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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON, D.C. 20523

PROJECT PAPER

PHILIPPINES

RURAL FINANCIAL SERVICES  
PROJECT

492-0394

SEPTEMBER 1985

USAID/MANILA

UNCLASSIFIED

<b>AGENCY FOR INTERNATIONAL DEVELOPMENT</b> <b>PROJECT DATA SHEET</b>	<b>1. TRANSACTION CODE</b> <input type="checkbox"/> A = Add <input type="checkbox"/> C = Change <input type="checkbox"/> D = Delete	Amendment Number _____ <b>DOCUMENT CODE</b> 3
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<b>2. COUNTRY/ENTITY</b> Philippines	<b>3. PROJECT NUMBER</b> 492-0394
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<b>4. BUREAU/OFFICE</b> ASIA/NEAR EAST	<input type="checkbox"/> 04	<b>5. PROJECT TITLE (maximum 60 characters)</b> Rural Financial Services Project
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<b>6. PROJECT ASSISTANCE COMPLETION DATE (PACD)</b> MM DD YY 1   2   3   1   9   0	<b>7. ESTIMATED DATE OF OBLIGATION</b> (Under 'B.' below, enter 1, 2, 3, or 4) A. Initial FY 8   5        B. Quarter 4 C. Final FY 8   6
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8. COSTS (\$000 OR EQUIVALENT \$1 = )						
A. FUNDING SOURCE	FIRST FY 85			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total	1,189	17,661	18,850	1,189	18,811	20,000
(Grant)	( 1,189 )	( 1,411 )	( 2,600 )	( 1,189 )	( 1,411 )	( 2,600 )
(Loan)	( - )	( 16,250 )	( 16,250 )	( - )	( 17,400 )	( 17,400 )
Other U.S.						
1.						
2.						
Host Country	-	116,340	116,340	-	116,340	116,340
Other Donor(s)	63,500	36,500	100,000	63,500	36,500	100,000
<b>TOTALS</b>	64,689	170,501	235,190	64,689	171,651	236,340

9. SCHEDULE OF AID FUNDING (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) FN	200	040	040			2,600	16,250	2,600	17,400
(2)									
(3)									
(4)									
<b>TOTALS</b>						2,600	16,250	2,600	17,400

<b>10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)</b> 041      042      043      044      246      253	<b>11. SECONDARY PURPOSE CODES</b>
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<b>12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)</b> A. Code      TNG	B. Amount
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**13. PROJECT PURPOSE (maximum 180 characters)**

To strengthen the policy and institutional framework necessary to develop a self-sustaining rural financial system.

<b>14. SCHEDULED EVALUATIONS</b> Interim    MM YY    MM YY    Final    MM YY                                 1 2 8 7    0 9 8 9	<b>15. SOURCE/ORIGIN OF GOODS AND SERVICES</b> <input checked="" type="checkbox"/> 000 <input checked="" type="checkbox"/> 941 <input checked="" type="checkbox"/> Local <input type="checkbox"/> Other (Specify)
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**16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a \_\_\_\_\_ page PP Amendment.)**

<b>17. APPROVED BY</b>	Signature <i>Frederick W. Schieck</i> Frederick W. Schieck Title Director	<b>18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION</b> Date Signed MM DD YY 0   9   2   3   8   5
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- A. CB Request for Assistance**
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## RURAL FINANCIAL SERVICES PROJECT

### SUMMARY AND RECOMMENDATIONS

1. Borrower/Grantee : The Central Bank of the Philippines (CB)
- 2: Guarantor : The Government of the Philippines (GOP)
- 3: Implementing Entity : The Central Bank of the Philippines
4. Loan/Grant Amount : Loan - \$17.4 million  
Grant - \$2.6 million
5. Purpose : To strengthen the policy and institutional framework necessary to develop a self-sustaining rural financial system.
6. Project Description : The Rural Financial Services Project represents a parallel co-financing effort with the World Bank's Agricultural Credit Project. It will consist of two components: a \$17.4 million loan and a \$2.6 million grant. The loan component will provide resources to the CB for rediscounting specified loans made by qualified rural financial intermediaries to the rural private sector. The grant component will provide for technical assistance, studies and training for the institutional development of the rural financial system.

#### 7. Project Elements (US \$000)

##### Loan

Reimbursement to CB	\$ 17,400
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##### Grant

Technical Assistance	1,304
Studies	200
Training	250
Evaluation	100
Inflation and Contingency	746

Total	\$ 20,000
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- 8: Total Project Cost : \$203.0 million of which AID will provide \$20 million, the World Bank \$100 million, the CB \$35.0 million, participating financial intermediaries \$24.3 million, and the subborrowers \$23.7 million.

9. Application : The GOP's application is included as Annex A.
10. Statutory Requirements: All statutory requirements have been met. See Annex C.
11. Analyses : The analyses presenting overall feasibility considerations are included in Section IV-G of this Project Paper.
12. Recommendation : That a \$17.4 million loan and a \$2.6 million grant be authorized to the CB based on terms and conditions described in the draft authorization.

13. Project Committee (USAID Manila):

- |                     |                                                |
|---------------------|------------------------------------------------|
| Keith Brown         | - Deputy Chief, OCD                            |
| Jonathan D. Halpern | - Agricultural Economist, ORAD                 |
| Michael Hauben      | - Assistant Project Development Officer, OCD   |
| Brian Miller        | - Regional Legal Advisor                       |
| William T. Oliver   | - Acting Deputy Director                       |
| Susan K. Riley      | - Assistant Project Development Officer, OD/PE |
| Cho Roco            | - Program Specialist, PO                       |
| Robert B. Stader    | - Chief, Logistics Division                    |
| Nimalka Wijesooriya | - Budget and Accounts Officer, CO              |

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## LIST OF ABBREVIATIONS/ACRONYMS

AID	Agency for International Development
ALF	Agricultural Loan Fund
ALFPAG	Agricultural Loan Fund Policy Advisory Group
<b>BANGKOOP</b>	<b>Cooperative Rural Banks Federation of the Philippines</b>
CB	The Central Bank of the Philippines
CBI	Central Bank Institute
CDSS	Country Development Strategy Statement
CRB	Cooperative Rural Bank
DBAP	Development Bankers Association of the Philippines
DBP	Development Bank of the Philippines
DLC	Department of Loans and Credit
GOP	Government of the Philippines
LBP	Land Bank of the Philippines
M99	Masagana 99
MRR	Manila Reference Rate
PB	Participating Banks
PD	Presidential Decree
PDIC	Philippine Deposit Insurance Corporation
PIL	Project Implementation Letter
PIO/T	Project Implementation Order for Technical Services
PNB	Philippine National Bank
RB	Rural Bank
RBAP	Rural Bankers' Association of the Philippines
SGB	Special Government Banks
STD	Special Time Deposit
TA	Technical Assistance
TBAC	Technical Board for Agricultural Credit
TOR	Terms of Reference
USAID	United States Agency for International Development
WB	World Bank

## PROJECT AUTHORIZATION

**PHILIPPINES**

**Rural Financial Services Project  
Project No. 492-0394**

1. Pursuant to Section 103 of the Foreign Assistance Act of 1961, as amended, and in accordance with my authority as conveyed in State 162201 dated May 29, 1985, I hereby authorize the Rural Financial Services Project (the "Project") for the Republic of the Philippines involving planned obligations to the Central Bank of the Philippines (the "Central Bank") of not to exceed \$17,400,000 in loan funds and \$2,600,000 in grant funds over a two year period from date of authorization subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is five years and four months from the date of initial obligation.
2. The purpose of the Project is to strengthen the policy and institutional framework necessary to develop a self-sustaining rural financial system in the Philippines. Loan funds will be used to provide resources to the Central Bank for funding specified loans made by qualified rural financial intermediaries to the rural private sector. Grant funds will be used to provide for technical assistance, studies and training for the institutional development of the rural financial system.
3. The Project Agreement, which may be negotiated and executed by the officer(s) to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate:

(a) Interest Rate and Terms of Repayment

The Central Bank shall repay the Loan to A.I.D. in U.S. Dollars within forty (40) years from the date of first disbursement of the Loan, including a grace period of not to exceed ten (10) years. The Central Bank shall pay to A.I.D. in U.S. Dollars interest from the date of first disbursement of the Loan at the rate of (1) two percent (2%) per annum during the first ten (10) years; and (2) three percent (3%) per annum thereafter, on the outstanding disbursed balance of the loan and on any due and unpaid interest accrued thereon.

(b) Source, Origin and Nationality

Except as A.I.D. may otherwise agree in writing:

(1) With respect to the Project's Loan-funded component, goods financed by A.I.D. shall have their source and origin in the Republic of the Philippines (the "Cooperating Country") or in countries included in A.I.D. Geographic Code 941; services financed by A.I.D. shall be of Cooperating Country or Code 941 nationality; and ocean transportation financed by A.I.D. shall be on vessels under flag registry of the Cooperating Country or countries included in A.I.D. Geographic Code 941 as in effect at the time contracts are entered into for such services.

(2) With respect to the Project's Grant-funded component, goods financed by A.I.D. shall have their source and origin in the Cooperating Country or the United States; services financed by A.I.D. shall be of Cooperating Country or United States nationality; and ocean transportation financed by A.I.D. shall be on vessels of United States registry only.

Clearances:

<u>Typed Name</u>	<u>Office Symbol</u>	<u>Date</u>	<u>Initial</u>
JATennant	OCU	<u>5/3/85</u>	<u>[Signature]</u>
DJClark	ORAD	<u>9-4-85</u>	<u>[Signature]</u>
WTOliver	PO	<u>9-4-85</u>	<u>[Signature]</u>
BLEckersley	CO	<u>9/4/85</u>	<u>[Signature]</u>
BBMiller	RLA	<u>9/4/85</u>	<u>[Signature]</u>
JSBlackton	OD	<u>9/1/85</u>	<u>[Signature]</u>

Signature: [Signature]  
Frederick W. Schieck  
Mission Director  
USAID/Philippines

Date : Sept. 23, 1985

## I. INTRODUCTION

1.01. The rural sector, with agriculture expected to play the predominant role, has been identified by the GOP to stabilize and provide the growth stimulus to revitalize the economy as a whole. The Mission's CDSS fully supports this objective. Accordingly, the Goal of the Rural Financial Services Project is to assist the GOP increase the rate of economic growth in the rural sector.

1.02 For the rural sector to perform in this capacity, it must have support from a strong rural financial system. The Philippines' rural financial system, as presently structured, will have difficulty supporting the higher levels of rural production necessary for this sector to grow. Macroeconomic forces and government credit policies have, over the past two decades, impeded rather than enhanced growth in the financial system, particularly the rural financial system. As a result, the weakened state of this system has remained a serious constraint to growth in the rural economy.

1.03 The World Bank (WB) has executed a \$100 million loan agreement with the Central Bank of the Philippines (CB) for an Agricultural Credit Project designed to introduce policy and institutional reforms essential for self-sustaining financial intermediation in the rural sector.

1.04 The Purpose of the Rural Financial Services Project is to complement the objectives of the WB's Agricultural Credit Project by assisting the GOP strengthen the policy and institutional framework necessary for a self-sustaining rural financial system.

1.05 To accomplish this purpose, the project provides a loan of \$17.4 million and a grant of \$2.6 million to the CB. The loan proceeds will be used to reimburse the CB for rediscounting specified loans made by the rural financial system to the agricultural sector. The loans from the CB to qualified participating rural financial institutions and the loans from those institutions to the subborrowers will be at market-oriented interest rates. The grant proceeds will be used by the CB to provide technical assistance and fund studies and training, as necessary, to strengthen the institutional framework of the rural financial system.

1.06 In consonance with the AID Policy Paper on Co-Financing, USAID has decided to participate with the WB on a parallel co-financing basis as it represents the most efficient application of AID resources in view of current GOP priorities and strategies for economic recovery through its increased emphasis on the rural sector. By pooling AID resources and policy dialogue efforts with the WB, the Mission will be in a better position to conduct a more intensive dialogue with the GOP on the adoption and implementation of appropriate interest rate policy and institutional reforms that directly affect the rural financial system. It will also provide the Mission with the opportunity to be closely associated with and have a direct influence on this very high priority project which our resources alone would not otherwise afford us.

## II. BACKGROUND

### A. A Macroeconomic Overview

2.01 Since the latter months of 1983, the Philippine economy has been in a severe crisis. Economic growth which had decelerated over the previous four years reached a negative growth rate in 1984. Industries producing for the domestic market have been operating far below capacity and are having difficulties meeting their debt service requirements. The agricultural sector, still suffering from the impact of a drought in 1982/83, has been further impacted by adverse movements in the terms of trade. Private investment has slowed, reducing the generation of new employment opportunities so that the already high under- and unemployment rates have increased further. By late 1984, inflation had accelerated to over 60% per annum and real wages were continuing their decline. Export volumes for primary commodities (e.g. sugar, coconut) and manufactured goods (e.g. electronics, garments) stagnated and export earnings fell due to deteriorating terms of trade. In comparison with most of its neighbors, which have faced many of the same economic problems, the Philippines' economic performance has been poor.

2.02 Although there are numerous factors contributing to this poor performance, the deterioration of the Philippine economy essentially followed the second oil crisis in 1979 and reflected the impact of the subsequent international recession as well as structural problems of the economy. The oil import bill increased substantially from 1978 to 1980. The international recession led to weak demand and lower prices for most exports, with export earnings from the traditional primary commodities, such as copper, sugar, and coconut sharply reduced. Agricultural exports in 1983-84 were also affected by adverse weather. Earnings from non-traditional manufactured exports stagnated. Services, therefore, were the main element that stabilized export earnings. Despite the deterioration in export performance, the country continued to import intermediate goods for industrial production, spurred by an exchange rate that did not reflect the true scarcity of foreign exchange. Despite the world recession, and partly to stimulate the domestic economy, the Government continued expanding its investment program, heavily financed by foreign borrowing. However, many of the projects were inefficient, poorly designed, overpriced or resulted in excess capacity and have therefore since become burdens to the economy.

2.03 Prior to 1983, the Philippines was still able to finance its growing current account deficits with loans from foreign commercial banks, although these banks were increasingly shortening loan maturities and raising interest rates on existing and new debt. With the sudden change in the political situation in August 1983, credit lines from foreign banks were reduced and capital flight increased resulting in a massive balance of payments deficit which could not be offset by a drawing-down of international reserves. The Government was forced to seek a moratorium on debt payments and to begin negotiations for a debt rescheduling which were not finalized until mid-1985.

2.04 Stabilizing the economy has been a major concern of the Governments'. Several measures have been taken since mid-1983 to achieve this objective. Most recently, the GOP developed an adjustment program that was accepted by the IMF for its SDR 615 million Stand-By Arrangement. This program stressed, among other aspects: (1) decontrolling the exchange rate; (2) limiting wage increases, especially for public sector employees; (3) diversifying market outlets, particularly for sugar and coconuts; (4) reforming the tax system by widening the tax base and emphasizing domestic collections; (5) reducing the dependence of major public sector corporations on the public exchequer; and (6) strengthening the financial sector and rehabilitating public financial institutions.

2.05 Much of the agreed-upon program is now in place and the Government continues its process of embracing all of the underlying principles of the program. It is now in the process of establishing timetables for policy reforms and investment plans. These issues are being addressed in several ways by: (1) the IMF in its quarterly review of the Standby Arrangement; (2) the WB through the sub-committee of the Consultative Group and the second tranche review under its Agricultural Inputs Loan; and (3) the U.S. Government's policy dialogue with the GOP through the AID Program.

#### B. Financial System

2.06 Recent years have shown substantial growth in the Philippine financial system. Total assets which stood at a mere P96 billion in 1974 have grown five-fold to P548 by 1984, for a per annum real rate of growth of close to nine percent during this period. The number of bank branches operating within the country have doubled since 1970 (5,674 as of the end of 1983).

2.07 However, the economic difficulties of the Philippines have adversely affected the financial system. The deteriorating performance of industrial and agricultural enterprises is reflected in the worsening portfolio and increasing liquidity problems of financial institutions. Due to the prolonged recession, many financial institutions are facing a liquidity crisis with several approaching insolvency.

2.08 Still recovering from the 1981 financial crisis in which a prominent businessman fled the country with over P700 million in unpaid debts, the financial sector suffered another serious setback beginning in August 1983 with the assassination of Senator Aquino. The political uncertainty which followed resulted in massive capital flight and deposit withdrawals which affected many financial intermediaries. Smaller intermediaries were most severely affected, but the larger ones and those with international collaborations were also severely constrained. By the end of 1983, the Central Bank had provided emergency loans to 46 financial institutions. A large savings bank and several smaller banks have been closed by the CB for insolvency. There have also been several mergers and consolidations of financial institutions following the crisis. The lack of confidence and the

element of uncertainty, which constitute major dimensions of the present crisis, have led to notable shifts of funds within the banking sector. This has created the paradoxical situation in which some large banks have high levels of liquidity while smaller banks are suffering from a shortage of funds. Particularly evident is a shift of deposits to foreign banks, which recorded a 67% increase in liquid assets in 1984. Nearly three-fourths of the interbank deposits were with foreign banks, compared to over ninety percent (90%) with domestic banks in the previous year.

