

**THE FINANCIAL MARKETS IN LOW-INCOME URBAN
COMMUNITIES: THE CASE OF SAPANG PALAY**

by

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WORKING PAPER SERIES NO. 88-05

March 1988

Philippine Institute f

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I. INTRODUCTION

1. Rationale and Objectives of the Study

Despite the prevalence of the informal credit markets (ICMs) in the economies of LDCs, they are unjustly treated in economic literature. The fault probably lies with economists who insist on applying to LDCs, economic theories which were successfully applied in advanced countries, and whose financial and capital markets are efficiently functioning. To a great extent, this mental conditioning has been successful. In almost all formal modelling exercises found in economic literature, features present in advanced economies are usually assumed to exist in LDCs. As a result, the policy prescriptions derived from such analyses are often irrelevant to the requirements of LDC economies.

*This is part of a larger study by the Social Weather Stations on the informal credit markets in the Philippines sponsored by the Asian Development Bank (ADB) through the Philippine Institute for Development Studies (PIDS).

**Respectively, Vice-President, Philippine Institute for Development Studies and Graduate Student, Asian Social Institute. The authors gratefully acknowledge the comments of Dr. P.B. Ghatge (Asian Development Bank), Dr. Mahar K. Mangahas (Social Weather Stations), Dr. Richard L. Meyer (Ohio State University) and the participants of the Philippine Economic Society Silver Anniversary Convention, 10 December 1987, Manila.

Van Wijnbergen (1982) has recently brought this problem to our attention. In his macroeconomic model for Korea which explicitly includes the role played by the ICMS, he found that restrictive monetary policy measures usually prescribed by the IMF to arrest inflation actually have stagflationary effects. In particular, increases in time deposit rate trigger tightened credit conditions and cause higher costs of working capital. The reason is that people shift out of the curb market, which provides working capital to Korean firms, rather than out of cash. The higher cost of financial working capital adversely affects output, and thereby causes more inflation.

In a related study, Kim (1986) has demonstrated that the ICMS can be incorporated in the analytical framework of the demand for money. His results show that the interest rates in the ICMS are a more appropriate reflection of the opportunity cost of holding money, rather than the interest rates on time/savings deposits, and that the demand for time/savings deposits is more responsive to changes in the interest rates in the ICMS than to changes in their own rates.

Incorporating the ICMS into formal macro models for the Philippines is not feasible in the near future. The main reason is that there is lack of systematic information about ICMS, although recently, there has been a number of studies that examine ICMS in the country. However, less attention is being given to the analysis of different sub-markets of ICMS, especially those that operate in urban areas (see Lamberte and

Lim [1987] and Mangahas [1987]) More baseline studies are therefore needed to identify sub-markets of the ICMs and to understand their operations

In general, this paper attempts to describe the ICMs operating in low-income urban communities. Specifically it addresses the following questions

- 1 Who are the major participants in the ICMs?
- 2 What is the size of their operations?
- 3 What is the structure of the market?
- 4 What is the role of ICMs in savings mobilization?

2 Scope and Limitations of the Study

Given a lean budget it is virtually impossible to study the ICMs in all low-income urban communities. It was therefore decided to focus on one low-income urban community namely Sapang Palay. The case method is utilized to allow more in-depth analysis of ICMs.

Sapang Palay is a resettlement area located at the outskirts of Metro Manila. It is known as one of the poorest resettlement areas in the country. In most depressed areas, like Sapang Palay, the ICMs are the financial markets.

3 Organization of the Study

The following section gives a brief description of Sapang Palay, while Section III discusses the methods of data collection. Section IV examines the characteristics, lending

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operations, and sources of funds, and components of the lending rates of moneylenders. In Section V, the operation and role of "paluwagan" (ROSCAS) in the ICMs are discussed. The last section contains the concluding remarks.

II. A DESCRIPTION OF SAPANG PALAY RESETTLEMENT PROJECT

1. Location

Sapang Palay, as the resettlement project is commonly called, was acquired by the Philippine Housing and Homesite Corporation (PHHC) in 1960 from the Sub-Urban Development Corporation at a low price of of ₱0.45 per square meter. The site was developed into a relocation center for squatter families from Manila in the same year. By 1975, National Housing Authority (NHA) absorbed the project from PHHC.

Sapang Palay is a big resettlement area covering 752 hectares. It is bounded by Norzagaray, Bulacan in the North; Newton Subdivision in the South; Norzagaray, Bulacan in the East; and Bo. Sapang Palay Proper and Norzagaray, Bulacan in the West. At present, Sapang Palay is under the territorial jurisdiction of San Jose del Monte, Bulacan. The project site is divided into 9 areas; namely, A, B, C, D, E, F, G, H and I. Among the 9 areas, Area H is the most developed because the past regime made it a "showcase" of the project. Its main road is asphalted, and it has a small market called Bgy. San Rafael Wet Market.

2. Population

As per the 1987 primer of the NHA, the estimated population of the resettlement project is 86,000, and is distributed as follows:

<u>Area</u>	<u>Population</u>
A	11,000
B	8,000
C	9,000
D	9,000
E	9,000
F	9,000
G	5,000
H	20,000
I	6,000

The relocated families came from areas affected by government infrastructure projects in urban areas; and from other urban slum areas such as North Harbor, Intramuros, Tatalon, Tambunting, Marikina, Quezon City, Tondo, Dagat-Dagatan, Customs Zone, Veterans Yard, Dumpsite and Makati. The average number of persons per household is five (5).

3. Land Use

Land use is categorized according to: a) developed areas, and b) underdeveloped areas. Developed areas are those which are presently used as commercial, residential, and educational areas

as well as government centers. The distribution of developed areas according to use is as follows:

<u>Area</u>	<u>Hectares</u>
Commercial areas	4.25 hectares
Industrial estates	16.70 hectares
Residential lots	444.58 hectares
Government centers	5.40 hectares
Cemetery	3.36 hectares
Community/Educational	41.29 hectares
Interaction Center	1.35 hectares
Roads/Alleys/Canals/Creeks	96.01 hectares
Dumpsite	2.21 hectares
Undeveloped Land	137 hectares

4. Community Facilities

a. Electricity

The National Electrification Authority (NEA) used to manage the facility for electric utility. Since January 1986, however, electric power in the resettlement project has been provided by MERALCO. Meralco's extension office is situated in Area G. It handles only customer complaints while the branch office in Sta. Maria, a town quite far from Sapang Palay, is responsible for collecting residential electric bills. Commercial electric bills, like that of the 7 Seas Apparel, are being collected by Meralco's main office in Pasig, Metro Manila.

Some 5379 KVA was installed throughout the project for residential use, while mercury lamps with 400 KVA, powers the industrial site. There are approximately 11,837 households, 292 business establishments and 10 commercial establishments with electricity. The break down in terms of consumer type is as follows:

<u>Area</u>	<u>Residential</u>	<u>Business</u>	<u>Commercial</u>	<u>Service</u>
A	4736	67	1	
B	469	167 (sampo market)	1 (sampo market)	
C	898	17		
D	1118	15		
E	808	4		
F	1660	4		
G	297			
H	1705	17 (Bgy. San Rafael market)	7 (Bgy. San Rafael market)	2
I	791	1		

b. Water Service

This is provided by the Bagong Buhay Water System and Service Cooperative, Inc. (BABWASSCO). It has a limited membership of 1,326, although the total number of households availing of the water service is approximately 3 times more due to illegal water

connections. The number of legal customers per area is as follows:

<u>Area</u>	<u>Customers</u>
A	212
B	87
C	62
D	45
E	142
F	66
G	47
H	480
I	175
Total --	<u>1,326</u> =====

The cooperative has five (5) operational pumps, four (4) of which are for residential use. Due to limited water service offered by the cooperative, residents and industrial/commercial enterprises resort to alternative sources of water supply in the resettlement project such as natural springs and "balon/poso."

Tabulated below are the sources of water supply:

Sources of Water Supply	Area									TOTAL
	A	B	C	D	E	F	G	H	I	
MWSS Artesian Well	6	35	7					6		54
Jetmatic Pump							3	4		7
Deep Well		65					20	26		111
Balon/Poso			60			5				145
Natural Spring			1			1				2
Number of Family Served							395	90	260	745

c. Housing

While travelling along the project site, the sharp contrast in the housing structure of the resettlements' residents is very noticeable. Wooden dwellings dominate the housing structure although a few modern houses worth about P200,000 and above are conspicuous. It is not surprising to see this duality since the poor relocatees sell their awarded titles to businessmen and/or to their relatively well-off fellow relocatees from other cities who have had established themselves in the resettlement projects. In connection with the dwelling structure, Area G, which has a steep and hilly terrain, is the least developed of all areas because the newly-relocated families are initially situated here.

d. Roads and Transportation

The resettlement project is highly accessible by transportation. The project is linked to Manila by the Quirino National Highway (Ipo-Novaliches Road) and the provincial road linking San Jose del Monte, Bulacan to the North Expressway. The main road which runs through the entire length of the project is approximately 5 kilometers, while the asphalted roads stretch 12 kilometers, and macadamized roads, 96 kilometers.

