organized rural groups as well as to NGOs and agribusiness entrepreneurs. The package of assistance focuses on facilitating access to the banks or link-up with banks for marketing, credit support, project development and institution-building. A unique feature is the commitment of a private organization, the Management Association of the Philippines (MAP), to provide project managers and consultants to the assisted project for a period of one to two years.

LEAD extends assistance to two types of clientele:

(1) the more progressive and bankable farmers who lack managerial expertise and market contacts; and
(2) the non-bankable farmers who do not have collateral or the track record to get bank loans.

There are two corresponding types of assistance:

(1) the bank-assisted component for the first type of clientele; and
(2) the grant-assisted component for the second type.

The DA refers the bankable farmer to banks for loans and to private businesses for marketing and management purposes. The grant-assisted component provides start-up funds for income—generating projects and supplemental budgets. Since 1988 the DA has used LEAD to provide livelihood assistance to farmers and fisherfolk in 13 regions, 77 provinces and more than 1,500 municipalities of the country. Available data over the past four years indicate the following:

- As of end 1991, a total of 2,928 projects have been generated, serving approximately 218,000 individual farmers/fishermen representing around 3,000 groups.
- Total financial assistance disbursed amounted to ₱325 million distributed almost equally between bank-assisted and grant-assisted proponents.
- By project type, as much as 41 percent of the total disbursements went to crop production, followed by fisheries and livestock/poultry projects sharing 16 percent and 14 percent, respectively.
- Location-wise, Region III appeared to be the biggest recipient of LEAD assistance, cornering nearly one-third, followed by Regions II and VII, each sharing about 13 percent, while the least served is Region I, receiving barely 2 percent of total disbursements along with Region VIII and the Cordillera Autonomous Region.
- Overall program recovery rate, however, stood at a low 7 percent.

5. Development Assistance Program for Cooperatives and People's Organizations (DAPCOPO)

This program was established in May 1990 to provide credit financing to non-bankable agri-based groups not serviced by banking institutions. The idea is to eventually bring these small farmers or their cooperatives and similar organizations into the mainstream of the financial system through their collaboration with the mature and viable rural-based, non-bank financial intermediaries like credit cooperatives and credit unions. As of end December 1991, the program has accomplished the following:

- mobilized loan support amounting to ₱18.8 million involving 10 cooperative federations of which three have already initiated lending activities;
- served a total of 3,178 beneficiaries representing three cooperative federations including the Federation of Free Farmers (FFFCI), Kalipunan ng mga Samahan ng Mamamayan (KASAMA) and the Philippine Federation of Credit Coop., Inc. (PFCCI);
- posted a repayment rate of 100 percent at the federation—bank level and repayment rate of 95.5 percent between the conduit federations and the cooperative-beneficiaries; and
- generated at the federation level a total of more than ₱0.5 million in capital build-up and savings.

6. Grameen Bank Replication Project

This project seeks to test an alternative credit-delivery mechanism for the poorest of the poor, among whom are coconut farmers and coastal fishermen. The prime objective is to uplift the economic status of the marginalized poor through a mechanism that will extend financial assistance for viable projects and enforce savings mobilization among members, proceeds of which will be utilized to meet the emergency needs of the beneficiaries.

Savings mobilization is carried out through an automatic deduction of 5 percent from the loans availed of by the beneficiaries. The other ways of generating savings include a compulsory group training fee amounting to ₱7 per member, personal savings which ranged from ₱1 to ₱10 a day (based on each member's capacity to save), penalties and an emergency insurance equivalent to 4 percent of loan availments. Only when the prospective beneficiaries have passed all the requirements (savings generation included) can they borrow from project funds. The loans, however, cannot be used for consumption or providential needs. For emergency purposes, the beneficiaries get special loans from the group savings pooled from the individual contributions of members, which cover loans for housing, children's education and the rehabilitation of projects destroyed by natural calamities. Patterned after the Grameen Bank in Bangladesh, which evolved into a financial institution serving over a thousand villages and 700,000 borrowers, the replication project in the Philippines is likewise supported by the NGOs and several government agencies. It accomplished the following as of end of 1991:

- extended grants/assistance to ten NGOs and three cooperative rural banks amounting to ₱700,000, and loans amounting to ₱3 million;
- serviced a total of 1,929 individual beneficiaries from 394 groups (i.e., loans averaged ₱2,074 per beneficiary);
- conducted four intensive training courses, one orientation seminar and one review conference attended by 12, 40 and 6 participating organizations, respectively;
- installed monitoring and evaluation systems in all the 13 project replicators.

