CAN THE INFORMAL LENDERS BE CO-OPTED INTO GOVERNMENT CREDIT PROGRAMS?*

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INTRODUCTION

This paper is a preliminary sketch of current government-funded agricultural credit programs which utilize non-financial institutions as conduits for lending. By non-financial institutions, we refer to input suppliers, traders, millers and/ or processors of agricultural commodities. It is generally known that these non-financial entities comprise an important source of credit for rural borrowers. Not only do informal loans involve lower borrower transaction costs; they are also more flexible with respect to both timing and use. Non-institutional lenders also possess a comparative advantage over financial institutions in lending to farmers on account of the stronger informational links they have with the activities of their rural clientele. Often, these links derive from dealing with the borrower in some other capacity involving a transaction in another market. This allows lenders to effectively enforce repayment, and as a result, incur lower transaction costs and risk.

The view that informal lenders perform a useful function in rural financial markets and operate efficiently has gained wider acceptance in the past decade. The failure of supervised credit programs to eliminate the informal money lenders is now well-documented. A number of authors have posed the following policy alternatives: (a) that government not do anything, simply allowing the unhampered operation of informal lenders; (b) that a more competitive environment be promoted by allowing formal institutions to match the terms obtainable in the informal market; and (c) that the informal lenders be co-opted and used as lending channels for formal credit in the rural areas. In this paper, we focus on the National Agricultural Productivity Program (NAPP) in the Philippines. These programs are aimed at providing credit to the agricultural sector by using, among others, informal lenders as conduits. The following section discusses the background, scope, mechanics and status of the NAPP. The third and final section contains some observations and comments about the program.

THE NAPP: AN OVERVIEW

The National Agricultural Productivity Program[1] (NAPP) comprises some twelve commodity-specific programs (Appendix 1)

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[1] NAPP was launched by Executive Order No. 976 which originally provides for an "Expanded Corn Production Assistance Program." However, the same Executive Order also provides for the extension of crop coverage beyond corn and the availability of funds initially established for it to "such other animal feed and food grains as may be deemed desirable and in the national interest" (Sec. 2). Provinces with the best potential for growing or increasing production of the crops were targetted for coverage. The National Food and Agricultural Council (NFAC) coordinates the entire program and formulates policies and guidelines for implementation.

geared toward attaining self-sufficiency in food supplies. The NAPP was launched in the second half of 1984 in response to the need to increase food production following the eight-month drought that hit some food-producing regions in 1983. It will be recalled that in addition to poor agricultural performance, 1983-1984 was attended by rising interest rates, high input costs, and the drastically reduced supply of credit from formal sources.

Under the NAPP, funds were set aside to be lent out to food producers at concessionary rates. However, the inability of most rural banks to participate in the program, because of their financially-distressed state, necessitated channeling the credit through other non-financial institutions. These included traders, millers, and input dealers, among others. Commercial banks also participated in the program, lending directly to farmers. In addition, the government through the National Food Authority (NFA) was also a direct lender. In effect, three alternative financing schemes are possible under the NAPP although the terms obtainable under each scheme are similar.

1. The NFA Assistance Scheme

The NFA Assistance Scheme is shown in Appendix 2. This provides for a revolving fund from the Ministry of Agriculture and Food (MAF) and the NFAC to enable the NFA to extend credit to farmers in the form of material inputs as well as their share of the crop insurance premium. Through its existing warehouses and buying stations in the targetted crop areas, NFA extends the loans and collects repayment. Production loans are extended to farmers who are NFA Passbook holders and are within a radius accessible to NFA buying stations and warehouses. Technical assistance is provided by MAF technicians to farmer-borrowers. These farmer-borrowers enter into a contract with NFA which directly purchases the farmers' produce at a guaranteed support price. The contract likewise allows farmers access to NFA's post-harvest facilities for storage, primary processing (drying, cleaning,etc.) and transport through the NFA Facility Assistance Program.

2. The Banking System Assistance Scheme

Through this scheme (Appendix 3), rural banks and commercial banks (including the Philippine National Bank (PNB) and the Land Bank of the Philippines (LBP)) which are determined eligible by the Central Bank avail of funds from MAF-NFAC in the form of Special Time Deposits (STDs). STDs may fund up to 100 percent of the borrowers' credit requirements which include costs of production inputs and crop insurance premium. Loans financed by STD releases are not rediscountable with the Central Bank. These loans are released by the banks directly to farmer-borrowers in accordance with the latter's approved farm plans and budgets. Farmers sign marketing agreements with buyers (including the NFA). In the case of government, the NFA has an agreement with the banks providing for a check payment scheme whereby output purchased by the NFA from farmers is paid by check to be drawn against the NFA's demand deposit account. The bank in turn deducts the full amount of the loan or a portion thereof plus corresponding interest from the amount payable to the farmer. Where the cash payment scheme is being implemented, the banks send their representatives to NFA buying stations to collect directly from farmers. An alternative scheme is through a tie-up with a Quedan Guarantee Fund Board (QGFB)-franchised operator. Extension of a production loan is subject to the additional condition that the grain harvest or a portion of it be sold to a specified quedan operator. Collection of the loan is carried out by the operator for the lending bank which guarantees the former a quedan loan at harvest time to procure more produce.

