INTEGRATIVE REPORT ON THE INFORMAL CREDIT MARKETS IN THE PHILIPPINES

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THE INFORMAL CREDIT MARKETS IN THE PHILIPPINES: AN INTEGRATIVE REPORT*

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I. INTRODUCTION

This study is part of a comparative study of informal credit markets (ICMs) in five Asian countries sponsored by the Asian Development Bank. The five countries -- Bangladesh, India, Indonesia, Philippines, and Thailand -- were selected to capture the diversity of ICMs in the region.

The issues hoped to be covered in the country study are quite comprehensive and wide ranging. Divided into four major groups, the topics encompass the following:

i) major structure of the ICMs, size and trends in size, and policy and legal environment;

ii) role of ICMs in savings generation and provision of consumption credit, allocation efficiency, issues on equity, interaction of ICMs with the formal sectors, and implications for monetary policy and depositor security;

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*An integration of the major results of various studies conducted under the Asian Development Bank-sponsored regional research on informal credit markets.

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iii) interest rate formation in ICMs and trends, competition between formal and informal sectors, ICMs as a possible source of innovations, interlinkage of credit with transactions in other markets, and promoting links with the informal sector; and

iv) an optimal legal and policy environment towards the informal sector.

The country study for the Philippines is a collaborative effort among various researchers. Five (5) study modules have been identified. The modules listed below focus on particular aspects and issues in the ICMs which are most relevant to existing financial and economic environment of the country and need for policy formulation.

Module 1 - a review of policies impinging on the informal credit markets in the country which highlights the contractionary and expansionary episodes in the formal credit system during the period 1970-1986, and the responses of the formal and informal credit markets;

Module 2 - the informal credit markets in urban Metro Manila, which probes into credit cooperatives, trade credits, rotating savings and credit associations (ROSCAs), and individual money-lenders;

Module 3 - the credit history of farming and non-farming households and history of lending by ICM lenders in six (6) rural villages;

Module 4 - the ICMs in relation to the overseas employment sector, which examines the case of financing the overseas contract workers and the role of the informal lenders; and

Module 5 - monitoring the market conditions within the ICM, which discusses the needs and methodologies for institutionalizing a monitoring system.

From the modules, it would appear that there is unequal treatment of the urban and rural ICMs. There are reasons for this. Studies on rural ICMs in the Philippines are quite abundant (see for example Table 6, this report). In fact, the most recent ones are included in this report. However, previous studies on rural ICMs use cross-section data. Thus, Module 3 is quite unique since it examines the credit history of rural villages. In contrast, there are very few studies on urban ICMs, hence the need to have more studies in this area.

There are other considerations. One is the need to focus on major economic activities or sectors that largely depend on ICMs for external finance. A case in point is the overseas employment sector which owes much of its continued vigor to the support of the ICMs. In 1987 alone, the estimated size of the credit market for overseas workers was ₱1.75 billion, of which 98 percent came from informal source (Mangahas 1989). The other is the need to study institutions in the borderline, e.g., pawnshops, money-shops, lending investors (LIs), and non-stock savings and loan associations (NSSLAs).

Nine (9) working papers have been completed for this study. They appear in Annex A, which also describes the respondents and the research instruments used in gathering information for the various papers. Since the methodological details are contained in the separate reports, data sourcing will be described here only briefly.

To study the urban ICM, the researchers undertook surveys and case studies of major informal lending arrangements in urban Metro Manila. They focused on trade credits in the footwear industry of Marikina; the cooperative credit unions in offices and public markets; and "paluwagan" units (the Philippine version of a ROSCA) and professional moneylenders in the low-income community of Sapang Palay, a resettlement area in the fringe of Metro Manila.

The micro-level history of rural ICM from 1972 to 1987 was analyzed with the survey data obtained in 1987 from some 162 rural households and 46 informal lenders in four rice-based and two rice-onion-based villages in the municipalities of Cabiao and Laur, respectively. Both towns are located in the province of Nueva Ecija in Central Luzon region.

Some 336 overseas contract workers (OCWs) and 12 lenders to overseas workers were interviewed in 1987. Of the OCWs, 153 are getting their overseas job for the first time; 183 respondents are "rehired," that is, either covered by contract renewal or getting another job placement abroad. In-depth interviews of selected lenders were conducted in view of the peculiarities of some financing arrangements in the sending of contract workers abroad.

Twenty seven (27) case studies of a mix of informal credit suppliers operating in either the rural or urban areas, or both, were done toward the design of a monitoring system on the ICM.

The information regarding the institutional aspects of the credit markets were obtained through interviews with officers of selected commercial banks, rural banks, money shops, and the Central Bank (CB). A report on the pawnshops was also prepared based on the 1980 to 1986 financial statements of 100 sample pawnshops drawn randomly from a total of 1,143 pawnshops

operating as of 1986. The CB kindly provided us the financial statements of the 100 randomly selected pawnshops. Secondary data were obtained from the Central Bank (CB), previous studies by the former Technical Board for Agricultural Credit (TBAC), and other recent studies on ICMs by other researchers, notably Floro (1986), Geron (1988), and Swaminathan (1982). From the data bank of SWS, the raw data from the 1987 survey of small enterprises in the informal sector of three (3) municipalities in Metro Manila were made available for this study.

The data of the nationwide surveys jointly implemented by the Social Weather Stations (SWS) and the Ateneo University in 1986 and 1987 were also made available to the study. The surveys polled 1,200 voting age adult respondents, distributed as follows: Metro Manila - 300; balance of Luzon - 300; Visayas - 300; and Mindanao - 300.1/ The locations and respondents were drawn at random. The data from these surveys permit us to estimate the size and trends in the ICMs from the demand side by national, regional, urban, and rural locations as well as by economic classification of families. Population weights were applied to get the nationwide estimates of the size of the informal credit markets.

This integrative report is organized along the following major topics mentioned above. The major findings of individual studies related to the abovementioned topics are covered in this report.

II. MAJOR STRUCTURE OF THE INFORMAL CREDIT MARKETS, POLICY AND LEGAL ENVIRONMENT AND SIZE AND TRENDS IN SIZE 2/

A. Structure of the Informal Credit Markets

To define the major structure of the informal credit markets the line between the formal and informal markets should first be drawn.

We use the criterion of flexibility to identify segments of the financial system that belong to the ICMs and the FCMs. ICMs are flexible because they function "outside the purview of

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1/ Nationwide sample size margin of error for ratio estimate is 2.9 percent; for regional sample, it is 5.8 percent. For details on the methodology and reliability, see Ateneo-SWS Public Opinion Report II and III, October 1986 and March 1987, and POR IV, October 1987 Survey.

2/ This section draws heavily from the Lamberte (1988) and Agabin (1988) studies.

regulations imposed on the formal sector with respect to capital, reserves and liquidity requirements, ceilings on lending and deposit rates, mandatory credit targets, and audit and reporting requirements" (Ghate 1986). In the Philippines, only the Central Bank imposes such regulations on financial intermediaries directly under its supervision. We may then say that financial intermediaries which do not fall under the direct supervision of the Central Bank belong to the ICMs.

Given the above definition, we can classify two groups of participants in the ICMs. One group consists of those which are registered with a particular government agency but are exempted by law from regulations imposed by the Central Bank. An example of this would be cooperative credit unions. The other group is composed of financial intermediaries which are not registered as such with any government agency. If registered and authorized by the CB, then they will be subjected to CB regulations because of the very nature of their operations. Note that they are not necessarily illegal in the sense that sanctions can be applied to them once they become known to authorities. Central Bank regulations and sanctions can be extended only to officially registered financial intermediaries with it.

Note that some of the formal financial intermediaries registered with the Central Bank are less regulated than others. Thus, they achieve a greater degree of flexibility almost similar to that of completely unregulated participants. These are represented by institutions like the pawnshops, lending investors, nonstock savings and loans associations (NSSLAs) and moneyshops. Because of their flexibility, they are included in our study of ICMs.

Viewed from a distance, it cannot be said that the financial system in the Philippines is dualistic. Instead, it can best be described as a continuum, with participants in the financial markets regulated at varying degrees.

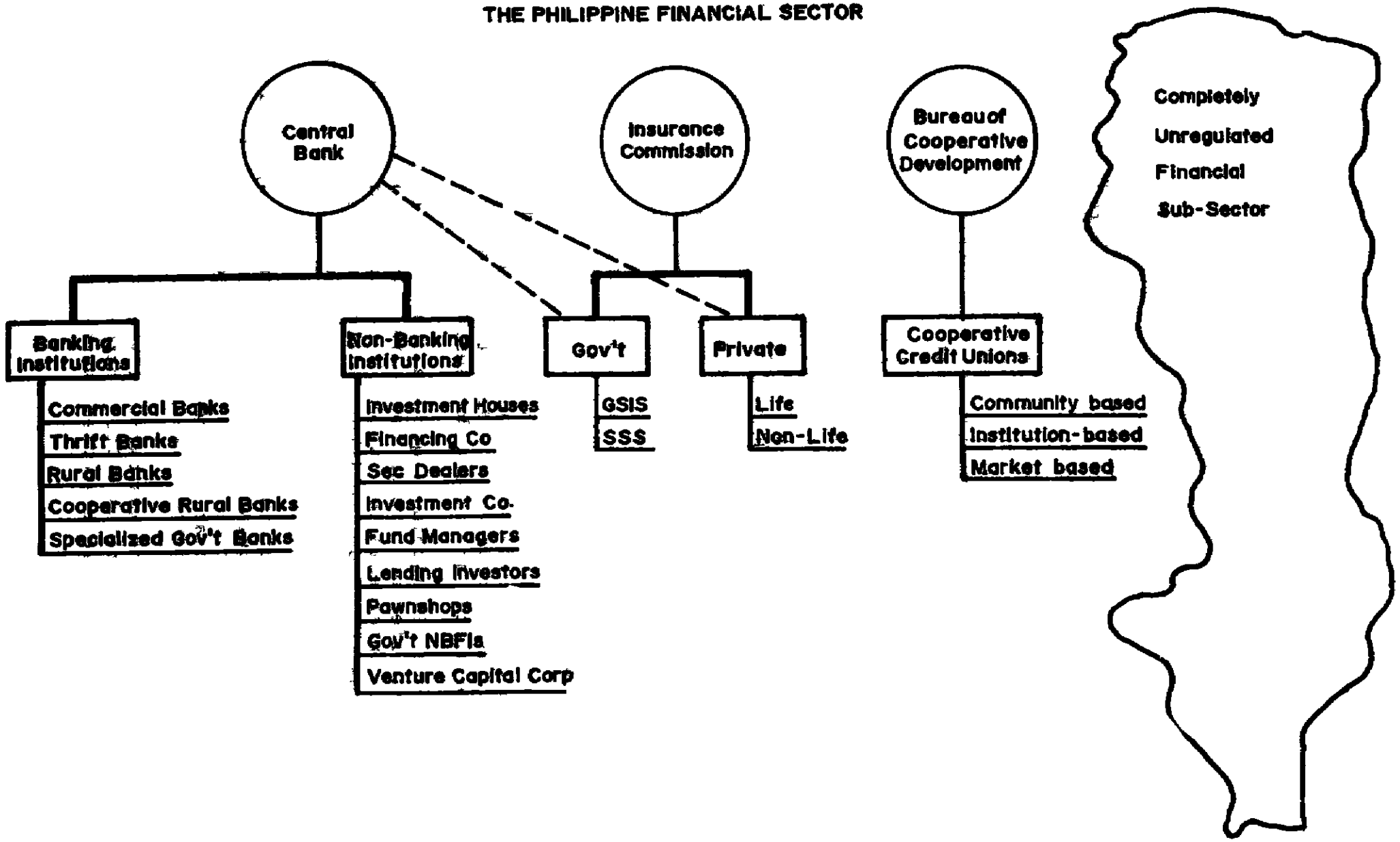
In the Philippines, quite a number of regulatory changes have been effected through the years. It is worth noting that financial intermediaries which once operated outside of CB regulations are now registered with and supervised by it. Examples of this are the so-called nonbank financial intermediaries (NBFIs).

A description of the Philippine financial system and a brief review of its regulatory environment can help clarify these issues. The financial system can best be described by grouping financial intermediaries under the regulatory agency(ies) directly supervising them (See Figure 1).

The Central Bank was explicitly given the mandate to oversee all banking institutions. Its control over banking institutions was meant to ensure the effectiveness of the monetary policy

FIGURE 1

THE PHILIPPINE FINANCIAL SECTOR



instruments. The usual regulations, such as minimum capital and reserve requirements, interest rate ceilings, etc., were applied to these institutions. As the economy grew, the financial system became more sophisticated. Thus, in the 1960s, several companies/entities registered with specific government agencies participated in the credit markets without being regulated by the Central Bank. New financial instruments, called deposit substitutes, started to emerge in the market. All these innovations arose as a response to the below equilibrium ceiling on interest rates (Lamberte 1988).

On the basis of the nature of their operations, the registered financial institutions may be grouped into three broad categories, namely: 1) institutions which regularly engage in the lending of funds obtained from the public in the form of deposits; 2) institutions which regularly engage in the lending of funds obtained from the public through the issuance of their own debt instruments other than deposits, such as acceptances, promissory notes, participations, etc.; and 3) institutions which regularly engage in the lending of funds but do not obtain funds from the public (either as deposits or their own debt instruments). The second and third groups are called non-bank financial intermediaries (NBFIs). Of the three groups, only the first was under the supervision of the Central Bank before 1972. The rest were not regulated by the Central Bank, although they were registered with other government agencies (e.g., Securities and Exchange Commission, Department of Trade and Industry), and as such could then be considered as segments of the ICMs.

The phenomenal growth of the NBFIs, specially in the 1960s, caused a major decline in the volume of total resources of the financial system subject to the direct control of the Central Bank. Funds shifted to the NBFIs because they paid interest rates much higher than the regulated rates. This threatened the effectiveness of monetary policy. The 1972 financial reforms tried to correct this weakness by putting all banking institutions and NBFIs under the control and supervision of the Central Bank. According to the Central Bank definition, NBFIs include:

> (a) A person or entity licensed and/or registered with any government regulatory body as a nonbank financial intermediary, such as an investment house, investment company, financing company, securities dealer/broker, lending investor, pawnshop, money broker, funds manager, cooperative, insurance company, nonstock savings and loan association, and building and loan association. (b) A person or entity which holds itself out as a nonbanking financial intermediary, such as by the use of a business name, which includes the term "financing," "finance," "investment," "lending" and/or word/phrase of similar import which connotes financial intermediation, or an entity which

advertises itself as a financial intermediary, and is engaged in a function where financial intermediation is implied.

In general, NBFIs are not allowed to borrow from the public. The term "public" refers to twenty or more creditors at any one time. However, NBFIs may obtain a license to have "quasi-banking" functions, in which case they are allowed to borrow from the public provided that deposits are not among the debt instruments they issue.

All the financial institutions which are under the supervision of the Central Bank belong to the formal credit markets. They are all subject to the minimum capital requirement, although this varies across different types of financial entities. For example, banks have higher capital requirements than non-banking institutions. Their debt instruments are subject to a specific reserve requirement ratio. Their borrowings and loan portfolio, particularly DOSRI accounts (i.e., loans to its directors, officers, stockholders, and related interests), are frequently monitored by the CB. Supervision includes not only the mere issuance of rules, but visitorial powers as well so that regulations can be fully implemented, and if violated, sanctions can be effectively imposed on violators.

It is then clear that in the Philippines finance companies, pawnshops, moneyshops, NSSLAs, and lending investors belong to the FCMs. However, they are less regulated than banks.

Pawnshops and lending investors (LIs) are the important ones in the small loans market. It requires only a minimum capital of ₱100,000 to set up one. Pawnshops have mushroomed all over, extending micro loans on the basis of pawns, usually pieces of jewelry and other articles of value, often for emergency needs of households and individuals. Pawnshops are required to set up shops wherein to conduct their business and to provide safety facilities for the safekeeping of the pawns.

Similarly, lending investors (LIs) provide relatively small loans, many on clean basis for business and consumption purposes to small firms, businesses, and wage employees. They are active in offices, public market places, and town centers where they extend loans to small businessmen under a daily collection scheme. In offices, they extend salary loans which are collected through payroll deduction or by a collector who makes the regular

rounds on paydays. They have very simple operations and employ two to five people.3/

As of end of 1987, the average resources of an LI were less than a million pesos (₱772,686), while the average loan volume was about ₱600,000. Majority (74%) of the 443 LIs which registered with the CB toward the end of 1987 are under single proprietorship; 25 percent are corporations, and one percent, partnership.

In a way, LIs are a crossbreed of sort. They operate like the nonstock savings and loan associations (NSSLAs), which is another type of nonbank financing institution, except that LIs can go to other offices to extend loans. Virtually unregulated, the only requirements imposed by the CB on lending investors are a minimum paid-in capital of ₱100,000, the submission of the quarterly financial statements and annual reports, and the biodata of officers. To register with the CB, only the submission of the organizational papers is necessary, while only a municipal license is needed in the case of single proprietorship. The CB merely acknowledges receipt of requirements. LIs are not audited by the CB, either. However, being registered, LIs enjoy the protection of the law of the land, unlike informal moneylenders.

NSSLAs are like credit unions. They are allowed by law to accept deposits from and grant loans limited to members only. However, they follow the corporate law in the sense that those who have more shares will have greater say in the running of the corporation, whereas credit unions follow the "one man, one vote" principle.

Insurance companies, both government and public, have never been under the supervision of the Central Bank. The Insurance Commission, which is an independent body, is empowered to regulate insurance companies. It is to be noted that insurance companies also engage in direct lending, although it is still limited to their own members. Their funds come mainly from the sale of insurance policies, not from the issuance of debt instruments similar to those issued by the NBFIs. However, insurance companies are required to submit financial statistics to the Central Bank. The purpose is to ascertain the effects of their operations on the monetary, credit, and exchange situation of the country, and not to supervise them. Since this allows the

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3/ An officer of the CB-Department of Financial Intermediaries relayed the observation to this author that a number of informal money lenders have registered with the CB as lending investors. They may have been encouraged to do so by the liberalization of the financial policy on interest rates.

Central Bank to maintain its control over total liquidity of the system, insurance companies may be considered part of the FCMs.4/

Another group of financial institutions are the cooperative credit unions (CCUs). They are registered with the Bureau of Cooperative Development (BCOD), now known as the Bureau of Agricultural Cooperatives Development (BACOD). Some of the CCUs are registered with the Securities and Exchange Commission (SEC). CCUs operate like mutual savings and loans associations, raising deposits from their members to lend to their own members. Except banks under the Rural Banking Act, CCUs are not under the supervision of the Central Bank. Neither are they required to submit reports to the CB. The BACOD is empowered to regulate CCUs. However, its functions are minimal and do not include a monitoring of the loan portfolio or the imposition of reserve requirements and intermediation taxes. Thus, CCUs operate virtually free of any regulations imposed by the Central Bank on the financial intermediaries under its jurisdiction. Also, CCUs are not monitored by the Central Bank. As a result, they have greater flexibility compared to financial intermediaries operating under Central Bank rules. In view of the foregoing, CCUs can be considered as a segment of the ICMs.

Aside from CCUs, many other institutions and individuals perform financial intermediation functions. Some of them raise deposits for on-lending; many use their own funds. Still, others use external aid funds or funds from the government treasury for on-lending purposes. To the extent that they are not subject to CB regulations, they are considered segments of the ICM. These intermediaries include the "paluwagan" (Philippine version of a ROSCA), trader/miller-lenders, farmer-lenders, manufacturer-lenders, service supplier-lenders, and professional moneylenders.

It is also to be noted that some governmental entities, private voluntary organizations (PVOs), and non-governmental organizations (NGOs) perform on-lending functions. Spawned by the environment in the 1970s and 1980s, these entities have had to implement essentially ad hoc lending programs as components of their organizational objectives and implementation programs (Agabin 1988, Lava, et al. 1988).

Examples of government agencies whose lending activities do not pass through the banks are: the Office of Workers Welfare Administration (OWWA), which administers the Welfare Fund collections from departing overseas workers; the National Electrification Administration (NEA), which provides loans to

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4/ Insurance firms are now becoming active writing debt contracts to non-members. For example, SSS recently approved loans of ₱1.0 billion each to two (2) firms.

electric cooperatives; the Southern Philippines Development Authority (SPDA), which provides credit, technical, and marketing assistance to poultry contract growers in the Mindanao regions; the Department of Agrarian Reform (DAR), which implements a direct loan assistance to settlers; the Department of Social Welfare and Development (DSWD), which provides urban and rural poor with credit and extension services; the Quedan Guarantee Fund Board (QGFB), which directly lends government funds to grains wholesale traders and millers for on-lending to farmers; and the Technology Livelihood Resource Center (TLRC), which handles a credit program called the Urban Livelihood Financing Program to support micro/small enterprises belonging to the low-income sector.