Transportation to and from the resettlement project is frequently available. Tricycles and jeepneys are the main mode of transportation within the area. Tricycle fare varies from ₱1.00 to ₱5.00, depending on the kilometer length and the interiority of the site. Jeepneys are available for main routes and costs only ₱1.00 from Sampol Market to any point within the project. There are also jeepneys which are bound for Grotto and Santa Maria. Long distance travel is by bus, via two routes - Novaliches and Sta. Maria. The Novaliches route has three (3) transit liners while the Sta. Maria route has only one (1) transit liner.

e. Chapel

In the resettlement area, there are 17 chapels belonging to the different religious organizations, such as the Roman Catholic Church, Iglesia ni Kristo and various protestants sects.

f. Hospital

Two main hospitals are operating in the resettlement area and both are located in Area F. One is the Emergency Hospital and another is the Roquero Hospital. The former is a government hospital while the latter is a private hospital. There are also 3 rural health units (RHUs) in the whole resettlement project.

5. Community Services

At the inception of the project, many social welfare agencies flocked to the resettlement project to provide basic services needed by the poor relocatees. The services rendered by these agencies were quite diverse, e.g., agriculture, livelihood, community development and social services. Contrary to the goal of self-reliance espoused by the implementing agencies, dependency on free and/or subsidized services has instead developed, and the dole-out mentality became prevalent. Informal conversations with the social welfare agency managers with respect to the agencies' credit program, clients' misuse of credit funds intended for business was often cited as a problem. The reality of poverty prompted clients to use their livelihood loans for food and the purchase of medicines. Others spent it on vices such as drinking or gambling. Thus, the problem of non-repayment of loans emerged. Coupled with this problem was the limited funds of the agencies to maintain their programs. In fact, some agencies have discontinued their livelihood services and has concentrated instead on social, educational and/or

community services. To date, there are a limited number of government organizations (GO's) and non-government organizations (NGO's) operating in the resettlement area. These are:

Agencies	Services
1. Government Organizations (GOs)	
1.1 National Housing Authority	- housing program
	- livelihood programs
	i.e., cooperative development, manpower development and enterprise development
1.2 Department of Social Welfare and Development	- livelihood programs
	- nutrition program
	- community development
1.3 Department of Health	- medical, dental and
1.3.1 Sapang Palay District Hospital	surgical services.
1.3.2 3 Rural Health Units	
1.4 Department of Education, Culture and Sports	
1.4.1 9 public elementary schools	
1.4.2 2 public high schools	
1.4.3 1 vocational school	
1.4.4 1 college with high school and elementary departments	
1.5 Department of Local Government/PC/INP	- peace and order

2. Non-Government Organizations

- 2.1 St. Martin de Porres - socio-medical center,
a UST Hospital Extension
Project;
- 2.2 Rotary Club - community projects
- 2.3 Catholic Children's Fund - supports schooling of
- 2.4 Christian Children's Fund indigent children
- 2.5 Gazelle Foundation - supports schooling of
- 2.6 World Vision indigent children
- 2.7 About 30 civic, religious and cause-oriented groups.

6. Economic Activities

Sapang Palay, with its 752 hectares, is indeed a big community. An 8,693 square meter market popularly called "Sampol Market" is located in Area B. The term "Sampol" draws its name from an incident totally unrelated to its commercial function. In the early stages of the project, there was no market in the present commercial site but rather a "sample" barangay post. There was a vacant lot adjacent to this post. Vendors started to use this vacant lot in selling their goods. Over the years, this trading center became known as "Sampol" because the "sample" barangay post became its land mark. The barangay post no longer exists today and commercial/ trading activities are no longer confined to the Sampol Market. Rather, small business establishments could be seen along the highway that divides Area B and Area D. These new business establishments include a pharmacy, an optical shop and a number of small family-owned eateries.

The NHA Survey of 1982 indicates that there are 191 officially identified stalls in the Market. These are distributed as follows:

	<u>No. of Stalls</u>
Fish Section	25
Meat Section	10
Meat and Chicken	1
Vegetable Section	47
Variety Section	59
Dress Section	8
Eatery Section	9
Dry Goods Section	13
Candy Section	2
Cooked Food Section	2
Stock Room	1
Recreational Center	1
School Supplies	1
Beauty Shop/Parlor	2
Snack Store/Stand	2
Refreshment Store	1
Magazine Stand	2
Eggs Section	1
Poultry Supply	1
Fruit Stand	1
Drug Store	1
Bakery	1
Total	<u>191</u>

Lot sizes of these stalls are small, ranging between 10 to 15 square meters at a cost of ₱75.00 - ₱85.00 per square meter, depending on the location of the lot. However, lot ownership of more than 15 square meters is allowed. As of 1984, the following factors were considered in the payment scheme for Sampol Market:

- a. Location of stalls
- b. A fraction of a square meter shall be considered as one (1) square meter
- c. Maximum area of occupancy
- d. Categorization

The terms of payment for the Sampol Market are a downpayment equivalent to 20% of the total value; an 18% interest per annum is charged for the balance; and a repayment period dependent on the area, as shown in the following table:

<u>Area (square meters)</u>	<u>Period (in months)</u>
1. Up to 10 square meters	12
2. Over 10 square meters but not to exceed 50 square meters	24
3. Over 50 square meters but not to exceed 200 square meters	36
4. Over 200 square meters	60

There are also other markets operating in the Resettlement Project, such as the Caguiat Market which began its operations in 1987 and is located opposite the Sampol Market; and Bgy. San Rafael Market which is located in Area H. This market has approximately 162 square meters and has about 40 stalls with lot sizes ranging from 2 to 6 square meters each.

7. Livelihood Profile

There is no census that could tell us the livelihood profile of the inhabitants of Sapang Palay, but results of some micro studies gives us a rough picture of the type of livelihood activities relocatees are engaged in. In her study, Barrios (1983) found that out of 137 household heads interviewed, 46 percent were craftsmen, production-process and related workers; 24 percent were working in the transport and communication industry; 20 percent were working in the service industry; and the rest were agricultural workers, clerical workers, and common laborers. The more important conclusions of her study are:

1. Less household heads are employed in the resettlement site than in their previous residence;
2. A greater proportion of household heads continue to work in Manila; and
3. The number of employed household heads decreased after relocation.

In a related study using another sample, Bunda (1986) pointed out that household heads of relocated families in Sapang Palay have gained employment after their relocation, mostly as self-employed. Relocatees include those who used to be employed in the manufacturing and service industries in urban centers. The lack of employment opportunities in the resettlement site, and the high cost of transportation between the resettlement site, and the industrial and commercial centers in Metro Manila compelled many of them to seek self-employment.

III. METHODS OF DATA COLLECTION

The overall strategy followed by this study was to identify major participants in the financial markets of Sapang Palay and gather information directly from them. The data collection phase of this study was done in three stages.

In the first stage, a visit was made to Sapang Palay to identify the major participants of the financial markets. An employee of the National Housing Authority (NHA) helped in identifying key informants.

After interacting with key informants for one week, we gathered a rough sketch of the existing financial markets in Sapang Palay. As it is, there are no formal financial institutions in Sapang Palay. After all, poverty does not attract banks. The nearest banks are located in relatively well-off areas which are an hour's ride from Sapang Palay. There is one unregistered credit union or savings association which is less popular among residents since it is newly-organized. As mentioned earlier, there are a number of government and private social welfare agencies which provide basic services to the poor relocatees, and some of them used to have special credit programs. However, these were stopped because of poor repayment rates which dissipated the meager funds available.

We identified three major participants in the financial markets of Sapang Palay. These are the informal moneylenders who are popularly known as "5/6" lenders; the rotating savings

and credit associations (ROSCAS) which are called "paluwagan" in Tagalog; and the traders/suppliers. The key informants helped in compiling their names and addresses.

The second stage involved establishing rapport with the participants in the financial markets of Sapang Palay. It was also an opportunity to refine further the list of participants. The junior researcher stayed for one month in Sapang Palay for this purpose. Ten market vendors, some of whom were members of "paluwagan" units and borrowers from moneylenders and traders/suppliers, helped in drawing the final list of major participants in the ICMs.

Initial contacts with a few market vendors in the Sampo Public Market aroused curiosity from the group of vendors. It thus became necessary to reveal to them the purpose and nature of the study. This proved to be a valuable strategy since market vendors who came to understand the importance of the study referred us to moneylenders, traders/suppliers and "paluwagan" managers whom they personally know.

Almost all of the traders/suppliers live outside of Sapang Palay, hence it was very difficult contacting them, not to mention the fact that many of them are "East Indians" (or "Bombay" in the vernacular). These factors prevented an in-depth study of their role in the financial markets of Sapang Palay, thus leaving the informal moneylenders and the "paluwagan" as the primary sources of information.

This study is primarily interested in professional moneylenders, i.e. those who regularly lend money for profit. A total of 33 moneylenders operating in the area were initially identified. However, after further verifications, only 20 were found to be real professional moneylenders. Others lend money by force of circumstances, that is, they could not turn down their friends and relatives who requested help from them. An informal interview was conducted with 3 of the professional moneylenders to gather some ideas regarding the issues dealt by the paper, and also to get a sense of difficulty in obtaining sensitive information directly from moneylenders.