3. The End users/Input Suppliers Assistance Scheme

Under this arrangement, end users and input suppliers enter into an agreement with MAF for refinancing, through their agent banks, of production loans extended to farmers. End users are individuals or enterprises which purchase farm produce for further physical processing such as for food or animal feed. Mere traders do not fall under this category. Agricultural input suppliers are enterprises which sell inputs (seeds, fertilizers, chemicals, etc.) to farmers. Mere dealers and distributors are not included here. Repayment of loans from the revolving fund is the sole responsibility of the end users/input suppliers and is not contingent on collection from farmer-borrowers. Contracts between farmer-borrowers and the credit source may take a variety of forms. For example, end users may advance production inputs and optional cash loans to borrowers. Borrowers in turn agree to sell their output to the end user at a price not lower than the government support price. When the output is purchased at harvest time, the amount initially advanced plus interest payments are deducted. Alternatively, end users may provide initial payments to farmer-borrowers at planting time in the form of seeds and other inputs with the balance payable upon delivery of the contracted output (Appendix 4). Under the agricultural input suppliers approach, local private input suppliers may sell agricultural inputs to qualified farmers on credit either directly or through local distributors or dealers. The credit is payable at harvest time or at some other mutually acceptable time (Appendix 5).

Traders and rice millers are utilized as credit channels under the Intensified Rice Production Program (IRPP). The term "trader-millers" refers to rice trader-millers accredited by the QGFB who possess primary facilities such as threshers, driers and mills. The trader-millers assistance scheme is essentially similar in its mechanics to the end users assistance scheme described above. Trader-millers enter into a tie-up arrangement with an input supplier to ensure timely provision of production inputs to farmers. Farmers contract with the trader-millers a specified volume of their produce at a buying price not lower than the government support price. The trader-miller is similarly required to enter into a "payment-in-kind" agreement with the NFA where the former agrees to deliver the milled rice equivalent to the amount of loan availed of.

In sum, what is common to all these approaches is the linkage established between and among the credit source which insures input provision, the market for the output, and the farmer-borrower himself.

The terms and conditions of loans under NAPP are shown in Table 1. The borrowing rate is uniformly set at 15% per annum regardless of the financing scheme employed. Loan maturity is 150 to 240 days depending on the crop being financed. The cost of fund under the direct agency and banking system schemes is 3% per annum and 6% per annum under the trader-miller/end user/input supplier scheme. The latter includes bank service charges. Participating banks and non-financial institutions are given from 160 to 250 days to repay their fund availments under the program. A penalty rate of 42% per annum (inclusive of cost of funds) applies to all past due obligations of banks and non-institutional lenders.

Data available from the NFAC (Table 2) show that as of October 1986, ₱893 million had been released under the three financing schemes of the NAPP. The bulk of these loans or about ₱592 million (66 percent) had been channeled through various government financial institutions or agencies. Another ₱162

Table 1

NAPP TERMS AND CONDITIONS

	Scheme 1 Direct Agency	Scheme 11 Trader-Miller/ Enduser/Supplier	Scheme 111 Banking System
	(1)	(2)	(3)
Bank		CB/MAF authorized bank	CB/MAF authorized bank
Interest to Farmer	15% per annum	15% per annum	15% per annum
Maturity Period for Farmer	150 - 240 days depending on crop		
Cost of Fund	3% per annum	6% per annum 1/	3% per annum
Service Charges of Agent Bank		1/2% per annum on principal amount released 2/ 1% per annum on principal amount collected 3/	
Maturity Period For Lender		Additional 10 days to date of loan maturity reckoned from date of financing	Additional 10 days to date of loan maturity reckoned from date of said availment
Penalty Rate 4/		42% per annum	42% per annum

1/ Inclusive of service charges of Agent Bank
2/ For ECP : 1% per annum
3/ For IRPP : 2% per annum
4/ Inclusive of Cost of Fund

Source : National Food and Agriculture Council (NFAC)

Table 2
NATIONAL AGRICULTURAL PRODUCTIVITY PROGRAM
As of October 1986

FINANCING SCHEME/ CONDUIT	INTENSIFIED RICE PROD. 1/				EXPANDED CORN PROGRAM 2/				NAT'L ROOTCROPS 3/				TOTAL NATIONAL			
	Loans Ret. (P000)	Loans Mat. (P000)	Loans Refd. (P000)	Repmt Rate %	Loans Ret. (P000)	Loans Mat. (P000)	Loans Refd. (P000)	Repmt/ Rate %	Loans Ret.	Loans Mat. --- 000 PESOS ---	Loans Refd.	Repmt. Rate %	Loans Ret. (P000)	Loans Mat. (P000)	Loans Refd. (P000)	Repmt. Rate 4/ %
I. DIRECT BANK LENDING										5/						
Rural Banks	68042	49872	46940	94	18652	18186	15211	84	1000	1000	424	42	87694	69058	62575	91
Land Bank	35830	23375	23375	100	13444	12330	12330	100					49274	35705	35705	100
UMSB	600	600	600	100									600	600	600	100
UCPB	3000	3000	3000	100	20795	20795	20795	100					23795	23795	23795	100
Bangko Palawan					300	300	300	100					300	300	300	100
Security Bank & Trust Co.				*					390	390	390	100	390	390	390	100
TOTAL	107472	76847	73915	96	53191	51611	48636	94	1390	1390	814	59	162053	129848	123365	95
Percent													18.15			
II. TRADER/MILLER/ENDUSER/INPUT SUPPLIER (Agent Bank)																
Viloria (RB Sol.)	3488	1929	1933	4/									3488	1929	1933	100
TMAID (LBP)	7176	3810	2871	75	14621	11014	7687	70					21797	14824	10558	71
Ferwins (RB Cab.)	243	243	201	83									243	243	201	83
Cruz (FEBTC)	357	357	306	86									357	357	306	86
Garcia (RB Cab.)	2016	2016											2016	2016		
SGANDI (PCIB)	1026	555	555	100	1080	240	240	100					2106	795	795	100
Calica (PCIB)	3125	3125	3125	100									3125	3125	3125	100
Silay (PCIB)	9000	7200	7200	100	24240	14520	14520	100	900	450	450	100	34140	22170	22170	100
PPI (PCIB)	12133	12133	12133	100	26011	26011	25902	100					38144	38144	38035	100
Marigold (LDB)	507	507	507	100									507	507	507	100
LBAS (LDB)	1899	999	999	100									1899	999	999	100
T. Borja (LDB)	2374	1496	1496	100									2374	1496	1496	100

