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CURRENT IMPERATIVES AND DEVELOPMENTS  
IN PHILIPPINE AGRICULTURAL CREDIT POLICY

by  
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March, 1987

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by

V. BRUCE J. TOLENTINO<sup>2</sup>

INTRODUCTION

This paper aims to provide three broad sketches: first, a picture of the current status of agricultural credit in the Philippines; second, a summation of the policy imperatives dictated by the current state of the economy and the agricultural credit system; and third, an outline of the major policy thrusts being undertaken by the Philippine government in response to such imperatives. Section 1 summarizes the imperatives to which policy must respond, while Section 2 points out the financial system's major features which have contributed to the problems enumerated in the first section. Section 3 lays out the policy thrusts that must be undertaken by the government, while Section 4 enumerates the various policies already being implemented by the government. Finally, Section 5 states some conclusions and

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1 An earlier version of this paper was presented at a symposium jointly sponsored by the Center for Policy and Development Studies, WINROCK International Foundation and the Agricultural Credit and Cooperatives Institute held at the University of the Philippines at Los Banos on December 9, 1986.

The research assistance of Ms. Magdalena Soberano of the Technical Board for Agricultural Credit and the suggestions of the Ohio State University Professors Douglas Graham and Richard L. Meyer are gratefully acknowledged.

2 Policy Coordination Fellow, CPDS, and Consultant to the Ministry of Agriculture and Food and to the Monetary Board of the Central Bank of the Philippines.

indicates various strengths as well as gaps in the current approaches of the government's credit policy and program.

1.

AGRICULTURE CREDIT AND TOTAL LOANS: AN OVERVIEW

Through the past two decades, the proportion of loans made to agricultural projects by the formal financial system of the Philippines has steadily declined. In 1966, that share averaged 18 percent of total loans. In 1976, it had fallen to its lowest on record to only 5 percent. In 1985, the proportion of agricultural loans to total loans was just under 10 percent making the average share over the past two decades about 10 percent (Table 1). It should be noted that the ratio of agricultural loans to agricultural gross value added does not display a pattern as monotonically decreasing as that shown by the ratio of agricultural loans to total loans. The former ratio varied between 14 and 22 percent from 1966 to 1979. It rose quickly to a peak of 33 percent in 1982, then began to fall reaching 17 percent in 1985.

The relatively small proportion of total loans going to agriculture is not that disturbing when structural shifts occur in the economic development process, i.e., a decline in agriculture with a corresponding expansion in industry (Eicher and Staatz, 1984). However, no such shift has taken place in the Philippine economy over the past twenty years. The share of agriculture in net value added in constant (1972=100) terms in

1966, 1976 and in 1985 was 34%, 31%, and 36% respectively, averaging 34% overall (David, 1983; NEDA, 1985). In contrast to the relatively constricted supply of credit to agriculture, the contribution of agriculture to the Philippine economy's income has remained relatively high.

The above observations indicate that what makes the small share of agricultural to total credit outstanding of the Philippine financial system disturbing is the implication that the formal system is not supporting and building on the economy's inherent strengths, in the face of the continuing importance and comparative advantage of agriculture in the Philippine economy. Moreover, such discomfort turns to alarm when we consider that about three-fifths of all Filipino families depend on agriculture for their incomes. Recent studies (Quisumbing, 1986; NCSO, 1984) point out that the average incomes of agricultural operators and workers are only 77% and 44% of the national average, respectively. In fact, about 81% of all families in the bottom 30% income class derive their incomes from agriculture.

When juxtaposed with the fact that agriculture continues to be a major source of income, the decline in agricultural credits granted by the formal financial system indicates the importance of the informal credit system. A nationwide survey conducted in 1982 by the Technical Board for Agricultural Credit (TBAC, 1986) showed that of all farmers, only 29% borrowed production loans while the rest self-financed their expenses. Of those who did borrow, 59% were supplied loans by the informal financial system.

We may deduce that the decline in loans provided by formal sources has been partly met by increases in informal credit and/or self-finance.