While the loan amounts involved and the initial project reach of both DAPCOPO and the Grameen Project may not look spectacular, it must be borne in mind that the target clientele are the non-bankable sectors of Philippine rural economy: landless peasants, coconut farmers and small fisherfolk who obviously can not access credit from banks. The poverty focus of these programs sets them apart from the lending programs moved by government to the banks such as the ALF and the IRF.

As experimental projects they seem to indicate that alternative credit-delivery models for reaching a targeted population can work. One area where the two schemes appear to be making headway is the promotion of savings mobilization among groups normally classified as "non-savers" because of their extremely low incomes. The intensive "social preparation" activities together with the savings philosophy inculcated in the minds of the project participants are the building blocks for sustained program implementation. It is also interesting to note that while both schemes cater to marginalized groups, both have consistently exhibited high repayment rates.

C. *Overall Impact Assessment*

The preliminary assessment of program impact indicates that these government interventions have positive effects on rural development and rural financial markets. The IRF and LEAD programs indicate a capability to promote employment, expand the use of farm resources, turn a profit and, most of all, increase farm incomes.[6] The increase in average net on-farm income of IRF beneficiaries was reported to be as much as 39 percent while that of the LEAD program 34 percent. As a result of program participation, clients of the IRF program increased their projects from three to four on the average, while the LEAD beneficiaries increased theirs from two to three. The significant impact of both programs on capacity utilization (as measured by the cropping-intensity index and the absolute size of farms under cultivation) is likewise indicated. Under the IRF the average cropping-intensity index (the number of times a particular farm has been tilled) rose from 1.6 to 1.8 or an increase of 13 percent, while under the LEAD the average farm size of beneficiaries inched up slightly from 2.4 to 2.6 hectares.

However, notwithstanding the positive contribution of the existing programs to the increased access by the agricultural and rural sector, particularly the small rural borrowers, to

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[6]All assessment figures are from the Evaluation Studies on the IRF and the LEAD Programs conducted by the ACPC under the author's supervision in the last quarter of 1991.

formal credit, it cannot be denied that access remains relatively small compared to the bank-loan share of commercial and big borrowers in both the agricultural and non-agricultural sectors. So while the programs and the new rural credit policies may have introduced efficiency in rural credit markets, the response of the formal system to the agricultural and rural sector remains weak. The formal financial system continues to be urban and trade- or commercially oriented. The commercial banks prefer to provide mainly short-term fully secured loans.

This view is consistent with the results of the assessment of the CALF guarantee program done by Llanto et al. (1991) which indicated several interesting results. The credit guarantees have yet to make a dent in banks' lending decisions. The presence or absence of a credit guarantee does not seem to be a major factor in the bank's decision to lend. In addition, the credit guarantee does not minimize the need for the usual collateral asked for by the banks. Levitsky and Prassad (1987) observed the same in similar guarantee institutions in many developing countries. The problem lies in bringing the private banks into the guarantee program and making them less risk-averse in lending to small borrowers.

The evaluation further noted that both guaranteed and non-guaranteed loans required the same length of processing time and collateral. However, the rationale of the CALF is not completely ignored by the banks. Some of the surveyed banks claimed that there is a need for credit-guarantee schemes in rural credit markets. These banks believed that the credit-guarantee scheme can work for the small farmer-borrower but that it is not sufficient to influence the bank's decision to lend.

Another reason why most banks do not find the guarantee programs attractive is that lending under the guarantee scheme is more costly and demands more administrative work than conventional lending programs (Llanto et al. 1991 and Magno and Meyer 1988). This may be true of the GFSME which spends about 14 centavos per peso of loan guaranteed compared to the cost of 7 centavos per peso granted by other lending programs. Quedancor has managed to keep its administrative costs at a low level of 3 centavos for every loan guaranteed between 1979 and 1989 but mainly because it catered to the large borrowers. PCIC spends approximately 2 centavos for every peso of loan guaranteed.

The experimental projects offer a fresh tack to rural lending but these are hampered by severe problems. In the first place, the transaction and administrative costs of these approaches are high because of the nature of the target clientele. The effort is labor-intensive and requires painstaking monitoring and constant evaluation of strategies and impact. The experimental projects envisage in the future the non-bankable borrowers gaining a track record and developing the capability to deal directly with banks and formal finance. At best, however, it remains a dream given the present orientation of the Philippine banking system and the depressed state of the rural economy.

The present time-bound strategic interventions such as the DAPCOPO and Grameen must be aware of the problems that arose in the past government-directed credit programs. As these credit programs proliferated came the problem of uncoordinated implementation. Past credit programs usually constituted an interagency management committee at the national level

for each program created. The committee largely acted as overall program coordinator, providing direction, making decisions, monitoring and evaluating the performance of the program as implemented by the executing agency (normally either a financing institution or another government agency). As the number of management committees expanded (one for each of about 50 special programs eventually established), the overall coordination and administration of the credit programs became costly and immensely difficult. The ultimate results were the following:

(1) overlapping functions of the management committees;
(2) less than satisfactory repayment record of the credit programs and large loan default problems; and
(3) huge government program management and administration costs.