II. (Continuation)

Atlas Ent. (LDB)	1630	899	899	100									1630	899	899	10
ECAIC (PCIB)	1046												1046			
Socohos (PCIB)					422	422							422	422		
Cyphil (Citytrust)					7514	7514	7514	100					7514	7514	7514	100
Far East Venture (Citytrust)					682	682	682	100					682	682	682	100
Advanced Agro (UCPB/RPB)					2320	528	528	100					8440 8/	528	528	100
H. Alberto (LDB)	756	756											756	756		
Auson, Inc. (PCIB)					1438								1438			
Philstarch (PCIB)									2728	768	1070	*/	2728	768	1070	*/
Unistarch (PCIB)									2586	200			2586	200		
Matling, Ind. (PCIB)									387				387			
Highgrains (Planters Dev't Bank)													1200 9/			
TOTAL	46776	36025	32225	89	78328	60931	57073	94	6601	1418	1520	*/	139025	98374	90818	92
Percent													15.56			
III. DIRECT AGENCY																
NFA 6/	160000				50000								213750 10/			
PNB 6/	65000				53200								118200			
Bangkoop 6/	25000												25000			
FSDC 6/	27000		11480 7/		8000								35000		11480 7/	
CIADP 6/	3000												3000			
NDFRB	4500	4500											4500	4500		
QGFB	106000	48945	48945	100	80000	36486	36484	100					186000	85431	85431	100
Abra	3000	3000											3000	3000		
RB Licab	1500	1500	978	65									1500	1500	978	65
Negros Oriental					2000	2000							2000	2000		
TOTAL	395000	57945	49923	86	193200	38486	36486	95					591950	96431	86409	90
Percent													66.28			
GRAND TOTAL	549240	170817	156063	91	324719	151028	142195	94	7991	2808	2334	83	893028	324653	300592	93
Percent	61.5				36.4				0.89				100.0			

1/ Cumulative from Phases 1-4
2/ Cumulative from Phases 84B to 86B
3/ Cassava: Cumulative from Phases 1(1985) to 2(1986)
4/ Repayment Rate = Loans Repaid/Loans Matured x 100
5/ Allocated from the IRF
6/ Revolving loan fund
7/ Unutilized portion returned to CBP shall not be considered as repayment
8/ P6120 under the PHF Assistance Program
9/ Under the PHF Assistance Program
10/ P3750 under the NSPP
*/ More than 100%; Conduit has advanced payments on

Source: National Food and Agriculture Council (NFAC) million (18 percent) went through the banking system under the direct bank lending scheme. The remaining ₱139 million (16 percent) was coursed through private individuals or corporations by Central Bank-approved agent banks under the trader-miller/enduser/input supplier scheme. By crop breakdown, ₱549 million (62 percent) were rice production loans under IRPP, ₱324 million (36 percent) Expanded Corn Program (ECP) loans and ₱8 million (1 percent) rootcrops loans under the National Rootcrops Program (NRP).

Borrower level data are not available at NFAC so there is no way of directly verifying whether the funds channeled through the various conduits eventually flowed to farmer-borrowers. Estimates on loans granted and recovered available from the Technical Board for Agricultural Credit (TBAC) do not seem to depart significantly from the institutional level data reported separately by the NFAC (Table 3). These figures, however, are a combination of borrower-level data, as reported by individual institutions, and conduit-level data as reported by NFAC where the former are not available. What TBAC does is to aggregate the amount of loans granted by the various credit sources to end-borrowers. However, since not all of the lenders submit their reports at the same time. the NFAC data which shows how much was released by the government to each of the credit channels are substituted for the unavailable borrower-level data. In other words, the assumption is that for lenders which have not filed reports on loans released and recovered from borrowers,

Table 3
SUMMARY PERFORMANCE OF SELECTED CREDIT PROGRAMS, CUMULATIVE DATA
As of September 30, 1986
(Amounts in P M)

Name of Program	Loans Granted	Loans Collected	Loans Outstanding	Loans Past Due	Past Due Ratio (%)	Repayment Rate (%)
I. Locally Funded						
A. Crops						
1. M-99 [a]	5,715.9	4,739.2	916.7	468.0	51.0	91.1
2. IRPP [b]	583.8	333.3	71.7	n.a.	n.a.	82.3
3. ECP [c]	295.9	184.2	111.7	n.a.	n.a.	84.4
4. NRP [d]	8.0	2.3	5.7	n.a.	n.a.	82.9
5. NSPP [e]	1.0	0.4	0.6	n.a.	n.a.	48.3
6. GSK [f]	74.4	58.5	15.9	14.6	91.8	82.0
7. Cotton [g]	274.2	227.7	46.5	42.7	91.6	83.1
8. IAF Tobacco	51.6	42.0	9.6	4.1	42.8	81.6
9. PTA Supervised Credit	7.5	3.3	4.7	3.1	65.3	41.1
10. SARF [f]	109.5	72.9	36.7	n.a.	n.a.	82.9
Sub-total: Crops	7,121.8	5,723.8	1,219.8	532.4	[h]	[h]
B. Fisheries						
1. Biyayang Dagat [i]	168.8	31.6	74.8	8.2 [j]	95.0 [j]	18.7 [k]
2. FSDC: CARE Dev't Prog. [l]	4.1	0.3	3.8	No Past Due		
3. Taal Lake Dev't Prog.	1.1	0.2	0.9	0.2	22.0	29.0
4. Laguna Lake Coop. Dev't Prog.	7.5	1.1	6.4	1.1	17.0	25.0
Sub-total: Fisheries	181.5	33.2	85.9	9.5		