The evidence that is currently available on the informal sector of the Philippine financial system is very fragmentary. There are currently no estimates of the size and directions of the financial flows through informal intermediaries. Only data on the regulated, formal institutions are available. Yet micro-level and anecdotal evidence indicates that certain informal credit institutions, like credit unions, actually intermediate financial flows on a scale even larger than many licensed banks.

Thus there are both efficiency and equity reasons for concern regarding the decline in the allocation of credit to agriculture by the formal financial system. The demonstrated and continuing comparative advantage of the Philippines in agriculture indicates productivity potentials unexploited by the economy and unsupported by the financial system. Equity considerations also demand that more resources be efficiently and effectively directed to agriculture from which majority of Filipino families derive their incomes, and within which the incidence of poverty is much greater. These are the imperatives to which public agricultural credit policy must respond.

## THE DECLINE IN FORMAL AGRICULTURAL CREDIT:

## THE BASIC CAUSES

The decline in formal credit to agriculture may be explained in terms of the costs undertaken by lenders in extending agricultural loans. The price of the loan is determined by the conditions shaping the lender's supply of loans - his cost of funds and his desired profit, including premia for risk and default (Tolentino, 1986). Thus lenders, as profit-maximizing businessmen, seek to lend to those sectors where their combined cost of funds and supervision are relatively lower, under given rates charged on loans. Through most of the past two decades, legal ceilings have been prescribed on interest rates in the Philippines. Interest rates on agricultural loans were also set lower than for other types of loans. To the extent that such ceilings prevented lenders from applying the full costs and margins on their loans, then all borrowers, especially agricultural, benefited. However, legal interest rate ceilings also prevented lenders from making loans to agriculture insofar as they perceived the ceilings as too low to allow acceptable returns to agricultural lending. Too low that is, to cover the necessary premia for the greater risks attendant to agricultural ventures and the greater probabilities of default by agricultural borrowers who generally generate lower incomes and are not able to offer any or only have lesser-value collaterals

Informal lenders, on the other hand, are largely unconstrained by the legal ceilings on interest rates. They are able to set their rates at levels which cover their total transaction costs as well as their desired profits. A distinction must be made, however, between the transaction costs and effective lending rates charged by the formal and informal lenders. Research has indicated that the effective lending rates of formal in informal lenders may actually be at similar levels (Saito, 1980; TBAC, 1981). In nominal terms, informal sector lending rates may appear to be much greater than that of the formal sector. However, when the total transaction costs of borrowing are considered, the borrower is often indifferent to either channel, and may even prefer to patronize the informal lender who will impose minimal time, energy, paperwork and other (costly) requirements.

The Philippines' experience with the use of interest rate ceilings as a tool for development finance is instructive. In the agricultural sector, the Masagana 99 (M-99) program was established. The primary feature of this thrust to attain self-sufficiency in rice was the supervised credit scheme, within which uncollateralized, low-interest loans for rice production were pumped by the government throughout the countryside through the rural banks and the Philippine National Bank. To substitute for collateral and borrower creditworthiness, the scheme provided intensive supervision and technical assistance, and provided a host of subsidies for operational costs (Lamberte, 1985). The

participating banks sourced their funds from special government deposits and the rediscount window of the Central Bank of the Philippines at rates of 3% or less. The banks were also allowed margins ranging from 9% to as much as 15%. Given such low-cost (at source) funds and the relatively wide margins within which the costs associated with operations, risk and default could be encompassed, many banks fully participated in the program.<sup>3</sup> In particular, the rural banks quickly evolved portfolios of assets largely composed of supervised credit program loans, and liabilities dominated by special government deposits and Central Bank rediscounts.

To spur development in the non-agricultural sphere of the Philippine economy, the government implemented a system of policies and incentives aimed at the promotion of industry (Power and Medalla, 1985). These included interest rate controls similar to those in agriculture -- only on a larger scale. The results have been explained and documented elsewhere (for example, Bautista and Power, 1979) but the results may be summarized: such policies made capital investments artificially attractive, creating an urban, manufacturing bias, and further diverting the flow of credit from agriculture to industry.