There are two types of "paluwagan" units in Sapang Palay; namely, the business-oriented and the consumption-oriented "paluwagan" units. The former are composed of members whose main purpose for joining a "paluwagan" is to raise additional capital for their business. They usually have a longer life span in the sense that the same members get together under the same "paluwagan" manager one cycle after another. In contrast, the latter are composed of members whose main purpose for joining a "paluwagan" is to raise money for consumption purposes, such as to buy some appliances, pay for their children's education, etc. They usually have a shorter life span in the sense that members do not get together under the same "paluwagan" manager after the completion of the cycle.

During the data gathering phase, almost all operating "paluwagan" units were of the first type, and all of them

concentrated in the Sampol Public Market. Therefore, this study limits itself to the business-oriented "paluwagan" units.

A total of ten (10) business-oriented "paluwagan" units were identified. An informal interview was conducted with 2 "paluwagan" managers and six (6) "paluwagan" members.

In the third stage, personal interviews were conducted with a sample of moneylenders, "paluwagan" managers and members using structured interview schedules. The bits of information gathered during the second stage of data collection were used as inputs in the construction of three (3) sets of structured interview schedules.

Ten out of the twenty (20) moneylenders were randomly selected. Of the ten (10) moneylenders, three (3) refused to be interviewed for various reasons. Thus, only seven (7) moneylenders were finally included in this study.

Six (6) of the ten (10) "paluwagan" units were randomly selected. These six (6) "paluwagan" units have a total of 116 members, excluding the managers. Fifty (50) members were selected using stratified random sampling proportional to size (see Table III.1). Two (2) sample respondents refused to be interviewed while three (3) gave incomplete and inconsistent answers. Thus, there were only forty-five (45) sample respondents who were interviewed during the whole month of October 1987. The managers of the six (6) "paluwagan" units were also interviewed.

TABLE III.1
DISTRIBUTION OF SAMPLE RESPONDENTS
(Paluwagan Members)

PALUWAGAN	Number of Members	Desired Sample Size	Actual Sample Size
A	22	10	10
B	16	7	7
C	26	11	11
D	24	10	10
E	18	8	4
F	10	4	3
Total	116	50	45

Sources: Records of "paluwagan" managers.

IV. ANALYSIS OF THE OPERATIONS OF INFORMAL MONEYLENDERS

This section discusses the socio-demographic and economic profile of the seven (7) sample moneylenders, their lending operations, sources of funds and components of the interest rate.

1. Socio-Demographic and Economic Characteristics of Moneylenders

Table IV.1 gives a summary of the socio-demographic and economic profile of moneylenders. The seven moneylenders interviewed are all female and married. Only two of them are below 40 years old. Two are college graduates; one is a college drop out; two are high school graduates; one is an elementary graduate; and one did not finish elementary grade.

Four (4) belong to single families while three (3) belong to extended families. Their family size ranges from two (2) to eight (8) members. The bigger families have more children who are still in school.

Of the seven (7) moneylenders, two (2) are market vendors. They work with their husbands in vending fish and meat in the public market. One female moneylender owns several stalls in the public market and rents them out to market vendors. Understandably, since her husband works in Saudi Arabia, part of her husband's earnings are used in her moneylending operations.

TABLE IV.1
SOCIO-DEMOGRAPHIC AND ECONOMIC PROFILE OF SEVEN INFORMAL MONEYLENDERS'
(Sapang Palay)

Information	A	B	C	D	E	F	G
1. Sex of respondent	Female	Female	Female	Female	Female	Female	Female
2. Age of respondent	40	42	46	59	45	21	31
3. Civil status of respondent	Married	Married	Married	Married	Married	Married	Married
4. Highest Grade Completed of respondent	College Graduate	College Graduate	High School Graduate	Grade 3	High School Graduate	Elementary Graduate	College drop out
5. Type of household	Single family	Single family	Extended family	Single family	Single family	Extended family	Extended family
6. Family size	8	5	4	2	6	6	8
7. Family members in school	5	1	1	0	1	1	3
8. Employment status of respondent	self-employed	employed	none	none	none	self-employed	self-employed
9. Employment status of spouse	self-employed	self-employed	self-employed	self-employed	employed	employed	employed
10. Type of business of respondent	meat vending	none	none	fish vending	none	none	renting stalls
11. Type of business of spouse	meat vending	transport	trading	fish vending	none	none	none
12. Total family income	₱30,000	₱6,500	₱4,000	₱8,555	₱3,500	₱2,500	₱8,000
13. Monthly family expenditure	₱11,800	₱6,200	₱4,960	₱6,940	₱2,000	₱1,900	₱3,450

Three moneylenders are unemployed housewives whose husbands are traders of dry goods in Metro Manila. One moneylender works as a cashier in a government office in Sapang Palay while the husband manages a small family-owned bus company. She is the only moneylender who does not live in the area.

The monthly household income of the moneylenders (excluding income from moneylending) ranges from ₱2,500 to ₱30,000. The value of their physical assets (i.e. house, lot and inventory, etc.) ranges from ₱157,000 to ₱1,250,000 (see Table IV.2). Moneylenders who are living in Sapang Palay own spacious and concrete houses. Some of them were able to buy lots and stall rights from less fortunate relocatees.

2. Lending Operations

The seven moneylenders have been operating for quite sometime (see Table IV.3). The earliest moneylender started in the business 9 years ago. According to our key informants, she pioneered the moneylending business in the area. Others followed suit upon seeing the profitable opportunities in moneylending. Two moneylenders are relatively new. One has been operating for 2 years, while the other started moneylending 1 1/2 years ago.

All of the moneylenders interviewed did not consider moneylending as a job. However, two of them admitted that they are full-time moneylenders. These are the unemployed housewives who have a lot of free time after doing the household chores. The rest spend only part of their time in moneylending activities.

TABLE IV.2
PHYSICAL ASSETS OWNED BY MONEYLENDERS
(Sapang Palay)

Assets	A	B	C	D	E	F	G
a. House	₱500,000	₱50,000	₱120,000	₱200,000	₱150,000	₱100,000	₱200,000
b. Lot	₱50,000	₱200,000	₱30,000	₱20,000	₱15,000	₱50,000	₱30,000
c. Appliances	₱30,000	₱60,000	₱10,000	₱20,000	₱15,000	₱5,000	₱40,000
d. Furniture and fixture	₱20,000	₱8,000	₱5,000	₱10,000	₱5,000	₱2,000	₱15,000
e. Motor vehicles	₱150,000	0	0	0	0	0	₱30,000
f. Business	₱500,000	₱150,000	₱70,000	₱15,000	0	0	₱60,000
g. Others	0	0	0	0	0	0	0
h. Total assets	₱1,250,000	₱468,000	₱235,000	₱265,000	₱185,000	₱157,000	₱375,000

TABLE IV.3
NUMBER OF YEARS ENGAGED IN MONEYLENDING, TIME DEVOTED TO MONEYLENDING
AND NUMBER OF ASSISTANTS

Information	A	B	C	D	E	F	G
1. Number of years engaged in money lending	6	5	9	5	6	1 1/2	2
2. Time devoted to moneylending	part-time	part-time	part-time	full-time	full-time	part-time	part-time
3. Number of assistants	0	0	0	0	0	0	1

One of the moneylenders is assisted by a relative who lives in the same house. The assistant is sent to school and is given a monthly allowance of ₱300.

The scale of operations greatly varies among the seven moneylenders (see Table IV.4). Five (5) of them had borrowers not exceeding 30 during the period January to September 1987. The other two moneylenders had 100 and 160 borrowers, respectively, during the same period. Five moneylenders granted loans to some of their clients several times during the same period. The two (2) who claimed to be full-time moneylenders had the most number of clients and loans granted.

There is a general notion that moneylenders lend only to their prime clients. The latter are called "suki" in Tagalog. Moneylending is a high-risk business venture, and information about the paying capacity and repayment record of borrowers counts a lot. But such information is costly to obtain. Thus, moneylenders who have been operating in the same market for quite some time tend to favor their "suki" because they have accumulated all necessary information. This lowers their transactions costs, including the risks involved in lending.

The suspicion that moneylenders limit themselves to their "suki" is supported by the data. At least 90 percent of the total borrowers of the four (4) moneylenders have been their "suki". With regard to the other three (3) moneylenders, their "suki" comprised not more than 50 percent of the total number of

TABLE IV.4
LENDING OPERATION OF MONEYLENDERS

Information	Moneylenders						
	A	B	C	D	E	F	G
1. Number of loans granted (Jan.-Sept. 1987)	30	35	12	120	196	25	39
2. Number of borrowers/clients (January-Sept. 1987)	30	20	10	100	160	25	29
3. Proportion of prime clients (suki) to total clients	50%	90%	100%	100%	90%	25%	21%
4. Cumulative value of loans granted (January - Sept. 1987)	₱80,000	45,000	39,500	300,000	60,000	8,000	120,000
5. Total outstanding loans (as of Oct. 1987)	₱60,000	40,000	15,000	150,000	60,000	1,500	40,000
6. Change in the number of borrowers over the past three years	+50%	+35%	-80%	+100%	+400%	+200%	+300%
7. Change in the value of loans over the past three years	+100%	0	-60%	0	+20%	+100%	+500%

borrowers. Note, however, that two of these moneylenders are relatively new in this market. They have not yet established a borrower-lender relationship with many of their borrowers, not to mention the fact that many of their clients borrowed from them for the first time between January and September 1987.