C. Cooperatives						
1. CDLF	190.4	50.9	139.5	57.6	41.2	81.2
Sub-total : Cooperatives	190.4	50.9	139.5	57.6		
D. Clientele-Specific						
1. Quedan Financing for						
-traders/processors	1,767.3	1,625.5	141.9	3.2	2.3	99.8
-small farmers	6.1	3.6	2.5	-	-	94.8
2. FSDC						
-Irri. System Support Services m/	185.6	18.8	210.3	54.0	25.7	25.8
-KAISA Agro-Industries m/	33.5	5.2	39.2	16.2	41.3	24.2
Sub-total : D	219.2	24.0	249.5	70.2		
E. Comprehensive Type						
1. KKK f/	1,423.9 n/	148.9	1,275.0	770.6	60.4	16.2
2. Pagkain ng Bayan	20.1	2.7	17.4	1.5	8.7	68.8
3. IRF	22.4	10.5	11.9	0.6	4.6	95.4
4. GFSME	189.4 o/	62.2	127.2	15.8 p/	12.4	96.7
Sub-total : E	1,655.8	224.3	1,431.5	788.4		
TOTAL: LOCAL	9,366.7	6,056.1	3,126.2	1,458.2		
II. Foreign-assisted						
A. Fisheries						
1. Panay Aquaculture g/	10.7	0.2	10.6	n.a.	h/	h/
2. No. Palawan Fisheries Dev't Project	5.9	0.3	5.6	n.a.	n.a.	55.0
3. Laguna de Bay Fishpen Dev't Project	10.3	2.4	7.8	3.8	48.8	57.9
Sub-total: Fisheries	26.9	2.9	24.0	3.8		
B. Cooperatives						
1. SNSP i/	5.9	2.3	3.6	1.2	33.4	65.8
2. CMP j/	46.3	16.7	29.6	6.1	20.5	73.4
Sub-total: Cooperatives	52.1	19.0	33.1	7.2		

C. Comprehensive Type						
1. ALTTP	108.5 k/	0.3	108.2	0.6	0.7	27.3
2. ALF f/	452.6	292.0	160.8			
Sub-total: C	561.1	292.3	269.0	0.8		
D. Others						
1. Agro-Processing r/ Marketing Project	1.2	0.1	1.1	0.0		100.0
2. PIADP	3.3	0.5	2.8	s/	s/	s/
Sub-total: Others	4.5	0.6	3.9			
TOTAL: FOREIGN	644.7	314.8	330.0	11.9		
GRAND TOTAL	10,013.4	6,370.9	3,456.2	1,470.0		

a/ RBs and LBP data as of June 30, 1986. PNB figures as of August 31, 1986.

b/ End-borrower level data reported by LBP (as of June 30, 1986), GSFB (under IRPP/ECP trader/miller scheme), FSDC and NFA (data includes interest charges); and for the rest of the conduits (such as rural banks, other private banks, Bangkoop and trader/miller/end-user/input suppliers, data (as of Oct. 31, 1986) reflects the performance of the conduits and not the end-users since information on the latter are not available.

c/ Includes end-borrower level data reported by PNB (as of August 31, 1986), LBP (as of June 30, 1986) and NFA (as of October 31, 1986); and conduit-level data of rural banks, other private banks, and trader/miller/end-user/input suppliers (as of October 31, 1986).

d/ Conduit-level data, as of October 31, 1986.

e/ Data reported by NFA as of October 31, 1986.

f/ Data as of June 1986 only.

g/ Only PNB and RBs reporting.

h/ Cannot be derived. Information on loans matured/past due loans not available.

i/ Data of DBP as of March 31, 1986 only; Data of PNB and RBs as of August 31, 1986.

j/ As reported by DBP and PNB only.

k/ Loans collected - Loans granted.

l/ Data as of August 31, 1986.

m/ Data on collected, outstanding and past due have included interest payable.

n/ At least 54.3 percent went to agriculture; 28.4 percent are aquamarine projects and 25.9 percent are livestock projects.

o/ Actual sum disbursed. Amount eligible for guarantee totalled P259.19M.

p/ Refer to total outstanding loans; some amortizations of which are past due. Available data as of August 1986.

q/ Data as of July 1986.

r/ Data shows status of the Private Modernization Component of the program as of November 30, 1986.

s/ No matured loans yet.

ource: Technical Board for Agricultural Credit (TBAC) the amount lent out is equal to whatever has been availed of from the government. Any real discrepancy, if any, between the two data sets can therefore not be detected or analyzed due to lack of information on actual loan releases to farmer-borrowers.