Under the present system, a management committee oversees each special program. Although mechanisms keep these committees as small and coordinated as possible, the lessons of the past must not be lost on the program implementors. It is instructive to consider whether the programs are cost effective.

Considering the amount of administrative and operational expenses so far infused into the IRF, LEAD, DAPCOPO and Grameen programs, the cost per peso of loan granted has been estimated by the ACPC to range from 10 to 28 centavos. The relatively much lower administrative cost of IRF (an average of 10 centavos for every peso of loan granted) was attributed largely to the credit-line financing approach which systematized the lending process, reduced paperwork, lessened processing time and consequently cut down the transaction costs. No other credit program for small farmers aside from the IRF seems to have been more successful in delivering credit to small rural borrowers. On the other hand, because the Grameen catered to disadvantaged groups, administrative costs were estimated at 23 centavos for every peso of loan delivered to clients.

In the past 20 years of implementing lending programs, the Central Bank, which administered most of the treasury-funded programs, spent on the average only about 3 centavos for every peso of STD extended. While this may appear low, the cost of collecting bad debts and the foregone earnings arising from them are not included in the estimated cost. It should be noted that DAPCOPO and Grameen are experimental and innovative and, therefore, incur social development and preparation costs. However, sustainability of credit programs requires the ability to more than cover the operating and administrative costs from the lending activities of these programs.

These experiments, while showing that the marginal groups can save and are good borrowers, cannot really take the place of the banking system insofar as financial intermediation is concerned. The banking system has the financial resources which it generates from all over the country and the expertise in a wide variety of financial transactions that can benefit the rural economy. The irony is that the banking system mobilizes the rural surplus which is used to finance urban investments. The challenge to policymakers and development practitioners is, therefore, how to reorient the urban bias and the preference of the banking system for trade

and commerce without losing sight of the emerging attempts by self-help groups, NGOs and PVOs to engage in rural financial intermediation.

IV. POLICY AND INSTITUTIONAL REFORMS

The financial reforms introduced more efficiency in the rural financial markets. Market-oriented financial policies eliminated excess demand for credit and induced banks to be more efficient in their intermediation functions. Savings mobilization is now emphasized. Various agents in the rural financial markets innovate to access the rural surplus in view of the strong message that the era of cheap money is over (see Llanto 1991). I propose that government consider the following policy reforms.

(1) *Create an environment of greater competition in rural financial markets*. The Central Bank's recent move to liberalize branching and bank-entry policy is laudable. The establishment of more branches and new banks will lead to more competitive interest rates in the rural areas. Positive incentives like increasing the number of services that private banks can offer in the rural areas will induce more private banks into these areas. To induce more private banking into the rural areas, there is also a need to review the role and current strategies in countryside banking of government banks like the Land Bank and the remaining non-financial government institutions which still have direct lending activities. While the Land Bank has had some success in providing access to a great number of rural borrowers, it does this through credit subsidies, notwithstanding the present market-orientation of credit policy.

(2) *Promote vigorous resource mobilization*. A more active role in resource mobilization by private banks may be expected if they are allowed to provide more banking services like checking accounts in the rural areas. Overdependence on the government's credit facilities does not make for competitive rural banking. Private banks' attempts to mobilize savings must be given due support and recognition. The resources generated by self-help groups, peoples' organizations, credit unions and cooperatives as source of intermediation funds must be explored by private banks. Various types of financial innovations are emerging from the effort of these self-help groups and peoples' organizations all over Southeast Asian rural financial markets, and it would be instructive for governments and private banks to consider these innovations in resource-mobilization campaigns (see Llanto 1992b).

(3) *Terminate direct lending by non-financial government institutions*. The continued presence of non-financial government institutions in the credit markets is contrary to the market-orientation of economic and financial policies of government. Their participation in credit markets is distortionary and discourages banks from expanding financial services in the rural areas. The past experience with direct lending by government agencies is a lesson that should not be forgotten or taken lightly. While there are various conceivable reasons to justify the direct intervention by government agencies in the credit markets, experience also shows convincingly why this approach should not be taken. The unsustainability of subsidized credit programs, the political pressure and manipulation applied to financial decisions, the lack of clear comparative advantage in financial intermediation, the incompatibility of incentives of

government-lender and borrowers and the absence of operational monitoring and feedback mechanisms are reasons that militate against this approach.