### C. Rural Financial System

2.09 The commercial banking system represents the largest network of banking facilities within the country, with more than 1,900 branch offices as of 1983. Thirty-seven percent (37%) of these offices are located in rural areas. The private rural banking system has well over 1,000 office, including branches, with ninety-six percent (96%) situated in rural areas, making it the largest network of rural financial institutions within the country. Thrift banks represent some 700 branch offices, over half of which are rural-based. Specialized government banks account for some 316 banking offices, seventy percent (70%) of which are located in rural areas. The remainder of the formal financial system is composed of nonbanking institutions such as various financial intermediaries, thrift institutions and credit unions. The entire system is regulated by the CB. All agricultural lending through banking channels is regulated by the CB per Republic Act 337, which grants the CB such regulatory powers.

2.10 Of the rural financial institutions, the most active have been the commercial banks, the private and cooperative rural banks, the government-owned Philippine National Bank (PNB), Development Bank of the Philippines (DBP) and Land Bank of the Philippines (LBP) and, to a lesser extent, the private development banks. In recent years there has been a trend toward greater participation in rural based lending by private commercial banks and a reduction of this type of financing by government banks, which have been burdened with mounting loan arrearages and nonperforming assets across sectors.

2.11 The rural financial system has been particularly hard hit by recent economic events. In addition to the factors contributing to the deterioration of the financial sector and the agricultural sector, the rural financial sector has perhaps been most affected by special programs and the associated credit policies aimed at increasing overall agricultural production. Low repayment rates have plagued almost all of these programs and as a result, the rural financial sector is in a weakened state. Very few of its institutions are able to perform the intermediation process efficiently, most have severe liquidity problems and several are insolvent. Loan arrearages with the CB are currently averaging as high as 72% for thrift, and private and cooperative rural banks. Also, the major reduction in the level of funds available for rediscounting by the CB has hit the rural financial system particularly hard. These conditions have forced many of the rural financial institutions out of these special programs, and have reduced their ability to service the credit and other financial needs of their constituents.

#### D. Agricultural Sector Policy

2.12 By and large, past government interventions in the economy have tended to discriminate against agriculture in favor of urban based industry. These interventions have depressed prices and incomes, reducing the incentives to farmers and agribusiness to make productivity-increasing investments.

2.13 The bias against agriculture stems from the combined effects of macroeconomic policies and commodity-specific policies. Prior to the mid 1970s, this bias was due mainly to strategies the government pursued in promoting industrialization. Overvalued exchange rates, high tariffs and tax incentives to industry and government guarantees for foreign borrowings of highly protected industries served to skew the structure of investment incentives toward industry. Since the 1970s, an additional element of bias has been the increasing regulation and implicit and explicit taxation of agriculture. Export taxes and high import tariffs on agricultural inputs and commodities have increasingly been levied on the sector. Concurrently, the number of public and parastatal agricultural institutions has grown, as has the scope of their interventions which has tended to hamper rather than enhance incentives for increasing agricultural productivity.

2.14 The combined effect of the abovementioned policies has been to draw savings from the rural sector into a highly-protected, import-substituting industrial sector. Interest rate subsidies and other policies designed to increase the flow of investment to agriculture had little impact, because the price structure favored investment in manufacturing and partly because low interest rates discouraged savings mobilization.

### III. THE PROBLEM

#### A. Background

- 3.01 For the last two decades the GOP has employed various policies intended to achieve a range of development objectives including food self-sufficiency, low food prices, increased farm income, and improved balance of payments. Price, interest rate and exchange rate controls, import tariffs, export taxes, and the establishment of marketing agencies have been the primary policy instruments through which the GOP has sought to achieve these development objectives. That these policies have not had the desired effects is in part a reflection of the varied and conflicting nature of the objectives these policies were designed to achieve.
- 3.02 The primary objective of the GOP over the past two decades in rural finance has been to increase the flow of credit resources to agriculture to support increased investment in productivity-increasing technologies, which in turn was to enhance aggregate and farm income, employment and output. The GOP did not seek to increase the flow of credit resources to agriculture and other subsectors of the rural economy through savings mobilization in the rural sector but rather through special agricultural credit programs at subsidized interest rates and by controlling the interest rate charged by the participating banks to the final borrower.
- 3.03 While these measures have achieved some degree of success in terms of the number of small farmers with access to formal credit (from 5 to 12%, 1965 to 1983), growth of retail banking outlets in rural areas (300 to 2300, 1970 to 1983) the growth in the proportion of total credit going to agriculture (averaging 12% p.a., 1972-83), they have also weakened the rural financial system itself, thereby limiting the system's capacity to perform its essential intermediation functions.
- 3.04 In addition to the adverse impact of interest rate and rediscounting policies, a number of other policies and administrative factors have contributed to structural constraints that confront the banking system. Foremost among these are: (1) management weaknesses within the financial system, (2) high transaction costs, (3) the proliferation of special financing programs, (4) limited effectiveness of risk management instruments (crop insurance, savers insurance), and (5) regulations constraining growth of normal banking services in rural areas.
- 3.05 Other factors affect the extent of credit needs and flows to agriculture. Most important are input and output price policies, exchange rates, government market interventions and international trade policies.
- 3.06 In summary, the Philippines' rural financial system, as presently structured, will have difficulty supporting the substantially higher levels of agricultural and rural production and employment necessary for the economy's recovery and future growth.

## B. Policy (Technical) Issues

### 1. Interest Rates

3.07 The GOP interest rate control and subsidization policies, promulgated to increase the flow of credit resources to the rural sector, have seriously impaired the ability of rural financial institutions to perform the financial intermediation process efficiently because they are at direct variance with the incentives necessary for mobilizing savings. Most of the special agricultural credit programs provide for rediscounting participating bank loans through the CB at subsidized interest rates and limit the interest rate spread that the participating banks can charge the subborrowers. The CB rediscount rates have been lower than the rates these banks pay on time deposits. As a result, with the borrowers in a position to avail themselves of the funding from these special programs, there has been little, if any, incentive for these banks to secure loanable funds through the marketing of savings instruments. Thus, growth in the rural financial sector over the past two decades has come primarily from the CB rediscount window rather than from additional capitalization or growth in savings deposits. The banks have, therefore, become almost totally dependent on highly subsidized government funds.

3.08 To illustrate, until recently, under GOP supervised credit programs for agriculture, the lending rates to borrowers were controlled at rates as low as 6-12 percent. Concurrently, to encourage the involvement of the rural financial system in the specialized credit programs focussed on agriculture and to support the controlled interest rates on these loans, through their rediscounting facility, the CB provided funds to participating banks for as low as 1-3 percent for 100% of the value of the loan. This was done when savings and time deposits were at a maximum of 9.5 percent and 14.5 percent, respectively.

3.09 A look at the loanable funds structure of rural banks reveals a heavy dependence on CB borrowings. As of 1983 borrowings were largely in the form of CB rediscounts and comprised more than half of the total assets during the year. Between 1972 and 1983, borrowings from the CB grew 35.9 percent annually compared to 14.0 percent and 23.2 percent in the capital and deposit accounts, respectively. The share of borrowings to total assets increased to 50.4 percent in 1983 from 27.7 percent in 1972, while that of deposit accounts remained stagnant at approximately 36 percent in 1983 and that of the capital account declined precipitously to 14 percent from 34.1 in 1972. One-third of the total rural banking system depends on CB funds for up to 75 percent of their loanable resources. In addition, the ratio of borrowings to net worth deteriorated from 31.5 percent in 1960 to 363.5 percent. As of December 1983, agricultural loans were more than 3 times that of rural deposits.

3.10 Moreover, the fact that these were government funds and the lending was supply-led rather than demand driven has tended to discourage repayment by both intermediary institutions and final borrowers. The financial intermediaries have had little incentive to supervise and collect loans as their exposure has been limited. The subborrowers have come to regard

government financed credit as temporary and with little or no penalty for non-payment were, therefore, less inclined to repay. Clearly, there are selected cases where natural calamities have restricted repayment capacity and contributed to the high arrearages. Nonetheless, the long history of GOP leniency in rolling over past due loans under these special credit programs has impaired repayment discipline among both participating banks and final borrowers.

3.11 The high default rates on loans extended under these government sponsored programs has led to the deterioration in the financial position of participating banks. Again, using the rural banks to illustrate this problem, 33 percent of the loan portfolio of rural banks are past due with ninety percent (90%) of that amount agricultural loans. Fifty percent (50%) of this latter amount is comprised of the supervised credit programs. A number of reasons have been cited for why borrower-rural bank arrearages are high, including the effect the economic crisis has had on farm income. However, the predominant reason cited is that the nationwide implementation of the supervised credit programs, with all the attendant high-profile promotional campaigns, conveyed the final-borrowers' view that the special credit programs were dole-outs they were entitled to, particularly as they were aware of how anxious the GOP was in raising agricultural production.

3.12 Relative to rural bank arrears with the CB, more than four-fifths of the rural banking system has past due obligations, with the CB-supervised credit constituting more than 50 percent of this total. Rural bank arrearages accounted for half of the total CB rediscount arrears in 1984. It should be noted that rural bank/CB arrears are much higher than borrower/rural bank arrears indicating that rural banks have not been defaulting with the CB solely on account of borrowers' loan default. A few of the reasons for this problem includes: (a) the rising costs of rediscounts under the Manila Reference Rate (MRR) floating rate scheme where banks opted to hold on to loan collections for use as roll-over funds rather than borrow again at the much higher rate; and (b) the deliberate non-payment of rural banks to the CB in consideration of the fact that penalty charges were lower than current market rates for alternative investments.

3.13 In addition, the reduction in all rediscounting facilities in 1984 reduced the availability of CB rediscounts from ₱8.16 billion in 1983 to ₱2.7 billion in 1984 of which agriculture (excluding sugar) received approximately 14 percent. This has had a major effect on lending to agriculture in light of the previously discussed heavy dependence by the rural financial system on CB rediscount funds as its primary source of loanable funds.

3.14 Having failed to develop programs to mobilize savings, the rural banking system's ability to provide financial services has been significantly reduced.

## 2. Conclusion

3.15 It appears from the discussion above that the best option available to the GOP in resolving these problems maybe to provide the rural financial system with the incentives necessary for it to perform the financial intermediation process in an efficient and effective manner. The critical first steps in accomplishing this objective involve the GOP: (1) deregulating interest rates on CB - rediscounted subloans; (2) phasing out government subsidies on agricultural credit; and (3) eventually discontinuing most if not all special government credit programs.

3.16 The CB agrees with this conclusion and in its negotiations with the WB as a precondition for the Agricultural Credit Project loan funds, has agreed to a number of policy reforms to: (1) free interest rates for agricultural-based loans; (2) provide an action plan to phase out government subsidies for agricultural credit; (3) establish a mechanism for the continuing review of rural credit policies, programs, and institutions, and (4) investigate and implement measures which would address the subloan arrearage problem.

### C. Institutional Issues

3.17 The following areas have been identified as additional potential constraints to the efficiency of the financial intermediate process in the rural financial sector. Accordingly, the policy and institutional studies component of this project will investigate the effects of these constraints and provide recommendations for the elimination of deficiencies in these areas. The training component will also serve to provide the necessary training to improve the intermediation process.

#### 1. Management Weaknesses

3.18 While the causes of loan defaults are many, at least part of the responsibility lies with the management of individual financial institutions. The inability to develop in-house technical capabilities in loan preparation, appraisal, supervision and collection has weakened the performance of banks engaged in lending to the rural sectors. Weak management information and reporting systems, cumbersome lending procedures, lack of knowledge concerning deposit and loan portfolio management and the inability to conduct even rudimentary planning and evaluation have been major factors in the performance of the rural financial system.

3.19 The declining availability of subsidized government rediscounted funds will require rural financial intermediaries to rely increasingly on deposit mobilization as a source of loanable funds. Banks which have heretofore depended on CB rediscount facilities will have to reorient the manner in which they market their services and manage their portfolios. A number of banks operating in rural areas lack the necessary expertise to meet the challenges posed by a liberalized interest rate regime. For financial institutions, particularly the rural banks (RBs), to pass through this transition period in a manner which strengthens and solidifies their financial position, their management and institutional capacities as well as those of the CB and bankers' associations should be improved.

3.20 Human resources development is needed in the rural banking system. Improved skills are needed in overall bank management, including loan and deposit portfolio management, management information and reporting, planning, accounting, control, auditing, and staffing. Similarly, technical skills should be developed in such areas as borrower selection, loan feasibility and appraisal, loan delivery and supervision, and agricultural finance in general. The capacity to provide training and technical assistance to support this development need should be institutionalized within the banking system.

3.21 In addition to training and technical services, a macro system planning capability should be developed within the financial system. Improved management information and reporting procedures, research, and monitoring and evaluation tracking mechanisms will be necessary to allow for the institutionalization of such planning capability. Also, private banking institutions, and the apex organizations which represent them, need to develop their own capabilities in these areas.

3.22 The organizational structure of the rural banking system needs to be reviewed carefully to determine future development needs and address existing structural deficiencies limiting growth and development.

## 2. High Transaction Costs

3.23 If the bank borrows from the CB, the paperwork and procedures for obtaining a loan in the rural financial system are complex and cumbersome. Paragraph 3.09 above indicates that most rural banks have and do borrow from the CB. Many of the requirements are imposed by the CB while others are required by the individual bank managements. These requirements impact directly on the loan administration costs which are translated into higher interest costs.

3.24 Process flows and requirements for availing of rediscount funds from the CB for special programs require at least ten (10) documents to be completed by the banks applying. All but three (3) of these documents are required to be submitted to the CB everytime a bank applies for rediscounting. Banks can wait as long as two (2) months before rediscounted funds are released. Undue delays in funds releases are caused by a number of factors including, incomplete documentation, computation errors, pre-audits, and delays in funds transmittal by depository banks. All of these procedures are repeated 24 times a year for rural banks because they normally rediscount eligible papers twice a month.

3.25 At least two other factors increase transaction costs. They include:

(1) The present guidelines for implementing the Manila Reference Rate (MRR) system. The MRR system allows for weekly changes in the MRR. This poses a serious problem for rural banks in distant areas where communications linkages are bad and it is very difficult to get updated information. This results in a misquoting of these papers and, subsequently, delays in the release of discount funds;

(2) The lack of coordination among CB departments/units results in delays in processing bank applications for rediscount funds due to the failure of one department to readily make available bank reports needed by the other.

3.26 Cumbersome CB procedures squeeze bank spreads and act as deterrents for lending to the agricultural sector. While these requirements and procedures assure the CB of proper funds allocation, a streamlining of CB requirements may be required to reduce costs to the CB, banks and in-turn to the final borrowers.

### 3. Proliferation of Special Financing Programs

3.27 The number of government financed agricultural credit programs increased from four (4) in 1970 to thirty-six (36) in 1984. Seventy-five percent (75%) of those are commodity specific supervised credit schemes, the remainder being for activities such as cooperative development, area development and farm mechanization. These programs carry different interest rates, terms and procedures leading to confusion on the part of subborrowers and in some instances, encouraging misclassification of loan use on the part of financial intermediaries.

3.28 While such programs have had some success in terms of transferring technologies, raising yields and output, they have done so with a very small percentage of the nation's farmers. Participation of financial intermediaries and farmers in such programs has been limited due to a number of factors, foremost being fragmented services that commodity specific agricultural lending programs engendered and their attendant high costs to both borrowers and lenders. Financial intermediaries must process separate loan applications and supervise each commodity financed (as must the CB). Final borrowers must apply for each program separately, with the attendant delays, paperwork and travel time. As rural banks rarely participate in more than two or three programs, the kind of credit available often does not match the farmers desired cropping pattern, preventing the bank from providing the appropriate mix of financing.

3.29 While the GOP has taken some initial steps to consolidate its many special financing programs, most still operate separately with high costs to lenders and borrowers alike.

### 4. Risk Management for Rural Financial Institutions

3.30 Lending to agriculture generally entails significantly higher risks than for other sectors due to uncertainties of weather, prices and markets as well as the relatively long gestation periods for even short term agricultural investments. The fact that the Philippines is in the typhoon belt adds to the uncertainty of investing in agriculture. The GOP has instituted several loan guarantee and crop insurance programs to reduce risks particularly those resulting from natural calamities to agricultural lenders. These programs, however, have been limited in coverage to government-sponsored rice and corn programs. While data on the success of these programs is sketchy, it appears that only a miniscule number of participating financial institutions whose

loans were affected by natural calamities have actually been able to collect. Furthermore, the vast majority of loans for all commodities is not covered by any kind of insurance. Given the risks inherent in agricultural production and the desire to preserve and strengthen the viability of these financial institutions lending to agriculture, the prospect for providing wider yet more cost effective insurance coverage should be investigated.

3.31 Just as insufficient risk protection has discouraged financial institutions from lending to agriculture, risks potential savers face regarding the security of their deposits have discouraged savings mobilization. The closing of several banks in the past two years has raised apprehension regarding the solvency of the financial system, in general, and the rural financial system in particular. The ability of the Philippine Deposit Insurance Corporation (PDIC) to guarantee payment of depositors' money has been questioned, given the delays in paying depositors in several cases of bank insolvencies. Moreover, even in more financially stable times, PDIC's limit on insuring only up to P40,000 and P100,000 of individual's and corporation's deposits, respectively, has no doubt restricted deposit mobilization.

#### D. Regulatory Issues

3.32 The following policies/regulations on capitalization and branch will constitute one key area of emphasis for the studies component of the Rural Financial Services Project. The effect of these policies and regulations will be investigated to determine their overall impact and recommendations for improvement or elimination of the policies/regulations will be determined.