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3 Some rural bankers and other observers allege that government policy practically forced participation on the banks, to the extent that bankers were made to manage loan portfolios of sizes and qualities they were ill-equipped to handle.

Since food self-sufficiency was the primary goal of the M-99 and the rest of the spectrum of supervised credit programs (of which there are now 38), the participating banks were basically considered as conduits for the loans. Particularly in the early stages of the program, much more attention was paid to pushing the loans down through the bank pipeline, while less energy was focussed on the measures necessary to ensure project feasibility, repayment capacity and collection. Since the capacity of the banking system to collect its agricultural loans was quite inadequate, the quality of the loan portfolios of the banks quickly deteriorated. In 1972, prior to the launching of the M-99 program, the proportion of past due loans in the rural banking system's loan portfolio was only about 11%. In 1984, fully one-third of all loans made by the system were past due. Since most of these loans were financed from special time deposits and rediscounts provided by the government, the rural banks' arrearages to the Central Bank correspondingly increased, from only 28% in 1979 to 72% in 1984 (TBAC, 1985).

The adverse effects of the financial policies of the Philippine government did not go unnoticed. Responding to observations and criticism from both within (Inter-agency Committee on the Study of Interest Rates, 1973; TBAC, 1985) and without the government (David, 1979; IMF, 1980), a process of interest rate deregulation was initiated by the Philippine monetary authorities in 1980. By late 1984, the interest rate structure of Philippine finance was almost wholly market-

oriented. Among the principal expected long-term effects of deregulation was to increase the private deposit-generating capacity of the banking system, and thus reduce its dependence on government deposits as its principal source of loanable funds. In the short-term, however, deregulation has further reduced the flow of loans to the agricultural sector. Indeed, while the deregulation: (a) of savings rates has increased the flow of private deposits into the system and simultaneously, (b) of rediscount rates has reduced the banks' accumulation of new liabilities to the government, the risk and default conditions surrounding agriculture have not significantly improved. Thus most investors are still reluctant to incur enlarged exposures to agriculture, and bankers still prefer to lend to non-agricultural, larger-scale, urban ventures for which the government-provided incentive structures still operate.

### 3.

#### THE REQUIRED EMPHASES FOR GOVERNMENT AGRICULTURAL CREDIT POLICY

In essence, government agricultural credit policy must respond to: (a) the efficiency imperative of agriculture's comparative advantage, and (b) the equity imperative of the agricultural sector's greater burden of population and poverty. To respond to these imperatives, more credit, both in absolute as well as relative terms, must flow to agriculture. Such flows must be sustained over the long term, requiring that the finan-

cial system source most of its loanable funds from the public, and that financial institutions evolve from being "borrower-dominated" to "depositor-dominated" firms, and in the process be enabled to operate as independent and viable firms. Furthermore, the flow of loans to agriculture must encompass a substantial sub-flow to the impoverished sector of small farmers, fishermen, and landless agricultural laborers.

The experience of the 1970's has amply demonstrated that credit cannot be forced through the system. Although the M-99 program channelled a huge amount of loans to agriculture, the proportion of total loans to agriculture rose only slightly and did not even surpass the pre-M-99 levels (Appendix Table 1). Furthermore, research has indicated (Esguerra, 1981) that the subsidies granted by the government through the M-99 program, although meant to be fully enjoyed by farmer-borrowers, were largely captured by the formal lenders.<sup>4</sup> Thus it seems clear that the aspect of agricultural lending which should be made less costly through government policy is not credit, but agriculture itself. In the absence of substantial government subsidies, lenders are wary of agricultural exposures because these entail greater risks and monitoring costs. The risks and the monitoring costs must be reduced in absolute terms, or their incidence shifted to government.

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4 Thus the quip: "The rural bank failed, but the rural banker got rich!"