(4) *Move away from loan quotas as a strategy to ensure loans to target groups.* Philippine experience with the agriculture and agrarian reform loan-quota is instructive. Instead of increasing loans to those sectors, the loan-quota law increased the banks' intermediation cost and thus, the lending rates. An incentive structure and a policy environment that make lending to the agriculture and rural sectors profitable will encourage more bank lending. The sad fact is, however, that there has been recent legislation imposing more loan quotas in favor of certain target beneficiaries.

(5) *Strengthen the CALF guarantee institutions.* The credit-guarantee scheme reduces the loan default risks faced by banks. Our assessment points out certain weaknesses and difficulties in implementing the guarantee schemes. Policymakers must review the operational structure of the CALF and the program management in each of the guarantee institutions so that the risk-reducing element of the credit guarantee will take precedence over the security and collateral orientation of the banking system. The common experience with the guarantee is that the bank tries to get the guarantee cover in addition to the collateral it requires from the small borrower. However, Llanto and Casuga (1992) documented evidence that the CALF guarantee has been used by a private development bank as a device to secure part of their loan exposure to small farmers without demanding from them additional security or collateral.

The Quedancor, originally created to deal with local traders and millers, has recently tried to shift its focus to small farmers and cooperatives at the direction of the ACPC. It is now a stock corporation and can raise equity capital from private investors and provide credit guarantee to a wider set of economic and business activities such as production inputs, farm equipment, post-harvest facilities, working capital and inventory. However, its current charter allows it to provide direct loans to the agricultural and rural sector and to engage in a host of functions more ably performed by banking institutions. Based on my earlier arguments against direct lending by non-financial government institutions, those provisions allowing Quedancor to engage in direct lending must be reviewed.

Quedancor should also improve its financial position by charging guarantee fees that cover operating costs and expected losses. By providing inventory finance to small farmers and cooperatives the Quedancor would help make interest rates more competitive in the rural financial markets. The PCIC reaches the small borrower but because it is undercapitalized it does not realize its full potential impact on rural financial markets. It needs more capital infusion from the government. It must also recognize variable rates to cover risk differentials in the different regions of the Philippines. GFSME has a small capital base and a lean organization that prevent it from reaching more borrowers. It is not a legal entity, being a mere program under another government corporation. The GFSME has to review its operating procedures and policies to assure sustainability of programs and consistency with overall agricultural credit policy. It must be strengthened and formally organized.

(6) *Co-opting the informal lender?* I pose this as a question because of unresolved issues surrounding informal credit. The popular image of the informal lender is that of a monopolist

who only immiserizes the small borrower. Others view informal credit as a complement rather than a substitute for formal credit, with a certain utility of its own given the nuances and problems in rural credit markets. This is an area of policy study which offers tremendous payoffs in terms of policy decisions and the data base about informal markets that will be generated. To take advantage of the greater flexibility and comparative advantage of informal lenders in the rural financial markets, there may be scope for seeking a wider and deeper linkage between the formal sector and the informal sector. These efforts, according to the ADB (1990), can be directed towards breaking down barriers to entry in the rural financial markets, weakening the monopoly powers of some informal lenders by increasing credit outlets offering variegated loan terms, and increasing the amount of financial resources available to the informal sector. Present experimental projects of the ACPC and those implemented by NGOs and PVOs with or without the collaboration of government agencies must be examined to find out whether the contemplated approach is indeed both workable and sustainable.

V. CONCLUSION

This paper discusses agricultural credit and banking in the Philippines and suggests certain courses of action to improve both efficiency and access issues in rural financial markets. The importance of financial-market reforms cannot be overemphasized. Formal financial institutions respond to the perceived loan default and other risks in the agriculture and rural areas, the transaction costs and informational problems that surround rural lending by lending to the more viable, less risky and bigger borrowers who can also offer better security for the loan. The financial reforms did not change the peculiar characteristics of rural credit transactions such as the inherent risks, asymmetry of information and huge transaction costs. While the financial reforms introduced efficiency, a concomitant set of actions must be undertaken to make agriculture and rural lending viable. This concerns the need for social and institutional infrastructure that the special programs like the IRF showed to be important in keeping the integrity of loan contracts. Adequate irrigation, communication and transportation facilities, in short, the support systems that will make agriculture and rural enterprise viable and profitable must be present to ensure access to financial services.

At the macroeconomic level, interest rates are greatly influenced by the pressure from the large fiscal deficit. Because of the government's inability to raise the tax revenues to cover its expenditure programs, it borrows heavily from domestic loan markets, raising interest rates in rural credit markets. In addition, the oligopolistic character of the local banking industry strongly influences the level of interest rates. Clearly, introducing fiscal reforms and greater competition in the banking industry are necessary.

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