In terms of repayment performance, the programs seem to be doing quite well with repayment rates mostly in excess of 90 percent (Table 2). Loan recovery under the direct bank lending scheme was slightly better (95 percent) than under the trader-miller/end user/input supplier scheme (92 percent). While most non-financial entities had 100 percent repayment rates, a few private individuals or firms had not repaid about 20 - 30 percent of their obligations, thus accounting for the lower repayment rate as a whole. With respect to specific programs, the NRP had the lowest repayment rate at 83 percent mainly due the poor showing of rural banks (42 percent). Going to the repayment rates shown in Table 3, not much can be said by way of a comparison because of the deficiency noted above in the compilation of borrower level data.

SOME IMPLICATIONS

While this paper was being written, the Philippine Government issued an executive order consolidating all commodity-specific agricultural credit programs into a single fund to be managed by an inter-agency committee headed by the Ministry of Agriculture and Food (MAF). This order in effect abolishes the NAPP and other similar special credit programs which target loans to specific agricultural sub-sectors. The centralization of the various agricultural funds under one office is expected to reduce the cost of funds administration. This is an unambiguous benefit considering that, in the past, the proliferation of activity-specific credit lines managed by different agencies not only resulted in lack of coordination but also generated a considerable amount of bureaucratic waste as the number of funds management committees alone will suggest. It is not clear, however, whether the consolidation of credit programs under the Consolidated Agricultural Loan Fund (CALF) spells the end for loan targetting. Under its terms of reference, the Agricultural Credit Policy Council (ACPC), which will oversee the CALF, is empowered to identify and prioritize usage of the funds. Thus it is likely that loan targetting will occur once again.

By coincidence or design, the NAPP reveals an important aspect of the behavior of lenders in the rural credit scene. This pertains to an implicit division of labor or a natural specialization among different formal lending institutions based on their perceived competitive advantages in rural lending. The availability of different financing schemes under the NAPP seems to have put to work a self-selection process among institutional lenders. Such is suggested by the information in Table 2 which shows that more rural banks participated under the direct bank lending scheme while commercial banks preferred to act more as agent banks channelling funds through the network of non-institutional lenders. The difference in the responses of the two types of banks may be explained by differences in their perception of risk. Rural banks are generally more familiar with agriculture and the rural community compared with the largely urban-based commercial banks whose costs of establishing the creditworthiness of rural clients may be higher. That is why the latter choose to leave the task of retailing small production loans to others who may have more information about rural borrowers. Whether a similar pattern may be observed for a commercial bank with an extensive branch network and why is an interesting research question to pursue. In general, it is more desirable to have a variety of mechanisms for credit delivery to the rural sector. The flexibility that alternative avenues for lending allow institutional lenders can only enhance their participation in financing agriculture. Unfortunately, there is no information on loans granted by rural banks and commercial banks from their own funds so that the extent of participation of these banks beyond relending government funds (STDs) cannot be ascertained. Comparing loans released by the government via the alternative financing schemes to loans released by institutions to farmer-borrowers might give a rough idea about the extent of private initiative in agricultural finance. But the deficiency in the reporting of borrower-level data already mentioned earlier renders any comparison meaningless.

How does one explain the generally high rate of recovery of government funds under the NAPP? There are possibly two reasons for this. One is the high penalty rate of 42% for all past due obligations which is comparatively higher than for previous credit programs. It could be argued, however, that without an effective enforcement mechanism, penalties are of no use. Moreover, the leniency exercised in the past toward rural banks with past due obligations with the Central Bank makes the threat of enforcing the sanctions less credible. If the threat of penalizing non-repayment were credible, however, then only those lenders with a good track record in loan recovery would join the credit program; otherwise, the cost of delayed repayments for delinquents would be high. It seems though that the financial crises which gripped the rural banking system during the period 1983-84 accomplished the 'sorting process'. That is, only those banks which were presumably better managed, and therefore survived the financial crises, were around to participate in the program.

Another reason that may account for the high recovery rate is the use of entities other than banks to extend credit to farmers. In the first place, the NAPP guidelines stipulate that fund availments from the government must be repaid independent of loan repayment by farmer-borrowers. Thus the trader-millers/end users/input suppliers could not use non-repayment by farmers as an excuse for delaying their payments. This provides them the incentive to be more selective in their choice of borrowers. On the farmer-borrowers' part, the link between credit and their transactions in the input and output markets insures loan repayment. The operative mechanism that is involved here is the timely provision of agricultural inputs during the planting season and a ready market for the farm produce at harvest time. Being involved in these same transactions, the creditor is in a position to enforce repayment, and with little cost.

Two years are probably not enough for the credit programs under the NAPP to have made any significant impact. However, as discussed above, the NAPP has probably revealed some basic principles and processes that are at work in rural financial markets. These pertain to the natural specialization among rural lenders according to their competitive advantage, of which the division of labor between funds wholesalers and retailers is just one aspect. Then there are also the potential benefits to be gained from linking credit transactions with transactions in other markets. At the same time, certain questions come to fore. The repayment of funds borrowed from the government by non-financial institutions regardless of repayment by farmer-borrowers is good for loan recovery. However, in providing the retailers of these funds the incentive to choose only creditworthy borrowers, there is the possibility that even the ineligible (based on the program's criteria) may be able to borrow as long as they have the ability to repay. Verification is costly and documentation can be falsified. On the other hand, following the guidelines entails a not insignificant amount of screening, documentation and reporting -- increasing the cost of transacting a loan for both lender and borrower. These are the all too familiar problems attendant to loan targetting.