Figure 2 depicts the broad structure of the informal credit markets in the Philippines in terms of the intermediation functions they perform, sourcing of funds, and linkage with the other markets.

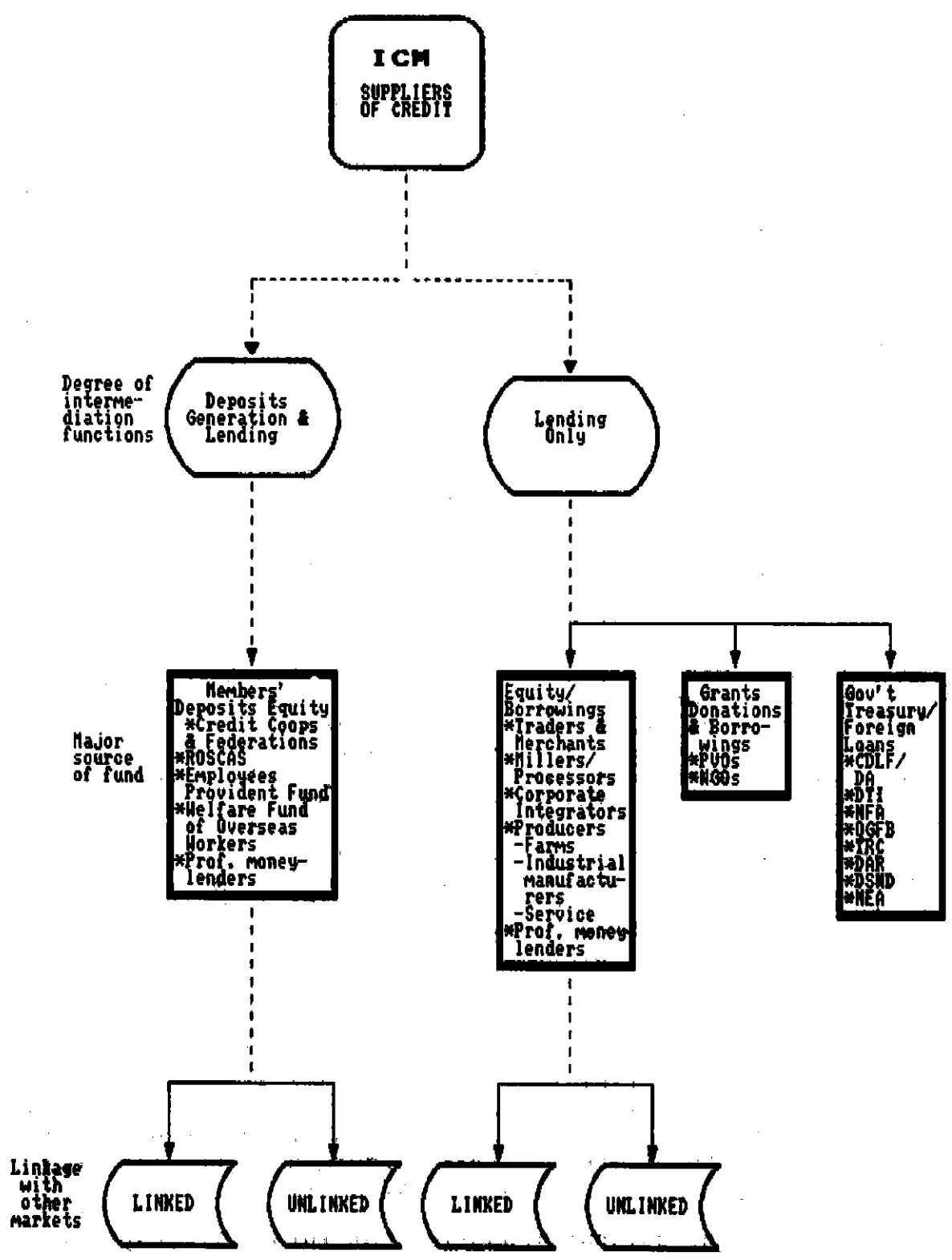
Most informal lenders have only a small circle of clientele and volume of loans; they operate in a circumscribed area, or in a specific niche of the market where personal knowledge of borrowers is possible. A large proportion of the loans they provide are reported being used for productive purposes. Small lenders rely mostly on their own savings while some raise funds from deposits. These points will be elaborated further in later sections.

It can, however, be said that the ICM structure basically reflects the extended family system and social structure. Kinship, friendship, and other personal ties underpin a large portion of informal loans: 30.0 to 60.0 percent of the amount of informal farm indebtedness (Agabin 1988); up to 78.0 percent in the small enterprise business sector (ISSI 1985); and up to 66.0 percent of borrowers in the underground micro business enterprises (Gatchalian, et al. 1986). Family and social ties also partly explain why around 25.0 percent of the informal loans are non-interest bearing. Sometimes, the loans take the form of long-term equity, or become part of the coping or survival mechanism of the social system. Homogeneity and other common ties also characterize the system of credit cooperatives, the "paluwagan" (ROSCAS), and other informally organized savings and lending clubs.

It can be surmised from the above that not all suppliers of informal loans are operating for profit or doing financial intermediation on a regular basis. Pieces of evidence suggest that up to one-fourth of the informal lenders are non-commercial lenders (Lava, et al. 1988, Mangahas 1989, TBAC 1981).

By locale, the dominant suppliers of informal loans vary according to the important economic activities in the area. For instance, richer farmers who may have the ability to integrate

Figure 2. **ICM STRUCTURAL CONFIGURATION**



other economic activities with farming are now a major source of credit in palay farming areas where landlords used to be one of the primary sources. In coconut-based areas, vegetable traders are important in vegetable producing communities. In urban areas and in the manufacturing sector, trade credits appear big. Lamberte and Jose (1988) found trade credits from input suppliers, wholesalers, and footwear manufacturers to be a large portion of financing in the footwear industry of Marikina.

The foregoing pieces of information serve to underscore a number of things. First, ICMs underpin the credit requirements of a large part of the economy. Second, the ICM structure has been dynamic and has responded to the impulses of change in the economic, credit, and social environments.

B. Policy and Legal Environment

The Philippine financial policy environment has been greatly altered in the past two decades. The change has been generally from a policy regime that tended to repress the development of the financial system to one that promotes a market-oriented financial development. In 1980, a set of financial reforms was introduced, including the removal of interest rate ceilings and the reduction of differentiation among types of financial institutions to encourage more competition in the financial markets. Toward the later part of 1985, the Central Bank started to align the rediscounting rate with the market rate. Similarly, about half of the special credit programs were phased out. In agriculture, funds for such special lending programs have been consolidated mostly for loan guarantee facilities to encourage banks to use their own funds for lending to farmers.

Restrictive regulations still remain, however. The existing regulations on branching and credit portfolio allocations are examples of such. Moreover, intermediation taxes are still imposed in the form of 5.0 percent gross receipts tax on loans that drive a wedge between deposit and lending rates.

Past monetary and credit policies partly reflected the biases against informal lenders and practices in the ICMs. These biases were enshrined in a number of legislations. The most prominent example is the Anti-Usury Law of 1916, now repealed by virtue of legislations issued in 1973 and early 1980s. Specialized financing institutions were also established to address the problem of lack of access to credit especially among the rural and agricultural populace.

Hence, at least over the past three decades, the authorities followed a supply-leading approach. Highly specialized financial institutions under government control were created. Special credit programs with below market rates and liberal loan guarantees were utilized to increase the flow of credit to the countryside and other priority sectors. All financial

institutions were also required to allocate 25.0 percent of their loanable funds generated for lending to agricultural borrowers in general, and to agrarian reform beneficiaries in particular.

The kind of monetary and credit policies between the 1970 and 1986 is well reflected in the movements of real rediscounts and advances from the Central Bank and loans from the formal financial system. Monetary policy was generally expansionary from 1974 to 1981, with peaks in 1975 and 1978. This was the era of liberal access to the rediscounting window of the Central Bank when rediscount funds could be obtained for as low as 1.0 to 3.0 percent. This was also a period when foreign borrowings became a significant source of loanable funds, and when special credit programs for sectors considered as priority also proliferated.

Monetary policy became highly contractionary in 1984 and 1985 as the country underwent the worst economic crisis in the post-war era. The financial crisis resulted in the closure of some banks and non-bank financial institutions. The problems with the country's balance of payments and budget deficits had been pestering the economy. Inflation rates soared to 50.4 percent in 1984, declined to 23.0 percent the following year, and became very minimal in 1986. In real terms, loans from the banking system was shrinking from 1984 up to 1986. But positive growth began to be reflected in 1987, when the economy experienced an upturn following two years of negative growth.

The surveys and case studies of informal suppliers of credit disclose that a substantial proportion of them became lenders only eitner during or after the crisis period (Lava, et al. 1988; Mangahas 1989). Moreover, within the formal financial structure, the segment which is least regulated expanded rather rapidly during the period when the rest of the system seemed to have receded. Among the institutions in this segment are the pawnshops (Lamberte 1988), credit unions (Lamberte 1988), and lending investors (Agabin 1988).

C. Size and Trends in Size of the ICMs

Nationwide Estimate of Size

The size of the ICMs is first estimated from the demand side at the level of the household. Two measurements are used, namely, the amount of borrowings and the proportion of the borrowing population who are informal credit users. This is done nationwide, by urban and rural dimension, and by economic status. We used the data from the nationwide surveys of the Social Weather Stations - Ateneo de Manila University in October 1986 and October 1987. Proper weights were applied to get the population values.

Having done the above, estimates of size from the supply side are then presented. Indicative figures are derived from studies undertaken under this ADB-sponsored research project.

The data from either the demand and supply side indicate the extent of lending activities taking place in the informal credit markets.

The total household borrowings in one year is estimated to reach ₱45.0 billion in 1987. Informal loans amount to ₱26.5 billion or 59.0 percent of the total (Table 1). This informal loan amount is equivalent to ₱8.8 billion loans outstanding.5/ Close to 10 million adults or 35.0 percent of the voting age adults borrowed in 1987. Of the borrowers, informal users comprised 66.0 percent (Table 2). A big portion of the borrowers obtained small loans only in the range of ₱1,000 to ₱12,500 (formal - 83.0 percent; informal - 93.0 percent). Formal loans averaged ₱5,225; informal borrowings averaged ₱4,040.

The average loan size in the informal sector obtained in the nationwide survey appears to be high compared to those obtained by micro studies. For example, Lamberte (1986) found that the average size of loans granted by pawnshops in 1986 was ₱418, while Lamberte and Bunda (1988) showed that most loans granted by moneylenders in 1987 were less than ₱2,000. It is possible that the nationwide survey has captured both the large and small segments of the informal credit markets, whereas the micro studies have limited themselves only to the small segments. The community studied by Lamberte and Bunda is one of the most economically depressed areas in the country. By its very nature the pawnshop market is basically small. However, in the case of credit union members in Metro Manila, Lamberte and Balbosa (1988) found that the average loan size in 1987 was ₱21,760.

Relative to the total claims by the banking system on the private sector, the proportion of informal indebtedness by the households is only 9.0 percent. It is to be noted, however, that corporate accounts make up around 70.0 percent of the loans from commercial banks. Commercial bank loans comprise the bulk of total credit from banks. To make our data comparable, we exclude the corporate accounts portion since our data on informal loans are largely made up of small loans to individuals. The result shows that the proportion of informal loans to private individual loan portfolio of the banking system is 23.0 percent.

5/ Derived by using turnover rate of three (3). Most ICM loans mature in four (4) to five (5) months. (See ACES 1988, Mangahas 1989, Lava, et al. 1988, Geron 1988).

Table 1: AMOUNT OF BORROWINGS & PERCENT DISTRIBUTION BY SOURCE, PHILIPPINES, METRO MANILA, URBAN & RURAL, 1987 Survey
(Amount in Million Pesos)

	ALL PHILIPPINES		METRO MANILA		BALANCE URBAN		RURAL	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Formal	15,265	34.0	2,932	42.0	6,551	52.0	5,758	23.0
Informal	26,500	59.0	4,011	57.5	4,745	38.0	17,726	70.0
Mixed	3,175	7.0	34	0.5	1,249	10.0	1,882	7.0
TOTAL	44,940	100.0	6,977	100.0	12,545	100.0	25,366	100.0
% Share		100.0		16.0		28.0		56.0

Source of basic data: SWS-Ateneo University. Public Opinion Report Survey Data, October, 1987.

Table 2: DISTRIBUTION OF BORROWERS IN METRO MANILA, URBAN AND RURAL PHILIPPINES, BY SOURCE OF CREDIT, 1986 & 1987
(in Percent)

	All Phils.		Metro Manila		Urban		Rural	
	1986	1987	1986	1987	1986	1987	1986	1987
I. Borrowers as % of total population in locale	32.0	35.0	33.0	36.0	31.0	33.0	33.0	36.0
Formal	10.0	10.0	11.0	13.0	10.0	16.0	10.0	7.0
Informal	21.0	23.0	20.0	22.0	20.0	15.0	22.0	27.0
Mixed	1.0	2.0	2.0	1.0	1.0	2.0	1.0	2.0
II. Percent distribution of borrowers in locale								
Formal	32.0	28.0	34.0	36.0	34.0	48.0	31.0	20.0
Informal	65.0	66.0	61.0	62.0	62.0	45.0	67.0	74.0
Mixed	3.0	6.0	5.0	2.0	4.0	7.0	2.0	6.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: SWS-Ateneo University. Public Opinion Report Surveys, October 1986 and October 1987.

Note: In the 1987 survey, "borrowers" are identified as those having borrowed at least P/1,000 in the past 12 months. In the 1986 survey, there is no minimum amount specified.

Note, however, that the banking system's individual loan portfolio includes accounts which are very large relative to the size of loans in the ICMs. The estimates were therefore refined further based on the distribution of bank loans by sectoral activities. The "small" private individual loans from the banking system are estimated to be about 60.0 percent of the claims on private individuals, largely on account of the rural banks, specialized government banks, and the state-owned Philippine National Bank.6/ These amount to some ₱17.5 billion loans outstanding in 1986. With this, the ratio of ICM loans to "small" formal loans is 50.4 percent. "Small" is roughly defined here as loans of ₱25,000 and below (Table 3).

In relation to the loans made by selected segments of the banking system, the total value of informal loans (flow data) is eight (8) times the loans granted by the rural banking system in 1987. In terms of loans outstanding the ratio of ICM loans to rural bank loans is 127.0 percent in 1987. There are roughly 20 ICM borrowers to one rural bank borrower.

The comparison of informal loans obtained by households can be rendered more meaningful if we relate their magnitude to the loans from the borderline institutions in the formal credit markets (FCMs) - the lending investors, pawnshops, and NSSLAs. By the end of 1987, the combined loans outstanding of these institutions totaled ₱3.03 billion. The amount of informal loans converted to stock data, is three (3) times this total.

Size of Rural and Urban ICMs

The 1986 and 1987 SWS survey data on the incidence and size of borrowings by locale and economic status confirm the assertion that the informal credit markets play a particularly important role in channeling credit to small borrowers in the urban and rural areas.

The sizes of rural and urban household indebtedness are shown in Table 4. The total rural ICM loans in 1987 is twice the size of urban ICM loans, with ₱17.7 billion and ₱8.8 billion in loans taken, respectively.

By urban and rural dimension, the ratio of borrowers to population differs only slightly (36.0 percent in Metro Manila, 33.0 percent other urban areas, and 36.0 percent in rural areas). However, the 1987 data suggest greater accessibility to formal sources in urban areas outside of Metro Manila. The urban informal borrowing ratio is four (4) out of 10 borrowers. In

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6/ Rural banks are small unit countryside banks which are widely spread in the Philippine rural areas.

Table 3: RATIO OF INFORMAL LOANS TO LOANS TO PRIVATE SECTOR AND INDIVIDUALS BY THE BANKING SYSTEM AND BY SELECTED NBFIs
(Amount in Billion Pesos)

	AMOUNT
A. Loans & Advances of Deposit Money Banks to Private Businesses or Individuals in 1986 a/	97.1
Less: Corporate Accounts (70%)	69.4
B. Equals: Loans & Advances to Individuals	29.1
C. Informal Loans to Households	
C.1. Loans Taken	26.5
C.2. Loans Outstanding (LO) Equivalent of C.1 (turnover rate: 3)	8.8
D. Ratio of Informal LO to Banks' Total Outstanding Loans & Advances to Private Sector (A)	9.0%
E. Ratio of Informal LO to Banks' Loans to Individuals (B)	30.0%
F. Ratio of Informal Loans (C.2) to Banks' "Small" Loans to Individuals b/	50.4%
G. Ratio of Informal Loans to	
1986: Loans Outstanding of RBs (P6.5 billion)	123.0%
1987: Loans Outstanding of RBs (P6.9 billion)	126.0%
H. Ratio of Informal Loans (C.2) to LO of	
1986: Pawnshops + LIs + NSSLAs (1.923 billion) c/	456.0%
1987: Pawnshops + LIs + NSSLAs (3.032 billion)	290.0%

a/ End of 1986 data; 1987 disaggregated data not yet available.
b/ "Small" loans defined as loans ₱25,000 & below. Loans above ₱12,000 comprise 43.0% of total loans taken by households from formal sources. For purposes of our computation & using institutional data, we have assumed that 60% of banks' loans to individuals are "small" (₱29.1 billion x .60 = ₱17.46 billion). This assumption may be on the high side.
c/ Pawnshops, ₱ 0.74 billion; LIs, ₱ 0.19 billion; NSSLAs, ₱ 0.993 billion (end of 1986).

Sources of basic data:
Central Bank (CB). Annual Report, 1986.
Central Bank (CB). Fact Book, 1987.
SWS-Ateneo University. Public Opinion Reports Survey Data, October 1987.

Table 4: AMOUNT & DISTRIBUTION OF LOANS BY SOURCE OF CREDIT, URBAN & RURAL PHILIPPINES, October 1987 Survey
(Amount in Billion Pesos)

	ALL PHILIPPINES		URBAN a/		RURAL	
	Amount	Percent	Amount	Percent	Amount	Percent
Formal	15.2	34.0	9.5	48.0	5.8	23.0
Informal	26.5	59.0	8.8	45.0	17.7	70.0
Mixed	3.2	7.0	1.3	7.0	1.9	7.0
TOTAL	44.9	100.0	19.6	100.0	25.4	2377.0
% Share		100.0		44.0		56.0

a/ Including Metro Manila.

Source of basic data: SWS-Ateneo University. Public Opinion Report Survey Data, October, 1987.

both Metro Manila and the rural areas, the ratio is six (6) informal borrowers out of 10 borrowers. The data for Metro Manila may appear surprising at first glance since Metro Manila has the highest density of financial institutions to population and it is where over 80.0 percent of total institutional loans are booked. As we noted earlier, however, the bulk of the formal loans are corporate accounts, which when excluded substantially reduce the bank claims on private individuals.

From 1986 to 1987, there was an increase in borrowing activities, but the portion of formal borrowings declined. The source of the reduction in 1987 came from the rural areas where borrowers from formal sources decreased substantially, while informal borrowers increased significantly.

Rural Informal Credit Markets. In the rural areas, ICM loans comprise 70.0 percent of the total amount of borrowings reported by rural households. In relation to the agricultural loans granted by the banking system, the ratio of informal loans to bank loans is high at 64.0 percent. In terms of stock data, the ratio of ICM loans to agricultural loans, excluding corporate loans, is 46.5 percent (See Table 5).

Micro level studies of rural villages have found even higher proportions of household indebtedness from informal lenders as evidenced in Table 6. On the supply side, there is a high density ratio of rural ICM lenders to population. The 1987 survey of six Nueva Ecija barangays (barrio or village) for this study found a total of 300 informal lenders operating in the six barangays anytime during 1972 to 1987. Some 210 were classified as active lenders, implying an average of 35 lenders per village of about 100 to 150 households (ACES 1988). Most of these lenders operate in one (1) to four (4) villages; some in as much as 10 villages. On the average, they lend to some 20 to 37 clients. Most come from towns within the province of Nueva Ecija, which is one of the major rice granaries in Luzon. But a few of the informal lenders come from other provinces like Bulacan, Pampanga, and Isabela. All these provinces are located in Luzon, with Isabela which is in the northernmost region in Luzon being the farthest from Nueva Ecija. It would appear that the lending activities of those coming from other provinces are linked to the trading of agricultural products.