The total value of loans granted during the period January to September 1987 also varies considerably among the moneylenders. The smallest moneylender granted loans amounting to ₱8,000 while the biggest moneylender lent out ₱300,000 during the same period.

Loans outstanding measures the degree of exposure of moneylenders. This is quite high for most of the moneylenders, ranging from ₱1,500 to ₱150,000. The ratio of total loans granted to loans outstanding ranges from 100 percent to 533 percent. There is no definite pattern between the turnover rate and loans outstanding.

Six (6) moneylenders experienced a significant increase in the number of borrowers over the last three years. However, only two (2) of them raised the value of loans by more than the increase in the number of borrowers. This means that to most moneylenders, the real value of loans granted per borrower declined over the past three years. This has also been the experience of other lenders, both formal and informal (see Lamberte [1988] and Lamberte and Balbosa [1988]).

Moneylenders offer various payment schemes to different borrowers to suit the latter's needs and paying capacity. This is one area where moneylenders exercise great flexibility. There were three (3) general payment schemes observed. One payment scheme is called "steady". Loans under this scheme do not have a maturity date but the interest on the principal is paid every month. It is up to the borrower when to pay part, or the whole of the loan principal. Borrowers under the "steady" payment scheme are mostly businessmen who are "suki" of the moneylenders. In effect, moneylenders become the preferred shareholders of the borrowers' businesses.

The second scheme is called the "revolving" payment scheme. Under this scheme, loans have definite maturity dates and therefore do not stay idle in the hands of the borrowers. Borrowers may select either daily, weekly or bi-monthly payment of principal and interest. Interest payments are not collected in advance. A variation of this scheme is one which has no fixed amortization schedule. The only requirement is that the principal and interest should be paid within the agreed maturity date. This scheme is offered to anybody who is willing to pay the interest.

The third payment scheme is called "Balikbayan" (returnees). Under this scheme, borrowers may ask for a loan any time they want. In Tagalog, these borrowers are called "balik ng balik" borrowers, that is, they always go back to the same moneylender to borrow. In effect, borrowers have a credit line with money-

lenders without a pre-established maximum credit line. Only the most creditworthy among the borrowers of the moneylenders can avail of this facility. Usually, these borrowers are businessmen who are in need of cash to finance their inventory. Both the principal and the interest under this scheme are paid within one day or one week.

Table IV.5 shows the distribution of the number of loans granted according to the abovementioned three types of loan. "Revolving" credit is the most popular type of credit. The proportion of loans granted under this scheme to total number of loans ranges from 33 to 83 percent. As can be observed, moneylenders granted a substantial number of loans under the "steady" scheme. The proportion varies from 15 to 42 percent of the total number of loans granted. The absence of any fixed maturity on the loan makes it very attractive to borrowers.

Table IV.6 gives the distribution of loans by maturity and size. They refer only to term loans, i.e., the second and third payment schemes. None of the moneylenders gave loans with maturity of more than 90 days. Most loans granted by moneylenders have maturity periods between 16 to 60 days. This is not significantly different from the maturity distribution of loans granted by commercial banks.

The data conform to the common notion that moneylenders grant small loans to borrowers who are otherwise considered as unbankable by formal financial institutions. Most of the loans

TABLE IV.6
PERCENTAGE DISTRIBUTION OF THE NUMBER OF LOANS GRANTED
BY MATURITY AND SIZE

	Moneylenders						
	A	B	C	D	E	F	G
A. <u>By maturity</u>							
1) 1 - 7 days	-	-	25%	-	-	28%	-
2) 8 - 15 days	-	-	-	-	-	-	-
3) 16 - 30 days	-	-	41%	50%	-	52%	-
4) 31 - 45 days	33%	-	34%	-	-	-	20%
5) 46 - 60 days	67%	50%	-	50%	-	20%	-
6) 61 - 90 days	-	50%	-	-	100%	-	80%
B. <u>By size</u>							
1) less than ₱2,000	50%	70%	90%	65%	83%	100%	24%
2) ₱2,001 - 5,000	50%	-	10%	15%	-	-	10%
3) ₱5,001 - 10,000	-	30%	-	10%	6%	-	52%
4) ₱10,001 - 20,000	-	-	-	10%	11%	-	14%

granted by moneylenders were less than ₱2,000, which is about the same as the average loan size of pawnshops (see Lamberte [1988]). However, some moneylenders gave relatively bigger loans, amounting to ₱10,000 or more. Still, these comprise a small proportion in the total loan portfolio of moneylenders.

Table IV.7 shows the interest rate charged by moneylenders by maturity, size and type of borrower. Moneylenders do not charge service fees, hence the figures refer to effective nominal interest rates. There is no uniform term structure of interest rate among moneylenders. Two moneylenders applied a declining yield curve; that is, loans with longer maturity are charged lower interest rate than those with shorter maturity. One moneylender charges the same rate for all loans regardless of maturity.

The interest rate differential among moneylenders for loans of the same maturity is quite substantial. For instance, for a loan with a maturity period of 30 days, one moneylender charges 195 percent per annum, another charges 224 percent per annum, and still another charges 120 percent per annum. This is a perfect example of the lack of competition and market segmentation. According to the moneylenders, those who are not willing to accept the interest rate they charge are not given the loan. They do not also bother to check the interest rate charged by other moneylenders since they find this exercise futile in view of the excess demand for credit in that particular market.

TABLE IV.7
INTEREST RATE CHARGED PER ANNUM BY MATURITY,
SIZE AND TYPE OF BORROWER

	Moneylenders						
	A	B	C	D	E	F	G
A. By Maturity							
(1) 1 - 7 days	-	-	91%	-	-	120%	-
(2) 15 days	-	-	-	-	-	-	-
(3) 30 days	-	-	195%	224%	-	120%	-
(4) 45 days	97%	-	195%	-	-	-	96%
(5) 60 days	70%	97%	-	137%	-	-	-
(6) 90 days	--	193%	-	-	175%	120%	97%
B. By Size							
(1) small (less than ₱2,000)	same for all	97%	same for all	same for all	same for all	60%	same for all
(2) large (₱2,000 and more)	-	193%	-	-	-	120%	-
C. By type of borrower							
(1) new	120%	same for all	same for all	190%	same for all	same for all	same for all
(2) old	84%	-	-	140%	-	-	-

Only two (2) moneylenders charge different interest rates for loans of different sizes but of the same maturity. The interest rate on large loans is at least twice as high as that charged on small loans. These moneylenders feel that large loans are riskier than small loans, and therefore must be charged a rate corresponding to the perceived risk. As of the time of the interview, however, they did not have any large borrowers.

Only two moneylenders discriminate between old and new borrowers. The former are charged lower rates than the latter.

It is commonly perceived that transactions in the informal credit markets are relatively simple and is characterized by the absence of any legal document to be filled up by borrowers. All moneylenders included in this study said that for small loans, borrowers are merely asked to sign in a notebook or a small piece of paper containing the terms of the loan contract. For a highly favored "suki," a verbal agreement suffices. For big loans, however, moneylenders require borrowers to sign a one-page document notarized by a lawyer. Lawyers charge ₱150 per loan contract notarized. Such expenses are paid by the moneylenders.

Usually, borrowers go to the house of the moneylenders to pay the loan. Only one moneylender regularly sends out her assistant to collect maturing loans.

Moneylenders were asked how much they spend for processing and collecting loans. The processing and collection costs reported were mainly lawyers' fees. The figures given vary from

₱0 to ₱7,500 (see Table IV.8). As a percentage of total loans granted, the processing and collection costs range from 0 to 10.4 percent.

The performance of moneylenders may be evaluated in terms of the quality of their loan portfolio. Four moneylenders indicated that they have borrowers who have past due loans (see Table IV.9). It is worthy to note that the two moneylenders who are new entrants have the highest past due loans to loans outstanding ratio. For these two (2) moneylenders, the average past due period for loan repayment is 90 days, compared to 50 to 70 days for the other two moneylenders. Only these new moneylenders have experienced loan defaults between January and September 1987.

It is clear from these results that new moneylenders have performed badly. They still have to know more about the market, gather more information about their clients and establish the "suki" system in order to improve their performance.