In allowing the trader-millers, input suppliers, and product processors to participate in the lending program, the NAPP merely formalized what is already commonplace in the informal credit market: namely, the use of contracts tying credit provision with specific transactions in other markets. These types of contractual arrangements allow risk-sharing between the contracting parties and thereby facilitate those transactions which might not have taken place (e.g. credit provision) in their absence. With reference to the scheme under the NAPP, the government which provides the funds is in effect sharing a portion of the risk burden with the trader-millers/input suppliers/end users. It has in fact transferred the cost of collecting loan payments to the latter, who in turn, because of the nature of the contract they have with farmers, can economize on collection costs. But it might be asked to what extent the informal credit market can be mimicked or co-opted to accomplish the goal of credit delivery to the small farmer while ensuring that the government gets its money back. Here we can only speculate at best. The advantage of the informal lender over the formal lender is that the former does not specify loan use. This is good for the borrower and lender alike in that no additional cost is incurred in paper work justifying the loan.

With special credit programs, much time is consumed in preparing application requirements in connection with a production loan. But such information is of little use because of the fungible nature of finance. Government credit programs (such as the NAPP) which attempt to exploit the risk-reducing advantages of linking with informal lenders are limited by the loan-targetting feature of their design. It is doubtful whether trader-millers/input suppliers/end-users are going to be enthusiastic about participating in a program that increases their transaction costs. It is thus unlikely that they will be meticulous about documentation, and possible that they will just continue to lend to farmers whom they would have lent to anyway even without the program. These are presumably the relatively bigger and better-off farmers.

One other issue arising from the discussion of formal-informal linkages in the credit market is the possibility of allowing rural banks to engage in other agricultural activities such as trading, input dealership and the like in order to compete more effectively with the informal lenders. The question here is whether such banks are equipped with the expertise to run businesses other than banking. There is also the related problem concerning the disposition of depositors' funds and the potential for abuse associated with using bank funds to finance the business operations of the same owner/s. Finally, there is the possibility that in all these, inequities are bound to arise given the unequal bargaining strengths between farmer and creditor who has possession of various transaction-specific assets. Policy-making should therefore proceed cautiously pending more rigorous analyses of the foregoing implications.

APPENDIX 1

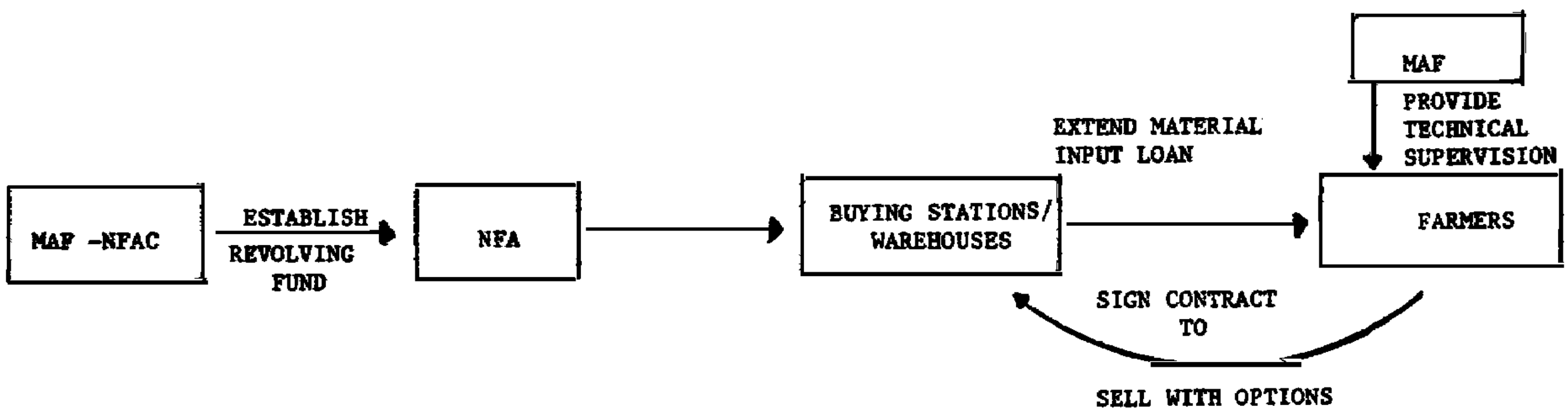
THE NATIONAL AGRICULTURAL PRODUCTIVITY PROGRAMS

1. Intensified Rice Production Program (IRPP)
2. Expanded Corn Program (ECP)
3. National Soybean Production Program (NSPP)
4. National Rootcrops Program (NRP)
   a) cassava
   b) sweet potato
5. Integrated Program on Ipil-ipil Leafmeal (IPIL)
6. Unified Azolla Program (UAP)
7. Post-Harvest Facility Assistance Program (PHF)
8. Others
   a) Gulayan sa Kalusugan (GSK)
   b) Kabataang Sakahan Para sa Kaunlaran Program (KASAKA)
   c) Multi-storey Cropping Under Coconut Program (MSC)
   d) Multiple Cropping Program (MCP)
   e) Rice-Fish Culture Program (RFCP)

Source: National Food and Agriculture Council (NFAC)