In part the problems of the agricultural credit system may be due to the confounding of the equity and efficiency goals of subsidies to agriculture. As early as 1971, researchers had raised cautions about the "credit need creed", pointing out that policymakers were tending to expect improbable achievements from the provision of subsidized credit to small farmers (Von Pishcke, 1971). Advances in productivity do not necessarily require cheap credit, but only simple improvements in technology in many cases. Increases in farmers' incomes do not necessarily require cheap credit, but rational pricing policies for farm inputs and outputs. In the short run, artificially cheapened loans provide for increases in income, but such income-transfer mechanisms based on cheap credit policies have distortionary long-run effects. Credit becomes confused with welfare assistance, and loan discipline deteriorates. Thus the much-maligned "dole-out mentality" of the small farmer.

Recent research also indicates that, indeed, formal-system credit must be considered as a specialized development tool that should be directed only at groups able to handle loans sourced from the formal financial system, i.e., recognize loans as entailing an obligation to repay, and also possessing the capacity to: (a) operate within the legal and paper-based structures of formal credit, and (b) utilize the increase in resources enabled by the loan as an opportunity for productive enterprise (NEDA, 1986). Loans granted to groups with incomes so low that such loans are invariably used for consumption purposes

will only make these groups debtors - and worse off than before the loan is made. For these groups, direct subsidies for productive activities will be a more efficient income-transfer as well as productivity-enhancing mechanism.<sup>5</sup>

4.

CURRENT GOVERNMENT POLICIES FOR AGRICULTURAL CREDIT

The two principal government institutions shaping agricultural credit policy in the Philippines are the Central Bank of the Philippines and the Ministry of Agriculture and Food. In general, both institutions have made a commitment to reforming the system to enhance its market orientation, and to reduce government intervention in the allocation of credit. The specific policies and programs that these institutions have set into motion are summarized below.

At the Ministry of Agriculture and Food

For over a decade the MAF has been involved in the direct management of loan funds. Unfortunately the MAF's performance as a quasi-banking institution has been poor. The current leadership of the MAF recognizes that fund management and lending are not an area of MAF strength, and that the appropriate institution

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5 Douglas Graham points out the seemingly, as yet, unresolved paradox that although informal-sourced credit is most often used for consumption purposes and these are more often repaid than not, formal-system loans used for consumption purposes are more often not repaid.

for lending is the Philippine financial system. The MAF's role is the identification of investment areas where finance will produce the greatest positive impact on agricultural and rural development. Once these priority areas are identified, the MAF then provides the support and assistance necessary for the privately profitable financing of investments in these areas. The MAF has initiated several major programs aimed at shifting the Ministry away from direct lending. These moves include the organization of the Agricultural Credit Policy Council (ACPC), the creation of the Consolidated Agricultural Loan Fund (CALF) and participation in the review and rehabilitation of the rural banking system being undertaken by the Central Bank of the Philippines.

The ACPC. The MAF has submitted to the Office of the President of the Philippines its proposal to create the ACPC. The ACPC will serve as the government's overall coordinator of agricultural financing with the mandate to support and facilitate private financing of agricultural enterprises. The Government recognizes the greater levels of risk and loss inherent in agricultural investments. Therefore, to the extent that private enterprise is prevented by extra-normal risks from participation in agriculture, then the government expects to implement programs to reduce such risks. Such programs will include those supporting improved and increased infrastructure/irrigation; crop insurance; extension, research, training; direct subsidies and rational input and output price policies imple-

mented through the MAF-attached agencies, councils, authorities and bureaus.<sup>6</sup>

The ACPC will have two divisions: research and Consolidated Agricultural Loan Fund management. The research division will monitor and analyze current events in agricultural finance, and provide policy analysis for decision-making.<sup>7</sup> CALF management will allocate and invest the government-owned agricultural credit funds which have been integrated into the CALF. The ACPC will work through a network of accredited, financial intermediaries, principally banks. While the ACPC will indicate broad, wholesale objectives in lending, the intermediaries will be fully responsible for the retailing of credit to specific projects.