Moneylenders have also developed some mechanism to protect themselves against loan defaults. One way is to cover the loan by a collateral. This is true for six (6) of the seven (7) moneylenders. Among others, the collateral usually accepted includes real estate property, home appliances, jewelries, certificate of time deposit, post-dated checks, and transportation licenses. (See Table IV.10). However, only two moneylenders are keen on covering their loans with a collateral, and about 60 to 90 percent of their total loan accounts are

TABLE IV.8
PROCESSING AND COLLECTION COSTS*

	Moneylenders						
	A	B	C	D	E	F	G
1. Peso Value	3,350	4,680	690	7,500	0	0	880
2. As a percent of total Loans Granted	4.2	10.4	1.8	2.5	0	0	0

*Mainly refers to attorney's fee in processing the loan document.

TABLE IV.9
LOAN PERFORMANCE

	Moneylenders						
	A	B	C	D	E	F	G
1. Number of borrowers who have past due loans as of October, 1987.	3	0	0	30	0	7	8
2. Total value of past due loans	P150	NAP	NAP	40,000	NAP	P500	P29,000
3. Average time of delay	50 days	NAP	NAP	70 days	NAP	90 days	90 days
4. Penalty charges	None	None	None	None	13% per month of arrearages	None	None
5. Number of borrowers who defaulted since Jan. 1987	None	NAP	NAP	None	None	5	1
6. Value of loans in default	NAP	NAP	NAP	NAP	NAP	P300	P700

Note: NAP means not applicable.

TABLE IV.10
COLLATERAL REQUIREMENTS

	Moneylenders						
	A	B	C	D	E	F	G
A. Proportion of loan accounts covered by a collateral to total loans granted	17%	10%	60%	10%	90%	0	31%
B. Kinds of Collateral accepted	Real Estate	Real estate, bonds/time deposits, salary of employees.	Real estate, appliances, jewelry.	Real estate, licenses of transportation.	Real estate, appliances, bonds/time deposits, jewelries.	N.A.	Real estate, appliances, post-dated check.
C. Usual loan to collateral ratio.	100%	Don't assess the market value of the collateral.	100%	50%	50%	N.A.	Don't assess the market value of the collateral.

covered as such. In fact, people in Sapang Palay call these two moneylenders as indigenous pawnshops because they demand collateral like appliances, jewelries, etc.

The loan to collateral ratio varies among moneylenders. For two (2) moneylenders, the ratio is 1:1, while for two (2) other moneylenders, the ratio is 1:2. The rest do not relate the amount of loan to the market value of the collateral.

3. Sources of Funds

Moneylenders usually raise their own capital to finance their lending activities. This is generally true in the case of moneylenders in Sapang Palay. The housewife whose husband works in Saudi Arabia suddenly found herself with excess funds, and eventually discovered moneylending as a profitable outlet for her idle funds. One of the respondent moneylenders accepts savings deposits (Table IV.11). In fact, mobilized savings comprise 70 percent of her total loanable funds. As of October 1987, this moneylender has 51 depositors. The minimum size of deposits is ₱100. The deposits are supposed to have a fixed term of 12 months, with an interest rate of 80 percent per annum. No interest is paid on any pre-terminated deposits. Between January and September 1987, this moneylender experienced 3 pre-terminations of deposits. It did not seriously affect her lending operations because the total value of deposits withdrawn was only ₱1,500. As of October 1987, total outstanding deposits reached ₱40,200. On the average, each depositor had an

TABLE IV.11
SOURCES OF LOANABLE FUNDS

Sources	Moneylenders						
	A	B	C	D	E	F	G
A. Own capital	90%	100%	100%	100%	30%	100%	50%
B. Mobilized deposits	0	0	0	0	70%	0	0
C. Borrowings from others	10%	0	0	0	0	0	0
D. Partner(s)	0	0	0	0	0	0	50%

outstanding deposit of ₦788.24 with this moneylender. Certainly, this is not an insignificant amount of savings mobilized by a moneylender in a low-income community.

The interest rate offered by the moneylender on deposits could be reflective of the opportunity cost of borrowed funds. The other moneylender who borrowed short-term funds from friends to supplement her own capital paid 60 percent per annum for such borrowed funds. This is not very far from the interest rate on deposits paid by the moneylender who is mobilizing deposits. The interest rate differential could be due to the different maturities of the two types of liabilities.

4. Components of the Lending Rate of Moneylenders

Although many patronize the services of moneylenders, the latter are still looked upon as socially undesirable in view of the exorbitant interest rate charged to borrowers. Not many realize, though, that the price of credit to those who do not have access to the formal credit markets and other alternative sources of credit is infinite, whereas the interest rate charged by moneylenders, no matter how high, is at least finite.

A very high interest rate is not necessarily an indication of the exploitative power wielded by moneylenders. One must examine the relative importance of the cost of funds and transactions costs in determining the lending rate. Table IV.12 summarizes our results in this regard. The cost of funds for

TABLE IV.12
COMPONENTS OF LENDING RATES OF MONEYLENDERS

Item	A	B	C	D	E	F	G
Weighted average ^{1/} lending rate	59.2	108.8	126.8	135.4	131.2	90.0	72.6
Less: Cost of Funds ^{2/}	45.0	60.0	60.0	60.0	60.0	60.0	60.0
Gross Spread	14.2	48.8	66.8	75.4	71.2	30.0	12.6
Less: Transactions Costs							
1. Processing/Collection Costs ^{3/}	4.2	10.4	1.8	2.5	0	0	0.7
2. Administrative Costs ^{4/}	8.5	15.3	17.4	4.6	22.9	-85.8	5.7
3. Cost due to delayed payments ^{5/}	0	0	0	9.2	0	9.8	17.3
4. Cost of default ^{6/}	0	0	0	0	0	20.0	1.8
Total	12.7	25.7	19.2	16.3	22.9	115.6	25.5
Net Spread	1.5	23.1	47.6	59.1	48.3	-85.6	-12.9

^{1/} The lending rate is weighted by the relative frequency of loans by maturity and is computed on the basis of nine months (i.e., January - September)

^{2/} Refers to the actual cost of borrowed funds for moneylenders A and E. The rest refer to the opportunity cost of using own capital which is assumed to be the same as the cost of borrowed funds of moneylender E who is mobilising deposits. All are computed on the basis of nine months.

^{3/} Taken from Table IV.8.

^{4/} Salary of the moneylender based on the minimum wage of ₱54.50 per day. Part-time is equivalent to one-half day.

^{5/} Interest rate due to delayed payments (see Table IV.9).

^{6/} Refers to actual cost of loan default (see Table IV.9).

moneylenders A and E are actual figures while for the rest, it is assumed to be the same as that for moneylender E. Transaction costs are the sum of processing and collection cost, administrative cost, cost attributed to delayed payments of loans and cost of default. The net spread gives an indication of the monopoly profits enjoyed by moneylenders.

The results are somewhat mixed. Moneylender A realized a net spread of only 1.5 percent despite a very high lending rate. This is lower than what most commercial banks are currently enjoying. The two moneylenders, F and G, incurred a loss in their lending operations. Being new entrants to the informal credit markets, the loss incurred could be considered as part of the sunk costs necessary to establish themselves in the informal credit markets. Indeed, administrative cost, the cost due to delayed payments and cost of default, form a major part of their transactions costs. These results suggest that high lending rates charged by moneylenders do not necessarily guarantee them high profit rates. The transactions costs as well as the cost of funds must be taken into consideration.

The other four (4) moneylenders enjoyed substantial profit margins. Moneylenders D and E realized the widest spread and have the greatest number of clients. It is indeed surprising to observe that clients do not transfer to moneylenders who charge relatively lower lending rates in an effort to eventually bring down the lending rates of other moneylenders. The wide dispersion of lending rates among moneylenders, and the lack of

mobility among clients to shift from one moneylender to another are indeed an indication of severely fragmented capital markets prevailing even in a small community like Sapang Palay. Because of this market structure, all seven (7) moneylenders admitted that they do not see each other as competitors.

V. "PALUWAGAN", A ROTATING SAVINGS AND CREDIT ASSOCIATION (ROSCAS)

This section briefly describes the characteristics of "paluwagan" units operating in Sapang Palay, discusses the role of the "paluwagan" manager, and examines the degree of participation of "paluwagan" members in the informal credit markets.

1. Characteristics of the Paluwagan

Rotating savings and credit associations (ROSCAS) are the traditional saving techniques prevalent in LDCs. They exist in an environment where formal financial markets are absent, or are not well-functioning, and where there are indivisibilities in investment and consumption. They have assumed varied forms in different economic environments, such that some are more sophisticated than others. In India, for instance, there are at least four different forms of ROSCAS, namely: (1) rotating lot chitty without discounts, which is the simplest form of ROSCAS; (2) lot chitty with discounts; (3) rotating lottery prize chitty; and (4) auction chit or business chit (Nayar, 1986). Other sophisticated forms of ROSCAS can also be found in Korea.

In the Philippines, the most common form of ROSCAS is the rotating lot chitty without discount. This is popularly known as "paluwagan".^{1/} The lot or prize amount is rotated among members of the "paluwagan" unit for a definite period. "Paluwagan"

^{1/} The origin of this word is discussed in Keyes (1983).

members call the lot "sahod".^{2/} The turn or rotation is determined by lottery. The "sahod" depends on the value of one share and the number of subscribed shares. For example, if one share is valued at ₱20 and there are 30 subscribed shares, then one "sahod" amounts to ₱600. Assuming that each member has one share and that the installment or contribution is made on a daily basis, then each day, one member receives a "sahod" equivalent to ₱600 less his contribution for that day. At the end of the cycle, each member shall have already received and raised the same amount of money.