It is interesting that this historical study of village credit underscores the autonomous nature of the indigenous system of informal lending. The borrowing pattern by rural households in terms of credit sourcing was only momentarily disrupted during the initial years of the implementation of the biggest credit program for rice (Masagana 99) and vegetable producers (Gulayan sa Kalusugan or GSK). This observation is affirmed by data on the participation of 46 informal lender respondents operating in these villages. It was found that the implementation of the government lending programs hardly affected

Table 5: THE SIZE OF ICM AS RATIO TO FORMAL BANK LOANS, RURAL AND URBAN AREAS, 1987
(Amount in Billion Pesos)

	AMOUNT
I. RURAL ICM IN RELATION TO FORMAL BANK LOANS, 1987	
A. 1987 Loans Outstanding (LO) to Agric. by Banks	: 23.0
B. Net of Corporate Loans (44% Corp. Loans)	: 12.9
C. Rural ICM Borrowings 1987	
C.1. Granted	: 17.7
C.2. Outstanding Equivalent a/	: 6.0
D. Ratio of ICM to FCM	
D.1. Ratio to A	: 26.1
D.2. Ratio to B	: 46.5
E. Ratio ICM Loans Taken to Loans Granted in Agric. by Banks	: 64.0%
II. URBAN ICM IN RELATION TO FORMAL BANK LOANS, 1987	
A. 1987 LO to selected sectors	: 59.1
B. Net of corporate accounts (63% corp.)	: 21.6
C. Urban ICM	
C.1. Loans taken	: 8.8
C.2. Loans outstanding equivalent a/	: 2.9
D. Ratio of urban ICM to Formal Bank: 2.9/21.6	: 14.0%

a/ Assumes turnover of 3 in a year; with 4 months average length of maturity but actually could be longer.

Source of basic data:

Central Bank of the Philippines (CBP). Annual Report, 1987.
Central Bank of the Philippines (CBP). Statistical Bulletin, 1986 & 1985.
SWS-Ateneo University. Public Opinion Reports Survey Data, October 1987.

Table 6: SUMMARY OF STUDIES INDICATING EXTENT OF BORROWING FROM FORMAL AND INFORMAL SOURCES a/
(In % of Total Number of Loans or Borrowers)

Period Covered	Author/Year of Publication or Release	Number of Loans/ Borrower-Respondents	Credit Source (%) Formal	Informal	(%) Mixed
1954-55	de Guzman (1957)	2,411 loans	12.0	88.0	
1957-58	Gapud (1958)	256 loans	10.0	90.0	
1957-58	Sacay (1961)	916 loans	13.0	87.0	
1960-61	BCS (1963)	1,679,000 loans	7.8	92.2	
1967-70	Mangahas (1975)	151 borrowers	11.9	88.1	
1970-71	Mangahas (1975)	297 borrowers	20.9	79.1	
1969-70	Almario (1970)	138 loans	37.7	62.3	
1969-70	Balagot (1974)	134 borrowers	21.6	78.4	
1973	DA (1974)	620 loans	51.3	48.7	
1973-74	PCARR-BAEcon (1974)	3,304 loans	92.2 b/	7.8	
1974	Cigaral (1977)	421 borrowers	94.0	6.0	
1975-76	DA				
	Iloilo (Feb. 1977)	341 loans	82.7	17.3	
	Ilocos (Jan. 1977)	703 loans	67.6	32.4	
	Zamboanga (Apr. 1977)	551 loans	74.6	25.4	
1976	DA (1976)	268 farmers	17.2	82.8	
1977	UPBRF (1977)	1,079 loans	36.9	63.1	
1977	DA (1977)	485 farmers	5.2	94.8	
1977	TBAC (1978)	656 borrowers	25.8	74.2	
1977-78	Laopao & Latorre (1979)	41 fishermen	29.3	70.7	
1978	DA (1978)	338 farmers	3.8	96.2	
1978	TBAC (1981)	2,110 loans	17.4	82.6	
1979	Manalo (1979)	203 cattle raisers	54.7	45.3	
1979-80	NIA-SGV (1980)	299 farmers	20.0	80.0	
1980	Capistrano (1982)	41 village households	2.1 c/	97.9 c/	
1981-82	TBAC (1986)	871,600 loans	40.2	59.8	
		626,300 farmers	34.0	58.7	7.3
1983-84	Floro (1986)	111 farm households d/	.9	99.1	
		448 loans	8.0	92.0	

(Continued next page)

Period Covered	Author/Year of Publication or Release	Number of Loans/ Borrower-Respondents	Credit Source (%) Formal	Informal	Mixed (%)
1984	UP ISSI (1985)	146 small and medium scale entrepreneurs	60.3	28.8	11.0
1985	NEDA (1987)	381,400 e/	20.7	79.3	
1986	Ateneo-Social Weather Stations	9.583 M persons of voting age	32.1	64.9	3.0
1987	-do-	10.322 M persons of voting age	28.4	65.7	5.9
1987	Geron (1988)	1,790 farmer-borrowers	3.0	97.0	

a/ Data comparability is limited by differences in sampling.
b/ Samples were drawn from list of borrowers of banks which explains the high percentage of loans from the formal sector.
c/ Out of 48 responses. Some borrowers had more than one source of credit.
d/ The respondents were all borrowers.
e/ Borrowers-respondents availed of credit anytime from 1975 to 1985.
M = million

Sources:

1. Adapted from: Sacay, Agabin, & Tanchoco. Small Farmer Credit Dilemma, 1985.
2. Ateneo-SWS. Oct. 1986 & Oct. 1987 Survey data.
3. Capistrano, Ana Doris N. "Study of A Village Economy: The Case of Villarica, Pantabangan, Nueva Ecija." M.S. thesis, U.P. at Los Banos, 1982.
4. Floro, Sagrario L. "Credit Relations and Market Interlinkage in Philippine Agriculture." Unpublished Ph.D. dissertation, Stanford University, 1986.
5. Geron, Ma. Piedad. "Philippine Informal Rural Credit Markets: Efficiency and Equity Issues." Paper presented at the Workshop on Policy Considerations for Structural Changes and Development in the Agricultural Sector, sponsored by the Agricultural Policy Research
6. Laopao, Manuel and Latorre, Estrella. Small-Scale Fishing in Leyte Province: A Socio-Economic Survey. Economics Research Report, BAEcon, Series No. 8, October 1979.
7. Manalo, Leonardo. "Credit Program for Cattle Raisers in Cagayan Valley." Unpublished Ph.D. dissertation, Centro Escolar University, 1979.
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9. UP ISSI. "Financial Factors and Small and Medium Industries in the Philippines." 1985.
10. TBAC. A Study on the Informal Rural Financial Markets in Three Selected Provinces of the Philippines. Manila, 1981.

their participation in the ICM. Some 14 lenders were already in the market prior to 1966. Seven (7) lenders entered the market during 1966-1970 after the fertilizer-responsive varieties of rice were introduced to farmers. Another seven (7) became lenders within 1971-1975, during which time the M-99 and GSK programs of formal credit for rice and vegetable farmers began to be implemented and reached peak lending volume. One-third or 16 of the 46 respondent informal lenders became lenders within 1976-1985. By 1987, at the time of the interview, only four (4) of the lender-respondents have stopped lending for reasons of bankruptcy, decision to invest in other business, or to simply get out of the credit business. By 1987, government's lending program had already become very minimal due to repayment difficulties and changes in policy direction.

Data for 30 of the 46 lender-informants showed total operating capital of ₱1.43 million by 1987 (August), for an average of ₱47,667 per lender in nominal terms. The average volume of loans made in 1987 was ₱82,023 nominally. This is 3.5 times the level in 1972, 2.5 times that of 1975, and close to twice the level in 1980 (See Table 7). The high inflation rates, however, reduced the volume of informal loans in the 1980s to levels lower than those in 1972 or 1973. For example, the real values of the 1984 and 1985 average volume per lender were only a third of the 1973 value. The nominal and real values increased significantly though by 1986.

It is worthwhile to note that the decline in the volume of lending per lender in real terms coincided with the increase in the number of borrower per lender over the same period. It means that lenders are lending out lesser amount in real terms to a greater number of borrowers. This deserves some comments. Agricultural loans granted by the formal banking sector in real terms expanded and reached a peak of ₱9 billion in 1983. It went down in the subsequent years as a result of the crisis. By 1987, the agricultural loans granted by the banking system amounted to only ₱3.7 billion in real terms. Note that special credit programs for agriculture proliferated up until 1983. What this suggests is that the expansion of formal agricultural credit in real terms during the period could have led to the decline in the volume and size of loans in real terms of informal moneylenders in these areas. The simultaneous drop in the agricultural loans granted by the formal banking system and the loan size of informal moneylenders in real terms after 1983 was mainly caused by the economic crisis.

Past nationwide surveys give a broader indicative picture of the trend in the participation of the ICMs in the rural economy. This is shown in Table 8. Most of the surveys prior to 1986 focused on farm households using cross-section data. The proportion of borrowers and informal loans were very high in the 1950s and 1960s when formal financial institutions were not yet as widely spread as today. A 1982 survey of farm indebtedness

Table 7: TOTAL AND AVERAGE VOLUME OF LOANS GRANTED BY INFORMAL MONEYLENDERS DURING YEAR 1972-1987 (Total n=46), Nominal and Real Values (in ₱)

Year	Number of Lenders a/	Total Loans		Average Volume	
		Nominal	Real c/	Nominal	Real c/
1972	26	597090	597090.0	22965	22965.0
1973	25	759775	643247.5	30391	25729.9
1974	27	762804	493001.2	28252	18259.3
1975	28	901180	537725.1	32185	19204.5
1976	27	1127115	615923.0	41745	22812.0
1977	29	1226903	624303.1	42307	21527.7
1978	31	1407493	655778.3	45403	21154.1
1979	32	1455776	588621.4	45493	18394.4
1980	35	1513645	529460.0	43247	15127.4
1981	35	1446830	456128.8	41338	13032.3
1982	35	1643950	478033.8	46970	13658.1
1983	34	1474249	383870.3	43360	11290.2
1984	35	1774150	309898.1	50690	8854.2
1985	37	1805045	267985.6	48785	7242.9
1986	36	2889144	421667.6	80254	11713.0
1987	26	2132598	299981.4	82023	11537.7

a/ Number of respondents out of total 46 who reported active during the year.
b/ Up to August.
c/ Deflated by the GNP deflator.

Source: ACES Foundation, Inc. "The Informal Credit Market of Six Selected Barangays in Nueva Ecija 1972-1987." August 1987. (Table III-58).

Table 8: TRENDS IN BORROWING AT THE HOUSEHOLD LEVEL, AGRICULTURAL/RURAL SECTOR, VARIOUS YEARS, VARIOUS NATIONWIDE SURVEYS
(in Percent)

	Borrowing a/	No. Borrowers	Loan Amt.	No. of Informal b/ Loans	SOURCE
I. AGRICULTURAL					
1954-1955	75	74	-	88	de Guzman [1975]
1960-1961	45	88	55	92	BCS [1963]
1981-1982	29	59	37	60	TBAC [1986]
II. RURAL					
1986	32	65	-	-	SWS-Ateneo Survey [1986]
1987	35	66	59	-	-do- [Oct.,1987]

a/ Base: Population
b/ Base: Borrowers

Sources: See list of sources in Table 6.

showed a decline in the early 1980s. However, the share of informal borrowings went upward again in 1986 and in 1987.

According to SWS survey data, rural ICM borrowers increased significantly from 1986 to 1987. In 1987, informal loans comprised 70.0 percent of all loans taken by rural households. It is to be noted that during the previous years (i.e., 1984-1986), the country suffered serious economic and financial difficulties compounded by a grave political crisis. The formal financial system became very unstable, and contractionary credit policies were adopted by the monetary authorities. Thus, by 1987 the full effects of the financial crisis of the previous years, changes in monetary and credit policies, and serious default problems facilitated the collapse of about half of the number of rural banks and immobilized two state-owned banks which had an important role in agricultural credit. Rural banks supplied about half of all formal loans taken by the small farming households in cropyear 1981-82 (TBAC 1986). Government banks were also reported in the TBAC study as the source of about half of the small farm loans during the same year.

The changes in rural borrowings reflect the structural dynamism in the informal credit markets. One finds the diminished role of landlord credit and the increasingly significant role being played exercised by farmer-lenders/farmer-trader-lenders, along with trader-lenders in the informal markets. Majority (68.0%) of the lenders in the study villages of Nueva Ecija reported farming as one of their major sources of income. In a separate survey, Geron (1988) also reported a majority of farmer-lenders in rice and coconut-based villages she studied in 1987. Many of them link credit with trading, thus, becoming part of the network of bigger traders in a town.

The nationwide agrarian reform program for rice and corn lands substantially reduced the incidence of landlord credit in the rural areas. The changes in rice production technologies in the rice sector beginning the second half of the 1960s created more demand for loans and an expanded role for lenders participating in the product markets. Although input suppliers also became an important source of credit in the 1970s, this seemed to have been influenced by the existence of government farm lending programs as evidenced by data from the rural village credit history (ACES 1988). The Masagana 99 credit, which financed the input portion of paddy production, created a lively farm input trading industry during the 1970s. The inputs funded with program loans were given in the form of fertilizers and pesticides through a chit system or a purchase order which the borrower presented to the input dealer; the dealer in turn collected payment from the bank. The incidence of loans in the form of fertilizer and pesticides was more than a third of loans obtained by the farmers during 1973-1978; this declined to only 12.0 to 15.0 percent in the succeeding years (ACES 1988). Geron also found very little input supplier credit to farmers.

The credit programs implemented by the government in the 1960s and 1970s to support food production sufficiency goals temporarily reduced the proportion of ICM borrowers. After these credit programs receded, richer farmers who have combined farming with trading seemed to have filled in the gap left by the withdrawal of landlord and government credit in the market (Agabin 1988). It is probable that the development of more infrastructure facilities such as rural roads, better transport, and irrigation has opened up opportunities for some farmers to participate in the other markets and with it, lending.

Urban Informal Credit Markets. The SWS survey data indicate the share of informal loans to be 45.0 percent of the total amount of loans obtained by urban households in 1987. The 1987 level of informal indebtedness of ₱8.8 billion incurred by families in Metro Manila and other urban locations translate to some ₱3.3 billion loans outstanding.

The disaggregated data for Metro Manila and balance of urban areas give an interesting pattern (See Tables 2 and 4). At least for 1987, the rest of the urban areas outside of Metro Manila seemed to have enjoyed better access to formal credit facilities than either Metro Manila and rural Philippines. This improvement coincided with some positive increase in real loans granted by the formal system in 1987 after three previous years of negative growth. Data on investments of households from the same nationwide surveys also indicate more rapid growth in investment in the urban areas than elsewhere during 1987. This trend in the urban ICM from 1986 to 1987 contrasts with that of the rural ICMs.

To get the ratio of urban ICM loans (Metro Manila included) to formal loans reported by banking institutions to the Central Bank, selected types of loans from the banking system were taken together to represent comparable urban formal credit data. These loans include those classified in the Central Bank Statistical Bulletin as trade, commercial, consumption, manufacturing, and a portion of loans lumped under "others." With certain adjustments in the 1987 CB data, the loans amounted to ₱59.0 billion. After deducting corporate loans (63.0%), the estimate of bank loans outstanding to private individuals and small enterprises in the urban sector comes to ₱21.6 billion. Given this, the proportion of urban ICM loans to formal urban bank loans outstanding is 14.0 percent. This may be an underestimate, however.

Data on the urban ICM from the supply side suggest a more significant size and role of informal lenders in providing credit to individuals, households, and small enterprises. Four (4) types of informal urban lenders were the subjects of case studies by Lamberte and other researchers for this project. These are the "paluwagan," professional moneylenders, cooperative credit unions, and trade creditors.

In the urban community of Sapang Palay where no formal financial institution operates, 20 active professional moneylenders, and 20 "paluwagan" units were found operating. Virtually all stallholders in the public market are members of a "paluwagan." Also, 20 other professional moneylenders actively lend in the community, and the density ratio comes to 860 households per moneylender. The case study of "paluwagan" units found that the 10 units were able to raise resources estimated to reach ₱7.2 million in 1987, on a cumulative basis. This shows the capacity of "paluwagan" in mobilizing deposits among the population with no access to formal financial services. The size of the "paluwagan" must be large even in areas where formal financial institutions operate. For example, it was found that 18.0 percent of the sample members of institution- and market-based credit unions are also members of a "paluwagan" and contributed an average amount of ₱19,096 between January to September 1987.

Cooperative Credit Unions (CCUs) are increasingly becoming popular in urban credit markets, particulary in offices and in public market places. They are also found in rural locations where not even a rural bank exists. They have demonstrated their potential for growth and for servicing small borrowers especially during the financial crisis period of recent years. The CCUs grew very rapidly then to service members' demand for loans for their small businesses and household needs. The counterpart of the CCUs in the formal sector, the nonstock savings and loan associations (NSSLAs), also showed phenomenal growth in resources and loans during the crisis period. Data indicate that the CCUs are very important as an alternative mechanism to provide financial services to people of limited means.

Unfortunately, there is no reliable information about the size of the CCUs taken together. A study in 1987 stated that there were 1,469 active credit unions in 1980 with a total membership of 167,844 (USAID 1987). However, there is no up-to-date information about their combined assets as well as their sources and uses of funds. The case study of CCUs by Lamberte and Balbosa (1988) shows that the combined assets of 44 market-based credit cooperatives, which are members of the National Market Vendors Cooperatives (NAMVESCO), and four institution-based credit unions amounted to ₱40.4 million in real terms or ₱278.7 million in nominal terms as of 1986. These are roughly 28.0 percent of the combined assets of all pawnshops in the country that same year. Thus, it can be surmised that the total size of the CCUs as a system is at least as large as that of the pawnshops. What is to be noted is that its absolute size is growing faster than those of pawnshops and the banking system. The figures also suggest that the relative sizes of the unregulated financial intermediaries, namely the CCUs, and one of the least regulated financial institutions, i.e., the pawnshops, expanded during the crisis period in contrast to the highly regulated financial institutions (i.e., banking system).

The data on trade credits from the flow of funds table prepared by the Central Bank show that the total availments of trade credit by the manufacturing sector in 1986 amounted to ₱22.Ø billion in nominal terms. Both the absolute and relative sizes of trade credits have been increasing since 1979 and reached a peak in 1983, a year before the full effect of the balance of payments crisis was felt. When banks continued to reduce their lending activities in 1985 and 1986, the period of severe economic instability, the manufacturing sector increased its reliance on trade credit.

The figures on trade credits presented in Table 9 could have been grossly underestimated since the flow of funds table made use only of data from corporations belonging to the top 1,ØØØ. In the footwear industry in Marikina where none of the firms belong to the top 1ØØØ corporations, trade credits comprise 82.Ø percent of the value of the sales of the sample footwear manufacturers and 8Ø.Ø percent of the value of their material inputs.

Informal Credit in the Urban Areas. Supplementary survey data for 1987 made available by the SWS data bank for this study reveal the borrowing pattern of enterprises in tne informal sector of three (3) municipalities in Metro Manila (Caloocan City, Pasig, and Taguig). Surveyed were some 45Ø respondents out of 2141 census listing of enterprises with less than 1Ø workers. They were engaged in crafts manufacturing, vending/selling, repair services, personal services, professional services, construction, and transportation. Among enterprises which obtained loans, informal borrowings dominate. About 2Ø.Ø percent of the respondents borrowed for their initial capital. While 94.Ø percent of the borrowers sourced their loans from relatives and friends, about 18.Ø percent obtained loans from professional moneylenders. Only 12.Ø percent borrowed from banks. Merely 3.Ø percent were able to obtain loans from a government lending program. It is to be noted that the government has been implementing a number of lending programs for small firms and cottage industries, such as the Urban Livelihood Financing Program of the Technology Livelihood Resource Center (TLRC), "Balikatan sa Kabuhayan" Program jointly implemented by the TLRC, Bagong Kilusang Kabuhayan at Kaunlaran (BKKK), and Land Bank of the Philippines (LBP), the Livelihood and Enterprise Development program being administered by the national secretariat of the BKKK, and the different credit projects under the state-owned Livelihood Corporation which are addressed to specific disadvantaged sectors, such as women, transport cooperatives, and itinerant vendors.