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6 There are currently a total of 29, such as the National Food Authority, the Fertilizer and Pesticide Authority, the Philippine Coconut Authority, the Philippine Seed Board, the Presidential Council of Agricultural Credit, the Philippine Agricultural Training Council, the National Food and Agricultural Council, the Philippine Training Center for Rural Development, the National Nutrition Council, the Philippine Tobacco Administration, the Philippine Virginia Tobacco Administration, the Philippine Virginia Tobacco Board, the Philippine Cotton Corporation, the Philippine Dairy Corporation, the Philippine Fisheries Development Authority, the Southeast Asia Fisheries Development Commission, the Fiber Development Authority, the Green Revolution Committee, the Livestock Development Council, the National Artificial Rain Stimulation Committee, the National Meat Inspection Commission, and the Bureaus of Plant Industry, Soils, Extension, Fisheries and Aquatic Resources, Animal Industry, Cooperatives Development, and Agricultural Economics.

7 The creation of the ACPC simultaneously disbands the moribund Presidential Committee for Agricultural Credit, and will absorb the Technical Board for Agricultural Credit, which has for the past 11 years focussed on agricultural credit policy analysis and research.

The ACPC will be an agency under the administrative control of the MAF. It will operate in partnership with the Central Bank. Its governing body will be chaired by the Minister of Agriculture and Food, and the Vice-chairman will be the Governor of the CB. The Director-General of the NEDA, the Minister of the Ministry of Budget and Management, and the Minister of Finance are the other council members.

The CALF. The MAF has proposed the creation of the CALF along with the organization of the ACPC. The CALF will result from the integration of all of the separate, commodity-specific, small funds into a single fund managed by a single board answerable to the ACPC. The initial phase of consolidation will involve only those funds directly controlled by the MAF, including those administered by the CB in MAF's behalf. Later phases of integration will cover other agricultural funds of other ministries and, after renegotiation, foreign-sourced funds.

The creation of the CALF is expected to result in:

- (a) the minimizing of fund administration costs;
- (b) the integration of fund control and management;
- (c) a shift from commodity-specific to line-of-credit financing;
- (d) the professionalization of fund management; and
- (e) the preservation and nurturing to growth of the funds through economic-size investment, and the allocation of a fixed proportion of earnings from investments into an endowment fund.

Initial investments from CALF funds will be into the expansion of the relatively successful and efficient operations

of the Guarantee Fund for Small and Medium Enterprises and the Quedan Guarantee Fund Board. In general, the fund will be used: (a) to support the private financing of initiatives in agricultural enterprises, and (b) to provide seed funding for pioneering/new ventures. In essence such support will be a means of risk-sharing which the government will undertake to reduce the burden of project development costs on private entrepreneurs.

#### At the Central Bank of the Philippines

The Central Bank of the Philippines has been grappling for nearly the past decade with the problem of declining credit to agriculture flowing through the Rural Bank system. Since the agricultural loans made by the banking system were largely financed by treasury-sourced seed funds and Central Bank-provided rediscounts, the major effects of the increasingly poor quality of the banking system's agricultural portfolio were effectively passed backward by the system to the CB resulting in an enlarged proportion of uncollectibles in the CB's portfolio of assets.

Financial Reform, 1980-1985. With the worsening levels of past dues in the agricultural portfolios of the banking system, and the corresponding increases in the amount of arrearages on repayments of rediscounts by banks (especially rural banks), the Central Bank has implemented several measures aimed at the correction of the portfolio problems of the banks. The measures have included restructuring of arrearages to the Central Bank, a payment plan for arrearages, and the conversion of the portion of

bank-to-government arrears into government equity, combined with matching fresh capital infusions by the bank owners.