Although the "paluwagan" is generally well known to Filipinos, hardly any in-depth study on its role in the informal credit market exists. An exception is the study done by Keyes (1983), in which the role of the "paluwagan" system in financing home improvements of settlers in Dasmariñas Bagong Bayan Resettlement area was analyzed.

As mentioned earlier, six (6) "paluwagan" units are included in this study. Their basic characteristics are summarized in Table V.1. All of them started in 1987 and most of them were in the middle of the cycle when the interview was conducted. In terms of the turn-over rate or frequency of contribution, two (2) units are on a daily basis, another two (2) units on a weekly basis, and one (1) unit each on a bi-monthly and monthly

^{2/}

In English, "sahod" means salary.

TABLE V.1
 CHARACTERISTICS OF THE SIX "PALUWAGAN" UNITS
 (Sapang Palay)

	Paluwagan units					
	A	B	C	D	E	F
1. Date started	24 June 1987	8 March 1987	14 June 1987	3 May 1987	15 March 1987	30 April 1987
2. Frequency of contribution	daily	weekly	daily	weekly	bi-monthly	monthly
3. Value of one share (₱)	20.00	100.00	140.00	350.00	2,000.00	3,000.00
4. Total number of shares	70	20	34	28	19	15
5. Lot or "sahod" (₱)	1,400	2,000	4,760	9,800	38,000	45,000
6. Number of members	22	16	26	24	18	10
6.1 core members	18	12	24	7	6	10
6.2 new members	4	4	2	17	12	-

basis. The value of one share ranges from ₱20 to ₱3,000, and it varies directly with the length of the cycle. The total number of shares ranges from 15 to 20, and it varies inversely with the value per share. The "sahod" ranges from a low of ₱1,410 to a high of ₱45,000.

To make the "paluwagan" manageable, the number of members is usually kept small. Stricter membership criteria are applied to "paluwagan" units whose price per share is relatively large. As shown in Table V.1, the number of members is less than the number of shares in all the "paluwagan" units, indicating that some members are holding more than one share.

Members of a "paluwagan" may be categorized into two, namely, core members and new members. Core members are those who were members of a previous "paluwagan" and whose manager is also the one managing the present "paluwagan". Most of the core members have been members of the same "paluwagan" units for about five cycles. Thus, the presence of core members gives some semblance of permanency and stability to a "paluwagan". New members are usually guaranteed by core members, or by the "paluwagan" manager. It is possible, however, that new members were members of previously operating "paluwagan" units managed by other managers.

There seems to be a variety of "paluwagan" units from which potential members may choose. Indeed, this offers low income groups opportunities to save and overcome the problem of indivisibilities in investment and consumption.

2. The Paluwagan Manager

The manager plays a very vital role in the "paluwagan." It is his/her duty to evaluate the credentials of each member. The manager is usually one of the well-respected and trustworthy members of the community. He/She does not have to have a higher socio-economic status in the community.

Four "paluwagan" managers are included in this study. All are female. Three are new managers who have been managing a "paluwagan" for not more than a year. Their core members prodded them to assume the leadership since the former managers had decided to stop managing the paluwagan either for personal reasons, or they had left Sapang Palay. One very enterprising manager organized three "paluwagan" units of varying sizes, and has managed them simultaneously for about four (4) years already. Aside from managing "paluwagan" units, she is also engaged in moneylending, and is one of the respondent moneylenders. However, she makes it a point not to lend money to the members of her "paluwagan" units, lest it destroy the very purpose of organizing a "paluwagan".

The circumstances under which the four became managers determine to a large extent their management style. The three (3) new managers consult their members in deciding what criteria to use in accepting members, and who are going to be accepted, whereas the more experienced manager decides alone. None of the four managers explicitly receive a commission or a fee for

managing a "paluwagan". In fact, they spend their own time, and sometimes their own money in collecting contributions from members and in delivering the "sahod". However, they claim that the transactions costs are negligible since most members are either living near the residence of the manager, or working in one place, like the public market. The cost of default is, however, fully shouldered by the managers.

The most important factor that motivates one to manage a "paluwagan" is having the first turn in each cycle. As will be shown below, the implicit interest, which is also the implicit commission that a manager receives for having taken the first turn, is very attractive.

The succeeding turns are determined by lottery. Each share, excluding that of the manager, has an equal chance of being drawn. This is the only time when "paluwagan" members are obliged to attend a meeting. Thus, "paluwagan" units are considered as purely economic associations. Sometimes, the manager gives priority to those who are in need of cash for emergency purposes, e.g., to pay the hospital bills, while the rest of the turns are determined by lottery. Exchanging turns is also allowed by the manager provided the members concerned agree.

The lottery has to be carefully managed by the manager because it determines the implicit interest rate a member will realize from his/her savings with the "paluwagan". The implicit interest rate enjoyed by each member is shown in Table V.2. The

TABLE V.2
FIVE-MEMBER, FIVE-MONTH "PALUWAGAN"

Rank of Member	Monthly Contribution (₱)	"Sahod" (₱)	Implicit Interest Rate (%)
1	3,000	12,000	15.1
2	3,000	12,000	15.1
3	3,000	12,000	11.7
4	3,000	12,000	6.7
5	3,000	12,000	0.0

Note: A member is assumed to deposit with the moneylender the "sahod" received, and where the moneylender offers interest rate on deposit of 80% per annum or 6.7 per month. Each month, he/she withdraws an amount equivalent to his monthly contribution to the "paluwagan".

implicit interest rates were obtained by assuming that a member deposits the "sahod" with the moneylender who offers an interest rate of 80 percent per annum, or 6.7 percent per month on deposits (cf. Section IV). As indicated, there is a great incentive to have the first and second turn at the "paluwagan" because the implicit interest rate for these turns is 15.1 percent for 5 months, or 36.2 percent per annum, compared to 0.0 interest rate for the last turn.

Usually, the minimum number of shares is one. However, the manager may admit members for half or a quarter of a share. She will then look for members to assume the remaining part. Otherwise, she is obliged to absorb them since only a full share is included in the lottery.

There is no prescribed ceiling on the number of shares a member may hold. However, the manager may decide to put a cap on a case-to-case basis. None of the four (4) managers had ever restricted members from joining other "paluwagan" units.

One manager said that one of the members defaulted before receiving the "sahod". In this case, the entire contribution was given back to the member and the manager assumed the abandoned share. Two (2) managers claimed that a member defaulted after receiving the "sahod". In this case, they assumed the defaultees' liabilities so that the "sahod" would not decrease in the succeeding turns. All of them said that some of their members were delayed in giving their contributions. In order for

members to receive the entire "sahod" when their turns are up, the managers advanced their own money to fill the gap. To minimize defaults, the most enterprising manager requires members to sign a written contract attested to by a lawyer. This helps reduce defaults to a large extent. However, this is also costly to the manager since the entire attorney's fee which is fixed at 5 percent of the value of the contract, is shouldered by the manager.

All these show that apart from managing the "paluwagan", the manager is also expected to absorb the risk inherent in a savings and credit association, and the cost of reducing such risk. Her compensation is the implicit interest she realizes by taking the first turn.

3. Paluwagan Members

a. Socio-Demographic and Economic Characteristics of "Paluwagan" Members

Of the 45 sample respondents, 73 percent are female, and almost all are married (see Table V.3): The average age of the sample "paluwagan" members is 37. Only one has a college degree, although most finished high school.

Sixty-seven (67) percent belong to a single family and 29 percent, to an extended family. The average family size is 6.3. On the average, each family has two members studying in school.

TABLE V.3
SOCIO-DEMOGRAPHIC CHARACTERISTICS OF "PALUWAGAN" MEMBERS

Characteristic	Average	Standard Deviation	Proportion (%)
1. Sex			
a) Male			26.7
b) Female			73.3
			<u>100.00</u>
2. Civil Status			
a) Single			8.9
b) Married			88.9
c) Widow/Widower			2.2
			<u>100.0</u>
3. Age	37.1	8.7	
4. Number of years in school	10.2	3.7	
5. Type of Household			
a) Single family			66.6
b) Extended family			28.9
c) Two or more non- related members			4.5
			<u>100.0</u>
6. Family size	6.3	2.8	
7. Family members in school	1.9	1.5	

All of the respondents are market vendors in the Sampol Public Market. On the average, each household has at least two members working, usually self-employed (see Table V.4). This is to be expected since both husband and wife tend to the family-owned store in the Sampol Public Market.

The average family income is ₱5,631 per month. It comes from various sources but a great proportion comes from family-owned businesses. Gross sales realized by the family-owned businesses average ₱19,870 per month while net sales average ₱4,370 per month. Only the latter are included in the computation of family income. Family expenditure averages ₱3,880 per month, where about 50 percent is spent on food.