Availment of trade credit for raw materials purchases were reported by 21.3 percent of the respondents for relatively short-term arrangements extending to 19Ø days or after disposal of the manufactured products. On the other hand, 25.Ø percent of the respondents were giving credit for goods and services delivered

Table 9: TYPES OF CREDIT IN THE MANUFACTURING SECTOR, 1979-1986
(In Million Pesos)

Year	Loans	Trade Credits	Total
1979	112,836.2 (89.3)	13,540.5 (10.7)	126,376.7 (100.0)
1980	115,553.1 (84.7)	20,894.1 (15.3)	136,447.2 (100.0)
1981	129,477.2 (86.7)	19,916.3 (13.3)	146,393.5 (100.0)
1982	140,146.7 (83.8)	27,079.0 (16.2)	167,225.7 (100.0)
1983	155,369.0 (83.0)	31,878.8 (17.0)	187,247.8 (100.0)
1984	119,154.0 (88.2)	15,891.0 (11.8)	135,045.0 (100.0)
1985	77,091.6 (73.5)	27,753.9 (26.5)	104,845.5 (100.0)
1986	79,718.4 (78.1)	22,376.0 (21.9)	102,094.4 (100.0)

Source: Lamberte, Mario B. and Jose, Anita A. "The Manufacturing Sector and the Informal Credit Markets: The Case of Trade Credits in the Footwear Industry." PIDS Working Paper Series No. 88-07, May 1988. (Table VI.1).

for a term of one (1) day to 60 days. It can be surmised from the foregoing that the informal urban economy, much like the rural economy, is largely a self-financing sector. The segment with external finance is largely dependent on informal credit. Much of the informal credit is, however, in the nature of "extended family equity" in the enterprises. Lending programs implemented by the government through the formal financial system hardly reached the small and micro enterprises.

ICMs and the Overseas Employment Sector. Focusing on the overseas employment sector, the 1987 survey by Mangahas (1989) found a significant participation of the ICMs in the provision of credit to overseas workers. The credit market in this sector is almost totally informal, half of which is non-commercial from the extended family system.

In nominal terms, the total placement expenses incurred by newly hired overseas contract workers from 1980 to 1987 is estimated at ₱14.4 billion. For 1987 alone, total placement expenses amounted to ₱2.9 billion, of which ₱1.72 billion or 59.3 percent were financed by ICM sources. The rest (₱1.2 billion) were self-financed or employer sponsored with no obligation to repay (Abrera-Mangahas 1989).

The role of formal credit is very marginal. Credit from government lending, mainly from a government social insurance agency, is also peripheral comprising only 1.9 percent of all funding transactions in overseas employment. At present the lone government credit program for overseas workers comes from the Welfare Fund (Welfund), which is supervised by the Overseas Workers Welfare Administration (OWWA) of the Department of Labor. The Welfund totaling more than ₱750 million, has been generated since 1981 from the required assessment of US$25 to US$50 from every departing contract worker. Among several programs and projects is a lending program for needy workers and their families. The credit program, funded at ₱15.0 million, is designed as assistance for pre-departure expenses, family assistance while the worker is abroad, and an educational skills upgrading course for seamen. Loans from Welfund are processed and released directly to borrowers by the OWWA. However, SWS survey results show no awareness of the programs.

About 60.0 percent of all first-hire contracts reported by 336 respondents were financed by loans to pay for the recruitment costs for processing, placement fees, other charges, and personal expenses.7/ This is a relatively high proportion --- compared

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7/ Total initial or first-hire contracts is 396. This includes first-hire contracts of respondents leaving for the first time in 1987 (referred to as "new hires"), and first-hire contracts of re-exiting worker-respondents whose initial work contracts were negotiated within 1980-1985 ("early hires").

to the rest of the sectors we have already covered. An important reason for the need of financing is the rising cost of overseas placement which has risen from ₱2,020 in 1980 to ₱9,831 in 1987. Job prices rose sharply in 1982 and peaked in 1985 at its highest level of (₱13,002).

Aside from the traditional family/friends and private individual moneylenders, the overseas employment sector developed its own specialized segment of the informal credit markets, with foreign employers and recruitment agents being the credit sources of about one-fourth of the borrowers. These sources provide advances to the overseas contract workers, subject to salary deductions (Tables 10 and 11). This form of tied credit (tied to employment contract) was used in the past mainly for travel expenses of workers bound for the United States and Europe. But following the rapid rise in recruitment costs, foreign employers and recruitment agents entered the informal credit markets more significantly starting 1981-82. The simultaneous rise in the placement costs and tightening of the credit market prompted employers and agents in the Middle East and Southeast Asia to provide interim financing for both placement and travel expenses so that departures for overseas job sites would not be disrupted. Employers and agents also found that combining credit arrangements with overseas work contract is less costly than replacing workers who are unable to find finance for their overseas jobs. This avoids more lengthy processing time and at the same time helps maintain their reliability as labor suppliers.

Size of the ICM by Economic Status

By income status, the incidence of informal borrowings is highest among the low income population, thus, confirming the important role of the ICMs in channeling credit to small and poor borrowers. In a survey of families belonging to the bottom 30.0 percent, some 13.3 percent of the 25.9 million low income population were borrowers anytime from 1975 to 1985 (NEDA 1986); 70.0 percent were getting their loans from the ICMs.

This high incidence of informal credit among borrowers of limited means is also reflected in the 1987 SWS data. Five economic classifications can be distinguished from the SWS surveys (AB - rich; C - middle class; D - poor; E - poorest). Across classification, the ratio of borrowers to population in the class is quite similar (Table 12). However, more of the poorest borrowers are ICM clientele (1986 - 75.0 percent; 1987 - 77.0 percent). The borrowings of the D and E households are about 2.5 times the combined indebtedness of the rich and the middle class households indicating in part the more serious cash flow problems and credit requirements for meeting household and production expenses among the poor and the poorest. In Table 13, the data by economic classification is shown in terms of the

Table 10: SWS SURVEY OF OVERSEAS WORKERS:
SOURCES OF FINANCING
(in Percent)

	Early Hires 1980-1985	New Hires 1987
Types of Fund Sources		
I. Employer Sponsorship	24.1	9.8
II. Self-Finances		
1. Personal Savings	32.9	48.4
2. Sale of Assets	1.2	3.2
Sub-Total	34.1	51.6
III. Borrowings and Advances from:		
1. Family (without interest)	42.8	41.2
2. Family (with interest)	10.3	14.3
3. Professional moneylenders	7.0	8.5
4. Gov't Financial Institution	2.5	2.6
5. Pawnshop		0.7
6. Credit from employer (advances)	4.1	13.7
7. Agent (advances)	2.0	5.2
8. Airlines (advances)	2.0	
Sub-Total for Borrowings and Advances	70.8	84.3

Source: Mangahas, M. A. "Response to New Market Opportunities: The Case of Overseas Employment Sector." Social Weather Stations, Inc., August 1989.

Table 11: SIZE ESTIMATE OF THE CREDIT MARKET FOR OVERSEAS EMPLOYMENT, 1987

Loan Source	% of Trans-actions	No. of Trans-actions	Average Size (₱)	Fund Volume (₱M)	% of Total Volume
Formal					
Gov't lending	3.0	8,242	1,700	14.0	0.8
Pawnshop	0.8	2,060	2,500	5.1	0.3
Credit agency	0.8	2,060	4,000	8.2	0.5
Sub-Total	4.6			27.3	1.6
Informal					
Family Loans (interest-free)	47.3	129,806	6,775	879.4	50.2
Family Loans (interest-bearing)	16.5	45,330	4,310	195.4	11.2
Professional Moneylenders	9.8	26,785	6,588	176.4	10.1
Employers (credit advances)	15.8	43,269	9,107	394.0	22.5
Agents (credit advances)	6.0	16,483	4,708	77.6	4.4
Sub-Total	95.4			1.72 B	98.4
TOTAL	100.0			1.75 B	100.0

Source: Mangahas, Ma. Alcestis A. "Response to New Market Opportunities: The Case of Overseas Employment Sector." Social Weather Stations, Inc., August 1989.

Table 12: AMOUNT BORROWED AND PERCENT DISTRIBUTION, BY ECONOMIC CLASS & SOURCE OF LOAN, October 1987 Survey
(Amount in Billion Pesos)

Source	AB		C		D		E		TOTAL	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Formal	1.06	43.0	7.09	66.0	4.67	22.0	2.43	23.0	15.25	34.0
Informal	1.38	57.0	3.52	32.0	14.74	70.0	6.85	65.0	26.49	59.0
Mixed	0.00	0.0	0.19	2.0	1.77	8.0	1.21	12.0	3.17	7.0
TOTAL	2.44	100.0	10.80	100.0	21.18	100.0	10.49	100.0	44.91	100.0
% Distb'n.		6.0		24.0		47.0		23.0		

Source of Basic Data: SWS-Ateneo University. Public Opinion Report Survey Data, October 1987.

Table 13: PERCENT DISTRIBUTION OF BORROWERS AND AMOUNT OF BORROWINGS BY SOURCE OF CREDIT, BY SELF-RATING OF WEALTH STATUS, October 1987 Survey

	NOT POOR		ON LINE		POOR	
	Amount	Percent	Amount	Percent	Amount	Percent
I. Percent to Population a/						
Did Not Borrow		63.0		58.0		67.0
Borrowed		32.0		40.0		31.0
Formal		14.0		14.0		6.0
Informal		17.0		25.0		22.0
Mixed		1.0		1.0		3.0
II. Percent to Borrowers						
Formal		44.0		36.0		18.0
Informal		54.0		62.0		72.0
Mixed		2.0		2.0		10.0
III. Amount & Distribution of Borrowing (amount in ₱billion)						
Formal	2.54	46.0	9.25	40.0	3.40	21.0
Informal	2.76	50.0	13.20	58.0	10.53	64.0
Mixed	0.19	4.0	0.53	2.0	2.44	15.0
TOTAL	5.49	100.0	22.98	100.0	16.37	100.0

a/ Balance of 100 accounted for by "Don't know's" and "no response."

Source: SWS-Ateneo University. Public Opinion Report Survey Data, Oct. 1987.

poverty self-rating by respondents, which further confirm the pattern of borrowings from and dependence on ICMs in Table 12.

The results are quite significant, particularly with regard to policies on credit subsidies and those that tend to constrict the supply of loans in the system. In the past decades, outright subsidies on loans to target groups and priority sectors had been liberally provided as part of the government's credit policies. While such policies may have been defensible from the point of view of encouraging activities in areas designated as government priority areas, the benefits of the subsidies were received by those who were better off. From the perspective of income equity, the poor and the poorest did not benefit because they essentially did not have access to the subsidized funds through the financial institutions. The subsidies may have even contributed to the widening in the income gap. Policy measures that attempt at providing credit subsidies even for the low income group should therefore be avoided. To them, what is more important is improved access to alternative sources of financial services. This can be promoted through more liberal branching policies, positive support to the development of credit cooperatives and informal grassroots savings and lending clubs. Fiscal policies that would improve the infrastructure support in the countryside will also enhance profitable economic activities for increasing wealth.

The other implications have to do with policies that affect the supply of loans in the system. Measures such as the former Anti-Usury law, fixing maximum spreads between the cost of funds and lending rates of banks, and making informal lending unlawful will tend to reduce the supply and/or make the act of lending more risky and, hence, increase the cost of credit to the borrowers. Since the majority of the borrowing population, especially the low income households, get their loans from the ICM, any of the above measures will hurt rather than help them.

III. SAVINGS, CONSUMPTION CREDIT, ALLOCATION EFFICIENCY, EQUITY, INTERACTION WITH FORMAL SECTORS AND IMPLICATIONS FOR MONETARY POLICY AND DEPOSITOR SECURITY

A. Role of ICMs in Savings Mobilization

In general, there is a strikingly high degree of reliance by informal lenders on their own savings and earnings from employment and business for on-lending. Nonetheless, certain segments of the ICMs exhibit their effectiveness and potential in mobilizing small deposits among low-income earners.

The savings mobilization role varies according to the segments of the ICMs. Professional moneylenders do not mobilize deposits, as a rule. An exception to this rule was, however, found in Sapang Palay where one moneylender plays the role of an indigenous banker. She accepts time deposits for as low as ₱100 and pays an interest of 80.0 percent per annum. This is an opportunity not provided by banks whose minimum time deposit is ₱5,000, an amount much higher than what low-income earners can afford. As of the date of interview, this moneylender had 51 depositors with combined deposits amounting to ₱40,200, comprising about 70.0 percent of her loanable funds. This demonstrates the capability of moneylenders to mobilize deposits. What seems to be important is that they can fashion out a savings instrument that is attractive and affordable to low-income groups.

Deposit-taking function is performed by cooperative credit unions (CCUs), "paluwagan," and other unregistered savings and lending groups with homogeneous and small membership. These self-help groups demonstrate their importance as a means of mobilizing deposits among low-income earners. They perform a particularly significant role in providing services to those who do not have access to the credit facilities of the banking system. A "paluwagan" is a mutual self-help group wherein a group of persons turn in the same amount of money towards a common fund and then take turns in using the amount so collected. Usually managed by one person, deposits in a "paluwagan" do not earn interest, but they serve the purpose of providing each member of the group with larger funds when his turn to collect the "sahod" (kitty) comes. "Paluwagan" is a significant segment of the credit markets in a low income community, such as Sapang Palay, as earlier mentioned.

Savings mobilization by unregistered savings and credit groups are undertaken among their members through schemes that encourage members to make small but regular deposits with the club. These are self-regulated groups. They are a crossbreed of sort between the "paluwagan" and the CCU. Deposits raised by the savings groups are usually used for specific purposes and investments, including lending to members. Some 54 savings clubs of agrarian reform farmer-beneficiaries in five municipalities are reported in Agabin (1988); the author personally played a role in their formation as part of a participatory planning and management-oriented project being implemented by the Department of Agrarian Reform (DAR). Members of low-income households are encouraged to form their own group to promote savings, generate local resources for the members' use, and address the problem of lack of access to bank services. Regular deposit per member of these groups range from ₱2.00-₱30.00 per month. These amounts are below the minimum amount of savings deposit required by banks to open and maintain an account. For many of the members of the savings groups, putting such small deposits in the bank means incurring relatively high transaction costs.

One such savings group in the agrarian reform settlement area of Sto. Tomas, Davao del Norte in the southern part of the Philippines raised ₱275.00 deposits initially among 10 families only in May 1988. Minimum regular deposit is ₱10.00 per month per member. As of February 1989, membership had grown to 33 and total savings rose to ₱18,158. This means that each member has built an average deposit of ₱550.00. The funds are invested in a consumer store from which loans in kind at no interest are available to any member up to the amount of his deposit with the savings group. Cash loans have been made available to members recently at 5.0 percent per month, and to non-members at 10.0 percent per month. The market rate in the community is between 15.0 and 20.0 percent per month. The rate of interest on deposits is tied to the income from investments, a consumer store, which has proven very profitable. This group so far has been able to pay up to 20.0 percent monthly interest on deposits of members. Through the savings club, the group of non-wealthy individuals and households has been provided access to saving and loan services. Members have also been able to benefit from the high interest income on their deposits. Formation of the groups came about after the farmers and some of their wives attended a training seminar on how to form and implement their own saving and lending schemes.

Saving with CCUs, "paluwagan," and savings clubs entail very low transactions cost because they operate in a limited geographic setting, e.g., public markets, offices, or around the neighborhood, and cater to fairly homogeneous individuals, e.g., market vendors, employees, neighbors. The method of collecting deposits is inexpensive, like, hiring collectors in the case of market-based CCUs and payroll deduction in the case of institution-based CCUs. Regular meetings of the savings clubs are used as occasions for getting deposits of members. In contrast, the transactions cost for depositing in a bank is prohibitively high. Lamberte and Bunda (1988) found that a bank depositor living in Sapang Palay spends on the average ₱13.93 every time he deposits/withdraws money from a bank.

One attractive feature of these informal savings institutions is reciprocity. Members save with the expectation that they can borrow, and they tend to save more if they want to borrow more. These savings institutions facilitate saving-investment decisions of low-income earners. In particular, the existence of a variety of "paluwagan" units offers them opportunities to save and overcome the problem of indivisibilities in investment and consumption in accordance with their financial capacity. Among small savings clubs, the regularity required in making deposits instills the habit and discipline of thrift. Moreover, the pooling of small savings gives the groups the chance to participate in economic opportunities which individual resources cannot possibly permit.

Savings mobilized by CCUs and "paluwagan" are substantial (Table 14). As of the date of the interview, the average fixed deposit of the sample CCU members stood at ₱9,145. This is about 12 times greater than their average initial fixed deposits. Considering that tne respondents of the study have been members of their respective credit unions for an average of 8.7 years, it means that on the average each member has been increasing his fixed deposit by ₱967.00 per year. In Sapang Palay, "paluwagan" members received "sahod" or kitty averaging ₱26,080 from the "paluwagan" for the past two years. These are not insignificant amounts of savings mobilized by such institutions.

The existence of CCUs, "paluwagan," and other savings groups has brought about net addition to total financial savings. For instance, those who do not have deposits with a bank constitute about half of the sample CCU members and 72.0 percent of the sample "paluwagan" members. Among the bank depositors, only a handful of them were able to borrow from a bank (Tables 15 and 16).

In the case of the savings group cited earlier, no one has any deposit nor borrowings with a bank. The uninvested amount of savings mobilized from members is, however, deposited with a local rural bank which is the only financial institution in the area. This deposit represents additions to the savings mobilized by the formal system.

B. Consumption Credit

Loans classified as consumption credit in the Central Bank Statistical Bulletin comprise a very minor portion (6.0 %) of total loans granted by the formal financial system in a typical year. For the banking system, the proportion of consumption credit to total credit disbursement in 1986 was 3.6 percent. Consumption loans from the NBFIs are significant though at 74.0 percent of loans given in the same year. Taken together, however, the formal system plays a marginal role in the provision of consumption credit.

ICMs perform fairly efficient in the Philippines in meeting the consumption requirements of borrowers. In general, lenders in the ICMs do not restrict the use of loan proceeds. This is one of their attractive features.

Such consumption credit includes those obtained for expenses on food, education, medical, other personal and providential needs, house repairs, and so on. The significance of consumption loans varies according to the type of borrower, that is, based on the major source of income. Among rice-based farm households, for instance, borrowings for production use is high. In the rice farming sector, it is interesting to note that farmers borrow more for production now than they ever did before. During the

Table 14: SAVING BEHAVIOR OF CCU MEMBERS

	Fixed Deposits		Savings Deposit		Time Deposits	
	No.	Ave. Amt. (₱)	No.	Ave. Amt. (₱)	No.	Ave. Amt. (₱)
1. CCU	82*	9,144.25	46 (56.1)	13,301.60	-	-
2. Banks	-	-	45	38,584.10	12	32,287.54
3. Paluwagan	-	-	-	-	22	19,096.26

*Two respondents did not give the answer.

Note: Figures in parentheses are percent.

Source: Lamberte, Mario B. and Balbosa, Joven Z. "Informal Savings and Credit Institutions in the Urban Areas: The Case of Cooperative Credit Unions." PIDS Working Paper Series No. 88-06. (Table V.16).

Table 15: BORROWING BEHAVIOR OF CCU MEMBERS, January - September 1987

	Sources of Credit	(1) No. of Respondents	(2) Average Amount Borrowed (₱)	(3) Average Maturity days	(4) Average Interest (%)
1.	CCU	80	21,760.30	258.7	19.5 [1]
		(97.6)	(23,615.20)	(572.4)	(5.8)
2.	Banks	4	12,750.00	322.5	19.5
		(4.9)	(18,191.12)	(75.0)	(7.33)
3.	Professional Moneylenders	7	2,785.70	65.7	120.0
		(8.2)	(2,118.50)	(30.3)	(0.0)
4.	Friends/Neighbors/Relatives	14	10,607.14	95.0 [2]	6.0 [3]
		(17.0)	(10,388.93)	(60.0)	(-)
5.	Traders/Suppliers	26 [4]	51,613.46 [5]	53.5	29.3 [6]
		(51.0)	(121,792.49)	(19.3)	(4.2)
6.	Paluwagan	22	19,096.26		- -
		(26.8)	(41,486.10)		- -

[1] Effective interest rate which is the interest rate discounted in advance plus all charges.

[2] Refers to only 7 respondents. The other 7 respondents have loans without maturity.

[3] Refers to only one respondent. The other 13 respondents were not charged interest on their loans.

[4] Refers to only those wno are engaged in a business.

[5] Refers to an average amount borrowed per month.

[6] Price differential between goods bought in cash and on credit. This is based on the responses from 15 respondents.

Note: Figures in parentheses in column (1) are percent, while in columns (2) - (4) are standard deviations.

Source: Lamberte, M. B. and Balbosa, J. Z. " Informal Savings and Credit Institutions in the Urban Areas: The Case of Cooperative Credit Unions." PIDS Working Paper Series No. 88-06. (Table V.21).

Table 16: ALTERNATIVE SOURCES OF LOANS, MATURITY PERIOD AND INTEREST RATE

Source	Respondent		Average Maturity Period (Days)	Average Interest Rate (%/ annum)*	Average Amount Borrowed (₱)
	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

Source: Lamberte, M. B. and Bunda, M.T. "The Financial Markets in Low-Income Urban Communities: The Case of Sapang Palay." PIDS Working Paper Series No. 88-05. (Table V.11).

1950s, loans were obtained primarily for consumption. The availability of new farm production technology did affect the type of demand for credit (Sacay, Agabin, Tanchoco [1985]). The picture is different among coconut-based borrowers, fishing households, and landless agricultural workers, where consumption loans are more significant. Informal borrowings for operating capital are important among market vendors.