##### 1. Capitalization and Branching Policies/Regulations

###### a. Capitalization

3.33 Capitalization of financial intermediaries, particularly rural banks, has been limited by: (1) legal restrictions on individual and family holdings; (2) taxation policies which effectively penalize banks with net worths of more than P1 million; (3) restrictions on deposit solicitation outside bank premises; and (4) failure of the GOP to fully match the initial capitalization of RBs. In addition, the resistance of rural banks to making public offerings of bank shares has contributed to this problem:

##### 1. Legal Restrictions

3.34 Equity holdings of individuals and family groups is restricted to twenty percent (20%) of the voting stock of the bank. This requirement is extremely restrictive. It acts as a disincentive by protecting individual investments and reduces an important source of additional capital. This restriction together with the GOP's taxation policy for RBs acts as an incentive to hold down the capitalization of RBs.

## 2: Taxation Policies

3:35 Tax subsidies have been a major component of the incentive scheme to the rural financial system, comprising of the difference between the taxes that RBs would have paid to the government without the tax exemption and the actual tax they paid. This structure of tax exemption has been a disincentive for rural banks to grow and expand.

## 3. Deposit Solicitation Restrictions

3:36 There are a number of restrictions on retail bank deposit solicitation and marketing. Generally, banks are allowed to solicit and accept deposits outside their premises provided that they can clearly define the area where they intend to solicit deposits, that they shall confine deposit solicitation within their target locality and that they can clearly establish that the deposit potentials of the area are still untapped. This policy has inhibited competition among banking institutions, resulting in lower returns to savers and limited savings mobilization in rural areas in general.

## 4: GOP Capitalization of Rural Banks

3.37 The provision of counterpart capital funding, upon the establishment of a rural bank, consists of a peso-for-peso matching by government of the initial paid-in capital in the form of preferred stocks through the Development Bank of the Philippines (DBP). While such government capital can earn a maximum of only two percent upon declaration of dividends, investing them in government securities yields a higher rate of return. Thus, such foregone earnings to the government is considered a subsidy to the RB system. A Technical Board for Agricultural Credit (TBAC) study in 1981 estimated that the government had subsidized rural banks in this manner to the extent of P74 million during the period 1953-1979.

3.38 Within a period of 10 years, government capital counterpart funds are retired through a sinking fund especially established for the redemption of preferred shares. As of September 30, 1984, total government investments in RB preferred stocks had reached about P199.2 million, of which P175.0 million were still unretired comprising 13.2 percent of the system's capital accounts.

3.39 The diminishing contribution of government through the DBP because of its major financial difficulties and the inability of the rural banks to raise additional capital has slowed the growth in capital accounts.

### b: Branching

3.40 Several GOP regulations have served as disincentives to increased bank branching, hence competition in rural banking. These include: (1) higher capital requirements for commercial and thrift banks relative to RBs; (2) prohibiting commercial and thrift banks from locating near RBs; and (3) prohibiting field extension offices of government banks from providing deposit facilities.

1. Higher Capital Requirements/Regulations on Bank Branching

3.41 Some regulations governing the establishment of new banking offices have always been biased in favor of rural banks and rural areas. For instance, the minimum capital requirements are lower for rural banks compared to other types of banks, and between urban and rural areas. The minimum capital requirements for rural banks is ₱500,000. For existing thrift banks, the minimum is ₱5 million and for private commercial banks ₱100 million existing as of August 1980, ₱300 million established thereafter and ₱500 million for "unibanks". This policy contributes to limiting branching opportunities and will be examined as a possible disincentive to the expansion of the rural financial system.

2. Location

3.42 Commercial and thrift banks wishing to establish branches are prohibited from establishing their offices adjacent to the premises of an existing RB. Thus, RBs are protected from the competitive pressures of bigger banks. The policy of protecting RBs from the competitive pressures of bigger banks should be assessed, since it appears that RBs have not fully taken advantage of this to tap the deposit potential of rural savers.

3. Lack of Deposit Generation Authority for Extension Offices and Agencies

3.43 Field extension offices of specialized government banks (SGBs) have heretofore functioned merely as credit outlets, and as a result incur very high administrative costs and continue to depend on head office resources for funds. The best examples are the Land Bank of the Philippines' (LBP) existing field extension offices and Development Bank of the Philippines (DBP) field agencies. Such offices are currently authorized only to operate as lending and collecting offices, and not as deposit-taking units.

3.44 Considering the current financial condition of SGBs, expansion of their activities at this point may not be a prudent course of action.

#### IV. THE PROJECT

##### A. Project Rationale, Goal and Purpose

4.01 The rural sector, with agriculture playing the predominant role and given its comparative advantage in the economy, is expected to provide the growth stimulus to the economy at large, in terms of employment and income. The sectoral and subsectoral liberalization measures currently being implemented by the GOP under its Agenda for Action in Agriculture are expected to increase production incentives in rural areas.

4.02 The Mission fully supports the GOP's Agenda for Action. Accordingly, the Goal of this project is to assist the GOP increase the rate of economic growth in the rural sector.

4.03 For the rural sector's expected increase in profitability to translate into increased production, employment and income, the rural financial system must develop the strength and resilience to support the expected increase in demand for financial services. This will require an increased capacity to generate funds within the rural economy through a structure of incentives which satisfies both the needs of savers and borrowers for access to convenient, timely, low cost financial services, and of rural financial institutions for reduced risks and transaction costs in providing those services. Accordingly, the project Purpose is to strengthen the policy and institutional framework necessary for sustaining a viable rural credit system.

4.04 The World Bank (WB) has executed a \$100 million loan agreement with the Central Bank of the Philippines (CB) for an Agricultural Credit Project. This project was designed based upon the WB's experiences in other projects and the findings in its "Agricultural Credit Sector Review" which concluded that various policy and institutional reforms should be carried out and that the GOP should establish a mechanism to provide financial resources and technical support for banks lending for agriculture and to coordinate their activities. The GOP accepted these recommendations and agreed that an Agricultural Loan Fund (ALF) should be established within the CB. The WB's Agricultural Credit Project was prepared with the objectives of making ALF operational and concurrently introducing policy and institutional reforms essential for viable financial intermediation in the rural area.

4.05 The objectives of the WB project are to: (a) help foster economic recovery through the provision of seasonal and investment credit to the agricultural sector; (b) help establish an appropriate institutional and policy framework and systems to support the development of a financially sound rural credit system; and (c) increase the capacity of rural credit institutions to mobilize rural savings and improve the efficiency of their farm credit operations through interest rate reforms, CB rediscounting policy reforms and strategies for the expansion of banking services in rural areas.

4.06 A more detailed description of the WB's Project is provided in Section III of the Agricultural Credit Project Staff Appraisal Report.

4.07 The WB's project provides AID with the opportunity to make a more efficient application of its resources and policy dialogue efforts. By pooling USAID's resources and efforts with those of the WB, the Mission is placed in a better position to conduct a more intensive dialogue with the GOP on the adoption and implementation of appropriate interest rate policy and institutional reforms that directly affect the efficiency of the rural financial sector in its performance of the financial intermediation function. Moreover, the WB's project provides the Mission with the opportunity to be more directly associated with and have a direct influence on this very high priority project which our resources alone would not otherwise afford us. For these reasons the Mission has decided to participate with the WB in this effort by co-financing the WB's Agricultural Credit Project.

4.08 For the duration of this co-financing effort, USAID and the WB will, together, conduct joint periodic reviews of the GOP's performance in implementing the credit policy and institutional reforms agreed to by the GOP under the WB's Project. These policy reform measures are listed on pages 41-43 of the WB Appraisal Report.

4.09 Also, through AID funding of technical assistance and AID/WB funding of policy/institutional studies and training, USAID will be an active participant in the identification of additional financial system policy and institutional constraints. Study recommendations that will subsequently emerge will serve as the basis for a continuing policy dialogue with the GOP. The studies are to be completed within the first two years of this project and the CB has agreed to immediately initiate remedial measures after consultation with USAID and the WB.

## B. Project Description

4.10 To accomplish this goal and purpose this five year project has two major components: A Short-Term Credit Component to support agreed to policy changes and an Institutional Development Component to assist the GOP identify and implement additional policy changes and institutional reforms. (See Logical Framework - Annex A). A detailed description of each follows:

### 1. Short-Term Credit

4.11 As discussed above in Section III of this Project Paper, CB borrowing has been the major source of loanable funds for the rural financial system, particularly the rural banks. The CB, in response to the country's current economic difficulties, has had to substantially lower its rediscounting facility. In recognition of the fact that restructuring of the rural financial system will take time, and if the rural sector, with agriculture playing the major role, is to be the catalyst to the economy as a whole, a level of credit higher than that now available to the agricultural subsector is required.

4.12 Accordingly, a loan of \$17.4 million will be provided to the CB. This loan will be used by the CB to fund short-term agricultural based loans made by participating banks to the rural sector. We expect the loans to be made to small, medium and large scale borrowers. This loan will co-finance, on a parallel financing basis, the \$99.5 million Credit Component of the WB's Agricultural Credit Project with the CB, which will provide short-, medium- and long-term credit. The AID and WB loans, together with the CB's counterpart contribution, will comprise the CB's ALF.

4.13 In response to the provision of this loan together with the WB's loan, the CB will fund bank loans at market-oriented rates without regulating bank spreads with the objective of (1) allowing banks a profitable return on lending and (2) allowing banks to market savings instruments with interest rates attractive enough for savers to earn a rate of return on their deposits commensurate with the risks in the financial system.

4.14 In addition, the CB agreed not to provide new agricultural credit involving interest or capital subsidies and by December 31, 1986 to complete the elimination of subsidies on agricultural credit provided by the GOP and channeled through the CB.

4.15 With respect to subsidized credit programs not channeled through the CB, the GOP will review their costs and benefits, formulating criteria satisfactory to the WB and USAID to determine which of those agricultural credit programs justify subsidies. The GOP has agreed to undertake a phased withdrawal of subsidies on those programs which do not meet the criteria. In addition, the Central Bank has affirmed the principle that interest rates on agricultural credit should be market-oriented. Accordingly, a program to phase out subsidies will be undertaken, focusing on three credit categories: (i) funds from the CB's own resources; (ii) funds channeled through the CB; and (iii) other funds. With regard to the first category, the CB has represented that existing lending of its own funds is at market-oriented rates and has given assurance that all new lending will be at market-oriented rates. With respect to the second and third categories, the GOP has agreed to undertake a review of the existing credit programs and to formulate criteria, satisfactory to A.I.D., to determine which credit programs may justify a subsidy. This review will be completed by and the criteria formulated by December 31, 1985. The criteria will be applied to all existing credit programs. For the second category, those programs that do not meet the criteria for exceptions would be phased out by December 31, 1986. For the third category, and the remaining programs under the second category, elimination of subsidies would be completed in accordance with a program and timetable to be agreed with A.I.D. by March 31, 1986. GOP programs which do not meet the established criteria will be at market-oriented rates. The GOP study will provide guidelines to identify less privileged, low income target groups without adequate access to institutional credit and define ways to assist such groups directly by means other than credit subsidies, as appropriate.

## 2. Institutional Development

### a. Policy and Institutional Studies

4.16 A number of the policy and institutional issues raised in Section III require further study in order to identify appropriate measures for

implementation. The WB Agricultural Credit Project Appraisal Report identifies four studies in this area that should be undertaken. USAID will grant finance two of the four studies, including a review of: (1) CB rediscounting policies and arrearages and (2) constraints to and strategies for expansion of banking services in rural areas.

4.17 A review of banking services in rural areas will include recommendations for the rehabilitation of financially distressed banks serving the rural areas, and recommendations for alternative strategies in the monetary, regulatory and other policies affecting the provision of banking services in rural areas. Given its breadth, this topic will not be undertaken as a discrete study but rather as a long term research program. A research institute such as the Philippine Institute for Developments (PIDs), in conjunction with TBAC, could carry out such a research effort. It is expected that the research program on banking services in rural areas will proceed in stages, moving from a general review of the performance of the system to a definition of a discrete research agenda which itself will be continually refined as new information becomes available.

4.18 A review of CB-rediscounting policies and their relationship to arrearages will include recommendations for rehabilitation of retail banks affected by arrearages. This review will be coordinated by the CB's Department of Loans and Credit (DLC), and will utilize the services of educational institutions (e.g., Asian Institute of Management), consultants from private banks (e.g., Bank of the Philippine Islands) and research organizations (e.g., PIDS). It is to be completed by March, 1986, with study findings and resultant action plans to be submitted to USAID by May, 1986 and to the Monetary Board by June, 1986.

4.19 Following USAID/WB review of these studies and the deliberations of the Monetary Board, the CB will implement the agreed-upon action plan accordingly.

4.20 The two remaining studies identified in the WB Staff Appraisal Report will be funded by WB. They include a study of:

1. Crop/sub-loan insurance which will provide recommendations for improving stabilization and crop insurance programs with a view toward reducing risks to participating banks;

2. Government assistance to low-income groups that lack access to institutional credit. The study will provide guidelines to identify target groups and define ways of assisting them directly by means other than credit subsidies.

4.21 In addition the WB will finance the preparation of technical guidelines for project lending for appraising technical aspects of agricultural and agroprocessing investments.

4.22 During the early stages of project implementation, a comprehensive research agenda will be refined and expanded. An output of this exercise is the identification of specific policies which impact on the performance of the rural financial system, and on agricultural lending in particular. The following is an illustrative list of research topics which AID may finance.

1. Constraints to and strategies for rural savings mobilization;
2. Strategies for consolidation of the many existing special financing programs in agriculture;
3. Impact of taxation policies and agricultural credit quotas on rural financial institutions and on agricultural lending in general;
4. Alternative loan guarantee arrangements (other than crop insurance);
5. Feasibility of establishing regional and/or national private apex banking structures; and
6. Informal savings and credit arrangements and their linkages to the formal financial sector.

Other presently unforeseen studies may also be conducted as required.

b. Training

4.23 Management weaknesses at various levels in the banking system, including the bankers' associations, which are constraints to effective financial intermediation have been identified in studies conducted by the WB and the Technical Board for Agricultural Credit (TBAC) and further defined in discussions with the Central Bank Institute (CBI's training entity) and representatives of the bankers' associations. AID Grant funds will be used to support:

1. The development of training curricula and training of trainers within the CBI and the bankers' associations including the Rural Bankers' Association of the Philippines (RBAP), the Cooperative Bankers' Association (BANGKOOOP) and the Development Bankers Association of the Philippines (DBAP), all of which work closely with the CBI in identifying member banks' training needs, organizing training courses and funding training programs.
2. Teachers' training courses to upgrade the capacity of staff within the CBI, bankers' associations, and other organizations that will conduct project-related training courses;
3. Mid-level courses in subloan appraisal, management, supervision, collection, and recovery;
4. Courses, primarily to benefit the bankers' associations and their member banks in strategies for and procedures on savings mobilization and deposit and asset management;
5. Workshops and seminars for CB staff, and bankers' associations; and
6. Other courses identified in project-related studies.

An estimated 1000 participants from CB, bankers' associations and banks will be trained.

4.24 The CBI will conduct training to address the human resource development needs defined under the project. This training will consist of three categories: (1) trainer training to help develop the institutional training capacity of banking associations/federations participating in project implementation; (2) technical training for CB regional loan teams to help develop their loan appraisal and supervision skills; and (3) technical, managerial and staff development for rural financial institutions participating in project-financed lending activity. Additional trainer training for key CBI staff members together with expanded training curricula development will be required early in the project to allow CBI to respond adequately to the specialized training requirements defined under the project. Please see Annex 3, page 80 of the WB Appraisal Report for more information on the training component.

#### c. Technical Assistance

4.25 A General Contractor will provide professional advisory services to assist in developing activities to improve the performance of rural financial markets and to design effective means of monitoring the impacts of policy reforms on the rural financial system.

4.26 The General Contractor will provide two long term consultants whose responsibilities will be to: (1) facilitate recruitment and management of short term technical assistance required for undertaking studies, training and monitoring/impact assessment components of studies; (2) monitoring, reporting and preparing recommendations regarding financial characteristics of potentially eligible banks, findings of institutional appraisals of potentially eligible banks; and (3) developing monitoring systems that will enable the CB to continually analyze the impacts of policy reforms on financial institutions.

4.27 Relative to policy institutional studies, the General Contractor will undertake, and/or subcontract for short term assistance as follows:

#### Review and Assessment of CB Rediscounting Policies and Arrearages Problems

Two short-term consultants over a period of 4 months will assist the CB Department of Loans and Credit in:

1. Assessing impact and performance of the CB's past policies and procedures on sub-loan rediscounting and related problems of arrearages and retail bank rehabilitation. (See WB Appraisal Report, Annex 1 paras. 11-16)
2. Provide recommendations regarding rediscounting, subloan restructuring and write-offs of arrearages.
3. Assessing effectiveness and efficiency of reporting systems and procedures under the ALF and making recommendations for changes to reduce costs of administration to the CB, retail banks and final borrowers.

Note: Deadline on study findings is March 31, 1986. Participation of contractor dependent on actual date in country.

### Additional Studies - Identification

Short-term consultants, recruited by the General Contractor for about 6 months of effort will assist the ALF Unit of the CB in the identification of studies (additional to 4 proposed in the WB Appraisal Report) that deal with performance of rural financial markets, informal financing and financing of small farm agriculture and rural enterprises. They will also assist the ALF develop terms of reference for identified studies in collaboration with relevant GOP agencies and research organizations.

### Studies - Implementation

Short-term consultancies with private research organizations, totalling approximately 14 months of effort, will be sub-contracted for by the General Contractor to assist the relevant GOP agencies or research organizations in carrying out studies identified above.