The Central Bank's experience of implementing the specific measures listed above was disappointing. Relatively few of the rural banks participated in the programs. However, the low participation level may have been affected by larger, more macroeconomic factors. It should be understood that these specific measures were implemented in the context of relatively weak Philippine economy also suffering from the effects of the "second oil shock" in 1980-81; and also interacting with the effects of the generalized reform program for the Philippine financial system launched in 1980 and largely completed by late 1985. The general reform program has freed interest rates on both deposits and loans from legislated ceilings, reduced the distinctions between bank types by merging three of the five types (saving and mortgage banks, savings and loan associations, and private development banks) of banks into only one (thrift banks). The scope of activities and investments into which banks can engage was expanded, particularly those for the commercial banks and the universal/expanded commercial banks.

The generalized reform program for the financial system, however, is focussed on long-term changes in the financial system, particularly in terms of encouraging savings deposit mobilization and the increased level of term loans in the system's portfolio. In the shorter term, the market orientation of interest rates has adversely affected the current operations

and status of the banks that had become dependent on the government-sourced, cheap, deposit and rediscount funds. The impact of the rise in the rediscount rate has compounded the effect of the heavy and growing burdens of past due subloans, arrearages and the resulting non-eligibility of many, mostly rural, banks for government funds.

The trends in the numbers of operating banks and the Central Bank's reports on the banks eligible for liquidity infusion under CB-administered financing programs reflect the growing inability of many banks to operate profitably, or even operate at all, under the reformed financial regime. The peak number of banks, 1214, in the system was reached in 1981. By year-end 1985 there were only 1055. The source of the downtrend has essentially been the rural bank sector. At its peak in 1981, there were a total of 1,168 rural banks. As of June 30, 1986, only 890 rural banks were operational. Of the 890 operational banks, only 232 were adjudged eligible by the Central Bank to approach the rediscount window.<sup>8</sup> Finally, out of the entire rural bank system, only 15 banks are accredited to participate in the most-recently implemented agricultural credit program, the USAID and WB-funded Agricultural Loan Fund.

The agricultural credit reform activities currently being carried out by the Central Bank include: (a) the operation of

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8 The current low participation rate of rural banks in rediscounting may reflect the joint effects of the market-orientation of rediscount rates and deposit rates. Initial data from the first year after the full deregulation of rates show an appreciable rise in savings deposit levels.

the Rural Bank Review and Rationalization Committee (RBRRC), (b) the studies of rediscounting and arrearages, and of agricultural finance.

The RBRRC. At the urging of the Ministry of Agriculture and Food, the CB Monetary Board created the Rural Bank Review and Rationalization Committees (RBRRC) on September 4, 1986. The RBRRC is a special, temporary committee with a one-year lifetime, mandated to focus exclusively on the revitalization of the rural banking system. In addition to the MAF, the CB, the National Economic and Development Authority, the Ministry of Finance, the Ministry of the Budget and Management and private sector representatives are RBRRC members. A Technical Working Group of staff, secretariat and consultants back up the work of the committee.

The RBRRC performs its work by providing the Monetary Board and the Central Bank with "implementation-ready" proposals which may immediately be acted upon. The Technical Working Group of the RBRRC, which includes senior officers from the CB departments most concerned with rural bank operations, organizes and distills the mass of data, proposals and recommendations that have already been aired and submitted by various interest groups and researchers, and packages these into a form which may be acted upon by the RBRRC, and also be reacted to by affected interest groups such as the Rural Bankers' Association of the Philippines.

Areas of RBRRC Concern. The RBRRC has mapped out its "Areas of Concern", and in the short-term is directing its attention to the most urgent problem currently facing the rural banking

system: the question of eligibility for credit infusions, and the handling and reduction of rural bank arrearages to the CB.

1. Bank Performance Analysis. The question of eligibility is being tackled by defining the process and methodology through which the authorities, particularly the Central Bank's Departments of Rural Banks and Loans and Credit, discriminate between rural banks performing well or poorly, and which banks may or may not be allowed to rediscount. Each of these departments has existing eligibility and creditworthiness criteria upon which the Central Bank's decision-making on bank supervision and the access of a bank to the various liquidity sources is based. The end-product of this process, which is expected to be completed by the end of the first quarter of 1987, will be a model which may be useful in terms of: (a) explaining the decision-making process of the CB with regard to bank supervision and eligibility determination, and (b) creating an operational, reliable "early-warning system (EWS)" pinpointing developing financially-troubled "problem banks". The EWS will be based on methodologies like factor analysis and multiple discriminant analysis on the data submitted to the CB by individual banks, as well as the financial data on individual banks already audited by the CB's examiners.