In the rural credit history study by ACES, farm production is reported to be the major reason for getting loans by 85.0 percent of the rice farmer-borrowers and 71.0 percent of the rice-onion farmer borrowers. Borrowings by the farmers rise during the months for planting, with the peak months in June and July, the main crop season for rice. Sub-peaks reflect the second season for rice and the planting season for onion. The seasonality of demand for loans by the farm households clearly reflect the counter cyclical pattern in the cash flows between farmers and traders. On the other hand, non-farm households borrow primarily for food consumption - 70.0 percent (ACES 1988). Twenty-one of the 38 non-farmer respondents reported farm work as their main source of income. The months when consumption loans seem acute also coincide with the planting months (June-July, August) as expenses for education and need for operating capital to do their farm jobs compete with their available cash balances for basic food requirements. The school year in the Philippines opens in June.

We do not have detailed data to provide analysis on how well the informal credit markets meet the requirements arising out of crop failures which would necessitate the evening out of consumption between crop years. The only indication we nave comes from the responses of the rural informal lenders studied by ACES. Some 29 of the 46 respondents reported increases in the number of borrowers anytime during the period 1972-87. When asked why, 13 of the 29 lenders cited typhoons and other natural calamities as the reasons. Judging from the purposes of borrowing, however, the additional loans could have been used for replanting the crop.

In coconut- and other crop-based areas, informal borrowing for consumption purposes alone is predominant. Geron (1988) found that 55.6 percent among coconut farmers, 43.0 percent among other crops farmers borrowed from ICMs for consumption purposes. Among fishermen, consumption was the reason for 34.4 percent of the borrowers but medical and education purposes were also high at 31.3 percent. Most of the loans were ₱1,000.00 or below and payable either "when able" and/or "upon harvests" (Table 17). These data accent the variations in the primary role being performed by various segments of the informal credit markets and their capacity for accommodating small consumptive and emergency loan requirements of rural households under very flexible lending terms.

Table 17: DISTRIBUTION OF SAMPLE FARMER BORROWERS, BY CROP GROWN/ECONOMIC ACTIVITY, BY PURPOSE OF LOAN, BY MATURITY PERIOD, EIGHT VILLAGES IN QUEZON, CAMARINES NORTE, AND NUEVA ECIJA PROVINCES, 1987 Survey

	Farming												Hired Labor		Fishing		Others	
	Palay		Coconut		Palay-Coconut		Other Crops											
	No.	%	No.	%	No.	%	No	%	No.	%	No.	%	No.	%	No.	%	No	%
Purpose of Loan																		
Production	212	49.0	17	11.1	65	51.2	5	35.7	4	4.0	4	12.5	-	-				
Consumption	66	15.2	85	55.6	41	32.3	6	42.9	67	67.7	11	34.4	4	40.0				
Trading	-	-	1	0.7	2	1.6	-	-	7	7.1	-	-	-	-				
Fiesta/Special Occasion	-	-	-	-	-	-	-	-	-	-	-	-	-	-				
Emergency (Medical/School expense)	29	6.7	9	5.9	4	3.1	-	-	11	11.1	10	31.3	5	50.0				
Production/ Consumption	126	29.1	41	26.8	15	11.8	3	21.4	10	10.1	7	21.9	1	10.0				
TOTAL	433	100.0	153	100.0	127	100.0	14	100.0	99	100.0	32	100.0	10	100.0				
Maturity Period																		
less than 1 month	4	0.9	4	2.6	4	3.1	1	7.1	4	4.0	3	9.4	-	-				
1-3 months	13	3.0	11	7.2	15	11.7	1	7.1		5.1	-	-	-	-				
4-6 months	274	63.3	4	2.6	22	17.2			30	30.3	-	-	5	50.0				
7-12 months	4	0.9	1	0.7	-	-	-	-	-	-	2	6.3	-					
1 to 2 years	-	-	1	0.7	-	-	-	-	1	1.0	1	3.1	-	-				
3 years & above	-	-	-	-	-	-	-	-	-	-	-		-	-				
payable when able	91	21.0	54	35.3	65	50.0	11	78.6	57	57.6	23	71.9	5	50.0				
payable upon harvest	46	10.6	78	51.0	22	17.2	1	7.1	2	2.0	3	9.4	-	-				
TOTAL	432	99.0	153	100.0	128	100.0	14	100.0	99	100.0	32	100.0	10	100.0				

Source: Geron, Ma. Piedad. "Philippine Informal Rural Credit Markets: Efficiency and Equity Issues." 1988. (Table 2).

Table 18 shows how borrowers allocated the loans obtained from CCUs and "paluwagan." The kinds of members of these savings and credit institutions determine to a large extent the uses of the loans. It should be noted that most members of the sample CCUs and "paluwagan" are market vendors. Thus, a great proportion of the loan proceeds was used for productive purposes. The relatively short maturity period of these loans prompted borrowers to use them for augmenting their working capital. It is to be noted, however, that a significant proportion of the loan proceeds was used for other purposes, such as family consumption, house repairs/improvement, acquisition of household appliances, education, etc. Productive consumption seems to be one of the important uses of loans.

C. The Efficiency Impact of ICMs

So far, it has been shown that (i) borrowers who participate in the ICMs compose the majority; (ii) the incidence of informal borrowings is highest among the poor; (iii) the ICMs have a large part in financing the credit obtained by small and micro enterprises especially in the informal sector; and (iv) that a large portion of the loans in ICMs is used for productive investments. It can also be argued here that loans for food and other consumption needs basic to keeping body and soul together are also in the nature of "productive" investments as they enable the borrower and members of his household to continue to do their income-earning jobs.

From the above, it is clear that the ICMs have been an important channel of financial services to individuals and enterprises which cannot be serviced by the formal credit markets. Hence, ICMs have helped address the problem of formal credit allocation imbalances. Such imbalances are engendered by the policies and preferences of the banking system as well as the high transaction costs inherent in small loans from banks.

To the extent that informal lenders have loans from the formal sources, these informal lenders have provided a network through which the financial resources of the formal system could be channeled to small borrowers.

By and large, segmentation seems to be more pronounced in the ICMs than in the formal credit markets. For instance, CCUs, "paluwagan," and small savings clubs tend to operate in areas where members are fairly homogeneous, like, all are market vendors in the same locality, employees of the same firm, or residents in the same neighborhood. Loans are given only to members. These are, however, features essential to the successful implementation and management of such saving and lending groups. Input suppliers do the same. They grant trade and cash credits only to manufacturers directly buying raw materials from them. Trader-lenders also tend to narrow their

Table 18: USES OF LOAN PROCEEDS, URBAN ICM
(In Percent)

Uses	CCU	Paluwagan
Business	60.0	49.2
Household appliances/furniture	5.8	3.2
House repairs/improvements	1.9	10.2
Family consumption	6.4	9.6
Payment of loans	3.7	12.3
Loans to others	1.7	2.4
Savings	0.9	7.8
Education	8.1	0.5
Medical care	2.5	-
House/lot acquisition	1.2	-
Application for overseas job	-	1.1
Jewelries	0.1	-
Others	7.7	3.8

Sources: Lamberte & Bunda, 1988. (Table V.8); Lamberte & Balbosa, 1988. (Table V.13).

lending to clients whose product is tied to the lender's participation in the product market. About 75.0 percent of the 125 informal lenders in Geron (1988) stated that they extend loans to assure the purchase of the farmers' outputs; some three-fourths (or 89) of the lenders are engaged in trading. Even moneylenders tend to narrow down their lending to "suki" or prime clients. Although this puts into question the allocative functions of the ICM, the narrow circle of clientele enhances operational efficiency, provides for better assessment of credit risks and collection, and lessens the cost associated with information gathering and administration costs.

D. The Equity Impact of ICMs

We have earlier shown that the incidence of borrowings by the population who are "not poor" or "on the line" is only slightly higher than the incidence of borrowings by those who rated themselves poor (see Table 13). In short, across income groups informal borrowing is significant, comprising half or more than half of total borrowings. But among those belonging to the poverty group, informal loans compose a much more substantial portion. Similarly, pieces of empirical evidence suggest that petty traders, artisans, small farmers, rural and urban overseas contract workers, service operators, market vendors, and other entrepreneurs in the informal sector rely greatly on informal sources for credit to augment their short term operating capital. Thus, the sectors not reached by banks are served by the ICMs. To many of them, the informal source is the only source available.

The issue on equity is usually associated with the price of informal loans, the usual notion being that it is extortionary. There is actually a wide variation in the interest rates on ICM loans. There are segments with very high rates of interests relative to the formal bank rates. The existence of high rates of interest reflect a situation of excess demand as well as imperfections not only in the credit markets but in the other markets as well. Where the incidence of very high rates fall on borrowers with more limited means, surplus extraction may be taking place. Unfortunately, data available to us do not permit us to analyze interest rates in this respect.

One segment which charges relatively lower rates is the credit cooperative sector where the financial intermediation functions are performed as a service to members. Nevertheless, certain internal policy practices of credit unions have some equity impact on members of the CCU. For instance, in Lamberte and Balbosa (1988), one credit union was found charging 25.2 percent per annum for loans up to ₱500.00 with a maturity period of five (5) months while it charges only 13.0 percent per annum for loans above ₱1,000.00 with a maturity period of 12 months. With the loan capacity formula credit unions are using, big

depositors can borrow several times larger than small depositors. This is aggravated by the fact that the effective interest rate is not adjusted according to risk.

Likewise, input suppliers tend to charge higher effective interest rate on trade credits to small footwear manufacturers than to big footwear manufacturers. Swaminathan (1982) found a parallel situation in farm credit in Nueva Ecija where the value of assets owned by the borrower affects the interest charged on farm loans in crop year 1980-81. Between the small farms and large ones the difference was 7.2 percentage points per month.

In another case, Abrera-Mangahas (1989) found that lenders with a large share (at least 75.0 percent) of overseas employment loans carry smaller-sized loans with lower interest rates and shorter maturity period. Being familiar with the overseas employment market, their subjective evaluation of risk is low, hence they also charge lower rates. In contrast, large lenders whose overseas employment loans are a minor portion of total lending offer larger loans with high interest rates, longer maturity period, and fewer installment payments. These are large lenders tapped by borrowers who want larger loan size. The larger loan size, longer maturity period and the unfamiliarity with the overseas employment market could be the reason why interest rate charged by these lenders are high compared to those lenders with a large share of overseas employment loans. A two-tiered pricing policy has been followed by two respondent-lenders since 1985: one lender charges five percent per month on loans below ₱5,000, and 10 percent on loans over ₱5,000; the other lender collects five percent per month on loans below ₱3,000 and 10 percent on loans above ₱3,000.

In her work with rural savings groups, Agabin observes that loans given to members usually carry rates lower than the prevailing commercial informal rates in their communities. For example, the savings group in Sto. Tomas, Davao cited earlier is charging a monthly rate that is 10.0 to 15.0 percentage points lower than the rates of other informal sources in the community.

The foregoing shows the wide mix of situations and practices in the ICMs that may or may not have impact on social equity.

E. Interaction with Formal Sectors

Whether the formal and informal sectors are substitutes or complementary to each other is an important issue that must be dealt with. Unfortunately, the nature of the data of the various studies do not permit us to construct a model to test such hypothesis. Only indicative results can therefore be presented from various studies.

One indicator of the substitutability of both sectors is that one expands at the expense of the other. In this regard we examine the behavior through time of borrowers and lenders in the six (6) rural villages studied by ACES and some segments of the urban ICMs. The credit history of the rural borrowers and lenders was traced by the researchers from 1972 to the time of interview in August 1987. Borrower-respondents are those who borrowed anytime within the period, while lender-respondents are those who actively provided loans also anytime between 1972 and 1987. In examining the data it should be recalled that the largest credit program offered for the rural areas with a low interest rate of 10.0 to 12.0 percent was started in 1973, peaked in 1974 and 1975 and thereafter continuously declined with rising default. Moreover, recall that the Philippines suffered the worst economic crisis during the period 1984-1986.

As may be seen in Table 19, the number of rural borrowers from the informal markets declined during 1973 and 1974, with many borrowers stating attraction to low interest rate as a motivation for borrowing from source. For instance, among rice farmers, 37 of the 77 who borrowed during 1974 obtained their loans from formal sources. Thereafter, formal borrowings declined substantially such that by 1986 only eight (8) of the 64 rice-farm household borrowers got their loans from the formal system.

On the other hand, the ACES historical data on ICM lenders show that the nominal value of loans granted by the informal lenders continue to rise except in 1974 when both nominal and real values declined (See Table 20). The government credit program appeared to be merely a temporary aberration to their lending activities. Indeed, only five of the 46 selected informal lenders stated that they ever experienced reduction in their lending activities due to the implementation of government credit programs in the rural areas. The lower real values obtained from 1979 onwards are on account of the double digit inflation rates. The effects of the crisis period are shown in the data to have eroded the real participation of ICMs in terms of the value of loans granted. Significant increases in capital and loan volume were, however, registered by 1986. None of the 46 lender- respondents reported having obtained any bank loan. Some 31 lenders reported farming as their major source of income, eight (8) were in palay/onion trading, and five (5) were professional moneylenders.

In Table 21, the real assets of both the sample CCUS and the banking system had been growing before 1984. However, during the crisis period, the real assets of the banking system had been shrinking while those of the sample CCUs had continued to increase. Pawnshops, which are one of the least regulated among the formal financial institutions, follow the same growth pattern as that of CCUs. The same can be said of trade credits. As shown in Table 9, both bank loans and trade credits grew in

Table 19. TOTAL NUMBER OF BORROWERS FROM FORMAL & INFORMAL SOURCES, RICE, RICE-ONION, AND NON-FARM HOUSEHOLDS, SIX NUEVA ECIJA VILLAGES, 1972-87

Year	Rice Households (n=80) Borrowers				R-Onion Households (n=44) Borrowers			Non-Farmer Households (n=38) Borrowers		
	Total	Formal	Informal	% Informal	Total	Formal	Informal	Total	Formal	Informal
1972	79	30	52	66.0	23	8	17	34	5	28
1973	79	35	45	57.0	37	32	6	32	6	26
1974	77	37	40	52.0	36	27	10	32	5	27
1975	75	33	47	63.0	38	19	19	32	4	27
1976	73	30	43	59.0	33	15	19	29	3	26
1977	76	26	50	66.0	32	8	27	32	4	28
1978	77	20	57	74.0	32	8	27	31	5	27
1979	75	15	60	80.0	32	5	29	28	2	26
1980	75	12	63	84.0	31	4	28	28	1	27
1981	73	11	62	85.0	34	3	32	27	3	25
1982	71	13	58	82.0	28	2	27	27	2	25
1983	63	10	54	86.0	31	2	30	26	1	25
1984	61	9	52	85.0	32	3	30	30	2	28
1985	58	7	51	88.0	31	5	28	29	0	29
1986	64	8	56	88.0	33	6	28	30	1	29
1987 a/	53	3	51	96.0	32	6	26	19 b/	0	18

a/ Borrowings up to time of interview in August 1987
b/ One no response

Source: ACES Foundation, Inc. "The Informal Credit Market of Six Selected Barangays in Nueva Ecija, 1972-87." August 1988. (Tables III-1, 22, 41).

Table 20: AVERAGE AMOUNT OF LOANS OBTAINED BY BORROWERS FROM FORMAL AND INFORMAL SOURCES, 1972-1987
(Nominal & Real, in Pesos)

	Rice Farmers (n=80)			Rice-Onion Farmers (n=44)			Non-Farmers (n=38)		
Year	Total No. Borrowers	Nominal	Real	Total No. Borrowers	Nominal	Real	Total No. Borrowers	Nominal	Real
1972	79	4832	4832	23	2791	2791	34	1306	1306
1973	79	3031	2433	37	2481	2004	32	1281	1035
1974	77	3680	2186	36	3276	1946	32	1328	789
1975	75	3797	2097	38	2928	1617	32	1102	608
1976	73	3902	2055	33	3002	1582	29	1319	695
1977	76	4343	2152	32	3923	1944	32	1105	548
1978	77	4659	2128	32	3414	1560	31	1177	538
1979	75	5121	2084	32	3958	1611	28	1205	490
1980	75	5540	2129	31	4386	1686	28	1092	420
1981	73	6872	2437	34	4297	1574	27	1865	661
1982	71	6640	2196	28	2224	1397	27	1463	484
1983	63	6408	1883	31	4763	1400	26	1402	412
1984	61	6578	1198	32	4200	765	30	1836	334
1985	58	5357	865	31	4004	647	29	1319	213
1986	64	6607	1098	33	3577	595	30	1080	180
1987	53	6021	952	32	3073	486	29	2060	326

Source: ACES Foundation, Inc. "The Informal Credit Market of Six Selected Barangays in Nueva Ecija, 1972-1987." August 1988. (Tables III-8, 27, & 46).

Table 21: COMPARATIVE PERFORMANCE OF SELECTED CREDIT UNIONS, PAWNSHOPS AND BANKING INSTITUTIONS, 1980-86

Year	Selected Credit Unions		Pawnshops		Banking System	
	Real Assets (PM)	Growth Rate (%)	Real Assets (PM)	Growth Rate (%)	Real Assets (PM)	Growth Rate (%)
1980	-	-	101.6	9.7	63,206.2	6.0
1981	-	-	105.9	4.2	67,343.8	6.6
1982	21.6	-	111.1	4.9	75,061.5	11.5
1983	25.1	16.2	114.1	2.7	82,801.7	10.3
1984	21.8	13.2	108.3	-5.0	65,587.1	-20.8
1985	25.5	17.0	119.3	10.1	55,810.0	-14.9
1986	40.4	58.4	146.6	22.9	41,160.0	-26.2

Sources: Table 2 (Lamberte [1988]); NAMVESCO Annual Reports (various years); and Financial Statements of a sample of Cooperative Credit Unions.

absolute terms before 1984. During the economic crisis, both types of credit dropped sharply. However, trade credits recovered fast and even increased their size relative to bank loans, implying that the manufacturing sector increased its dependence on trade credits when bank loans became more scarce.

Viewed from the macro perspective, results seem to suggest that during normal times, both the formal and informal are complementary, while during abnormal times, both become substitutes to each other. This general observation should, however, be qualified by taking into consideration the survey results. As already pointed out, financial markets in LDCs are severely fragmented. One cannot easily move from one market to the other. Thus, for low-income individuals who do not have access to bank credit, the question of substitutability between formal and informal credit markets is irrelevant. As can be gathered from survey results, only a handful had access to bank credit. However, among segments of the ICMs, some element of substitutability seems to exist. For instance, CCUS and "paluwagan" were organized partly to free members from money lenders. Thus, only very few CCU and "paluwagan" members borrowed from moneylenders. In Sapang Palay, Lamberte and Bunda (1988) found one moneylender who organized two "paluwagan" units; but even this moneylender does not lend to the members of her "paluwagan." Also, the availability of trade credits has somewhat reduced the demand for cash credit from moneylenders.

The strength of linkage between the formal and informal sectors seems to vary with the segment of the ICMs. On the supply of funds side, bankers report cases of bank loans to traders and poultry integrators which are used to finance advances to farmers. In the poultry industry the advances are in the form of biologics, feeds, and chicks to contract growers (Agabin 1988). The contract growers are usually entrepreneurs/ farmers who have the means to put up the fixed capital for poultry housing and the operating capital for labor and maintenance during the growing period.

Similarly, Geron (1988) reports that 76 of the 125 rural informal lenders she investigated borrow from banks to augment their operating capital requirements for their businesses, which are mostly trading. Unfortunately, the data available to us do not give a breakdown of the sources and uses of funds of the informal lenders. An earlier study of rural ICMs in 1978 decomposed the sources and uses of funds of 163 lenders (TBAC 1981). This study found that while a high proportion (88.4 percent) of their total funds came from own savings and earnings, around 9.0 percent of the amount were borrowed from banks. Some 10.0 percent of the total funds were on-lent; 87.0 percent were used for business expenses, e.g., purchases of merchandise, inputs, and produce.

Weak linkage between formal and informal sector is, however, observed in the operation of CCUs, "paluwagan," and individual lenders. Only four (4) of the 27 informal lenders investigated by Lava (1988), borrow from banks for on-lending. All of the 12 informal sources lending to overseas workers in Mangahas (1989) have no bank borrowings. None of the urban moneylenders interviewed in Sapang Palay ever borrowed from a bank to finance their lending operations. This is also the case with the 46 lenders operating in six (6) rural villages of Nueva Ecija. The reliance on internal resources limits the size and scope of their lending operations.