On the average, "paluwagan" members are net savers. The difference between monthly family income and expenditure averages ₱1,750. However, 29 percent of the respondents are found to be dissavers, i.e., their monthly family expenditure exceeds their monthly family income.

The market value of the physical assets owned by the respondents average ₱87,000. Physical assets include house, lot, home appliances, furniture and fixtures, motor vehicles, and business (including licenses, inventories, equipment, etc.).

b. Membership in the "Paluwagan"

Of the total sample respondents, only 22 percent directly applied for membership in a "paluwagan." The rest were recruited

TABLE V.4
ECONOMIC CHARACTERISTICS OF "PALUWAGAN" MEMBERS

Characteristic	Average	Standard Deviation	Proportion (%)
1. Number of family members working	1.9	0.6	
2. Family Income per month (₱)	5,631.13	5,075.68	
3. Sources of family income			
a) Employment			22.7
b) Business			72.8
c) Others			4.5
			100.0
			=====
4. Family expenditure per month (₱)	3,879.53	2,524.14	
5. Distribution of family expenditure			
a) Food			49.2
b) House/Land rental			3.3
c) Fuel, light and water			5.9
d) Clothing, footwear and other wear			7.3
e) Education			5.5
f) Durable and non-durable furnishings, furniture, equipment			3.5
g) House maintenance and repairs			5.3
h) Medical care			6.8
i) Recreation			4.1
j) Transportation and communication			6.3
k) Household operations and personal care/effects			2.6
l) Others			0.1
			100.0
			=====
6. Surplus income (₱)	1,751.60	4,699.32	

either by the manager or by the core members. The latter aggressively seek out additional members to increase the amount of the "sahod".

The respondents were asked the factors they consider in joining a particular "paluwagan". Most of them indicated amount of contribution, frequency of contribution, personal knowledge of the manager, and personal knowledge of the majority of the members as the first, second, third and fourth important factors, in that order. In other words, "paluwagan" members evaluate first how much he/she would like to raise and can afford before joining a "paluwagan". The presence of several "paluwagan" units, with varying amount and frequency of contribution, allows them to make a choice on the basis of their financial capacity.

What were the motivations for joining a "paluwagan"? Several of the respondents mentioned "to finance the family-owned business, to save, to pay old debts, to raise funds for household consumption, and to avoid borrowing from moneylenders", as the most important motives for joining a "paluwagan" (see Table V.5). About 95 percent of the members' contribution came from their current income (see Table V.6).

Savings mobilized through the "paluwagan" are not negligible. The average "sahod" received or to be received by respondents from the present "paluwagan" is ₱12,577 (see Table V.7). To most of the "paluwagan" members, this amount of savings would not have been made possible without the "paluwagan".

TABLE V.5
REASONS FOR JOINING A "PALUWAGAN"

Reasons	Percent
1. To raise funds for household consumption	68.9
2. To raise funds to finance own business	95.6
3. To pay old debts	80.0
4. To avoid borrowing from moneylenders	57.8
5. To raise funds for lending to others	22.2
6. To raise funds to buy home appliances, furnitures and fixtures	44.4
7. To raise funds to repair/improve the house	44.4
8. To raise funds to apply for a job abroad	13.3
9. To save	93.3

TABLE V.6
METHOD OF FINANCING THE CONTRIBUTION TO
THE PRESENT "PALUWAGAN"

Sources	Percent
1. Current Income	95.4
2. Savings	2.6
3. Borrowings	1.8
4. Others	0.2
Total	<u>100.0</u>

TABLE V.7
"SAHOD" RECEIVED/TO BE RECEIVED FROM THE PRESENT PALUWAGAN

Sahod (₱)	Frequency	
	Absolute	%
Below 3,000	12	26.7
3,000 - 5,999	8	17.8
6,000 - 8,999	1	2.2
9,000 - 11,999	12	26.7
12,000 - 14,999	1	2.2
15,000 - 17,999	1	2.2
18,000 and above	10	22.2
TOTAL	45	100.0

Mean - ₱12,577

S.D. - 14,266

What are the uses of the savings raised through the "paluwagan"? Table V.8 shows the allocation of the "sahod" received/to be received by members. Forty-nine (49) percent of the sahod were/are going to be used for business purposes. This is not surprising since the "paluwagan" members included in the study are market vendors, and as mentioned earlier, raising funds to finance the family-owned business is one of the most important reasons for joining a "paluwagan". This demonstrates how a "paluwagan" helps small entrepreneurs in overcoming the problem of indivisibilities in investment. Payment of loans and house repair/maintenance occupy the second and third most important uses of the "sahod", respectively. In Keyes' (1983) study, the "paluwagan" was observed to be an effective method of raising funds to finance home improvements.

"Paluwagan" members usually make investment and/or consumption plans for a particular planning horizon. They make a decision regarding what "paluwagan" to join on the basis of these plans. Since the turns are determined by the lottery, the timing of receiving the "sahod" is therefore crucial. Respondents were therefore asked whether the "sahod" they received/will receive from the present "paluwagan" coincided/will coincide with their expected time for using it. Ten (10) of the total respondents gave a negative answer. The estimated average time of delay is about 7 days or one week. It seems that the planned investment/consumption of these ten "paluwagan" members cannot be postponed. Seven (7) of them

TABLE V.8
ALLOCATION OF THE "SAHOD"

Purpose	Average (%)	
	Present	Past Two Years
Business	49.2	44.6
Household appliances	3.2	2.5
House repairs/improvement	10.2	11.2
Family consumption	9.6	16.8
Cash savings	7.8	6.6
Payment of loans	12.3	6.4
Loans to others	2.4	0.4
Education	0.5	2.4
Medical care	0.0	0.7
Application for overseas job	1.1	0.0
Others	3.8	8.5

resorted to borrowing from moneylenders, while the other three (3) used their own savings.

The extent of dependency of the respondents on the "paluwagan" is quite substantial. Seventy-six (76) percent of them join a "paluwagan" after every "paluwagan" cycle, while the rest join a "paluwagan" during a particular period of the year, like the Christmas season. On the average, respondents joined a "paluwagan" six (6) times during the past two years. The "sahod" they received in the past two (2) years averaged ₱26,080 (see Table V.9). The pattern of allocation of the "sahod" received in the past two (2) years is not substantially different from that of the present "paluwagan" (see Table V.8). It seems that small entrepreneurs are constantly increasing their investments through the "paluwagan".

c. Alternative Ways of Saving and Sources of Credits

The "paluwagan" is not the only saving mechanism patronized by "paluwagan" members. Twenty-two (22) of the respondents have savings deposits with a bank located elsewhere (Sta. Maria and Novaliches), and their outstanding deposits averaged ₱3,746. Six (6) of the respondents have deposits with the informal savings association in Sapang Palay. However, the average outstanding deposits is only ₱347. A significant relationship does not exist between income and the level of deposits.

TABLE V.9
 "SAHOD" RECEIVED FROM THE PALUWAGAN IN THE PAST TWO YEARS

Sahod (₱)	Frequency	
	Absolute	%
Below 10,000	12	27.3
10,000 - 19,999	13	29.6
20,000 - 29,999	8	18.2
30,000 - 39,999	2	4.6
40,000 - 49,999	4	9.1
50,000 and above	5	11.4
TOTAL	44	100.0

Mean ~ ₱26,080

S.D. ~ 15,000

One observation is missing.

The transactions costs in depositing/withdrawing money from a bank are quite high. On the average, it costs a depositor ₱13.93 per visit to their bank (see Table V.10).

"Paluwagan" members have other sources of credit other than the "paluwagan". Table V.11 presents the alternative sources of credit of "paluwagan" members during the period January to September 1987. Traders/suppliers appear to be the most important alternative source of credit.^{3/} Fifty-three (53) percent of the respondents obtained trade credits from traders/suppliers. The average value of trade credit was ₱3,482, with an average maturity period of thirteen (13) days. Those who obtained trade credits said that there was no difference between the cash price, and the price of the same commodity bought on credit from traders/suppliers. This means that the latter did not charge any implicit interest on their trade credits, but selling in bulk to their customers (market vendors) allows them to realize economies of scale.

Twenty (20) percent of the respondents admitted that they borrowed money from moneylenders during the period January to September 1987. The average amount borrowed was ₱1,558 and the interest rate was 111.11 percent per annum. As earlier noted, 54 percent of the respondents said that one of the reasons for joining a "paluwagan" is to avoid borrowing from moneylenders.

^{3/}

A more detailed treatment of trade credits can be found in Lamberte and Jose (1988).

TABLE V.10
TRANSACTION COSTS IN DEPOSITING/WITHDRAWING MONEY FROM A BANK

Activity	Amount
Travelling time (roundtrip)	₱0.73*
Waiting time in the bank	₱2.27**
Transportation cost (roundtrip)	₱10.93
TOTAL	₱13.93 =====

*72.6 minutes x ₱0.01 = ₱0.73
 where 72.6 minutes = average travelling time (roundtrip)
 ₱0.101 = opportunity cost per minute (Net sale per person per month divided by the number of minutes worked per month. It is assumed that a person works for 10 hours per day, 7 days a week.