Specific scopes of work will vary by study but will involve, survey/sampling, data analysis, policy formulation.

4.28 The General Contractor will provide short term consultancies for the training component as follows:

### Training (Retail Banks and Association Level)

Short-term consultants will be recruited by the General Contractor for about 9 months of effort to assist the CBI, DLC, and Bankers Associations in assessing management weaknesses and training needs of retail banks and Bankers Associations (particularly Rural Bankers Association and Cooperative Rural Bankers Association).

Following the consultant(s)' review of CBI's current training programs the consultants will:

1. Assist CBI training staff in packaging already identified modules regarding content, format and presentation.
2. Survey/sample rural, thrift and commercial banks to identify additional training needs. Three training areas already identified are: deposit mobilization strategies; loan portfolio and asset management; and loan recovery strategies.
3. Assist CBI in formulating expanded training program.
4. Work closely with Bankers Associations to identify strategies and developing action plans for increasing their role as facilitator and provider of technical assistance to their members.

### Training Curricula

Short-term consultants will be recruited by the General Contractor for approximately 6 months of effort to assist CBI and Bankers Associations in developing curricula to meet training needs identified above. These consultants will:

1. Assist CBI and the Bankers Associations in design of curricula in terms of content, format, presentation.
2. Assist CBI and Bankers Associations in pretesting and refining training materials.

4.29 Project Impact Analysis. Either the General Contractor or a separate organization such as Ohio State University under the Science and Technology Bureau's Experimental Approach to Rural Savings Project will be responsible for providing the Central Bank Policy Advisory Group and ALF Committee, over a period of 24 months, with analyses of the impact of major policy and institutional changes on the rural financial system and based on these analyses, make recommendations regarding additional policy and institutional reforms and other measures that may help achieve the project's goal.

### C. Financial Plan

4.30 The total cost of this project is estimated at \$203.0 million. AID's contribution will be \$20 million, the WB \$100 million, the CB \$35.0 million, participating banks \$24.3 million and the subborrowers \$23.7 million.

4.31 Of AID's contribution, \$17.4 million will be a loan - to be disbursed as local currency - and \$2.6 million a grant, with \$1.4 million to be disbursed as local currency and \$1.2 million as foreign exchange. The terms and conditions of the AID loan will be in accordance with the standard concessionary terms and conditions for countries in the Philippines' economic classification. (Please see the draft Project Authorization for details.) The AID Loan to the CB will be guaranteed by the GOP. The AID grant will be fully obligated in FY 1985. \$16.1 million of the loan will be obligated in FY 1985 and the remaining \$1.3 million in FY 1986. AID loan funds will be used to reimburse the CB for approximately 100% of the total amount of loans made by the CB to PBs that were provided for short term local currency procurement only. AID grant funds will be used for both dollar and peso funded services. As in the case of the WB Project, the loan repayments of Participating Banks (PBs) will be deposited in the CB's Agricultural Loan Fund (ALF) for use as new loans.

4.32 The WB's loan to the CB has a term of 20 years, including five years of grace, at their standard variable interest rate. This Loan is guaranteed by the GOP. The CB will on-lend the equivalent in Pesos of \$99.5 million of the WB loan to qualified PBs. \$.5 million will be used by the CB to finance technical assistance, policy and institutional studies and training. (Please see pages 24-26 of the WB Appraisal Report for a more detailed presentation of WB project financing).

4.33 The WB's contribution will reimburse the CB for an average 54.5% of the total amount of subloans the CB rediscounts from PBs.

4.34 The CB, in-turn, will rediscount up to a maximum of 90% of the subloans made by PBs. The difference of \$35.0 million peso equivalent or 17% of total estimated project cost will be the CB's contribution to the project.

4.35 PBs may make loans up to 90% of the subborrower's requirements. It is estimated that PBs will contribute \$24.3 million or 12% of total estimated project cost. It is expected that the subborrower will contribute not less than 10% of the production and investment cost of the subproject. Therefore, \$23.7 million or 12% of total estimated project cost is estimated to be the subborrowers contribution.

4.36 A combined Project Financing Plan and Summary of Cost Estimates is presented in Table IV-1.

4.37 An inflation factor of approximately 20% per annum is applied to the Grant. The contingency, estimated at approximately 15% of total estimated Grant costs, will permit flexibility in responding with Grant funds to presently unanticipated needs throughout the life of the project. Flexibility between line items of up to 20% for AID Grant funds is authorized, provided Life of Project Grant levels are not exceeded.

4.38 The Projection of Total Project Expenditures by Fiscal Year is provided in Table IV-2. The Projection of AID Grant Expenditures by Fiscal Year is provided in Table IV-3. The AID loan disbursement rate is based upon that of the WB's. (See Table 15 of the WB Appraisal Report).

4.39 A Methods of Payment/Methods of Implementation presentation is included as Table IV-4.

Table IV-1  
SUMMARY COST ESTIMATES AND FINANCIAL PLAN (ALL YEARS)  
(US\$000)

<u>ELEMENT</u>	<u>A I D</u>				<u>Central Bank</u>	<u>Participating Banks</u>	<u>Subborrowers</u>	<u>World Bank</u>		<u>TOTAL</u>
	<u>FX</u>	<u>GRANT</u>		<u>LOAN</u>		<u>LC</u>	<u>LC</u>	<u>LC</u>	<u>FX</u>	<u>LC</u>
		<u>LC</u>	<u>FX</u>	<u>LC</u>	<u>LC</u>					
A. <u>Credit</u>	-	-	-	17,400	35,000	24,270	23,730	63,300	36,200	199,900
B. <u>Studies</u>	50	150	-	-	-	-	-	100	200	500
C. <u>Tech. Assistance</u>	789	515	-	-	-	-	-	50	50	1,404
D. <u>Training</u>	45	205	-	-	-	-	-	50	50	350
E. <u>Evaluation</u>	80	20	-	-	-	-	-	-	-	100
F. <u>Inflation</u>	125	247	-	-	-	-	-	-	-	372
G. <u>Contingencies</u>	100	274	-	-	-	-	-	-	-	374
<u>TOTAL</u>	1,189	1,411		17,400	35,000	24,270	23,730	63,500	36,500	203,000

**Table IV-2**  
**PROJECTION OF EXPENDITURES BY FISCAL YEAR**  
**(US\$000)**

<u>U.S. Fiscal Year</u>	<u>A I D</u>		<u>Total AID</u>	<u>World Bank</u>	<u>GO P</u>		<u>TOTALS</u>
	<u>L</u>	<u>G</u>			<u>Central Bank</u>	<u>Other</u>	
86	8,000	470	8,470	46,000	16,100	22,080	92,650
87	6,000	625	6,625	20,000	7,000	9,600	43,225
88	3,400	450	3,850	14,000	4,900	6,720	29,470
89	-	284	284	16,000	5,600	7,680	29,564
90	-	25	25	4,000	1,400	1,920	7,345
Subtotal	17,400	1,854	19,254	100,000	35,000	48,000	202,254
Inflation	-	372	372	-	-	-	372
Contingencies	-	374	374	-	-	-	374
<b>TOTAL</b>	<b>17,400</b>	<b>2,600</b>	<b>20,000</b>	<b>100,000</b>	<b>35,000</b>	<b>48,000</b>	<b>203,000</b>

Table IV-3  
Expenditure Projections by Fiscal Year  
AID GRANT (\$000)

FY	<u>86</u>	<u>87</u>	<u>88</u>	<u>89</u>	<u>90</u>	<u>TOTAL</u>
Studies	100	100	-	-	-	200
T.A.	295	400	400	209	-	1,304
Training	75	75	50	50	-	250
Evaluation	<u>-</u>	<u>50</u>	<u>-</u>	<u>25</u>	<u>25</u>	<u>100</u>
Subtotals	470	625	450	284	25	1,854
Inflation	<u>95</u>	<u>125</u>	<u>90</u>	<u>57</u>	<u>5</u>	<u>372</u>
Subtotals	565	750	540	341	30	2,226
Contingency	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>374</u>
TOTAL	565	750	540	341	30	2,600

Table IV-4

Method of Implementation/Method of Financing

<u>Method of Implementation</u>	<u>Approximate Method of Financing</u>	<u>Amount (US\$000)</u>
<u>Loan:</u>		
HC-Rediscounted Credit to Agricultural Enterprises	Reimbursement to Central Bank	<u>17,400</u>
<u>Grant:*</u>		
1. AID Direct Technical Assistance Contract	Direct Pay	<u>1,826</u>
2. <u>Training</u> - Host Country		<u>355</u>
a. Educational Institutions	Direct Pay or Reimbursement to the CB	
b. Central Bank Training Facilities	Reimbursement	
c. Technical Institutes	Direct Pay or Reimbursement to the CB	
3. <u>Studies</u>		<u>282</u>
a. AID Direct Contract	Direct Pay	
b. Host Country Contract	Reimbursement to Central Bank	
c. Sub-contractors under Technical Assistance Contract	Direct Pay through Prime Contractor	
4. <u>Evaluation</u>		<u>137</u>
a. AID Direct Contract	Direct Pay	
	TOTAL	<u>20,000</u>

\*All amounts include inflation and contingency.

#### D. Relation to the CDSS

4.40 The Mission's current CDSS emphasizes the role that a more liberalized, unfettered rural sector can and should play in the economic development of the Philippines. It also emphasizes that this can best be achieved by relying on freely functioning markets.

4.41 One element of our strategy for the rural sector is to alleviate policy and institutional constraints which currently impede rural growth. A primary focus includes deregulating rural credit markets.

4.42 For a more market-oriented rural economy to thrive it must be supported by a financial system which can provide its services efficiently and effectively. Therefore, a major objective of our strategy is to obtain the GOP's commitment to and then implementation of measures to, inter alia, deregulate credit markets.

4.43 A primary strategy means to achieving this objective has been a continuing dialogue on credit policy reform among appropriate U.S. government agencies, including USAID, the GOP and Philippines private sector, and other donors. Critical to the effective execution of this strategy means is the extent to which USAID and other donors, particularly the WB, maintain a consistent front and coordinated approach on this policy issue.

4.44 The Rural Financial Services Project clearly and fully supports the Mission's development strategy for the Philippines and its objectives.

1. Financial policy and institutional constraints that are currently impeding rural growth are being addressed;
2. The GOP will commit to and take the steps to implement measures to deregulate the rural credit market;
3. AID will be continuing its dialogue with the GOP on a range of credit policy reform issues as policy recommendations emerge from the policy and institutional studies to be undertaken; and
4. By this project's co-financing the WB's Agricultural Credit Project, AID and the WB will have collaborated, on a regular basis, on the issue of credit policy reform and coordinated its efforts to achieve this end.

#### E. AID Policy

4.45 This project is in consonance with the AID "Co-Financing" Policy Paper as outlined above. This project also conforms to the AID Policy Papers entitled "Pricing, Subsidies, and Related Policies in Food and Agriculture" "Private Enterprise" "Institutional Development" and "Population Assistance".

4.46 Specifically regarding the AID Policy Paper on Population Assistance, the project will indirectly contribute to lower fertility by improving factors correlated with lower fertility, namely the productivity, employment status, and income of women. Project training and TA will improve the productivity and eventual income of employees of rural financial institutions; most of these employees are women, for example over two-thirds of all accountants are women. Roughly half of the employees of enterprises which will benefit and grow from a stronger rural financial system are female. These enterprises include agricultural producers, processors, and input suppliers. The growth of paid female employment in these enterprises will contribute to increase age of marriage and lower fertility. Furthermore, the project indirectly should stimulate productivity and income growth of family farms; such growth is correlated with fertility decline in the long term.

4.47 This project addresses three of AID's four pillars: (1) policy dialogue; (2) institution building; and (3) private sector support. The Project directly addresses rural credit policy reform as discussed in paragraphs 4.15 - 4.17 above. Institution building will be addressed by the Project's training component, the purpose of which is to strengthen the capacities of the CB, bankers' associations and rural financial system to provide the appropriate range of services to its respective clients on a cost effective basis. The studies will contribute to this effort, as they will identify additional general policy and specific technical measures needed to enhance the efficiency and effectiveness of the rural financial system. The private sector will be supported in several major respects by this Project. First the immediate impact will be to expand the availability of credit facilities to farmers and other private rural entrepreneurs and enterprises, facilitating private sector trade and investment. Next, over the medium to long-term, it will rationalize the rural financial system by enhancing its capacity to perform its financial intermediation function as it was originally designed to do. In other words, the private sector financial system will function as it should providing the private sector with a means for saving and the private credit system with an opportunity for earning a return on its investment. And, it will improve the investment climate by significantly reducing the predominant role played by the GOP in rationing credit for the rural financial system and make it a potentially attractive area for private institutional investors

## F. Summary of Analysis

### 1. Economic and Financial Analysis

4.48 The economic benefits to be derived from this project and the financial rates of return of individual subprojects are impossible to quantify at this point. However, the WB Appraisal Report includes an economic and financial analyses of typical subprojects for a series of illustrative models (Please refer to pages 37-40 of the WB Appraisal Report).

## 2. Environmental Analysis

4.49 The project does not require an Initial Environmental Examination or Environmental Assessment. This is in accordance with the Agency's Environmental Procedures, 22 CFR Part 216.2(c)(1)(ii) and 216.2(c)(2)(x), which categorically exclude projects satisfying the following conditions:

-- AID assistance does not require, either prior to approval of financing or prior to implementation of specific activities, knowledge of or control over, the details of the specific activities that may have an effect on the physical and natural environment and AID will not in fact, have such knowledge or control.

-- AID support is for an intermediate credit institution when the objective is to assist in the capitalization of the institution or part thereof, and when such support does not involve reservation of the right to review and approve individual loans made by the institution.

4.50 The project's purpose and proposed activities clearly meet the above conditions. AID assistance will stress the establishment of a policy framework and strengthening of the institutional framework necessary to develop a self-sustaining rural financial system. AID will finance policy studies, technical assistance and training to facilitate institutional development and improvement of banking system management. Loan funds will reimburse the CB for rediscounted sub-loans offered through intermediate credit institutions. In providing support for such activities, AID does not reserve the prior right to approve or disapprove sub-loans to farmers made by the intermediate credit institutions participating in this project. As a prerequisite for reimbursement, AID reserves the right to review subloans rediscounted by the CB to ensure that these sub-loans are offered at market-oriented interest rates and for adherence to AID procurement policy requirements, as outlined below in Paragraphs 5.19 - 5.20.

## 3. Administrative Analysis

### a. Central Bank of the Philippines

4.51 The CB was established under Republic Act 265 in 1949. As the nucleus of the country's financial system, the CB monitors and regulates the activities of the monetary, banking and credit system in the country. Under its original Charter, its main functions are to:

- Maintain monetary stability;
- Ensure preservation of the international value and convertibility of the Philippines Peso currency into other freely convertible currencies; and
- Foster monetary, credit and exchange conditions to promote a balanced and sustainable growth of the economy.

4.52 Moreover, it performs clearing functions and has custody of commercial banks' reserves, acts as a financial advisor and fiscal agent to the GOP, and collects national revenue taxes. Chart 3 of the WB Staff Appraisal Report shows the CB organization.

4.53 As stated in the WB's Staff Appraisal, the CB has been the primary financial entity involved in refinancing agricultural-based subloans under both supervised and nonsupervised credit programs. Also, over the past two decades it has extended financing for up to 90% of medium- and long-term rural loans extended under the WB's rural credit projects. Please refer to the Project Implementation Section of this PP and pages 30 and 31 and Annex 3 of the WB Appraisal Report for additional information on CB arrangements and capabilities to administer this project.

#### b. Participating Banks (PBs)

4.54 Of the rural financial institutions, the most active have been the commercial banks, the private and cooperative rural banks, the government-owned PNB, DBP and LBP, and, to a lesser extent, the private development banks. In recent years there has been a trend toward greater participation in rural based lending by private commercial banks and a reduction of this type of financing by government banks, which have been burdened with mounting loan arrearages and growth in nonperforming assets across sectors. Given the current financial plight of the government banks, the future ability to serve the expanding financial needs of Philippine agriculture will increasingly be a responsibility shared by private sector banking and informal lending entities. Commercial banks will continue to play the dominant role in financing commercial and export-oriented agricultural production as well as promoting the further development and expansion of agribusiness. In this regard, private development banks will have an important role to play in financing agribusiness development, particularly in rural areas once serviced by specialized government banks. Private and cooperative rural banks have and will continue to be an important institutional vehicle for delivering credit and related services to the rural sector.

#### 1. Private Commercial Banks (PCB)

4.55 The development of the private commercial banking system in the Philippines is a post-World War II phenomenon. Today the system is composed of twenty-eight (28) domestic banks and four (4) branches of foreign banks. Collectively the system represents some fifty-five percent (55%) of the total assets of the commercial banking system, with government and foreign banks accounting for the remainder. PCB lending accounts for some sixty-five (65%) of the total institutional financing for agricultural production within the country, and ten percent (10%) of such financing for agricultural related activities other than production. Overall, however, agriculture accounts for only twelve percent (12%) of the total lending portfolio of these banks. Of this amount, more than sixty percent (60%) is loaned for commercial and export oriented agricultural crops and animal production.