Similarly, not one of the sample CCUs ever borrowed from a bank. From Central Bank data, bank loans to cooperatives sector in general do not even reach one-third of 1.0 percent. In 1986, the loans outstanding to the cooperative sector by commercial banks amounted to ₱187.6 million out of the total loans outstanding of ₱90.2 billion at the end of the year. Banks, however, serve as depository of CCU funds. In 1986, deposit with banks of sample CCUs comprised 6.0 percent of their total assets. As net depositors with the formal financial system, CCUs, in effect, serve as feeder network for the banks in savings mobilization. Through the funds transfer mechanism, banks are able to search for more profitable investment areas for deposits generated. Branches of commercial banks in the rural areas evidently transmit funds to the head office in Manila or other urban centers in search of higher yielding investment areas. In such a situation, CCU funds, which are raised at low transaction cost become accessible to a wider number of borrowers with relatively high productive need for funds.

It is ironic, however, that the CCUs do not seem to enjoy reciprocity from the banks. Segments of the CCUs do suffer from lack of funds. A number of regional and national federation of credit cooperatives and other types of cooperatives have started their own interlending mechanism. This is essentially a fund transfer mechanism through which excess funds of member cooperatives may be mobilized to answer the liquidity needs of other member cooperatives. This development marks a change in the level of segmentation within the credit cooperative sector, at least on the supply of funds side.

Input suppliers in the footwear industry also have very limited contact with banks as sources of additional funds. Only two of the nine sample input suppliers borrowed money from the bank in 1987. One of them obtained a long-term loan to finance the acquisition of fixed assets while the other secured a short-term loan to augment his working capital. Only the latter seems to be able to link the formal credit market with the informal credit market. The reason why the majority did not borrow from bank is that they have access to trade credits. In fact, all of the sample input suppliers availed of trade credits from manufacturers of raw materials.

Depositor security seems to be less of a concern to the participants in the ICMs. As in banking, trust is an operative norm being observed by participants in the deposit side of informal intermediation. In the past few years, a number of banks collapsed. Newspapers then were full of stories about the predicament of depositors who tried to claim their deposits from the Philippine Deposit Insurance Corporation (PDIC). In contrast, none of the sample CCUs experienced a run on deposits. It is interesting to note in Table 14 that about half of the sample CCU members have larger savings and time deposits with banks. While all have fixed deposits with the CCU representing their share capital, only half has savings deposit with the CCU. The average amount of deposit with CCU is only about a third of the bank deposit. This may have something to do with depositor security, since deposits with the CCUs do not have any deposit insurance coverage.

The case study on "paluwagan" shed some light on the safety of deposits of members. Two managers claimed that a member defaulted after receiving the kitty. To prevent the kitty from decreasing in the succeeding turns, the managers assumed the defaultee's liabilities. This gesture is essential in ensuring the manager's credibility and the security of the contributions of the members. The presence of core members, i.e., those who have been members of the same "paluwagan" units, also gives some semblance of stability to the "paluwagan."

IV. INTEREST RATES FORMATION AND TRENDS, COMPETITION BETWEEN FORMAL AND INFORMAL SECTORS, ICMs AS SOURCE OF INNOVATIONS, INTERLINKAGE OF CREDIT WITH TRANSACTIONS IN OTHER MARKETS, AND PROMOTING LINKAGES WITH THE INFORMAL SECTOR

A. Interest Rate Formation and Trends

There is great heterogeneity among informal lenders when it comes to interest rate determination. Various segments of the ICMs have their own way of determining the interest rate on savings deposits and loans. The credit cooperative unions which are the most organized among segments of the ICMs claimed to have based their interest rate on savings deposits on the prevailing bank rates. During the period 1982-1986, the average interest rate on savings deposits of CCUs was consistently lower by about 1.0 percentage point than the average deposit rate given by banks (see Table 22). Lamberte observes that savings deposit rates of both the CCUs and banks seem to be insensitive to inflation rate. Except for 1986 when the inflation rate dropped to less than 1.0 percent, savers have been penalized by both CCUs and banks.

Table 22: TRENDS IN THE INTEREST RATES ON SAVINGS DEPOSITS
(Percent Per Annum)

Year	CCUs		Banks	
	Nominal	Real	Nominal	Real
1982	8.6	-1.6	9.8	-0.4
1983	8.6	-1.3	9.7	-0.3
1984	8.7	-41.6	9.9	-40.5
1985	8.6	-14.5	10.8	-12.3
1986	8.0	7.2	8.6	7.8

Source: Lamberte and Balbosa. "Informal Savings and Credit Institutions in the Urban Areas: The Case of Cooperative Credit Unions," 1988. (Table IV.1).

In Sapang Palay where no financial institutions operate, the moneylender who mobilizes deposits pays the rate of 80.0 percent per annum for deposits in 1987. This seems to reflect the opportunity cost of capital and also higher than the inflation rate (3.8 percent) for that year. The small savings group in Sto. Tomas, Davao is another case in point. It is able to pay a high rate of 20.0 percent per month (or 240.0 percent per annum). The market rate on informal loans in the community is between 15.0 percent and 20.0 percent per month. It is able to pay a high rate on deposit since this is linked with the profitability of the business (presently, a consumer store) which the savings group capitalizes and operates.

One of the stereotypes about informal lenders is that they generally charge very high interest rates. It is more accurate to say, however, that there is a very broad range of interest rates in the ICMs. At the lower end of the pole, one finds "social" loans with zero or low rates; there are also rates which parallel those of the formal loans; and at the upper end, one encounters interest charges which exceed 200.0 percent per annum.

Lending rates in the ICMs vary according to type and size of loans, maturity period, repayment scheme, type of lenders, and to the degree of monopoly power being exercised by lenders. Even among the same type of lenders variations in lending rates can be great. Within the same community wide variations in rates also exist. We will leave out the "interest-free, no strings attached" social loans. There are many cases of this observed both in the earlier literature and in the small-scale surveys done by SWS and other researchers for the ICM research project.

The determination of the lending rates among the rural ICM lenders in the six-village case history seems to hinge more on their assessment of risks. About two-thirds of the 46 informal lenders cited risk-related factors (default, delays in repayment, lack of collateral and formal contract) why they charge "high" interest rates. Only six (6) of the informal lenders claimed they based their rates on the prevailing lending rates in the locality. In Table 23, nominal rates given by borrower respondents and informal lenders are shown to vary greatly among different types of borrowers. Rates reported by rice farmers have generally exceeded 100.0 percent per annum in the period 1972-1987, with rates over 200.0 percent since 1984. In contrast, lower rates were reported by the rice-onion farmers. Except for 1980 and 1981, rates appear under 90.0 percent per annum. The differential rates may be due to the fact that the rice farmers obtained higher number of non-cash loans from moneylenders and repaid them in non-cash basis compared to onion farmers. The imputed interest rate for non-cash loans seems to be higher than the rate on cash loans. Storage and marketing costs which moneylenders are going to incur for receiving non-cash payment for loan may have been incorporated in the interest rate they charge.

Table 23: TRENDS IN INTEREST RATES PER CROPPING SEASON (PCS) & PER ANNUM (PA), AS REPORTED BY RICE FARMERS, RICE-ONION FARMERS, NON-FARMER RESPONDENTS, INFORMAL LENDERS AND BANKS, SIX NUEVA ECIJA VILLAGES, 1972-1987
(in Percent)

	Rice Farmers		R-Onion Farmers		Non-Farmer	As Reported By Informal Lenders		Banks b/
Year	PCS	PA	PCS	PA	PA	PCS	PA	PA
1972	39	117	29	87	113	14	42	
1973	38	114	11	33	114	14	42	12
1974	40	120	10	30	121	15	45	12
1975	48	144	12	36	125	15	45	12
1976	48	144	14	42	134	15	45	12
1977	56	168	11	33	108	19	57	12
1978	50	150	19	57	112	23	69	12
1979	67	201	15	45	103	26	78	12
1980	59	177	30	91	106	30	90	12
1981	70	210	35	105	122	32	96	12
1982	60	180	18	54	127	33	99	12 to 26
1983	66	198	18	54	130	36	108	32
1984	79	237	21	63	128	43	129	32
1985	97	291	18	54	92	49	147	32
1986	98	294	22	67	88	50	150	32
1987	91	273	21	64	109	57	171	24

a/ A crop season is approximately 4 months long.
b/ Representing rates quoted by a rural bank in San Isidro, Nueva Ecija

Source: ACES Foundation, Inc. "The Informal Credit Market of Six Selected Barangays in Nueva Ecija (1972-1987)." August 1988. (Tables III-14, 33, 52, 77, & 96).

The sample rural informal lenders report nominal rates which are much lower than those reported by the rice farmers. What is interesting, however, is that the nominal rates claimed by the lenders showed relative stability during the period of active lending by the Masagana 99 and GSK credit programs of government from 1973 to 1976; thereafter the nominal interest rate rose steadily and steeply. The average rate reached very high levels during the 1983-84 economic crisis period and kept on rising even after. For the 1987 loans, the rate averages 171.0 percent per year. It should be recalled that during this year, the SWS data presented in Section I show a significant increase in rural borrowings and informal credit. The continuing rise in interest rate after the liberalization of interest rate may be reflective of the failure to encourage more competition and increasing the flow of bank resources to the rural areas. It should be noted, however, that general economic and political instability prevailed during the period 1983 to 1987.

With the high rates of interest, informal lenders have been able to enjoy positive real rates (See Table 24). On the other hand, real rates of interest of a community rural bank which services the villages in the study were negative for some years. This bank has been able to adjust its interest rates upward after the interest rates liberalization in 1981.

Table 25 pulls together the findings of other studies on rural ICM interest rates showing variations in interest rates by value of assets owned by borrower, by level of development of the area, and by linkage of the credit market with the other market in which the lender/borrower participates. By size of farmholding in Nueva Ecija, large farms enjoy a "prime client" status as reported by Swaminathan (1982). By level of development, the study of rice farming communities by Floro (1986) found lower average rates in the developed areas (more commercialized, more productive, more capital-intensive) than in the marginal ones. The margin of difference is 4.8 percent per month on unlinked loans, and 1.2 percent per month on linked loans. Average rate on linked loans in undeveloped area is, however, reported lower than unlinked loans. Linkage in this instance does not imply that the lender necessarily controls or exploits the borrower. The linkage is similar to the relationship of interest rates of collateralized and uncollateralized loans. The linkage helps to guarantee the loan repayment.

On the other hand, Geron's study of eight (8) rice-based and coconut-based barangays found higher average rate in developed barangays than those classified as undeveloped (See Table 26). The rate represents all loans including non-interest bearing ones. The study reported that more lenders operate in areas classified as "developed" than in areas considered "undeveloped." Her finding on level of interest rate seems to suggest that the existence of more lenders in the developed areas

Table 24: REAL INTEREST RATES PER ANNUM, AS REPORTED BY SIX NUEVA ECIJA VILLAGES, 1972-86

Year	Rice Farmers	R-Onion Farmers	Non-Farmers	Informal Lenders	Banks
1972	108.77	78.77	104.77	33.77	
1973	97.50	16.50	97.50	25.50	-4.50
1974	85.84	-4.16	86.84	10.84	-22.16
1975	137.22	29.22	118.22	38.22	5.22
1976	134.77	32.77	124.77	35.77	2.77
1977	158.07	23.07	98.07	47.07	2.07
1978	142.71	49.71	104.71	61.71	4.71
1979	184.49	28.49	86.49	61.49	-4.51
1980	159.40	73.40	88.40	72.40	-5.60
1981	197.61	92.61	109.61	83.61	-0.39
1982	169.79	43.79	116.79	88.79	1.79-15.79
1983	187.83	43.83	119.83	97.83	21.83
1984	186.65	12.65	77.65	78.65	-18.35
1985	267.90	30.90	68.90	123.90	8.90
1986	293.23	66.23	87.23	149.23	31.23

Source: ACES Foundation, Inc. "The Informal Credit Market of Six Selected Barangays in Nueva Ecija (1972-1987)." August 1988.

Table 25: AVERAGE ANNUAL INTEREST RATE ON RURAL AND INFORMAL LOANS, VARIOUS STUDIES AND YEARS

PERIOD COVERED	AUTHOR/AGENCY	SURVEY AREAS	INTEREST RATE (% p.a.) A. Including zero interest loans	B. Excluding zero interest loans
1957-58	Gapud	Nueva Ecija	98.0 a/	126.8 a/
1957-58	Sacay	18 provinces	82.0 a/	
1978-79	TBAC	Bulacan	32.6 a/	57.7 b/
		Camarines Sur	50.7 a/	80.5 b/
		Isabela	83.3 a/	87.7 b/
1980-81	Swaminathan	Nueva Ecija c/		
		small farm	91.2 d/	
		medium farm	104.4 d/	
		large farm	67.2 d/	
1981-82	TBAC	Nationwide	48.2 a/	76.1 a/
1983-84 e/	Floro	Cagayan, Nueva Ecija, Iloilo		
		Marginal area f/		
		unlinked loans	230.4 g/	
		linked loans	212.4 g/	
		Developed area f/		
		unlinked loans	172.8 g/	
		linked loans	198.0 g/	
1987	Geron	Quezon, Camarines Norte, Nueva Ecija		
		Developed bgys.	75.3 a/	
		Less Dev. bgys.	32.9 a/	

a/ Interest rates on fully paid loans.
b/ Including traditional credit only, in contrast to figures on left which include traditional loans, "legal" type of informal credit and non-commercial loans.
c/ The study was conducted in two areas, the control and the ACES areas. Interest rates computed for this table came from the control area only.
d/ Loan rates are for the wet season only, based on monthly rates of 7.6, 8.7 and 5.6 percent for the respective farm sizes.
e/ Wet season only.
f/ The researcher classified the 14 sample villages into two groups. The developed area is more productive, capital-intensive, and commercial marginal area.
g/ Based from monthly rates of 19.2, 17.7, 14.4, and 16.5

SOURCES:

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2. Gapud, Jose P. "Financing Lowland Rice Farming in Selected Barrios in Munoz, Nueva Ecija, 1957-58." Unpublished B.S. thesis, University of the Philippines at Los Banos, 1958.
3. Geron, Ma. Piedad. "Philippine Informal Rural Credit Markets: Efficiency and Equity Issues." Paper presented at Workshop, UP Los Banos, March 29, 1988.
4. Sacay, Orlando J. "An Analysis of the Crop Loan Program of the Agricultural Credit and Cooperative Financing Administration." Unpublished M.S. thesis, Cornell University, September 1961.
5. Swaminathan, Madhura. "The Study on the Credit Behavior of Farm Families in Nueva Ecija." IRRI Ag. Econ. paper No. 82-27.
6. TBAC. A Study on the Informal Rural Financial Markets in Three Selected Provinces of the Philippines. Manila, 1981.
7. TBAC. "Small Farm Indebtedness, 1981-82." Draft Report. Manila, February 1984.

Table 26: COMPARISON OF ANNUAL INTEREST RATES, BY TYPE OF BORROWER, IN EIGHT VILLAGES IN THE PROVINCES OF QUEZON, CAMARINES NORTE, AND NUEVA ECIJA, 1987 (in Percent) a/

	Ex-Ante		Ex-Post	
	Average Rate	No. of Loans	Average Rate	No. of Loans
Loan 1				
Farming				
Palay	71.97	316	87.50	267
Coconut	60.04	140	53.85	112
Palay-Coconut	2.41	95	5.50	85
Other Crops	3.94	14	4.20	13
Fishing	2.06	32	2.79	18
Landless Labor	22.88	80	26.58	69
Non-Farm Related	53.65	10	60.72	9
ALL BORROWERS	38.29	687	56.30	573

a/ Rates on loan no. 1 only.

Source: Geron, Ma. Piedad. "Philippine Informal Rural Credit Markets: Efficiency and Equity Issues." 1988. (Table 16).

does not necessarily mean lower pricing on loans. The researcher concluded that the competition among lenders does not necessarily happen in terms of loan pricing but in terms of services rendered, such as more timely and doorstep delivery of loans, accommodations in terms of bigger loans and form of loans desired by the borrower, and provision of other services like transport/ pick up of farmer's produce or repayment. When taken together with borrowing costs, the additional/better services may have the effect of lowering overall costs to the farmer. This is merely a deduction though. What would seem to account for the lower average rate is the much larger portion of zero-rate loans obtained by borrowers in the undeveloped barangays. What would be interesting to see in future research on ICMs is a full accounting of the costs incurred by the lender in rendering the other services to the borrower which are clearly connected with the loan transactions.

The wide variances in informal rates are also shown in commercial (interest-bearing) loans to overseas contract workers. The data in Table 27 shows highest average rate on loans from moneylenders.

In the case of CCUs, the determination of the effective lending rates is somewhat complicated. Interest rate payments are collected in advance and additional charges (i.e., service fee, loan redemption insurance, collection charges) are being imposed. All these have the effect of raising the effective interest rate. Table 28 shows that the nominal rate, which is known to members is only half of the effective interest rate, the other half being accounted for by the advanced payment on interest and other charges. The average effective lending rate of CCU approximates the lending rate of banks.

Lending rates across CCUs operating in Metro Manila vary greatly. Even CCUs belonging to the same federation have different rates. This is because members of the federation operate independently as units with self-governing policies. The variation in lending rate seems mainly due to the differences in the nominal rates and service charges.

Variation in the lending rates cannot be completely attributed to the geographic location of the credit markets. In the small urban community of Sapang Palay, the researchers found substantial interest rate differential among moneylenders for loans of the same maturity (See Table 29). Moneylenders claim they do not 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 community.

The various case studies of urban informal lenders by Lamberte provide detailed examination of the components of the lending rates.

Table 27 ANNUAL INTEREST RATES CHARGED ON LOANS OF OVERSEAS CONTRACT WORKERS FROM COMMERCIAL SOURCES, 1987
(in Percent)

Sources	Early Hired	Newly Hired
Informal		
F/F, with interest	47	100
Prof Money Lenders	130	132
Emp/Agent Advances	68	45
Airlines	10	
Sub-Total	78	104
Formal		
Gov't Fin Inst / Rural Banks	21	7
Pawnshop/Private Credit		96
Sub-Total	21	37
Total	73	98
Percentage with cash interest	75	59
Percentage with unknown interest	25	33

Source Mangahas, M A "Response to New Market Opportunities The Case of the Overseas Employment Sector," Social Weather Stations, Inc , August 1989

Table 28: LENDING RATES OF COOPERATIVE CREDIT UNIONS, 1986
(In Percent)

	CCUs	NR	NRC	NER
1.	BVDCI	6.5	11.9	13.5
2.	PSPDCI	7.0	18.7	23.0
3.	CMDCI	6.5	17.3	20.9
4.	DTDCI	10.8	21.6	27.6
5.	MCMCCI	7.9	22.3	28.7
6.	MVDCI	6.5	20.9	26.4
7.	UPCCI	10.0	12.2	13.8
8.	FEUCCI	9.0	13.0	14.9
9.	DSE(CBP)KBCI	9.0	10.0	11.1
10.	PECCI	12.0	14.0	16.3
	Average	8.5	16.2	19.6

Source: Lamberte and Balbosa. "Informal Savings and Credit Institutions in the Urban Areas: The Case of Cooperative Credit Unions." 1988. (Table IV.2).

Note: NR = nominal lending rate

NRC = nominal lending rate plus other charges

NER = nominal effective lending rate discounted in advance

Table 29: INTEREST RATE CHARGED PER ANNUM BY MATURITY, SIZE, AND TYPE OF BORROWER, SAPANG PALAY MONEYLENDERS
(In Percent)

		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 P2,000)	same for all	97	same for all	same for all	same for all	60	same for all
	(2) large (P2,000 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	-	-	-

Source: Lamberte, M. and Bunda, M.T. "The Financial Markets in Low-Income Communities: The Case of Sapang Palay." 1988. (Table IV.7).

Table 30 shows the components of lending rates of moneylenders in Sapang Palay. The results are mixed. Despite very high rates, one moneylender realized a net spread of only 1.5 percent, while two (2) new entrants in the credit market incurred a loss. The loss of these new moneylenders could be considered part of the sunk costs of establishing their business. The rest of the moneylenders enjoyed hefty profit margins. Moneylenders D and E have the biggest number of clients and realized the largest profit spread. There is wide dispersion of lending rates among moneylenders. It is also observed that borrowers lack the ability to transfer to moneylenders who charge relatively lower lending rates. These are indications of a severely fragmented capital markets prevailing even in a small urban community.

The case of trade credit is something else. The effective interest rate on trade credit is found to consist of the explicit and implicit rates. The explicit rate can be further broken down into the discount rate on post-dated checks and plain interest rate. The implicit rate arises out of price differential of inputs or of outputs in the case of "tied" credit arrangement. The results of estimating the effective interest rate on trade credits and their components are in Table 31. The bulk of the components of effective interest rate consists of the implicit rate.

The discount rate on post-dated check and plain interest rate are almost the same for plain trade credit and tie-in credit. However, the implicit interest rate on trade credit greatly differs between the two sources of trade credit. The implicit interest charged by input suppliers is twice as high as the implicit interest rate charged by wholesalers/traders who are also input suppliers. What account for these results?