**22.5 minutes x ₱0.101 = ₱2.27
 where 22.5 minutes = average waiting time in the bank
 ₱0.101 = same as above.

TABLE V.11
ALTERNATIVE SOURCES OF LOANS, MATURITY PERIOD AND INTEREST RATE

Source	Respondents		Average Maturity Period (Days)	Average Interest Rate (percent)/ annum)*	Average Amount Borrowed (in ₱)
	Number	% of Total			
Bank	0	0	-	-	-
Savings Association	4	8.9	67.5	66.2	1,137.50
Moneylenders	9	20.0	76.4	111.11	1,558.89
Relatives	8	17.8	10.62	0.0	2,525.00
Traders/ Suppliers	24	53.3	12.58	0.0	3,481.67
Others (friends, neighbors, etc.)	7	15.6	23.43	13.7	12,021.43

The proportion of respondents who borrowed money from moneylenders could have been higher had there been no "paluwagan". Interestingly, among the other sources of credit for "paluwagan" members, moneylenders offered the longest maturity period for their loans.

Although some respondents have bank deposits, none of them obtained credit from a bank. The lending rate of the savings association in Sapang Palay is quite high at 66.2 percent per annum. This reinforces our earlier observation that the opportunity cost of capital in the area is very high. Other important sources of credit include relatives, friends and neighbors.

d. The Saving-Investment Hypothesis

In this case, joining a "paluwagan" is actually a saving-investment decision. As in less sophisticated economies, the decision to save is not divorced from the decision to invest. This firm-household model has been popularized by McKinnon (1973). The basis for his argument is that average cash balance holdings are positively related to the propensity to invest (save), under the formal constraint that all investments are self-financed. In other words, money and capital are complementary. This is contrary to the traditional view which argues that money and capital are substitutes.

The presence of a "paluwagan" does not substantially alter the McKinnon model, except that the manner by which saving-investment has taken place has become a little more complicated. The study has tried to capture the decision-making process of "paluwagan" members using a simple utility function. The maximization of the utility function results in the following reduced form equation:

$$S_i = f(r_i, W_i, AC_i, AS_i); \quad i = 1, 2 \dots 44, \text{ where}$$

S stands for the "sahod" or the level of saving made by the *i*th "paluwagan" member; *r* is the expected rate of return on savings/investment; and *W* refers to wealth, and which is treated here as a scale variable. Two dummy variables have been added; namely, access to alternative sources of credit (AC) and alternative saving mechanisms (AS). It is expected that *S* responds positively to *r* and *W*, and negatively to AC and AS. In the absence of information on the rate of return on investment, gross sales (*r*₁) and net sales (*r*₂) are used alternatively as proxy for *r*. *W* is represented by physical assets of respondents valued at current market prices. The results of estimating the equation above using OLS are as follows:

	<u>Model I</u>	<u>Model II</u>
Constant	15238.75	14410.37
r1	0.23065 (2.71)*	-
r2	-	1.04487 (2.29)*
W	0.0076 (2.25)*	0.00642 (1.81)**
AC	-11053.03 (2.18)*	-10235.09 (1.95)**
AS	-450.46 (0.13)	572.98 (0.16)
R ²	0.31	0.28
F	5.91*	5.22*

* significant at 5% level.

** significant at 10% level.

All the coefficients of Model I which uses gross sales as a proxy for the expected rate of return on investment have the expected signs. However, AS is found to have no significant effect on S. In Model II which uses net sales as a proxy for the expected rate of return on investment, only the coefficient of AS is inconsistent with our hypothesis. Also, it is statistically insignificant. The adjusted R² is reasonably high considering the type of data we are using.

In brief, the results tend to show that the model described above seems to capture the saving-investment process of "paluwagan" members.

e. Lending Behavior of "Paluwagan" Members

"Paluwagan" members are not purely borrowers in the ICMS. In fact, 82 percent of the respondents had been granting loans during the period January to September 1987 (see Table V.12). Being market vendors, they cannot help but provide consumer loans to their clients. However, they limit their borrowers to close friends, relatives and "suki." On the average, each has at least four (4) clients who either borrowed or bought goods from them on credit several times during the same period.

Of the thirty-seven (37) lender-respondents, only three (3) were found to be lending cash and therefore can be considered as professional moneylenders, based on our definition. The three were not included in our sample of moneylenders.

The amount of loans granted averaged ₱2,713.43, with an average maturity period of 95 days. As of the interview date, only 16 have loans outstanding which averaged ₱2,243.50. Three (3) of them charged interest on their loans, and these are the professional moneylenders earlier mentioned. The interest rate they charged for loans averaged 75.3 percent per annum. Others did not charge higher prices for goods bought on credit. In other words, they were not charging any implicit interest on

TABLE V.12
LENDING BEHAVIOR OF "PALUWAGAN" MEMBERS

Lending Activities	Degree of Participation
1. Loans granted (Jan.-Sept. 1987)	
a) Number of respondents granting loans	37
b) Average amount of loans granted	₱2,713.43 (5,875.90)
2. Average maturity period	
	95 (31)
3. Loans outstanding (As of October 1987)	
a) Number of respondents having outstanding loans	16
b) Average amount of loans outstanding	₱2,243.50 (5,875.90)
4. Interest rates	
a) Number of respondents charging interest on their loans	3
b) Average interest rate (per annum)	75.3% (57.8)
5. Past due loans	
a) Average amount of past due loans	₱954.81 (1,406.98)
b) Average period overdue	95.1 days (21.3)

Note: Figures in parentheses are standard deviations.

their consumer loans at all. It should be recalled that market vendors were not charged any implicit interest on the trade credits they obtained from traders/suppliers.

Sixteen (16) of the lender-respondents admitted to having past due loans as of the date of the interview. The average amount of past due loans was ₦954.81. This is about 42.6 percent of the total outstanding loans. There was no effort made to collect the loans, and no penalty charges were imposed on overdue loans. The thinking was that someday, the borrowers will pay the loan.

VI. CONCLUDING REMARKS

This study has examined the financial markets of a low-income urban community. Specifically, it has examined the role and degree of participation of professional moneylenders and "paluwagan" in the ICMS.

In low-income communities, the ICMS thrive well. In fact, they are the financial markets in such communities. They provide financial services to those left out by the formal financial institutions.

The professional moneylenders stand out as the most important source of credit. In Sapang Palay, there are 20 professional moneylenders actively engaged in lending. The density ratio is one (1) professional moneylender per 860 households. If total loans outstanding can serve as an indicator of the financial resources of a moneylender, then the combined resources of the 20 moneylenders would amount to ₱1.05 million which would be available for on-lending in the community.

Moneylenders are innovative. Various schemes that suit the needs of borrowers were designed. To them, information about the characteristics of borrowers is very important. The "suki" system, developed through time between lenders and borrowers, helps reduce the rate of default. New entrants who have not yet developed the "suki" system are likely to encounter high default rates as has been noted in this study.

This study reasserts the view that access to credit is more important to borrowers than the interest rate. Moneylenders were charging very high interest rates, yet many borrowed from them. If only small borrowers have access to bank credit, then there is no doubt that they would be willing to pay a high rate.

Moneylenders enjoy a wide spread, and this could be attributed mainly to the lack of competition in the area. The wide dispersion of lending rates among moneylenders, and the lack of mobility among clients to shift from one moneylender to another, are indications of severely fragmented capital markets that prevail even in a small community like Sapang Palay.

Moneylenders usually use their own capital for their lending operations. However, they may also mobilize deposits, and the success of this activity depends on the attractiveness of their deposit instruments to low-income earners. In Sapang Palay, one moneylender has been successfully playing the role of an indigenous banker. She accepts time deposits for as low as ₱100, carrying an interest rate of 80 percent per annum. This is an opportunity not provided by banks, whose minimum time deposits is ₱5,000, an amount way above what low-income earners can afford.

The existence of a variety of "paluwagan" offers low-income earners opportunities to save and to overcome the problem of indivisibilities in investment and consumption, in accordance with their financial capacity. Savings mobilized through the

"paluwagan" are significant amounts. Contrary to the commonly-held view, "paluwagan" units do not necessarily cease to exist after the completion of the cycle. The presence of core members gives some semblance of permanency and stability to a "paluwagan." Being core members, small entrepreneurs are able to constantly increase their investments by raising deposits through the "paluwagan." The lottery gives one a chance to spend/invest in advance, and earn a very high rate of return on funds. This opportunity is not available in the formal credit markets.

All these seem to challenge the conventional wisdom which states that no financial savings can be mobilized in low-income communities. The presence of an instrument that exacts low transactions costs on the part of the participants, and offers attractive returns can tap those savings.

ICMs exist almost everywhere in the country. The total volume of transactions involved in all ICMs in the country is certainly not negligible. Yet it does not find its way into the official financial statistics published by the Central Bank and other government agencies. Researchers using the published financial statistics should be aware that they are getting only a partial picture of our financial system. Efforts should therefore be exerted to compile financial statistics that reflect the overall features of our financial system. This paper shows some possibilities in obtaining information from the ICMs.

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