4.56 While the private commercial banks have in years past performed relatively well, more recently their profitability and liquidity have been squeezed partially due to depressed world commodity prices of the crops which these banks have traditionally financed such as sugar, coconuts, and rubber. Many of these banks have been slow to identify new profit centers for Philippine agriculture. This can partially be explained due to a lack of banking system technical expertise in agricultural fields outside of traditional areas of lending. Additionally, commercial banks need to improve the capabilities of their loan officers to follow proper loan project feasibility and appraisal procedures. Since commercial banks are relatively new to long-term agricultural lending, an assurance was obtained from the CB in negotiations with the WB for the WB funded Agricultural Credit Project that it would extend necessary technical assistance to the commercial banks participating in the project in preparing and implementing institutional development plans commensurate with their current and prospective agricultural lending operations.

## 2. Rural Banks (RB)

4.57 The rural banking system in the Philippines was established in 1952. By 1977 some 400 of these community-based, family-owned banks had been established with the help of government and privately-owned investment capital. By 1980, over 1,000 RBs were operating throughout the country and today, 856 remain active.

4.58 Clearly, the rural banking system is presently in a moribund state. Among the major problems of RBs is its limited deposit base which stemmed largely from over reliance on CB funds. This dependence on the CB and the eventual reduction in rediscounting facilities deprived the RBs of the incentive to tap the potential for savings in the rural sector. Moreover, the high incidence of non-repayment of agricultural loans affected the viable operations of RBs, rendering them ineligible for CB rediscounting.

4.59 The default problem is the single most important reason disqualifying as much as 80 percent of all operating rural banks from further participation in government programs. Considering all of the CB criteria, about 91 percent of the RBs would not pass a strict screening for government program participation. All regions are similarly affected.

4.60 Compounding the system's problems is its inability to raise its capitalization due to a poor return on investment track record, limitations on individuals or family holdings, and even intentional lowering of their capital base for tax reasons. Many RBs still lack management expertise since they are run by family groups who either lack the ability or the inclination to run banks. Management deficiencies can be traced to a lack of training and experience, inadequate staffing, uncompetitive salary scales, absentee officers, internal conflicts of interest, and insufficient internal control safeguards.

4.61 The question is whether the rural bank can survive based on a freely competitive market. With the current restrictions on CB borrowings and scarce budgetary support in view of the present financial crisis, RBs are faced with no other option but to generate funds internally. Tapping the full potential of savings in the rural sector will be constrained considering their inability to price their deposits competitively and attract relatively large depositors. RBs appear to be poorly placed in view of a lack of confidence in their financial muscle relative to other types of banks. RB deposit generation will be mainly confined to depositors not being served by other banks. Likewise, other options in raising loanable funds, i.e., raising the capital to a range within the allowable expansion on risk-assets will be difficult in the short term. Rural banks, therefore, will have a difficult time even after economic conditions turn better. RBs cannot rely on their present loan portfolio as a source of funds. Repayment capabilities of their borrowers are also subjected to the difficult times and as such may not be able to provide hard liquidity.

4.62 The rehabilitation and restructuring of the rural banking system will be a major focus of the studies, technical assistance and training components of this project.

### 3. Cooperative Rural Banks (CRB)

4.63 The first cooperative rural bank was granted a charter to begin operating in December 1974. Today, twenty-nine (29) CRBs exist in the Philippines, supported by a recently established (March 1984) national federation, the Cooperative Rural Banks Federation of the Philippines (BANGKOP), Inc. CRBs differ from RBs in the respect that CRBs are organized on a provincial basis and are owned by associations of small farmers and other primary cooperatives. In virtually all other respects they operate according to the same basic guidelines and procedures as do rural banks with whom they compete.

4.64 In spite of the rapid growth in the CRB system over the last decade, the network of these cooperatively-owned unit banks suffers from many of the same problems inherent to other private rural banks. Although CRBs have been able to generate significant internal capital from their membership, they continue to fall victim to concessionally-priced government source funds. Because of their geographic coverage, they are more vulnerable to weaknesses in loan servicing than are community-based rural banks. Past due loans account for twenty-nine percent (29%) of total lending activity. Several CRBs are now experimenting with branching in order to reduce transaction costs, serve more borrowers and improve loan supervision.

4.65 The development of the CRB's will also be a focus of the project's policy/institutional studies, training and technical assistance components.

#### 4. Thrift Banks

4.66 The family of thrift banks in the Philippines is composed of eight (8) savings and mortgage banks (SMB), forty-five (45) private development banks (PDB) and some eighty-three (83) savings and loan associations (SLA). Of this group, the PDBs are most concerned with rural financing. The SMBs are for the most part Manila-based and do little rural lending. SLAs finance some agri-enterprise, but for the most part restrict their lending to real estate.

4.67 PDBs began to appear in the Philippines during the early 1950s as a result of government promotion through the Development Bank of the Philippines (DBP). Growth of the PDBs in the early years has been uneven due to management weaknesses and problems. They are generally privately-owned but often accept government capital investment.

4.68 PDBs have historically relied heavily on the DBP for source funds. In recent years DBP has not been able, due to limited resources, higher cost of borrowing and financial difficulties, to meet the growing demand for funds coming from the PDBs. Partly because of this fact, they have had to mobilize internal resources through savings and deposits which now account for more than half of the system's overall resources.

4.69 Thrift banks are supported by a national Chamber of Thrift Banks which serves as a lobby interest on behalf of the member lending and saving institutions. The Development Bankers Association of the Philippines (DBAP), established in the mid-1960s, represents the specific interests of the forty-five PDBs. As of August 1984, total arrearages for thrift banks equalled 7.5%, 13% and 23% for SMBs, PDBs and SLAs, respectively. The thrift banks will also benefit from the institutional development component of this project.

#### 5. Specialized Government Banks

4.70 There are three specialized government banks: the Philippine National Bank (PNB), the Development Bank of the Philippines (DBP) and the Land Bank of the Philippines (LBP).

4.71 The PNB, established in 1916, has some 200 offices throughout the country of which 28 are located in urban areas. The PNB is the largest commercial bank in the country accounting for twenty percent (20%) of the total resources of the commercial banking system. Historically, the PNB's agricultural financing has been restricted primarily to estate crops. However, in 1973 the Bank joined the RBs and the now defunct Agricultural Credit Administration in extending supervised, noncollateral seasonal loans to small farmers under the Masagana Program. During the period 1973-1977 PNB extended loans to small farmers for rice and corn production, sustaining loan losses equal to 29.1 percent of its loan portfolio in this area. This lackluster showing in the area of small farmer lending contributed significantly to the bank's current liquidity problems. Since 1980, the PNB's overall agricultural portfolio and total portfolio has stagnated. Presently the bank is limiting all new agricultural loan activity to priority crop areas only.

4.72 The DBP was established in 1958 with a mandate to provide primarily medium and long term financing for industry, housing and agriculture. In 1964 it was given responsibility for assisting to develop smaller PDBs as a means to further decentralize its services in rural areas. As of 1984 the DBP had 70 offices operating throughout the country. Although only twelve percent (12%) of the bank's portfolio in dollar terms is directed to agriculture, agriculture loans account for more than sixty percent (60%) of the total number of loans extended. The DBP finances a wide-range of agricultural activities, including estate crops, food crops, the animal and fishery sector, irrigation, transport, processing, manufacturing and warehousing. Within the last few years the DBP too has experienced severe liquidity and solvency problems resulting from high loan arrears and nonperforming assets.

4.73 The LBP was created in 1963 for the purpose of financing the acquisition of landed estates for redistribution to tenant farmers under the Philippine land reform program. This responsibility accelerated with the revitalized land reform movement during the early martial law years. In 1972 the LBP was allowed to enter commercial lending in order to help generate revenue to offset the high cost of financing land transfer and to provide expanded financial services to new land reform beneficiaries. LBP presently has some 55 branch and field offices throughout the country. Its loan portfolio for agriculture accounts for less than one percent (1%) of total amount of institutional credit for agriculture within the country. In recent years LBP has increased its total resources significantly largely due to increased deposits, increased capitalization, profits and bond issuances.

4.74 Participation of the specialized government banks is not envisaged at this time. However, their participation would depend on the findings of an on-going WB study to strengthen GOP financial institutions and subsequent implementation of recommendations, which will require WB and AID approval.

4.75 For additional information on rural credit institutions please refer to pages 8-13 of the WB Agricultural Credit Project Staff Appraisal Report.

## 6. Eligible Banks

4.76 To date, the CB has identified 137 banks in semi-urban and rural areas as initially eligible for access to project funds. The eligible banks comprise twenty-four (24) private commercial, thirty-four (34) thrift and seventy-nine (79) rural banks. This identification has been made in accordance with the qualifying criteria for the project on pages 31 and 32, as well as Annex 4 of the WB Appraisal Report.

4.77 As outlined in the WB Appraisal Report, by July 31, 1985, the CB will have: (a) informed all banks in the country of the project's scope and lending terms and conditions, including eligibility criteria for project funds; and (b) notified all banks with arrears of less than 15% of outstanding loans of their eligibility for project funds; and by September 30, 1985 prepared a plan for the institutional appraisal of commercial banks with arrears of more than 15% but less than 20%, of thrift, rural and government banks with arrears of more than 15% but less than 25%, and of banks which have arrears exceeding the

specified ceilings, but which apply for project funds on the basis of their compliance with the CB's minimum capital requirements. Appraisal of priority banks would be completed by March 31, 1985. However, it is expected that the banks which already satisfy these criteria will begin lending soon after loan effectiveness. The CB has agreed to provide to USAID and the WB by September 30, 1985 an updated list of participating banks and the plan for institutional appraisal of banks expected to participate in the project, and thereafter by March 31 and September 30 of each year, furnish to USAID and the WB an updating of such list and plan.

4.78 Please refer to paragraph 5.03 below and pages 31 and 32 of the WB Appraisal Report.

#### 4. Social Soundness Analysis

4.79 The purpose of the proposed project is to rehabilitate the rural financial system. To do so it intends on one hand to introduce or initiate structural and policy reforms in the financial system, while on the other hand it will provide credit funds for agricultural producers, and enterprises engaged in processing, storage and marketing of agricultural commodities. To achieve the objective of structural and policy reforms requires technical assistance, various types of training for personnel working at different levels in the financial system, and research studies on the functioning and weaknesses of the current system.

##### a. Project Beneficiaries

4.80 The project is designed to improve the rural financial system and thus benefit all groups which use this system. By rehabilitating and strengthening the rural financial system, the project will benefit a very wide range of enterprises and people. Topping the list of beneficiaries are the qualified financial institutions. Structural and policy reforms in addition to training and technical assistance will improve the institutions' capacity to provide a wide range of financial services. Indirectly, enterprises and individuals who rely on these services will also benefit. Access to credit has been a known need of credit-starved enterprises and individuals engaged in production, processing, storage and trading of agricultural commodities. Furthermore, interest rate changes will provide the incentive for enterprises and individuals to save their excess funds. In turn, improved opportunities for savings will expand availability of funds for further investments in the rural areas.

##### b. Sociocultural Feasibility

4.81 The question of sociocultural feasibility or mutual adaptability of proposed project activities and the culture and practices of beneficiaries is best understood by classifying the project into its major components. First, regarding the training and technical assistance component, sociocultural feasibility appears to be a non-issue. Experience in other development

projects show beneficiaries have a degree of openness to technical assistance and training. Second, the credit delivery component in general closely parallels previous GOP agricultural credit programs, owing to which we can claim that the introduced component is not foreign to the recipient system. The major difference arises from the project plan to use more stringent criteria for selecting participating retail banks and end-users.

4.82 The credit delivery component, however, will have initial difficulties in getting small farmers to participate on account of market-oriented interest rates to be charged on subloans, in addition to known cultural and economic constraints to availment of credit from formal or institutional sources. Recognizing this, the project includes an approach which allows for wider participation. Subloans to processors and traders of agricultural commodities will allow movement of credit funds to the informal credit network, the small farmer's preferred source of credit. Moreover, research studies funded through the project will investigate how low income groups with inadequate access to institutional credit can be assisted.

c. Spread Effects

4.83 Diffusion of benefits will hinge upon successful structural and policy reforms. If these reforms succeed in reorienting the rural financial system to respond not only to the credit needs of prospective clients but also to their savings and other technical needs, there will be likelihood of benefits diffusion beyond the initial beneficiaries. For instance, improvement on the savings-side of the project package potentially increases availability of credit funds for additional rural investors.

d. Social Impact

4.84 The purpose of the project is to lay the foundations for a sound rural financial system. Structural and policy reforms will have its most immediate impact on participating retail financial institutions. Technical assistance and training is expected to improve the institutions' capacity for financial intermediation. Access to credit funds, which retail institutions will on-lend at market-oriented interest rates, not only provide them access to scarce resources but also the means to improve capacity for savings mobilizations. On the the aggregate, the expected reforms will enhance the financial system's contribution to the country's economic growth.

4.85 During the initial year(s) of the project, those likely to benefit the most from the credit component includes the larger borrowers--medium- to large-scale agricultural producers, processors and traders of agricultural commodities. This will happen on account of more stringent criteria for the provision of sub-loans, i.e., retail institutions are likely to be more conservative in choosing their clients. The clients who are likely to pass this scrutiny are those who are currently better credit risks.

4.86 Thus, initially small farmholders, tenants, and the "land poor" are expected to benefit relatively less. Nonetheless this sector will have indirect benefits from a number of sources. For instance, as mentioned above, possibility of availment of credit funds from project resources by the informal credit network indirectly provides credit access to small farmers since the informal network is the preferred funding source of farmers. Moreover, the rural economy is expected to improve and grow because of the project, thus new employment opportunities will be created for the "land poor".

## V. PROJECT IMPLEMENTATION

### A. Implementing Entities

#### 1. Central Bank

5.01 In conformance with the WB's Agriculture Credit Project, the Central Bank of the Philippines (CB) will have primary implementation responsibility for this project. Chart 3 of the WB Staff Appraisal Report shows the CB organization. Within the CB organization the Department of Loans and Credit (DLC) will have specific implementation responsibility. An Agricultural Loan Fund (ALF) Unit will be established within the DLC to handle the day-to-day project implementation requirements. The Central Bank Institute (CBI), the CB's training entity, will have primary responsibility for project related training in association with the DLC. In addition, an Agricultural Loan Fund Policy Advisory Group (ALFPAG) will be established within the CB to provide policy oversight as well as coordination among CB departments and other agencies. Chart 4 of the WB Appraisal Report shows the CB organization for project implementation. A more detailed description of these CB implementation units is provided on pages 30, 31 and 36 of the WB Appraisal Report.

#### 2. Participating Banks

5.02 Retail banks complying with qualifying criteria issued by the CB will have access to project funds. Determining eligibility will be the responsibility of the ALF Unit. The qualifying criteria, summarized below in paragraph 5.03 are fully detailed in Annex 4 of the WB Staff Appraisal Report.

5.03 Qualifying Criteria for participating banks (PB) are as follows: Total subloan arrears (defined as the uncollected amount of principal overdue for more than three months) should be less than 15% of the outstanding loan portfolio. However, the CB may relax this criterion under the following circumstances: (1) A satisfactory institutional appraisal by the ALF Unit confirming the financial viability and management capability of the bank in question would qualify commercial banks with subloan arrears of less than 20% and thrift and rural banks with arrears of less than 25%. (2) A bank with arrears exceeding these specified ceilings may apply for project funds if unimpaired equity and reserves, after allowing for default risk, are sufficient to meet CB's minimum capital requirements. Eligibility of such a bank would also require a satisfactory institutional appraisal. (3) If such a bank has arrears exceeding 35%, approval of the WB and AID will be required. Changes in the above criteria will require AID and WB approval. Subloan arrears outstanding for more than a year after the due date may not exceed 20% of total arrears, and annual repayments of project subloans must be at least 70% of the aggregate amount fallen due during that calendar year. Banks deemed to have insufficient or inadequately trained staff to appraise and supervise project subloans will not qualify. Participation of Government Banks (i.e., PNB, DBP, and LBP) will depend on (a) the findings of an on-going WB study to strengthen GOP financial institutions; and (b) subsequent implementation of recommendations for rehabilitation, and will require WB and AID approval.

5.04 Based on the qualifying criteria, the CB has identified 137 banks in semi-urban and rural areas as initially eligible for access to project funds. The eligible banks comprise 24 commercial, 34 thrift, and 79 rural banks.

**B. Implementation Process**

**1. Short-Term Credit Component**

**a. Lending Procedures and Terms**

5.05 Lending procedures including subloan terms and conditions will be the same for this project as for the WB Agricultural Credit Project outlined in Annex 5 and as discussed on pages 32, 33 and 34 of the WB Appraisal Report, except as presented below in paragraph 5.13.