Wholesalers/traders usually have marketing contracts with big retailers or exporters. To assure themselves of a steady supply of footwear products, they engage in tie-in arrangements with footwear manufacturers. This is the best way they can reduce business risk arising from non-delivery of goods when they have no control on production. Since footwear manufacturers have alternative outlets for their products and have also alternative sources of inputs, wholesalers/traders are therefore compelled to give footwear manufacturers a better price for their products. The marketing contract also reduces the risk of default on the credit that wholesalers/traders extended to footwear manufacturers.

The case is different with the input suppliers who are merely supplying inputs. Footwear manufacturers find the necessity of borrowing from the input suppliers since their working capital is tied up with the trade credits they extended to their customers. Therefore, input suppliers can exercise some

Table 30: COMPONENTS OF LENDING RATES OF MONEYLENDERS IN SAPANG PALAY

Items	A	B	C	D	E	F	G
Weighted average lending rate 1/	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 to 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 mobilizing deposits. All are computed on the basis of nine months.

3/
Taken from Table IV.8. (Lamberte and Bunda 1988).

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.

6/
Refers to actual cost of loan default.

Source: Lamberte & Bunda. "The Financial Markets in Low-Income Urban Communities: The Case of Sapang Palay." PIDS Working Paper Series No. 88-05 (Table IV.12).

Table 31: COMPONENTS OF EFFECTIVE INTEREST RATE IN THE FOOTWEAR INDUSTRY

Source/Component	Percent per year	Percent Share
A. Plain Trade Credit (Input Suppliers)		
Discount rate on post-dated checks	33.18	28.51
Plain interest rate	7.35	6.32
Price differential	75.84	65.17
Total	116.37	100.00
B. Tie-in Credit (Wholesalers/traders who are also input suppliers)		
Discount rate on post-dated check	31.84	40.67
Plain interest rate	9.60	12.26
Price differential	36.85	47.07
Total	78.29	100.00

Source: Lamberte, M. B. and Jose, Anita A. "The Manufacturing Sector and the Informal Credit Markets: The Case of Trade Credits in the Footwear Industry." PIDS Working Paper Series No. 88-07, May 1988. (Table IV-20).

degree of pricing power which is reflected in greater overpricing of inputs.

The total effective interest rates charged by input suppliers is 116.37 per annum; it is 78.29 percent per annum for the wholesalers/traders. In both cases the implicit interest rate accounts for the major portion of the total effective interest rate on trade credits.

In determining the effective interest rate, results show that input suppliers discriminate between small and large firms. Loans to small firms carry higher rates than large firms. Large firms usually cater to big, well-established department stores whose post-dated checks are considered less risky than those issued by small retailers and, thus, command a lower discount rate. Large footwear manufacturers also exercise better bargaining power with their input suppliers compared with small ones, and therefore, they are able to get better terms. In other words, larger firms are charged lower implicit interest rate on their trade credits than the small firms.

The lending rates among segments of the formal and informal sectors starting from 1981 when interest rates were liberalized up to 1986 is shown in Table 32. There is a wide variation in lending rates among these segments of the financial markets. Banks and CCUs appear to have the lowest lending rate. With the implicit interest rate added to the discount rate on post-dated checks, the effective interest rate on trade credit could have been the highest among the interest rates of the various segments of the urban ICMs examined for this study.

Looking at trends in the various interest rates in the markets, it would seem that the interest rate liberalization failed to encourage more competition in the financial system. The real lending rates of the various segments of the financial markets established an increasing trend interrupted only in 1984 and 1985 when inflation rates skyrocketed. This trend has been shown earlier to be true also for segments of the rural financial markets. It should however be noted that interest rate liberalization alone cannot encourage more competition. It should be accompanied with liberal bank entry. Unfortunately, bank entry and branching has remained overly restrictive at the time when interest rate was liberalized. In view of the oligopolistic market structure of the banking system in the country, the interest rate liberalization only gave banks an opportunity to raise the lending rates. Real bank spread has widened since interest rates were freed. Our results seem to suggest that tne increase in the lending rates in the formal sector have spilled over into the informal sector.

Table 32: TRENDS IN THE LENDING RATES OF BANKS, FINANCE COMPANIES, PAWNSHOPS, AND CCUs
(Percent Per Annum)

Year	Banks		Finance Cos.		Pawnshops		CCUs		Discount Rate on Post-dated Checks	
	Nominal	Real	Nominal	Real	Nominal	Real	Nominal	Real	Nominal	Real
1981	16.5	3.4	28.0	14.9	26.5	13.4	-	-	28.2	15.1
1982	16.5	6.3	28.9	18.7	23.4	13.2	20.99	10.74	28.2	18.0
1983	18.6	8.6	34.3	24.3	35.3	25.3	20.99	11.00	30.5	20.5
1984	26.2	-24.1	58.9	8.6	43.2	-7.1	20.72	-29.62	36.0	-14.3
1985	26.9	3.8	40.4	17.3	48.2	25.1	20.52	-2.60	42.0	18.9
1986	14.0	13.2	27.5	26.7	52.2	51.4	19.63	18.86	31.7	30.9

Sources: Table 8 (Lamberte 1988); Table IV.2 (Lamberte and Balbosa 1988); and Table V.7 (Lamberte and Jose 1988).

B. Competition Between Formal and Informal Sector

In earlier section, we have elaborated on the degree of linkage between the formal and informal credit markets. We found that the two markets are largely complementary. They cater to what are essentially different segments of the financial markets. The various linkages that exist on the resource generation side and lending side among segments of the formal credit market and ICMs help reduce fragmentation in the financial system. Bankers observe that a great deal of trade credit to their clients ends up being lent informally. For instance, traders and industry integrators in the agriculture sector who borrow working capital loans from banks become, in effect, retailers of bank funds in the informal credit markets (Agabin 1988). Findings of earlier studies on rural ICMs support this claim. In particular, a large number of trader-lenders in Geron (1988) are borrowers from banks. Such borrowings to augment capital are evidently tied to the lenders' trading businesses where lending is but a tool to assure supply.

An area of competition between the formal and the informal markets seems to be present only to a limited degree in a segment of the loans market. This is the small loans market wherein pawnshops, money shops, lending investors and, to a certain extent, rural banks may have encroached into. For example, the money shop is an innovation that was introduced in 1973 with the agenda of reaching segments of the traditional market of informal lenders in public market places. Money shops are the smallest unit or "scooping station" of banks for small deposits and loans. Under regulation by the Central Bank, money shops were allowed to collect higher service charge of 2.0 percent per month on small loans to market stallholders. Money shops mimic the practices of the informal lenders. Amortized daily on a straight basis and with interest collected up front, money shops could collect an effective rate of between 24.0-28.0 percent on clean loans during the time when the legal ceiling rate was only 14.0 percent per annum. The money shop concept was first experimented on by a big commercial bank, the Philippine Commercial International Bank (PCIB) to try to compete down the interest rate in the public market that was dominated by so called "5-6" lenders. At the time of their entry in the public market places, informal rates were reported in the level of 20.0 percent daily in 1973; these declined to 20.0 percent per month around the mid-1970s, and by the 1980s were around 5.0 to 10.0 percent per month.

Experience over the years and internal bank policy shifts have made some money shops to be very selective. For instance, a money shop operated by PCIB in urban Metro Manila since 1973 no longer grants loans below a certain loan size because of high administrative costs. Also, it is now paying more attention to loan securities whereas before loans were granted on clean basis. It has also ceased to lend to vendors of perishable goods because of the smaller loan requirements and unsuitability of what they

sell for chattel mortgage. In other words, this money shop's selectivity tends to confine its lending to the "prime" clients in the public market place, and in this respect competition between the money shop and the informal sources seems to be limited only to the prime client segment of the small loans market. It is also, however, observed that those excluded in the selection process are serviced by the other informal lenders operating in the public market. These include around ten "5-6" lenders and a credit cooperative. What is interesting is that the credit cooperative of market vendors and stallholders has become the major competitor of informal lenders and corners around 60.0 percent of the credit market therein. The cooperative offers the lowest rates to members and a variety of product lines, and borrowing procedure is much simpler compared to that of the money shop. A moneylender interviewed for this study confirms this competition from the credit cooperative, stating that her lending volume in this public market has declined and has lead her to service a limited number of her "suki" (prime clients) which are mostly confined among the meat vendors.

The same commercial bank lately opened a Shoe Industry Desk in its Marikina branch, where the biggest footwear industry is located. The target clientele of its special credit program are the footwear manufacturers, not the input suppliers. In fact, it tries to compete with input suppliers in discounting post-dated checks by offering a lower discount rate usually one (1) percentage point below the discount rate charged by input suppliers. However, the competition put up by PCIB is still limited to the so-called "prime" checks which are issued by big and well-known department stores in the country. This suggests that the formal sector competes with the informal sector only in the less risky financial instruments. With the large volume of post-dated checks floating around in the Marikina shoe industry, the participation of PCIB in the market for post-dated checks was hardly felt by the majority of the input suppliers interviewed for this study.

Pawnshops and lending investors may have taken away some of the customers of the informal credit markets. Because of their rapid expansion they have provided small borrowers an alternative source of credit. A number of informal moneylenders, encouraged by the recent interest rate liberalization, have registered with the Central Bank as lending investors. As noted earlier, these institutions belong to the least regulated segment of the formal financial system. Hence, they enjoy greater flexibility in their operations. These institutions are close to the borderline of the ICMs in the financial system continuum and, thus, have features almost similar to the ICM lenders.

The issue of competition between the formal sector and specific segments of the informal credit markets in the rural areas should be a focus of mere detailed study in the future.

The data available to us at present do not allow us to derive meaningful analysis.

C. ICMs as a Source of Innovations

The terms and conditions of an informal loan can be variable. Maturity seems to cluster around four (4) to six (6) months. In the rural areas, loans tend to be incurred early during the planting seasons, both wet and dry, and repayments during harvest seasons. This arrangement fits well into the cash flow pattern of farming households, which is marked by seasonality. Other lenders employ a daily collection system as in the public market places. Salary deductions are the mode of collection of office-based credit unions. Many lenders do not require any collateral nor paper work.

For a credit market to be sustainable in the long-run, the repayment rate should be reasonably high. Loan repayment partly hinges on the financial practices being used. That ICMs tend to create financial practices that suit well the cash flow pattern of borrowers is demonstrated in the low-income urban community of Sapang Palay. Here, a variety of "paluwagan" units exist from which a member can choose depending on how much money the individual wants to raise and on his cash flow pattern. Thus, one may join a "paluwagan" that requires small amount of contribution on a daily basis or one that demands a bigger amount of contribution.

The repayment schemes of CCUs are also aligned with the cash flow pattern of their members. In the case of institution-based CCUs, loan repayments are scheduled on pay days. In addition, longer loan maturities ranging from five (5) to 48 months are granted to members because of their security of tenure in the institution where they are working. In contrast, market-based CCUs use a daily repayment scheme because of the high cash turnover of their members. Here, loan maturities are much shorter, not exceeding 200 days.

Moneylenders in Sapang Palay offer various payment schemes to different borrowers to suit the latter's needs and paying capacity. Three (3) general payment schemes are observed: one is called "steady" - no maturity date, only the interest on the principal is paid, with mostly businessmen as borrowers; the second is called "revolving" - loans have definite maturity dates and borrowers may select either daily, weekly or bi-monthly payment of principal and interest. A variant of this second scheme requires no fixed amortization schedule but the principal and interest should be paid within the agreed maturity date. The third payment scheme is called "balikbayan" (returnees) - borrowers may ask for a loan from the same moneylender any time they want which, in effect, provides borrowers with a credit line without a pre-established maximum credit line. This last scheme

is available only to borrowers with good track record with the lender. The loan principal and the interest are payable within one (1) day or one (1) week.

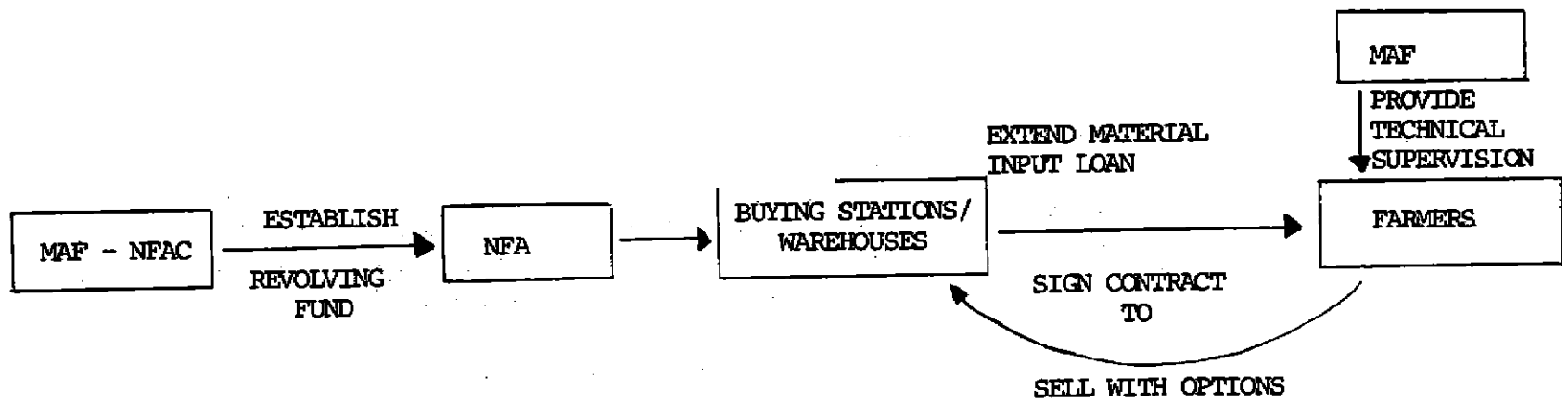
In trade credits, the security instrument created is the post-dated check. This is considered the most highly negotiable instrument. In case the issuer of the post-dated check defaults, the footwear manufacturer who used it as a security for his trade credits is still liable to the input supplier who granted him the trade credits.

Some of the practices of the ICMs have been tried by the formal financial system, such as by the lending investors, the non-stock savings and loans associations (NSSLAs), and the money shops. Lending investors are reported active in public markets and offices and employ collectors for daily or every pay day collection of repayments. NSSLAs are like CCUs and service only the loan requirements of their members. Some rural banks are experimenting with the daily collection scheme on loans to market vendors. The money shops and the discounting of post-dated checks found in the footwear industry of Marikina are adaptations by the formal system of some ICM practices.

A short-lived experiment was also done by the government in the early 80s to channel funds to farmers through informal conduits, such as the grains traders and millers as well as input suppliers. The government then had a program called National Agricultural Productivity Program (NAPP) which included twelve commodity-specific program (see Esguerra 1987). Since most of the rural banks were financially distressed in the early 80s, the government decided to channel the funds through non-conventional conduits. There were three alternative financing schemes being developed, namely: (1) the National Food Authority (NFA) Assistance Scheme; (2) the Banking System Assistance Scheme; and (3) the End Users/Input Suppliers Assistance Scheme. These are all depicted in Figures 3 to 6. 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 repayment rates of the various schemes had been remarkable mostly in excess of 90 percent. Despite its impressive repayment rate, the program had an undesirable result. That is, it was found that the additional loans obtained by the conduits merely substituted their own funds that would have gone anyway to the ultimate borrowers. The entire program was terminated in 1986 since the newly-instituted government consolidated all commodity-specific agricultural credit programs into one fund. This was part of the move to do away with special credit programs. The consolidated fund is now used in beefing up the resources of the existing guarantee programs.

Figure 3

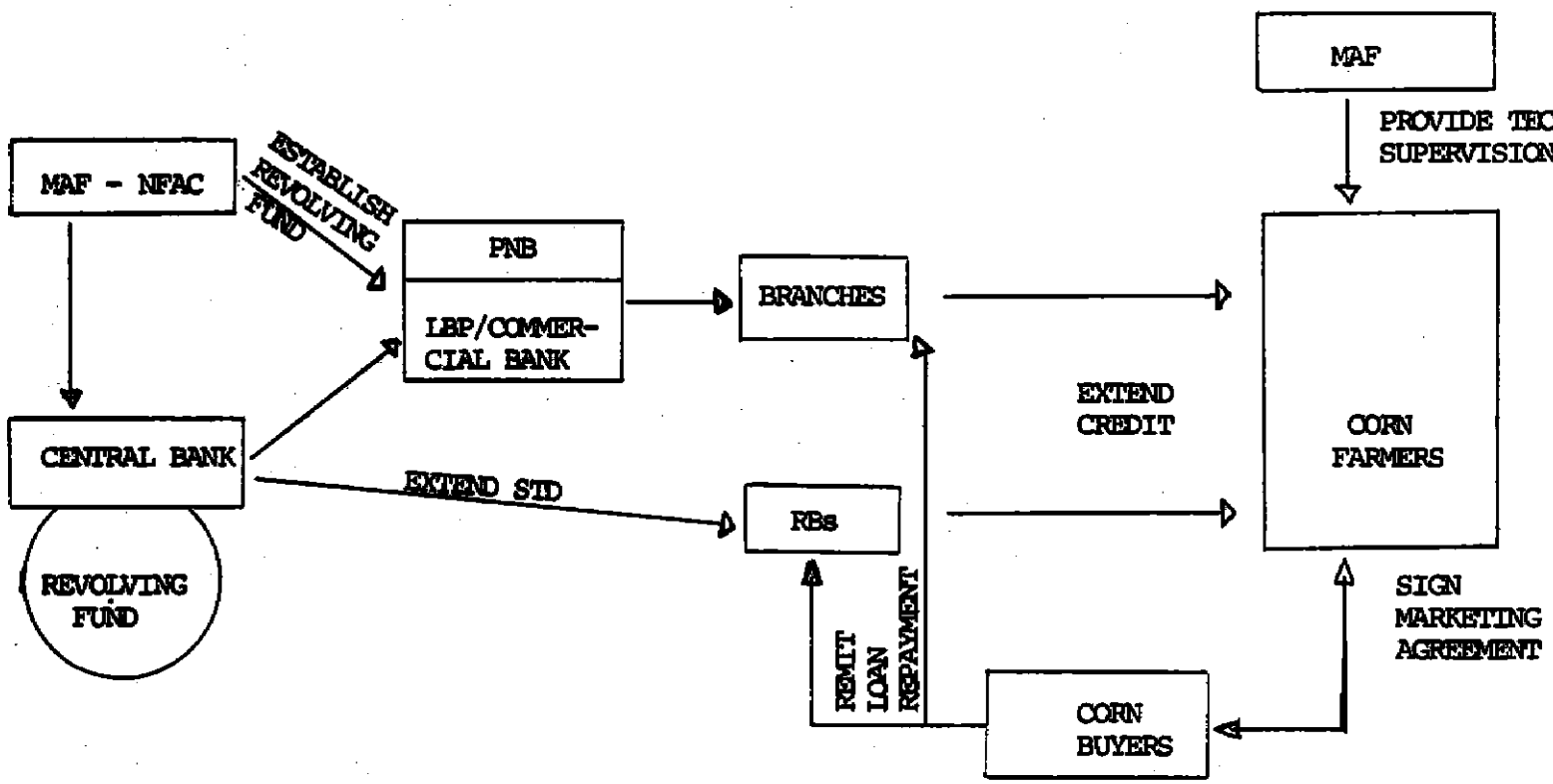
THE NFA ASSISTANCE SCHEME



Source: National Food and Agriculture Council (NFAC).