APPENDIX 2

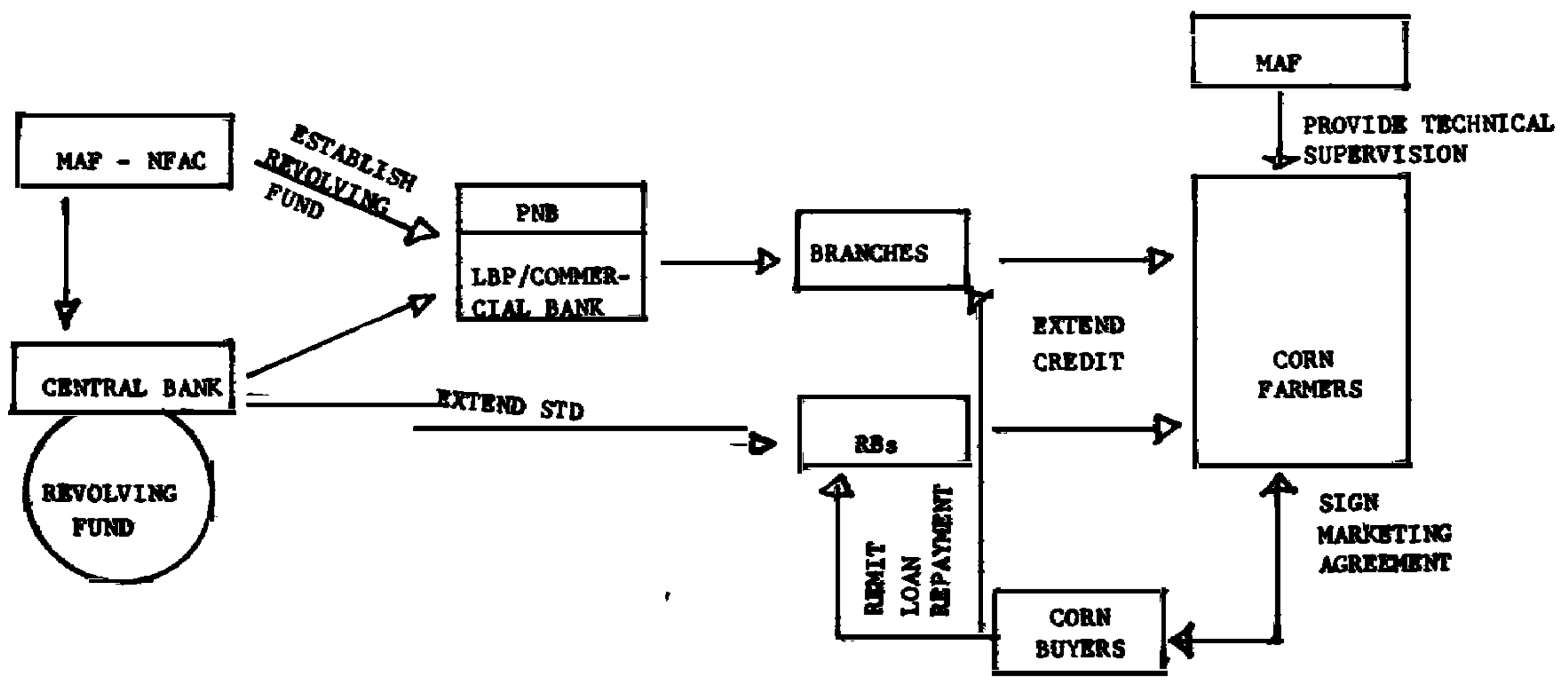
THE NFA ASSISTANCE SCHEME



Source National Food and Agriculture Council (NFAC)