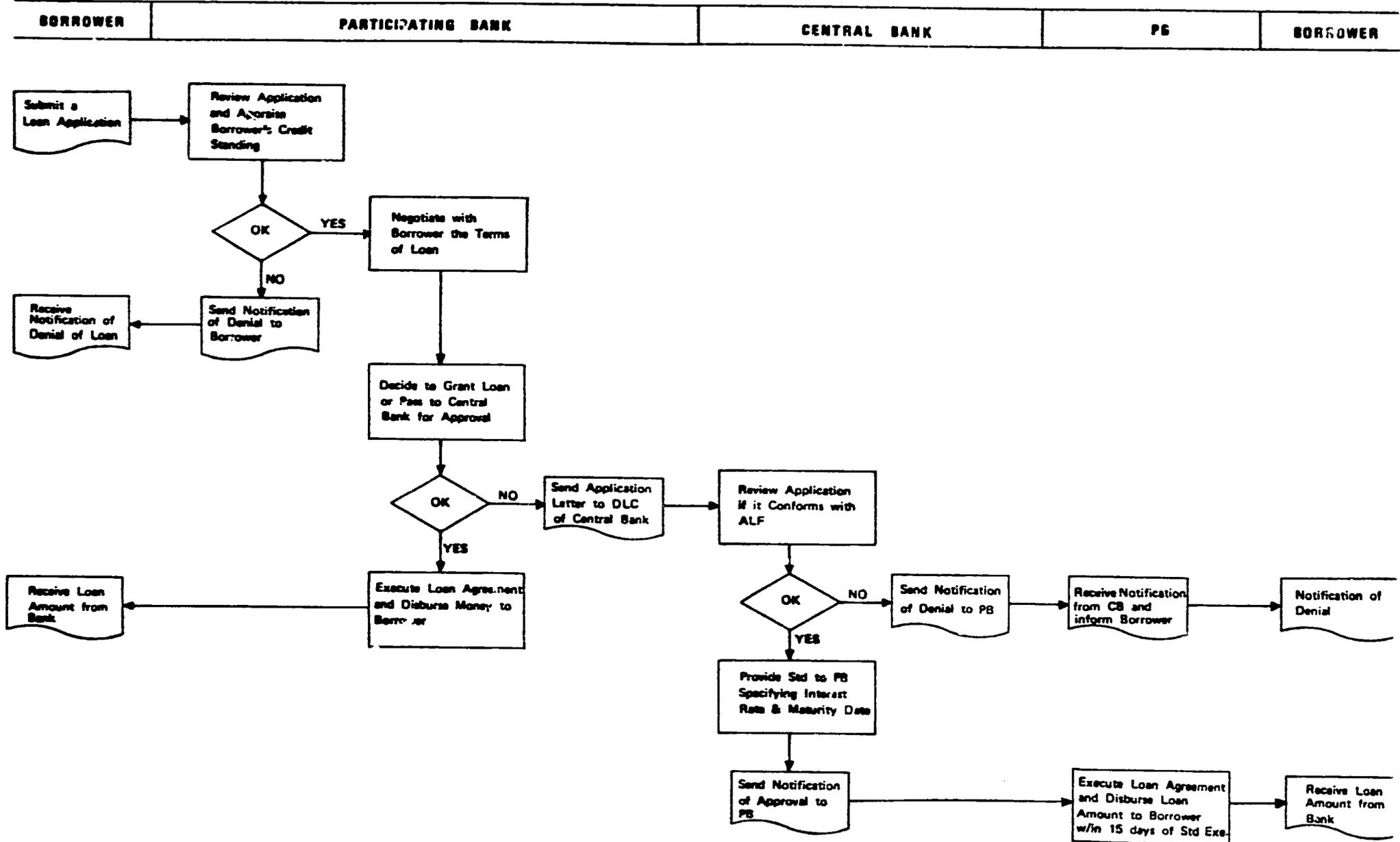
**b. Loan Disbursement Procedures**

5.06 Loan disbursement procedures commence when a potential borrower applies for a loan from a PB by submitting a loan application on a prescribed form together with other relevant attachments such as feasibility studies, commodity lists, etc.

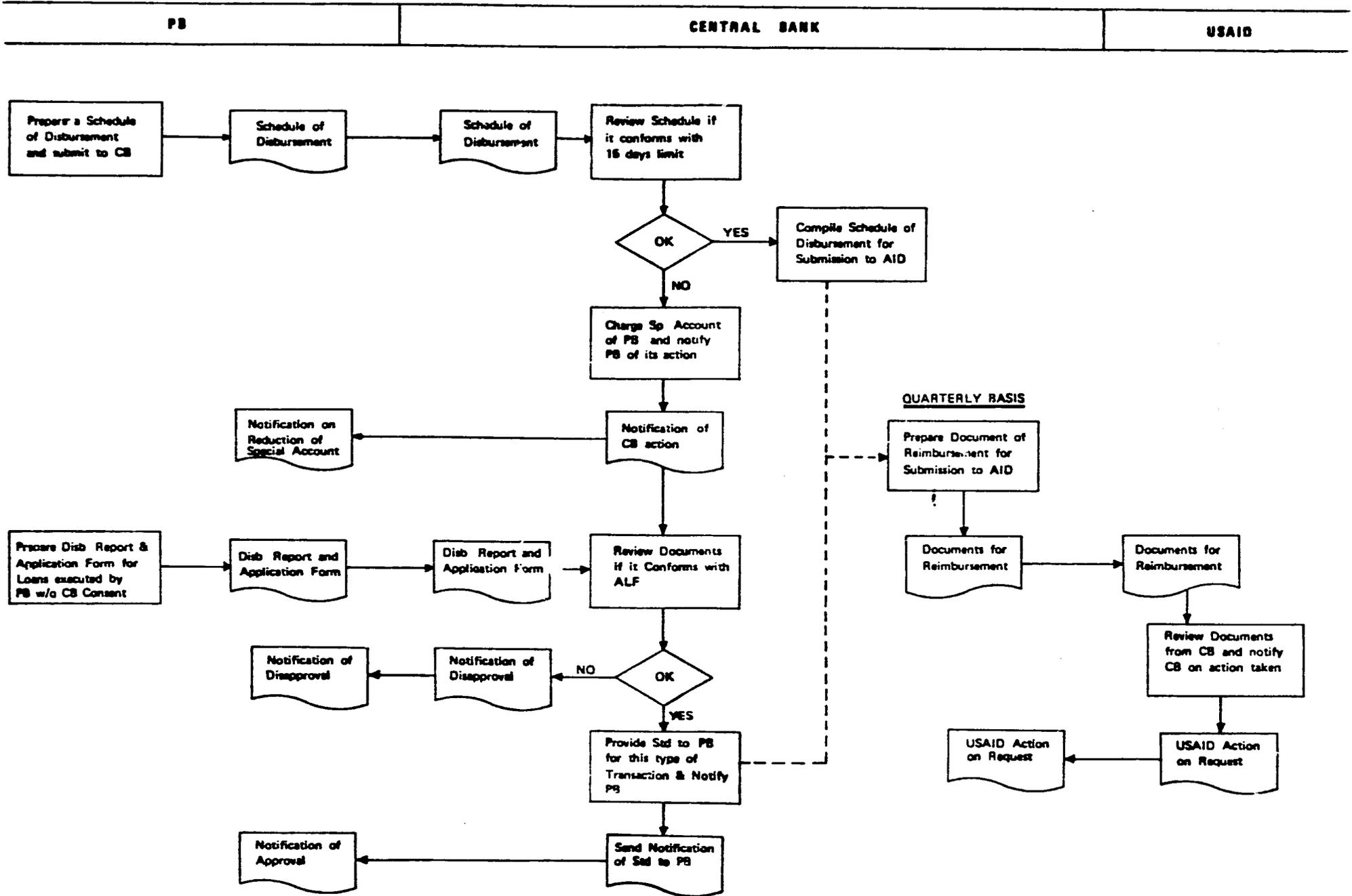
5.07 The PB is responsible for loan appraisal. (Please see Annex 6, Table 1, Page 4 of the WB Appraisal Report which outlines the functions of PB staff). The PB's review of the documents submitted by the borrower and appraisal of the credit standing of the applicant culminates with a decision to, or not to extend credit to the applicant. When credit is not to be extended, the applicant will be so notified. When credit is to be extended, the PB and the borrower will negotiate the terms (interest rate, loan period, payment schedule, collateral needed, etc.) of the loan which may be incorporated into a loan agreement (executed or unexecuted) and/or noted on the loan application form. These documents will then be collated and transmitted to the DLC for rediscounting.

5.08 The DLC will review the PB submissions for compliance with the ALF policies and guidelines. If found to be in order, the DLC will release a Special Time Deposit (STD) to the PB in the amount requested by the PB. The STD and the concomitant documents (i.e. note explaining terms) will specify the interest rate charged by the CB and the maturity date. DLC release of the STD will trigger a loan payable on the part of the PB. On the STD's maturity date, the PB's special account will be charged with the repayment. Commercial banks maintain special accounts at the CB while most rural banks do not. Accordingly, in the case of participating rural banks, the rural banks correspondent commercial bank will be notified of such charge. Interest will similarly be charged the special account on a periodic (monthly) basis. The CB will place the STD in a special account to ensure that funds will be utilized for the purpose specified in the loan application.

**PROCEDURE FLOWCHART:**



PERIODIC BASIS (MONTHLY)



5:09 The PB will execute a loan agreement or such other document and release the funds to the borrower within 15 days of receipt. That portion of the STD not released to the borrower within 15 days of issuance will be recalled by the CB.

5:10 The PB will submit to the DLC periodic statements of loan releases made to sub-borrowers. The DLC will collate and consolidate all such reports and submit a quarterly reimbursement request with necessary supporting documentation to USAID for review and approval.

5.11 USAID will review such application and, if found to be in order, process a check payable to the account of the "Agriculture Loan Fund-Central Bank of the Philippines" for the 100% reimbursement of the request.

5.12 Alternatively, the PB under Step 2 above may execute a loan or such other agreement under which disbursements may be made to the borrower. The disbursements may then be recorded on the disbursement report, attached to the loan application form and submitted to the DLC for rediscounting.

c. Subloan Eligibility for USAID Reimbursement

5:13 Any CB funded subloans up to the equivalent of \$5,000 for short term agricultural credit will be eligible for reimbursement by AID. Also eligible for AID reimbursement are CB funded short term subloans over the equivalent of \$5,000 for the purchase of locally produced agricultural output other than citrus, oil palm and sugar. If appropriate, AID and the CB may consider modifying these limitations on the eligibility of funding subloans for reimbursement. It is not contemplated that short term subloans will be made for machinery, equipment and civil works.

5.14 CB requests for AID reimbursement will include the following information on a per-subloan basis:

1. Evidence that the subloan has been disbursed.
2. Crop which the subloan is financing.
3. The terms and conditions of STD issued by the CB to the PB and of the subloan made by the PB to the subborrower

d. Supervision and Monitoring

5.15 Subloan supervision and monitoring will be the responsibility of the PBs. The responsibilities of the PB in this regard are delineated on pages 35 and 36 of the WB Appraisal Report.

5.16 The ALF Unit will require progress reports from the PBs and consolidate these reports for CB, USAID and WB review. Quarterly reports will show subloan terms and disbursements by PB and type of commodity. Semi-annual reports will include tabulation of subloan amounts approved and disbursed by activity, term and bank; physical achievements of subloan-financed activities; and collection performance on subloans classified by bank and by age.

5.17 USAID, involving the General Contractor, will conduct monthly subloan review sessions. The purpose of these reviews will be to determine the CB's progress in implementing policy reforms that have already been undertaken and will be primarily measured in terms of their complying with the reforms relative to the financial system on lending at market-oriented interest rates. These reviews will also be used to review the eligibility of funded subloans for reimbursement by USAID. AID reimbursement will be contingent upon satisfactory review findings.

5.18 End-use verification will be conducted on a sample basis.

e. Procurement

5.19 AID funds are not intended to be used to finance production, processing or marketing of any agricultural commodities restricted under section 522 of the Foreign Assistance and Related Programs Appropriation Act of 1985 or AID Policy Determination 71, Handbook 1. A negative list of the restricted crops will be provided to the CB.

5.20 Shelf-item and other AID procurement rules contained in AID Handbook 1B, Chapters 4, 5 and 19 are applicable to commodity procurements under this project. However, in accordance with AID Handbook 1B, Chapter 19, Section 19A(3)(a), AID procurement policies will not apply to individual subloans the equivalent of \$5,000 or less. Given the restrictions in paragraphs 5.13 and 5.27 above, the statutory restrictions on selected commodities as described in Handbook 1B, Chapter 4 and the source, origin and nationality restrictions described in Handbook 1B, Chapter 5 will not need to be enforced in the case of subloans the equivalent of \$5,000 or less. However, shelf item and other AID procurement rules are applicable to the extent provided in Section 19 A(3)(c) of Chapter 19, Handbook 1B in the case of subloans the equivalent of more than \$5,000. However, these loans will not present special monitoring problems since such loans will be reimbursed by AID only if documentation presented to AID shows that proceeds were used to purchase local agricultural output not prohibited under the provisions cited in paragraph 5.13 above.

2. Institutional Development Component

a. Policy and Institutional Studies

5.21 The policy and institutional studies outlined in paragraphs 4.18 - 4.23 will be coordinated by the ALF unit of the CB. Their terms-of-reference (TOR) will be developed by the CB, National Economic and Development Authority (NEDA) and TBAC and executed within the first two years of the project by U.S. and Filipino private contractors and/or Filipino research organizations. Prior to undertaking any study financed by A.I.D., the CB will obtain the agreement of A.I.D. on terms-of-reference (TORs) for such study. In the case of any study not financed by A.I.D., the CB will consult with A.I.D. in developing TORs for such study and provide the TORs to A.I.D. prior to commencing the study.

5:22 Upon completion of the studies, USAID and the WB will review and discuss study recommendations with the CB and other pertinent GOP agencies; After these deliberations the Monetary Board will present to the Office of the President the recommended policy and institutional change and action plan for the implementation for approval, as necessary.

b: Training

5.23 The CBI is currently carrying out a survey to identify the training needs of the rural financial system: The CBI is being assisted in this task by the bankers' associations including the Rural Bankers Association of the Philippines (RBAP), the Cooperative Rural Banks Federation of the Philippines (BANGKOOP) and the Development Bankers Association of the Philippines (DBAP). The CBI will use this information to develop a training plan for USAID and WB approval: CBI will develop training plans for each succeeding year of the project for USAID and WB approval that is based upon their and the bankers' associations continuing review of training needs:

5:24 The CBI, bankers' associations and other training organizations, including academic institutions, will be eligible to submit training proposals for financing under the project in accordance with the training plans. These proposals will be reviewed by the CBI and submitted through the ALF unit to USAID for approval. USAID approvals will be provided through the issuance of Project Implementation Letters (PILs) to the ALF Unit:

c. Technical Assistance

5.25 A General Contractor will provide professional advisory services to assist in developing activities to improve the performance of rural financial markets and to design effective means of monitoring the impacts of policy reforms on the rural financial system:

5:26 Relative to policy and institutional studies, the General Contractor will undertake and/or assist the CB and other GOP agencies in the design, implementation and evaluation of additional policy studies that deal with the structure, conduct and performance of the rural financial system and on various aspects of agricultural lending: In addition, the ALF Committee and Policy Advisory Group will consider utilizing a policy advisor to assist periodically in their ongoing review and assessment of the impacts of policy reforms already agreed to.

5:27 The General Contractor will also: (1) assist the CBI and other training organizations, including the bankers' associations develop appropriate training materials; (2) coordinate the roles of the bankers' associations in training; and (3) assist the CBI monitor the impact of training on institutional performance.

d. Monitoring and Reporting

5.28 The ALF Unit's semi-annual monitoring report will track progress in institutional development. The report will focus on progress in training of CB and retail bank staff, progress in rehabilitation of potentially eligible banks, and major ALF Policy Advisory Group reviews and recommendations.

5.29 In addition, the General Contractor will monitor project progress. A monthly progress report prepared for USAID and the CB will review progress in undertaking studies and implementing recommendations, impact of policy changes, training progress, and progress in defining and addressing institutional constraints.

e. Procurement

(1) Studies

5.30 Funds will be included in the technical assistance contract described above to subcontract for U.S. or Filipino individuals and Philippine research institutions or consulting firms to perform studies. These individuals and firms will be subcontractors to the General Contractor. The General Contractor will select these subcontractors, based on its normal subcontracting procedures and executed in accordance with AID contracting requirements, subject to USAID and CB concurrence. Prior to contracting for the General Contractor, selected studies will be undertaken by short-term contractors and a Philippine research institute. They will be either directly contracted by USAID or contracted on a host country basis. If directly contracted by USAID, the direct payment mode will be used. If a host country contract is used, either the direct reimbursement or direct payment mode will be used.

(2) Training

5.31 AID and the WB will review the CBI training plan to determine which activities each will fund. For those activities AID will finance, AID will do so on a direct reimbursement basis. In those instances where private individual trainers and/or institutions are contracted to perform a training activity, host country contracting procedures as presented in AID Handbook 11 - Country Contracting will apply. Grant funds will be provided to partially reimburse the CB for contract training services rendered, except when the CB requests that AID pay a contractor directly, as services are being delivered. Honoraria will not be paid for CBI staff training activities. AID-financed training activities and workshops will primarily be held in the Philippines. Short-term specified training may be held in the ASEAN Region.

(3) Technical Assistance

5.32 An AID direct contract with a U.S. and/or Filipino consulting firm will be the contracting mode for procuring technical assistance. The contract will provide long-term technical services of the planning and training advisers and

the agricultural credit policy expert, as well as short-term expertise to be identified in the course of the project: AID will reimburse the General Contractor directly against submission of appropriate documentation. In the Mission's consideration of sources for the General Contractor services minority companies, including 8A firms, will be given full consideration. The project may also draw on the Science and Technology Bureau's Experimental Approach to Rural Savings Project, as appropriate and necessary.

(a) Gray Amendment - Early Alert

5.33 The Project Committee has given full consideration to the potential involvement of small and/or economically and socially disadvantaged enterprises and has determined that the Technical Assistance required under this amendment will not be provided through the 8-A set aside.