Figure 4

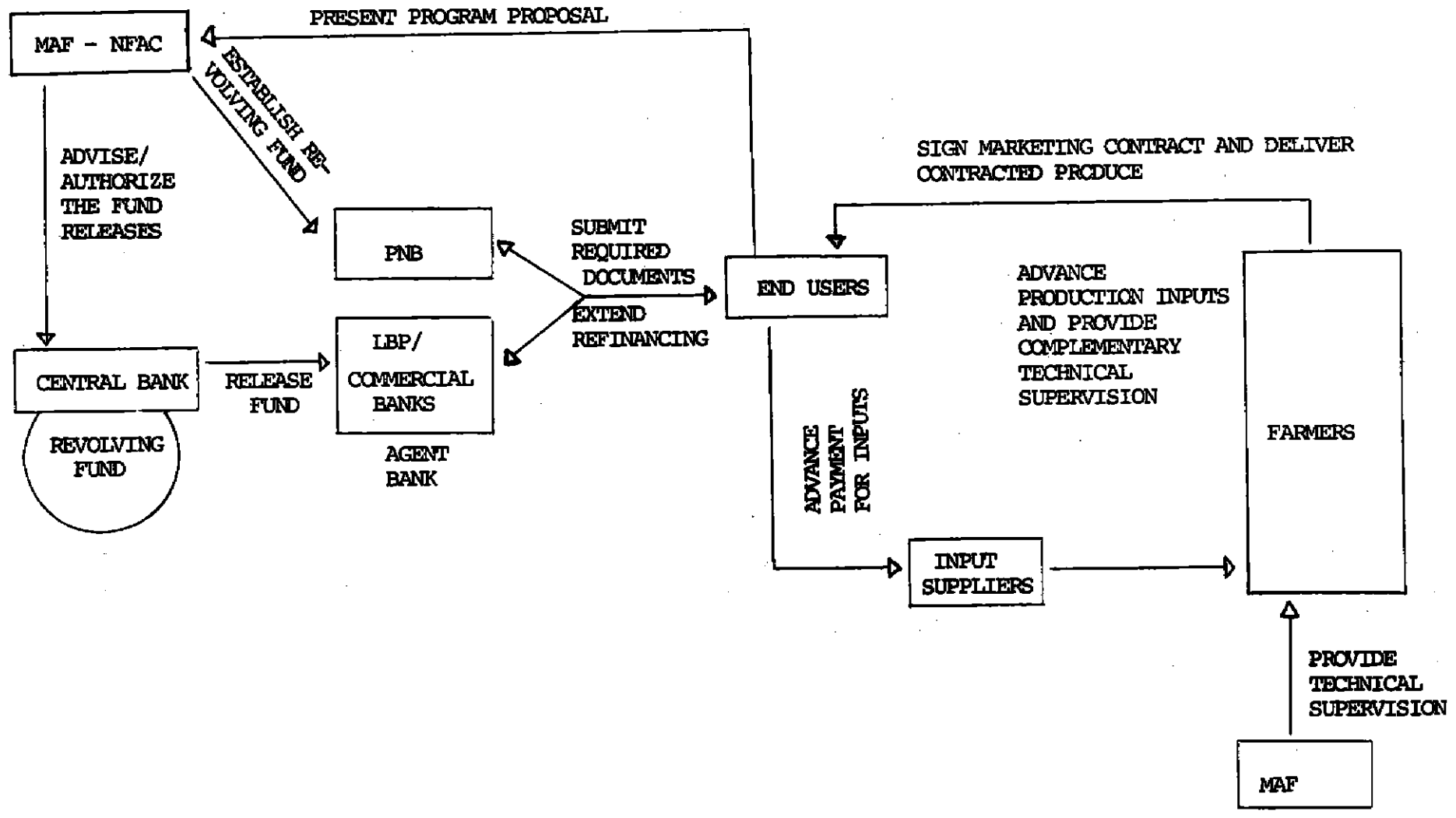
THE BANKING SYSTEM ASSISTANCE SCHEME



Source: National Food and Agriculture Council (NFAC).

Figure 5

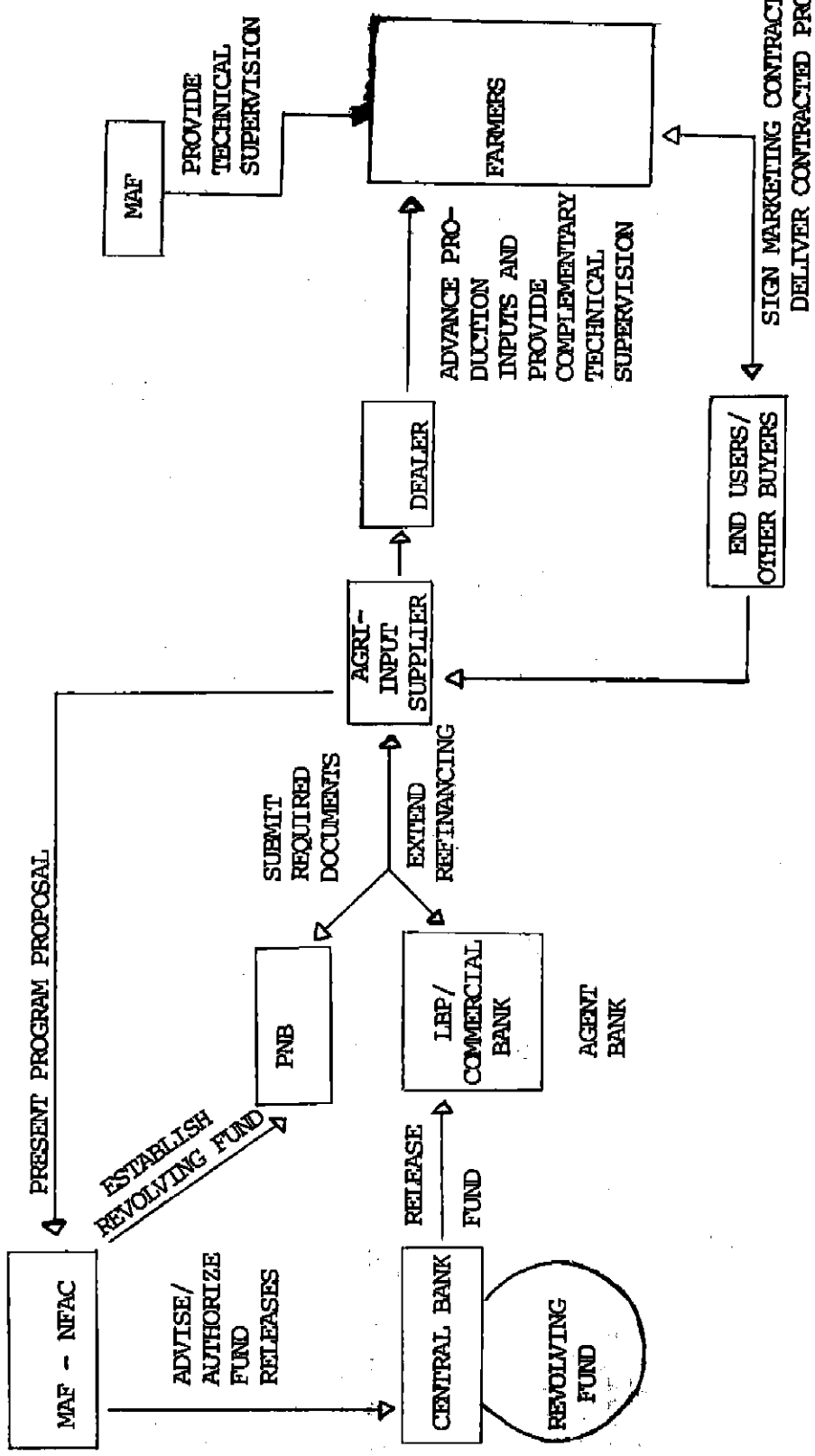
THE END USERS APPROACH



Source: National Food and Agriculture Council (NFAC).

Figure 6

THE AGRICULTURAL INPUT SUPPLIERS APPROACH



Source: National Food and Agriculture Council (NFAC).

One innovative financial arrangement which is gaining popularity among federation of CCUs is the so-called "interlending scheme" or central liquidity fund CCUs operate much like a unit bank CCUs do not have funds transfer mechanism, they cannot rediscount with the Central Bank Although most of them are bank depositors, they do not generally enjoy a reciprocal arrangement from the bank on the borrowing side To cope with the problem of liquidity and boost investment opportunities, the interlending scheme was designed by cooperative federations Member CCUs contribute to the general fund managed by the federation and can borrow several times their contribution With this scheme, surplus CCUs would have a ready outlet for their excess funds, while deficit ones or those experiencing sudden increase in the demand for credit can immediately access external funds without resorting to credit rationing CCU federations which have this scheme find such activity highly profitable

Instead of competing with the ICMs, some banks are currently devising schemes to strengthen their linkage with the ICMs A "wholesale-retail" program is being considered in which banks provide wholesale credit to credit union federations which, in turn, retail them to their member CCUs The Land Bank of the Philippines is soon to begin implementation of such a scheme Similarly, a suitable loan guarantee scheme is being designed to encourage banks to lend to cooperatives on the strength of such guarantee

Schemes to foster the linkage between the formal and informal sectors can exploit the potential comparative advantage inherent in the sectors Clearly, one particular segment of the ICMs where linkage arrangements seem suitable is with the credit cooperative sector and other self-help savings and lending groups

V AN OPTIMAL POLICY AND REGULATORY ENVIRONMENT

It cannot be claimed that this research is the "study to end all studies" about ICMs A number of otner important issues still need to be studied more closely The sector is also a very dynamic one, which would call for continuing research and monitoring The results of the study have certainly increased our understanding of the workings of some segments of the ICMs.

It is shown in this report that there is great diversity in the ICMs in terms of participants, instruments, interest rates, among others It is shown that the magnitude of the informal finance in the Philippines is sizeable The incidence of informal borrowings is highest among the poor The ICMs also play a significant role in supplying the credit demand of small

and micro enterprises, market vendors, small farm producers, and overseas job seekers. A large portion of the loans obtained from the ICMs is used for productive investments. ICMs employ terms and conditions that suit the taste and preferences of borrowers. In particular, informal institutions have fashioned repayment schemes that fit well to the cash flow pattern of borrowers, helping ensure high repayment on loans. Contrary to common perception, informal institutions have successfully mobilized significant amount of deposits from non-wealthy individuals and households. All these suggest that the ICMs in the country cannot be ignored anymore. Unfortunately, however, monitoring of the ICMs has been ignored in the accounting system of the Philippine financial system. A number of important conclusions deserve to be underscored at this point:

First, the ICMs serve as an important channel of financial services to individuals and enterprises which have very little or no access at all to the formal financial markets. Thus, ICMs help address the problem of allocation imbalances caused by the policies and procedures of banks.

Second, there is a particularly high incidence of informal indebtedness among the small and poor borrowers. Hence, any policy intervention that would curb supply of credit in the informal markets would hurt rather than help the poor.

Third, ICMs have helped vitalize the economy by mobilizing resources to meet the credit demands of a large part of the economy. To the extent that informal lenders have loans from the formal sources, these lenders provide a network through which the financial resources of the formal system could be channeled to small borrowers.

Fourth, financial markets in the country are severely fragmented and one cannot easily move from one market to the other. Hence, for the non-wealthy individuals who do not have access to bank credit, formal credit cannot be a substitute to the informal credit they get. Savings clubs and credit cooperatives are, however, effective substitutes for higher priced ICM sources. Their role in mobilizing small deposits is also potentially quite significant. It is important to stress that reciprocity counts a lot in the effectiveness of these institutions in mobilizing savings.

Fifth, the existence of high rates of interest reflect a situation of excess demand as well as imperfections not only in the credit markets but in the other markets as well. Interlinked market arrangements are rather common in some segments and the exercise of certain degree of monopoly power by the lender is possible as evidenced in the input-supplier credit to footwear manufacturers.

Sixth, under economic normal situations, complementarity rather than substitutability between the formal and informal credit sectors seems to be dominant The area of competition appears narrow and confined only to the better off or "prime" clients both in the deposits and loan markets This implies that even with the expansion of banking services, banks would still be hard put to provide credit access to a relatively large segment of the small borrowers/entrepreneurs and poor individuals and households

Seventh, the positive reactions and rapid expansion exhibited by the lending investors and pawnshops to the financial crisis and liberalization of interest rates should be instructive for purposes of policymaking

Eighth, the role of women in the ICMs is very prominent Women have a penchant for details, frankness, and innovations These are important characteristics that one must have to effectively drive through the maize of ICMs The involvement of women in informal finance flows naturally from their major role in the household In the Philippines, the wives take care of the financial matters of the household It is common that husbands surrender their cash income to their wives

Ninth, ICMs are constantly innovating to suit the needs of clients Thus, clients have a wide array of credit arrangements to choose from Innovations had the creation of a culture, and a culture has to invent concepts or terms to capture and express the meaning of a transaction The concept has to be unequivocally understood by the transactors Thus, the term "5-6" was born since moneylenders were known to lend ₱5 and demand ₱6 for payment after a certain maturity date Differences in maturity can lead to differences in effective lending rates The term "Balikbayan" was created to reflect the transaction wherein a borrower with good track record can borrow anytime he wants from his moneylender

The policy track then should be one that would increase rather than decrease the suppliers of credit Measures which re-introduce anti-usury policies would be counter productive and hence, should be avoided For example, two legislative bills before the Philippine Congress would do exactly this One bill proposes to place a ceiling on interest rates which pawnshops can collect on loans below a certain size Another proposes to put a cap on the lending spread of banks

Instead, a fruitful area for policy initiative is in the area of bank entry The restrictive bank entry and branching policies should be relaxed in favor of encouraging more financial outlets Presently, the establishment of new banks is not encouraged by the monetary authorities Those who want to enter banking are asked to buy a bank under receivership or one that has been closed down by the CB The existing branching policy

restricts opening up of new branches in areas considered "overbanked," and requires the purchase of government securities for every branch to be established. In the rural areas, the present ban on opening new rural banks may be hurting the development of the rural financial markets. Such ban came about as a reaction to the financial problems encountered by the rural banking system on account of past policies, economic difficulties, and participation in the government lending programs.

Liberal bank entry will facilitate conversion of CCUs ready to become a bank. Examples are NAMVESCO, the credit cooperatives of Baclaran, San Dionisio, and Philippine Long Distance Telephone (PLDT) employees. Similarly, some informal groups like "paluwagan" and savings and credit societies which have grown into cooperatives are in a position to have their own banks. By becoming banks, their services will not be limited to members only. These self-help groups have the expertise to handle small loans and deposits which other banks do not have. Moreover, depositors' security can be extended to these institutions by the Philippine Deposit Insurance Corporation. Although no case of run on deposits has been experienced by CCUs even during the worst years of the financial crisis, the coverage of deposit insurance will enable the converted CCUs to attract larger deposits from members and non-members.

Supporting linkages of self-help groups with banks through proper policy environment is another area to explore. This option is currently gaining support from a number of sectors. Effort in this area is being spearheaded by a number of non-governmental organizations. In this regard, a re-orientation of the existing credit guarantee facilities of the government in support of self-help groups would help in promoting such linkages. The government presently implements several guarantee programs 8/ which have been found to benefit mostly large borrowers and the banks accredited to participate in the schemes (Magno and Meyer 1988).

Support to the sustained development of small savings club and cooperatives through training would make an impact on equity, allocation efficiency, and balancing of economic powers. There is wide scope for cooperatives and other self-help savings groups to engage in local resource/savings generation and lending. Along with this, the potential is also large for a cooperatives-based promotion of investment opportunities among the population with no access to banks and have limited resources to exploit

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8/ These are the Guarantee Fund for Small and Medium Enterprises (GFSME), Quedan Guarantee Fund Board (QGFB) program, and the guarantee scheme under the Philippine Crop Insurance Corporation (PCIC).

investment and market opportunities. But a great deal of training inputs is necessary to equip them with capabilities to plan, manage, implement savings, lending, and investment activities as well as to keep simple accounting and auditing systems.

With respect to trade credits, this is bound to grow rather than diminish in time. It should be recalled that discounting of checks is a popular mode used by informal creditors. The issue is how to make the credit instrument, i.e., the checks issued to manufacturers, become a more widely bankable instrument especially for the benefit of the smaller manufacturers. There are pockets in the informal trade credit sector, like the footwear industry of Marikina, where bank initiative to discount issuer checks offers an alternative to the manufacturer. Nevertheless, discounting by this bank is still limited to checks issued by big and established department stores.

Considering the importance of trade credit to small manufacturers and the rather large pricing differential against their favor, the government should encourage the setting up of an investigative agency to provide information on issuers of checks. This would be similar to the Credit Information Bureau, Inc. which the government helped establish a number of years ago to provide credit information on big borrowers to member banks. This investigative agency can be a private or a semi-private entity, possibly capitalized by manufacturers' associations and/or subscribers, including banks. The participation of manufacturers will be crucial especially in determining who to investigate among the issuers of checks.

The export of manpower is a significant source of foreign exchange for the country. Yet, as we have seen, the sector is largely fueled by ICMs. The priority policy option here is to make the job contract a negotiable instrument for bank loans and rediscounting with Central Bank. The scheme would be similar to exporters' credit wherein the eligible credit instruments are given priority by bank and in the rediscounting window of CB. One problem here, however, is that banks try to avoid small loans because of high handling costs. One avenue to provide legitimate contract holders access to bank loans is by developing tie-ups between duly authorized recruitment agencies and banks. The agency can endorse and guarantee job contracts to the bank. The agency, in effect, will participate in the loan screening process which reduces the bank's transactions costs, and in the remittance of loan repayments. Moreover, seed funding and loan insurance/guarantee coverage on bank loans should be provided from the Welfare Fund, which has been set up with forced contributions from the workers. The above would be a better option than setting up a bank which is being considered by some quarters, to cater to overseas workers.

Pawnshops have a potential capacity for mobilizing deposits. As of the end of 1987, 1,676 pawnshops outlets have been established throughout the country. Yet the physical, manpower, and other resource capacities of pawnshops have not been considered for servicing deposits in the same way that they are able to service relatively small loans. Being in the formal sector, deposits mobilized by pawnshops can enjoy the protection of the deposit insurance system. One constraint in getting them to perform deposits generation comes from the difficulty of supervising so many small units. The Central Bank has the supervisory power over the pawnshops presently. In some countries like Sri Lanka, small financial institutions in the rural areas who lend on the basis of pawns are also allowed to accept deposits, but they are linked and supervised by a state-owned commercial bank. The monetary authorities should seriously consider tapping this segment especially because depositors with only small amounts to deposit are likely to be benefited. Moreover, access to savings would be a source of additional loanable fund for the pawnshops' credit activities. Right now, many pawnshop operators depend largely only on their own funds. Blending own funds with deposits may result to lower interest rates on pawned loans.

Lastly, a monitoring system on the ICMs should be instituted. The most basic data needed for any market for an economic good or service, is the price of the commodity and the flow of transactions in the commodity. In the case of the informal credit markets, it is essential to have data on rate of interest. The initial concern is standardization.

In view of the great heterogeneity among informal credit suppliers and reliability of data, a more viable option is to monitor the interest rates of the borderline institutions such as the pawnshops and lending investors. Presently, the Central Bank does not monitor the interest rates charged by these institutions. Because of their large number of units, monitoring all of them may not really be feasible. Instead, a sample distributed according to geographic location and size of the institutions can be tracked through time.

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ANNEX

TYPE OF DATA, RESPONDENTS, AND RESEARCH INSTRUMENTS OF THE VARIOUS STUDIES

Title of Study	Type of Data	Type of Respondents	No. of Cases	Research Instrument
1. "Response to New Market Opportunities: The Case of Overseas Employment Sector"	Primary	Newly hired OCW	153	Structured questionnaire
		Vacationing/Returning OCW	183	Structured questionnaire
		Moneylender	12	Structured questionnaire
		Contractor-agent	45	Structured questionnaire
		Owner/manager, rec. agency	4	Open-ended questionnaire
		Remittance courier	3	Open-ended questionnaire
2. "The Informal Credit Market of Six Selected Barangays in Nueva Ecija, 1972-87"	Primary	Rice farmer-borrower	88	Open-ended questionnaire
		R-Onion farmer-borrower	44	Open-ended questionnaire
		Non-farmer household	38	Open-ended questionnaire
		Moneylender	46	Open-ended questionnaire
		Bank	5	Open-ended questionnaire
3. "A Review of Policies Impinging on the ICM"	Secondary			
	Primary	CB officer	3	Open-ended questionnaire
		Money shop officer	4	Open-ended questionnaire
		Rural bank officer	4	Open-ended questionnaire
		Commercial Bank officer	4	Open-ended questionnaire
4. "The Size and Trends in ICMs: An Analysis and Policy Implications"	Primary	Voting age adult	1200	Structured questionnaire
5. "An Analysis of the Role of Pawnshops in the Financial System"	Secondary	Pawnshop units	100	

Title of Study	Type of Data	Type of Respondents	No. of Cases	Research Instrument
6. "Informal Savings and Credit Institutions in the Urban Areas: The Case of Cooperative Credit Unions"	Primary	Coop credit union member	82	Structured questionnaire
		CCU manager	10	Structured questionnaire
7. "The Financial Markets in Low-Income Communities: The Case of Sapang Palay"	Primary	Moneylender	7	Structured questionnaire
		Paluwagan manager	4	Structured questionnaire
8. "The Manufacturing Sector and the Informal Credit Markets: The Case of Trade Credits in the Footwear Industry"	Primary	Footwear manufacturer	63	Structured questionnaire
		Input supplier	9	
9. "Case Studies on the Monitoring of Informal Credit Markets"	Primary	Rural informal lender	10	Open-ended questionnaire
		Urban informal lender	12	Open-ended questionnaire
		Urban-rural inf. lender	5	Open-ended questionnaire
10. "Towards a Monitoring System for Informal Credit Markets"	Secondary			