APPENDIX 3

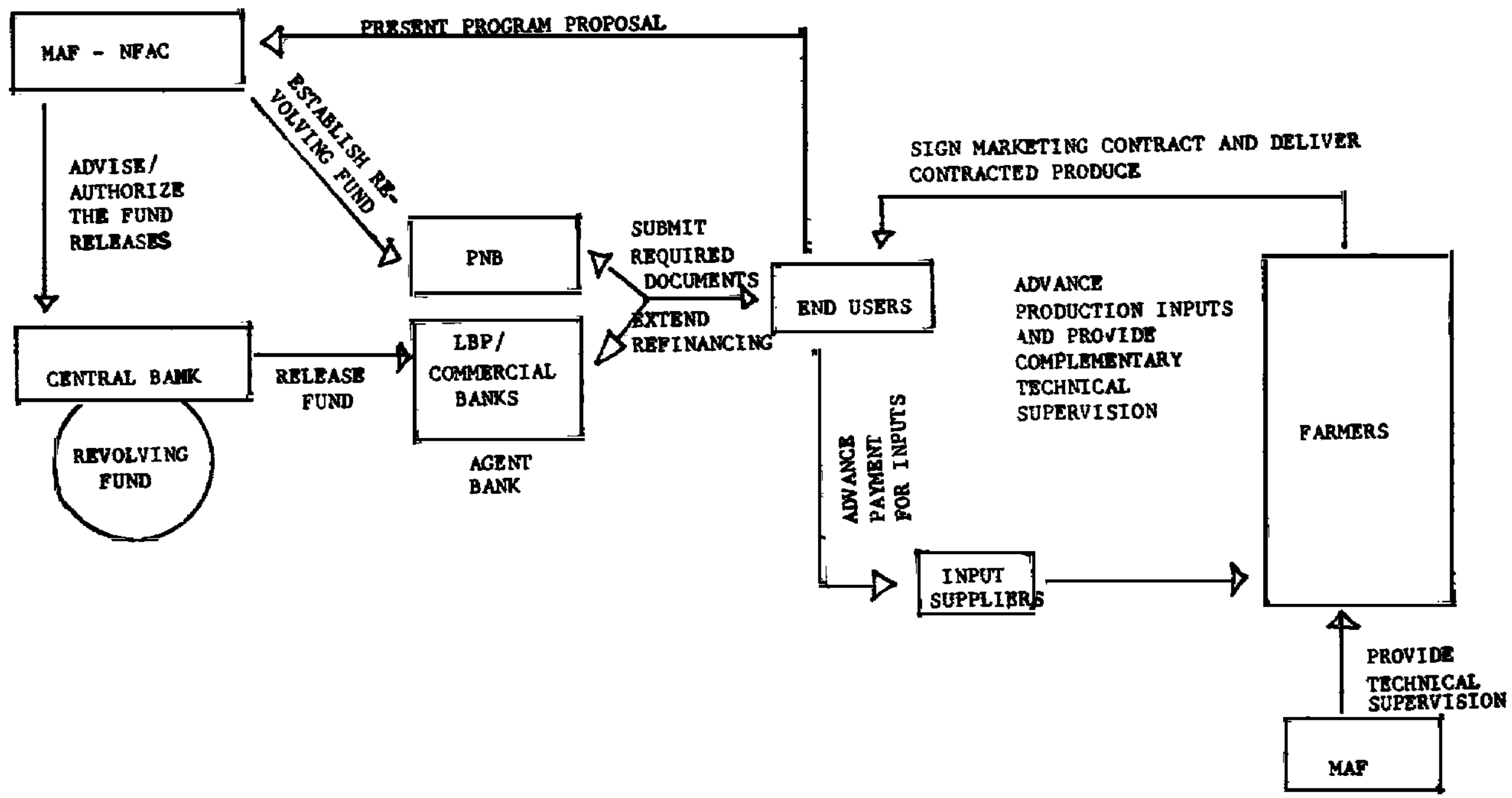
THE BANKING SYSTEM ASSISTANCE SCHEME



Source National Food and Agriculture Council (NFAC)

APPENDIX 4

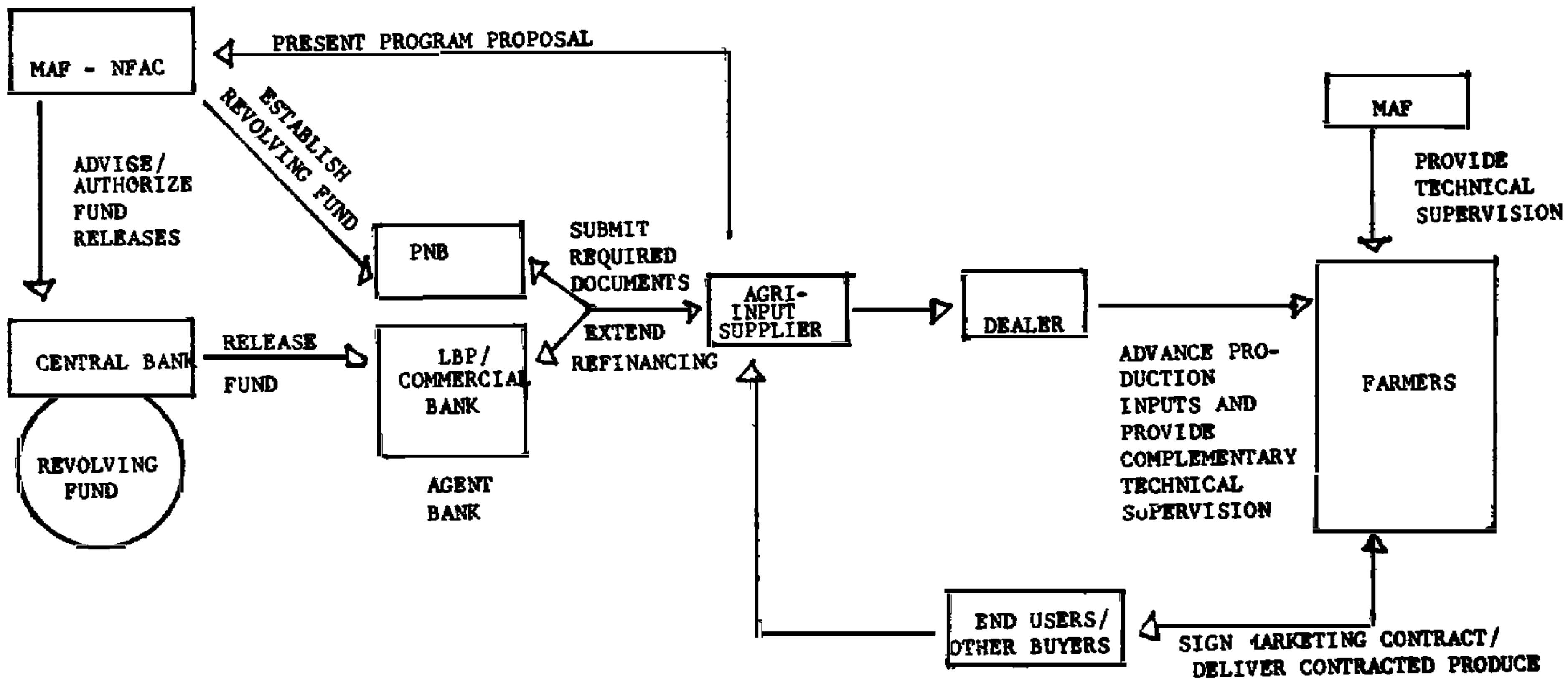
THE END USERS APPROACH



Source National Food and Agriculture Council (NFAC)

APPENDIX 5

THE AGRICULTURAL INPUT SUPPLIERS APPROACH



Source National Food and Agriculture Council (NFAC)

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