C: USAID Staff Project Management

5.34 Project management will be the responsibility of the Office of Capital Development (OCD). The OCD Project Officer will work closely with an officer from the Office of Rural and Agricultural Development (ORAD) in executing his/her project implementation responsibilities. He/she will spend approximately 30% of his/her time on the project and require approximately 30% of the time of a FSN project assistant liaising with the CB, bankers' associations and other institutions involved in project implementation. In collaboration with the OCD Project Officer, the ORAD Project Officer will supervise the General Contractor specifically as it relates to the performance of the policy and institutional studies and the review and implementation of study recommendations. The OCD Project Officer will draw upon assistance from other members of the project committee as needed, including ORAD, Office of the Program Economist, Controller, and Legal Counsel.

5.35 Regular reviews of progress will be held at least quarterly involving senior Mission management: If major problems surface relative to achieving the project's purpose, these reviews will be followed by meetings involving senior Mission and WB management together with senior CB management, as necessary:

D. Implementation Schedule

5.36 Following is a schedule of project implementation milestones:

	<u>FY 1985</u>	<u>Responsible Entity</u>
- Authorization of project	Aug 1985	USAID
- Obligation/Guarantee of FY 85 funds	Aug 1985	USAID/CB/GOP
	<u>FY 1986</u>	
- Satisfaction of initial CPs	Sep 1985	CB/GOP
- First loans to subborrowers eligible for AID reimbursement	Oct 1985	CB/PB

- Program and timetable established for the phase out of all GOP special program subsidies Dec 1985 CB
- Technical Guidelines for Project Lending Completed Dec 1985 CB
- Submission of first Training Plan for 1986 Dec 1985 CB
- Revision of Policy Manual for Lending Dec 1985 CB
- Commercial Bank Institutional Development Plans Completed Dec 1985 CB
- Initiation of training program Jan 1986 CB
- T.A. contract signed Jan 1986 USAID
- Quarterly subloan disbursement reports submitted to USAID and quarterly thereafter Jan 1986 CB
- First reimbursement of credit component and quarterly thereafter Feb 1986 USAID
- Obligation of FY 1986 funds Feb 1986 USAID/CB/GOP
- Semi-annual report on subloan and policy/institutional development performance submitted to USAID and semi-annually thereafter Mar 1986 CB
- Completion of study on government assistance to low-income groups Mar 1986 CB
- Joint USAID/WB review of subloan performance, policy and institutional reform programs, conducted semi-annually thereafter Apr-May 1986 USAID/WB

FY 1987

- Subsidies on special government programs coursed thru the CB not meeting the subsidy criteria phased out Dec 1986 CB
- Submission of Training Plan for 1987 Mar 1987 CB

FY 1988

- Interim evaluation conducted Dec 1987 USAID/WB
- Major policy and Institutional studies completed Dec 1987 CB
- USAID in-house review of status of credit disbursement and subloan collection Feb 1988 USAID
- Submission of Training Plan for 1988 Mar 1988 CB

FY 1989

- Termination of training adviser; decision on whether to retain policy adviser for final year Dec 1988 USAID

FY 1990

- Final evaluation Nov 1989 USAID
- PACD Dec 1990

5.37 The terminal date for satisfaction of conditions precedent to initial disbursement will be 60 days after the date of signing of the project agreement:

5.38 The project assistance completion date is December 31, 1990, which provides for a life of project of five years and four months.

E: Planned Audit Coverage

5.39 In accordance with the provision of Policy Statement No. 6 as outlined in State 263872 dated September 5, 1984, USAID has evaluated the potential risks, assessed USAID's vulnerability and considered the need for special audit coverage beyond that usually afforded by the GOP, and we have concluded that plans for special audit coverage do not at this time appear to be warranted. Should an unanticipated critical need for an audit emerge during project implementation, we will use the guidelines recommended in State 263872 to request assistance. However, as we feel that the probability that a special audit will be required is very low, we have decided that project funds should not be set aside for this purpose. For additional information on the auditing of this project please refer to page 29, paragraph G-Accounts and Audit of the WB Appraisal Report.

## VI. EVALUATION

6.01 Project reviews will be undertaken at least annually, and, in general, in conjunction with WB supervision missions to Manila to assess: (1) the appropriateness of structural and policy reforms introduced; (2) savings mobilization progress; (3) defining and addressing institutional constraints to achievement of project objectives; and (4) effectiveness of the technical assistance and training in improving the skills of employees in the rural financial system. AID/W participation is anticipated.

6.02 In late 1987 or early 1988, AID will conduct a mid-project evaluation focusing on achievement of project purpose and lessons learned relevant to improvement of rural financial projects in other contexts. It is designed to assess both the impact of reforms already in-place and institutional development. Furthermore, it will investigate project effects on direct and indirect beneficiaries such as, users of both formal and informal credit as well as rural depositors.

6.03 An AID internal review of credit disbursement and subloan collections status will be conducted in the last quarter of CY 1988, when projections show most AID credit funds will have been disbursed. The General Contractor will play a major role in conducting this review.

6.04 An end-of-project evaluation will also be conducted by an independent contractor. This review will evaluate whether or not the project purpose has been achieved and assess whether additional policy changes and supporting activities are needed.

6.05 The CB will also conduct process and ex-post evaluations. The Mission and WB will review and provide input to the scope and methodologies of these evaluations. Please see page 36 and Annex 6 of the WB Appraisal Report.

**VII. CONDITIONS PRECEDENT AND COVENANTS**

7:01 The following are conditions precedent and covenants A.I.D. intends to negotiate in the Project Agreement. Their substance is not expected to change during agreement negotiations.

**A: Conditions Precedent to Initial Disbursement**

7:02 Prior to first disbursement of AID project assistance, or the issuance by AID of documentation pursuant to which the first disbursement will be made, the CB shall furnish to AID, except as AID may otherwise agree in writing, in form and substance satisfactory to A.I.D.:

1: An opinion of the General Counsel of the Central Bank that the Loan and Grant Agreement between AID and the CB has been duly authorized and/or ratified by, and executed on behalf of the CB and that it constitutes a valid and legally binding obligation of the CB enforceable in accordance with all of its terms.

2: A statement of the names of the persons authorized to represent the CB for implementation of the project and of any additional representatives together with a specimen signature of each such person.

3: A duly authorized and executed Guarantee Agreement between the GOP and AID whereby the GOP has agreed to guarantee the obligations of the CB under the Loan and Grant Agreement.

4: An opinion of the Ministry of Justice that the Guarantee Agreement between the GOP and AID has been duly authorized and/or ratified by, and executed on behalf of the GOP and that it constitutes a valid and legally binding obligation of the GOP enforceable in accordance with all of its terms.

5: A statement of the names of the persons authorized to represent the Guarantor with respect to the Guarantee Agreement and of any additional representatives, together with a specimen signature of each such person.

6: Evidence that the WB has notified the CB that the conditions to the effectiveness of the Loan Agreement dated June 10, 1985 for the Agricultural Credit Project between the CB and the WB (the "WB Loan Agreement") have been satisfied:

7. Evidence of the establishment and designation of the staff of the Agricultural Loan Fund Unit, including designation of its head, as required by the WB Loan Agreement.

8: Evidence of the formal establishment of the Agricultural Loan Fund Policy Advisory Group and designation of the members of the ALFPAG, including its chairperson and the core staff:

9: An AID Project Implementation Order for Technical Services (PIO/T) duly approved by the CB and delivered to AID authorizing AID to procure the services of a "General Contractor" under an AID direct contract using grant funds:

B: Conditions Precedent to First Disbursement for Reimbursing the CB for Rediscouted Subloans from Participating Banks

7.03 Prior to first disbursement of AID project assistance for reimbursing the CB for CB funded subloans from Participating Banks, or to the issuance by AID of documentation pursuant to which such disbursement will be made, the CB will, except as AID may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID:

1: A complete initial list of all Participating Banks, together with a certification by the CB that the Participating Banks satisfy the qualifying criteria for participation in the CB's Agricultural Loan Fund, and the CB plan for the institutional appraisal by the CB of banks expected to participate subsequently in the project:

2: The Agricultural Loan Fund Policy Manual.

C: Conditions Precedent to Disbursement for Training Activities

7.04 Prior to disbursement of AID project assistance for activities under the training component, or to the issuance by AID of documentation pursuant to which such disbursement will be made, the CB shall, except as AID may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID an annual training plan for training activities for the year of the project in which such training will be performed, which will include both AID and WB-financed portions of that year's program.

D: Conditions Precedent to Disbursement for Policy and Institutional Studies

7.05 Prior to disbursement from time to time of AID project assistance for the conduct of any Policy and Institutional Study, or to the issuance by AID of documentation pursuant to which such disbursements will be made, the Borrower/Grantee will, except as AID may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID the Terms-of-Reference for such study prior to undertaking such study.

E: Covenants

7.06 The General Covenants in the Combined Loan and Grant Project Standard Provisions Annex as prescribed by AID Handbook 3 will be included in the Project Loan and Grant Agreement. In addition, the following covenants shall be included:

1. Any change in the formula for calculating the interest rates applied to any loan from the Central Bank to a Participating Bank under the Agricultural Loan Fund shall be determined on the basis of agreement between A.I.D. and the Central Bank. The Parties agree that any such proposed change will be the subject of prior collaborative discussions among the Central Bank, the World Bank and A.I.D. and A.I.D. agrees to give due consideration to the views of the World Bank with respect to any such proposed change.

2. Any change in or application of the Agricultural Loan Fund Policy Manual including, without limitation, any change in or suspension of the Participating Bank eligibility criteria, shall be determined on the basis of agreement between A.I.D. and the Central Bank. The Parties agree that any such proposed change will be the subject of prior collaborative discussions among the Central Bank, the World Bank and A.I.D. and A.I.D. agrees to give due consideration to the views of the World Bank with respect to any such proposed change.

3. The Central Bank shall not provide new agricultural credit involving interest or capital subsidies and shall by December 31, 1986 complete the elimination of subsidies on agricultural credit provided by the Guarantor and channeled through the Central Bank, in accordance with a program satisfactory to A.I.D.

4. Acceptance and implementation of any recommendation of any policy study wholly or partially financed by either A.I.D. or the World Bank, shall be upon the basis of agreement, which shall not be unreasonably withheld, between A.I.D. and the Central Bank.

5. Except as AID may otherwise agree in writing, repayments by the Participating Banks of principal to the Central Bank on loans made under this Project shall be deposited in the Central Bank's Agricultural Loan Fund for relending for the same purposes of this project.

6. The Central Bank agrees to provide to A.I.D. no later than March 31 and September 30 of each year a current list of all Participating Banks, together with a certification by the Central Bank that the Participating Banks satisfy the qualifying criteria for participation in the Agricultural Loan Fund, and an updated plan for conducting institutional appraisals of banks expected to participate subsequently in the project.

7. A.I.D. and the Central Bank agree to establish an evaluation program as an integral part of the Project. Except as the Parties otherwise agree in writing, the program will include, during the implementation of the Project and at one or more points thereafter:

a. Evaluation of progress towards attainment of the objectives of the Project;

b. Identification and evaluation of problem areas or constraints which may inhibit such attainment;

c. Evaluation, to the degree feasible, of the overall development impact of the Project.

**ANNEXES**

- A: GOP Request for Assistance**
- B: PID Approval**
- C: Statutory Checklist**
- D: Logical Framework**
- E. World Bank Appraisal Report**

ANNEX A

*Central Bank of the Philippines*

MANILA

OFFICE OF THE GOVERNOR

August 21, 1985

Mr. Frederick W. Schleck  
Director, USAID Mission  
Ramon Magsaysay Center  
Roxas Boulevard, Manila

• Dear Mr. Schleck:

I have the honor to request AID assistance in funding the Agricultural Credit Project to be implemented by the Central Bank of the Philippines.

The project seeks to: help foster economic recovery through the provision of seasonal and investment credit to the Agricultural Sector; establish an appropriate institutional and policy framework and systems to support the development of a financially sound rural credit system; and strengthen the capacity of rural credit institutions to mobilize rural savings and improve the efficiency of their farm credit operations.

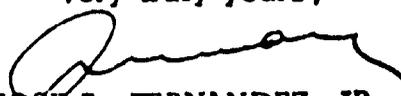
Specifically, the assistance requested will consist of \$17.4 million in loan and \$2.6 million in grant to finance two (2) major components of the project as follows:

- |                                                                                       |                       |
|---------------------------------------------------------------------------------------|-----------------------|
| a) Loan component to reimburse CB for specified loans extended by participating banks | - \$17.4 million      |
| b) Technical assistance, studies and training                                         | - <u>2.6</u> million  |
| Total                                                                                 | <u>\$20.0</u> million |

The above amount will co-finance on a parallel basis the \$100 million credit line extended by the World Bank for the same project for which the Central Bank committed to provide local counterpart funds amounting to \$13.7 million over a four-year implementation period.

Thank you and warm regards.

Very truly yours,

  
JOSE B. FERNANDEZ, JR.  
Governor

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SH  
ACT· AID-6 INFO: AMB DCM ECON ADB CBRON/10

ANNEX B

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AIDAC

E.O. 12356: N/A

TAGS:

SUBJECT: RURAL FINANCE PROJECT (492-0394), CONCEPT PAPER APPROVAL

REFERENCE: (A) MANILA 11081; (B) MANILA 15274

1. ON MAY 2, 1985, THE MISSION'S SUBMISSION (REF A) AND THE WORLD BANK'S STAFF ASSESSMENT REPORT (THEN IN DRAFT) WAS REVIEWED BY THE ANE/ASIA PROJECT COMMITTEE (PC). THE PC REVIEWED THESE DOCUMENTS IN LIEU OF A PROJECT IDENTIFICATION DOCUMENT (PID) AND RECOMMENDED DEVELOPMENT OF THE PROJECT PAPER TO PROVIDE FINANCING IN PARALLEL WITH THE WORLD BANK.

2. THE AA/ANE ACCEPTED THE PC'S RECOMMENDATION IN THE COURSE OF THE PHILIPPINES PROGRAM WEEK "WRAP-UP" MEETING ON MAY 3, 1985. MISSION IS AUTHORIZED TO PROCEED WITH THE PREPARATION OF THE PROJECT PAPER AND AUTHORIZATION OF THE DOLLARS 2,000,000 GRANT AND DOLLARS 19,000,000 LOAN FUNDED PROJECT FOR FY-85 FUNDING TAKING INTO CONSIDERATION THE GUIDANCE CONTAINED IN THIS CABLE. OBLIGATION OF PROJECT FUNDS IN EARLY AUGUST IS SUBJECT TO PRIOR AID/W APPROVAL AS DISCUSSED IN CDSS DECISION CABLE TO FOLLOW.

3. RAPID DISBURSEMENT OF AID LOAN FUNDS: GIVEN THAT AID LOAN FUNDS ARE EARMARKED FOR SEASONAL PRODUCTION CREDIT AND THAT THERE ALREADY EXISTS BACKLOG OF SUBLOANS READY FOR REIMBURSEMENT, WE EXPECT LOAN FUNDS TO BE DISBURSED FAIRLY QUICKLY. PROJECT COMMITTEE EXPRESSED CONCERN THAT QUICK DISBURSEMENT MAY DEPRIVE MISSION OF INFLUENCE ON DIRECTION OF PROJECT DURING LATER STAGES OF IMPLEMENTATION. PP ANALYSIS SHOULD SHOW THAT TA AND TRAINING WILL BE SUFFICIENT TO PROVIDE AID WITH SUCH INFLUENCE DURING LIFE OF PROJECT.

4. TARGETING OF LOAN FUNDS: PC DISCUSSED FACT THAT AID LOAN FUNDS INTENDED TO (A) REIMBURSE SUBLOANS MADE FOR SEASONAL PRODUCTION FOR LOCAL FOODGRAINS AND (B) LIKELIHOOD MOST REIMBURSEMENTS TO GO FOR LOANS MADE TO RELATIVELY LARGE OPERATORS. PC EXPLORED WAYS IN WHICH SMALL OPERATORS CAN GET BETTER ACCESS TO INSTITUTIONAL CREDIT. IT WAS NOTED THAT CONDITION OF WORLD BANK LOAN

**ACTION COPY**  
Action Taken \_\_\_\_\_  
No action necessary? \_\_\_\_\_  
Date \_\_\_\_\_

REQUIRES GOP TO CONDUCT A STUDY TO DEFINE ITS APPROACH TO AND POLICIES TOWARD ASSISTING LOW INCOME GROUPS WITH INADEQUATE ACCESS TO INSTITUTIONAL CREDIT. PP SHOULD IDENTIFY HOW -- PERHAPS THROUGH AID-FUNDED TA AND TRAINING -- GOP, CB/ALF AND BANKING SYSTEM CAN ADDRESS (SHORT OF QUOTA) THE NEED TO IMPROVE CAPABILITY OF MEETING SMALL OPERATOR'S NEEDS EITHER DIRECTLY OR INDIRECTLY.

5. INSTITUTION BUILDING: TO ASSIST INSTITUTIONAL SIDE OF PROJECT, WE BELIEVE MISSION MAY WISH TO CONSIDER BUY-IN FOR SHORT AND LONG TERM TECHNICAL ASSISTANCE FROM THE S AND T BUREAU PROJECT, EXPERIMENTAL APPROACH TO RURAL SAVINGS.

6. AID LOAN APPROVAL: THE WORLD BANK WILL APPROVE AGRICULTURAL CREDIT LOANS ABOVE \$1,000,000. PP SHOULD CONSIDER THE DISTRIBUTION OF SUBLOANS AID WILL REIMBURSE AGAINST LOAN SIZE AND DETERMINE WHETHER AID APPROVAL WILL BE REQUIRED FOR INDIVIDUAL SUBLOANS AFTER A CERTAIN LEVEL. DETERMINATION SHOULD BE BASED ON MINIMIZING STAFF REQUIREMENTS AND AT THE SAME TIME ENSURE PROPER USE OF AID FUNDS.

7. LOAN MIX AND RECOVERY: MISSION'S SUBMISSION STATES THAT AID WILL REIMBURSE SIXTY-SIX PERCENT OF SUBLOANS BUT IS NOT CLEAR IF BALANCE OF THIRTY-FOUR PERCENT TO BE PROVIDED BY THE CENTRAL BANK (CB), BY THE RETAIL BANK, OR BY BOTH. WE NOTE FROM WORLD BANK REPORT THAT CB PLANS TO RAISE ITS CONTRIBUTION FROM THE BOND MARKET, PARTICIPATING BANKS, AND SUBBORROWERS, AND THAT ALF

LENDING TERMS AND CONDITIONS WILL REQUIRE PARTICIPATING BANKS TO SELF-FINANCE NO LESS THAN 10 PERCENT OF ANY GIVEN SUBLOAN. WE ARE CONCERNED THAT PARTICIPATING BANKS NOT MERELY BE A CONDUIT FOR CB REDISCOUNTED LOANS, AND SHARE WITH YOU THE CONCERN THAT THE ALF REDISCOUNT RATE BE SET PROPERLY TO ENSURE MAXIMUM DOMESTIC RESOURCE MOBILIZATION BY THE BANKING SYSTEM. PROJECT PAPER SHOULD DISCUSS THE MIX BEING PROPOSED AND THE AMOUNT OF EQUITY CAPITAL (DEPOSIT AND SAVINGS ACCOUNTS) THAT RETAIL BANKS HAVE AVAILABLE FOR THEIR SHARE OF LOAN.

8. WAIVERS: MISSION'S SUBMISSION IMPLIES THAT PROCUREMENT WAIVERS BY AID/W ARE REQUIRED. IN ORDER TO ENSURE TIMELY AUTHORIZATION AND OBLIGATION, MISSION SHOULD SUBMIT ANY SUCH WAIVERS TO AID/W FOR PROCESSING ASAP. SHULTZ

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**5C(2) .PROJECT CHECKLIST**

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A. includes criteria applicable to all projects. Part B. applies to projects funded from specific sources only: B.1. applies to all projects funded with Development Assistance loans, and B.3. applies to projects funded from ESP.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT? Yes Yes

**A. GENERAL CRITERIA FOR PROJECT**

**1. FY 1985 Continuing Resolution Sec. 525; FAA Sec. 634A; Sec. 653(b).**

(a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or nor more than \$1 million over that amount)?

1.(a) Congressional Notification submitted on July 8, 1985 and expired on July 22, 1985 without comment.

(b) Yes

**2. FAA Sec. 611(a)(1). Prior to obligation in excess of \$100,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?**

2.(a) Yes

(b) Yes

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

3. No further legislative action is required.

4. FAA Sec. 611(b); FY 1985 Continuing Resolution Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973, or the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See AID Handbook 3 for new guidelines.)

4. N.A.

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed \$1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?

5. N.A.

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

6. No.

7. FAA Sec. 601(a). Information and conclusions whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.
8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).
9. FAA Sec. 612(b), 636(h); FY 1985 Continuing Resolution Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.
10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?
- 7.(a) The project will increase private sector trade. A portion of this trade may be for export.
- (b) Farmers and other private rural entrepreneurs and enterprises will avail of expanded credit facilities which will facilitate private trade and investment.
- (c) Interest rate policy reforms and institutional development activities will provide incentives for and contribute to the design and execution of savings mobilization programs and strategies, respectively by the rural financial system which includes cooperative banks and thrift institutions.
- (d) N.A.
- (e) The rural financial system will be rationalized, enhancing its capability to perform its financial intermediation function properly. Technical Assistance and training will be provided to pertinent government agencies and the private rural financial system to improve their respective operational efficiencies.
- (f) N.A.
8. A private U.S. contractor will be procured to provide policy advice and coordinate the Project's Institutional Development Component.
9. N.A.
10. N.A.

11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? 11. Yes
12. FY 1985 Continuing Resolution Sec. 522. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? 12. No
13. FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16. Does the project or program taken into consideration the problem of the destruction of tropical forests? 13. Yes  
N.A.
14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)? 14. N.A.

15. FY 1985 Continuing Resolution Sec. 536. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution?

15. No.

**D. FUNDING CRITERIA FOR PROJECT**

**1. Development Assistance Project Criteria**

- a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote

1.(a) This project will improve access to credit for farmers, including small farmers, as well as rural entrepreneurs and enterprises all of whom employ the rural poor.

(b) Eligible rural cooperative banks and private rural banks will participate in the project and will receive rediscounted funds for lending and technical assistance and training to improve their management capabilities consultants

(c) The project will encourage rural savings mobilization for rural investment and reduce the rural sector's dependence on special government credit programs, many of which are international donor funded.

(d) Training and TA will improve productivity of employees of rural financial institutions; most of these employees are women, for example over two-thirds of all accountants are female. Many, if not most, of the employees and important financial decision-makers of groups benefitting from a strong rural financial system are women. Such groups include small and medium agricultural processors and input suppliers as well as individual farm families.

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the participation of women in the national economies of developing countries and the improvement of women's status, (e) utilize and encourage regional cooperation by developing countries?

(e) N.A.

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?

b. Yes

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

c. N.A.

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed country)?

d. Yes. The GOP and the private sector will together contribute 41% of total project costs.

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project for more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country

e. N.A.

"relatively least developed"? (M.O. 1232.1 defined a capital project as "the construction, expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than \$100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character."

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

f. Yes

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

g. Farmers and other rural entrepreneurs and enterprises will express their credit needs through the project. The rural financial system will express its institutional needs directly and indirectly, through their associations, to the GOP. The project will utilize GOP and local private training institutions, local private research and educational institutions and local private consultants. The project will provide training to the Central Bank to enhance its institutional capabilities.

2. Development Assistance Project  
Criteria (Loans Only)

- |                                                                                                                                                                                                                                                                                                                     |              |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|
| a. <u>FAA Sec. 122(b)</u> .<br>Information an conclusion on<br>capacity of the country to<br>repay the loan, at a<br>reasonable rate of interest.                                                                                                                                                                   | a. Available |
| b. <u>FAA Sec. 620(d)</u> . If<br>assistance is for any<br>productive enterprise which<br>will compete with U.S.<br>enterprises, is there an<br>agreement by the recipient<br>country to prevent export to<br>the U.S. of more than 20% of<br>the enterprise's annual<br>production during the life<br>of the loan? | b. N.A.      |

3. Economic Support Fund Project  
Criteria

- |                                                                                                                                                                                                                                                                                                             |            |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|
| a. <u>FAA Sec. 531(a)</u> . Will this<br>assistance promote economic<br>and political stability? To<br>the extent possible, does it<br>reflect the policy<br>directions of FAA Section<br>102?                                                                                                              | 3.(a) N.A. |
| b. <u>FAA Sec. 531(c)</u> . Will<br>assistance under this<br>chapter be used for<br>military, or paramilitary<br>activities?                                                                                                                                                                                | (b) N.A.   |
| c. <u>FAA Sec. 534</u> . Will ESF<br>funds be used to finance the<br>construction of, or the<br>operation or maintenance of,<br>or the supplying of fuel<br>for, a nuclear facility? If<br>so, has the President<br>certified that such use of<br>funds is indispensable to<br>nonproliferation objectives? | (c) N.A.   |

d. FAA Sec. 609. If  
commodities are to be  
granted so that sale  
proceeds will accrue to the  
recipient country, have  
Special Account  
(counterpart) arrangements  
been made?

(d) N.A.

**5C(3) - STANDARD ITEM CHECKLIST**

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

**A. Procurement**

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?
2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him??
3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

1. Commodities will not be directly financed by the project. Services will be procured in accordance with Standard AID policies and procedures.

2. Procurement can be from the U.S., the Philippines and Code 941 Countries.

3. N.A.

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) 4. N.A.
5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries which are direct aid recipients and which are otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one of these areas? Do these countries permit United States firms to compete for construction or engineering services financed from assistance programs of these countries? 5. N.A.
6. FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates? 6. N.A.

7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? 7. Yes  
Yes
8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available? 8. Yes
9. FY 1985 Continuing Resolution Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? 9. Yes

B. Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? B.(1) N.A.
2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? (2) N.A.

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3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the CP)? (3) N.A.

C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? C.(1) Yes
2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? (2) N.A.
3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? (3) Yes.
4. Will arrangements preclude use of financing: (4) N.A.
- a. FAA Sec. 104(f); FY 1985 Continuing Resolution Sec. 527. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice

abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

- |    |                                                                                                                                                                           |        |
|----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| b. | <u>FAA Sec. 620(q)</u> . To compensate owners for expropriated nationalized property?                                                                                     | b. Yes |
| c. | <u>FAA Sec. 660</u> . To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? | c. Yes |
| d. | <u>FAA Sec. 662</u> . For CIA activities?                                                                                                                                 | d. Yes |
| e. | <u>FAA Sec. 636(i)</u> . For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?  | e. Yes |
| f. | <u>FY 1985 Continuing Resolution, Sec. 503</u> . To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel?                     | f. Yes |

- g. FY 1985 Continuing Resolution, Sec. 505.  
To pay U.N. assessments, arrearages or dues? g. Yes
- h. FY 1985 Continuing Resolution, Sec. 506.  
To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? h. Yes
- i. FY 1985 Continuing Resolution, Sec. 510.  
To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields? i. Yes
- j. FY 1985 Continuing Resolution, Sec. 511.  
Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? j. No
- k. FY 1985 Continuing Resolution, Sec. 516.  
To be used for publicity or propoganda purposes within U.S. not authorized by Congress? k. Yes

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**PROJECT DESIGN SUMMARY  
LOGICAL FRAMEWORK**

Life of Project:  
From FY 85 to FY 90  
Total U. S. Funding 120.0 million  
Date Prepared: July 12, 1987

Project Title & Number: RURAL FINANCIAL SERVICES PROJECT - PROJECT NO. 492-0394

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS																														
<p><b>Program or Sector Goal: The broader objective to which this project contributes: (A-1)</b></p> <p>To assist the GOP in increasing the rate of economic growth in the rural sector.</p>	<p><b>Measures of Goal Achievement: (A-2)</b></p> <p>Accelerating growth in income, employment and production in rural areas.</p>	<p><b>(A-3)</b></p> <p>GOP economic data.</p>	<p><b>Assumptions for achieving goal targets: (A-4)</b></p> <ol style="list-style-type: none"> <li>1. Pricing policies of agricultural inputs and commodities adjusted to provide attractive returns on investment in agriculture.</li> <li>2. Borrowers' use credit resources for productivity enhancing investments.</li> <li>3. Implementation of GOP's "Balanced Agro-Industrial Development" strategy, with significant increase in GOP resources devoted to rural infrastructure, technology generation and dissemination.</li> <li>4. Political stability.</li> </ol>																														
<p><b>Project Purpose: (B-1)</b></p> <p>To strengthen the policy and institutional framework necessary for sustaining a viable rural financial system.</p>	<p><b>Conditions that will indicate purpose has been achieved: End-of-Project status. (B-2)</b></p> <ol style="list-style-type: none"> <li>1. Interest rates carried on loans to FMs will be market oriented, reflecting both weighted average cost of banking system's savings and time deposits;</li> <li>2. Interest subsidies will be phased out by December 1986 for those programs not using CB resources which do not meet "poverty group" exemption criteria;</li> <li>3. Additional discrete policy and institutional reform measures, identified under "studies", will be implemented;</li> <li>4. Agricultural Loan Fund Advisory Committee functioning in CB Governor's Office; undertaking continuing review of credit policies;</li> <li>5. Higher rates of savings mobilization and reduced dependence on CB rediscounted funds, particularly among rural and private development banks.</li> </ol>	<p><b>(B-3)</b></p> <p>Interim and Final Evaluation. Central Bank records consultants reports.</p>	<p><b>Assumptions for achieving purpose: (B-4)</b></p> <ol style="list-style-type: none"> <li>1. Interest rate subsidy phase-out implemented on schedule.</li> <li>2. Implementation of rehabilitation measures for insolvent banks.</li> <li>3. Continued implementation of GOP stabilization program, i.e., holding to inflation and monetary targets.</li> </ol>																														
<p><b>Project Outputs: (C-1)</b></p> <p>Establishment of an agricultural loan fund in the Central Bank to provide short, medium and long term agricultural credit to the banking system.</p> <p><b>Studies</b></p> <ol style="list-style-type: none"> <li>a. Constraints to and strategies for expansion of banking services in rural areas.</li> <li>b. Government assistance strategies to poverty groups, identifying if and under what conditions credit subsidies are warranted.</li> <li>c. Review of CB rediscount policies and measures for dealing with retail bank arrears.</li> <li>d. Review impact of crop insurance programs designed to reduce risks to participating banks.</li> <li>e. Technical guidelines for project lending.</li> <li>f. Other studies to be identified in the course of project.</li> </ol>	<p><b>Magnitude of outputs: (C-2)</b></p> <ol style="list-style-type: none"> <li>1. Credit funds totaling 233.25 million (includes 10.472 CB and 73 contributions)</li> <li>2. Studies, completed within first two years of project; other studies to be identified and completed within life-of-project;</li> <li>3. Policy recommendations submitted to Monetary Board of Central Bank;</li> <li>4. 100 CB staff trained 120 trainers trained 200 FB staff trained</li> <li>5. Revised loan application procedures</li> <li>6. Establishment of technical assistance programs within bankers associations.</li> </ol>	<p><b>(C-3)</b></p> <ol style="list-style-type: none"> <li>1. Quarterly review of loan documentation.</li> <li>2. Studies to be submitted to USAID.</li> <li>3. Consultation between USAID and CB.</li> <li>4. Consultant's reports and reimbursements documentation.</li> </ol>	<p><b>Assumptions for achieving outputs: (C-4)</b></p> <ol style="list-style-type: none"> <li>1. Willingness to borrow at "market-oriented" interest rates.</li> <li>2. Studies completed on schedule.</li> <li>3. Policy recommendations accepted by GOP.</li> <li>4. Bankers receptive to participating in training program.</li> <li>5. Bankers Associations capable of assuming additional responsibility in providing technical assistance to their member banks.</li> </ol>																														
<p><b>Project Inputs: (D-1)</b></p> <p>Local currency for agricultural credits; Local currency for financing studies; Local currency for financing development to training curricula; T.A. to ALF Advisory Committee to monitor and evaluate phasing and impact of policy reforms, and to coordinate studies (also long term consultant); T.A. to monitor status of FMs; review and recommend simplifications in credit approval and disbursement procedures; and coordinate training courses (1 long term consultant); T.A. to perform selected studies (short term).</p>	<p><b>Implementation Target (Type and Quantity) (D-2)</b></p> <table border="1"> <tr> <td>1. Credit Funds:</td> <td>World Bank</td> <td>\$100 million</td> </tr> <tr> <td></td> <td>AID</td> <td>99.5 million (L)</td> </tr> <tr> <td>2. Studies</td> <td>WB</td> <td>.300 million</td> </tr> <tr> <td></td> <td>AID</td> <td>.220 million (C)</td> </tr> <tr> <td>3. Training</td> <td>WB</td> <td>.180 million</td> </tr> <tr> <td></td> <td>AID</td> <td>.250 million (C)</td> </tr> <tr> <td>4. TA</td> <td>WB</td> <td>.180 million</td> </tr> <tr> <td></td> <td>AID</td> <td>1.234 million (J)</td> </tr> <tr> <td>5. Evaluation</td> <td>AID</td> <td>.120 million (C)</td> </tr> <tr> <td>Contingencies/ Inflation</td> <td>AID</td> <td>.745 million (C)</td> </tr> </table>	1. Credit Funds:	World Bank	\$100 million		AID	99.5 million (L)	2. Studies	WB	.300 million		AID	.220 million (C)	3. Training	WB	.180 million		AID	.250 million (C)	4. TA	WB	.180 million		AID	1.234 million (J)	5. Evaluation	AID	.120 million (C)	Contingencies/ Inflation	AID	.745 million (C)	<p><b>(D-3)</b></p>	<p><b>Assumptions for providing inputs: (D-4)</b></p>
1. Credit Funds:	World Bank	\$100 million																															
	AID	99.5 million (L)																															
2. Studies	WB	.300 million																															
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5. Evaluation	AID	.120 million (C)																															
Contingencies/ Inflation	AID	.745 million (C)																															
<p><b>Continuation of Project Outputs (C-1)</b></p> <p>Implementation of recommendations of studies.</p> <p><b>Training</b></p> <ul style="list-style-type: none"> <li>- Development of training curricula for loan appraisal and collection as well as portfolio and deposit management.</li> <li>- Enhancing skills of a wider range of trainers both within CB, other GOP agencies and private organizations in various sectors of banking.</li> </ul>	<ul style="list-style-type: none"> <li>- Enhancing capacity of CB staff to conduct institutional appraisals and supervision of participating banks.</li> <li>- Reduced loan processing time through training of CB and FM staff in ALF procedures and administration.</li> <li>- Increasing capacity of bankers associations to assume greater role in providing technical assistance to their members.</li> </ul>																																