2. Arrearages. Fully eighty percent of all rural banks are now saddled with arrearages to the CB. Such liabilities not only limit the scope of their operations, but also limit their (a) eligibility for further government assistance, and

(b) their attractiveness as potential investment areas by the commercial banking system, which is currently very highly liquid and should thus require relatively little persuasion to indeed invest in rural banking. Measures which will effectively reduce the burden of arrearages, while not requiring additional outlays of government support, but still increasing bank liquidity are already being considered by the RBRRC, including: (a) the acceleration of guarantee payments for bad M-99 loans budgeted as early as 1982 but yet unpaid by the Philippine Crop Insurance Corporation; (b) the upward modification in the ceiling on the voting equity of family groups in rural banks; (c) the establishment of a longer-term formula under which rural banks may progressively repay their arrearages to the CB; and, finally, (d) the strengthening of the guarantee operations of two well-performing guarantee funds -- the Guarantee Fund for Small and Medium Industries, and the Quedan Guarantee Fund Board.

3. Structural Concerns. Areas of longer-term RBRRC concern have to do with the structural features of the rural banking system, including the laws and regulations determining: (a) entry into the system, (b) access to liquidity, (c) access to support, (d) scope and size of operations, (e) the competitive position of the rural banking system vis-a-vis the rest of the financial sector, and, finally, (f) the question of whether the equity-enhancing features of rural banking merit continued allocations of government budgetary support.

4. ALF Studies and ALF Operations. Under the general program of the World Bank and USAID-funded Agricultural Loan Fund, the Central Bank has undertaken several studies related to the review of the agricultural credit system, and the potentials and means for the expansion of the system. Two studies have been completed "in-house" by the CB, the first dealing with the "Rediscounting and Arrearages Problem" (Ad Hoc Committee, 1986,) and the other with "Agricultural Financing by the CBP" (Task Force, 1986). Two other studies that have just been completed by government agencies other than the CB are the studies on "Credit Support to Low-Income Groups" (NEDA, 1986), and on "ALF Crop/Sub-loan Insurance" (PCIC, 1986). The remaining study on "Expansion of Banking Services in the Rural Areas" has been opened by the CB to international competitive bidding. This remaining study will most probably be begun early in 1987, with the results completed late in the year. The results of all of the studies should be input into the deliberations of the RBRRRC and the MB.

Of course, it should be noted that the operations of the CB in administering the U.S. \$120M Agricultural Loan Fund reflect a substantial departure from much of the previous financing patterns of the previous two decades. CB officers previously involved in the supervised credit system set up the guidelines for the ALF program carrying with them their past experiences, and thus building into the ALF safeguards against perceived leakages in the supervised credit scheme. Thus, ALF subloans are made: (a) on a "non-targeted" basis, i.e. not limited to a

specific set of activities and (b) under market-oriented interest rates, both on the CB-to-bank and bank-to-borrower ends. Vary rigid eligibility criteria designed to ensure management efficiency are applied to banks seeking participation.

#### Other Government Agricultural Credit Programs

While the Central Bank of the Philippines and the Ministry of Agriculture and Food are the principal actors in Philippine agricultural credit, both in policy and volume, there are several other government credit programs that bear examination in the context of this review. These programs include those of the Land Bank of the Philippines, the Philippine Crop Insurance Corporation, the Quedan Guarantee Fund Board, the Guarantee Fund for Small and Medium Enterprises and the "New" KKK.<sup>9</sup> Not specifically covered are the current and future operations of the Philippine National Bank and the Development Bank of the Philippines. Although these two institutions will continue to have sizeable agricultural portfolios, their operations are expected to be more attuned to the signals given by the market, much like those of regular commercial banks.

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9 The BKKK - or the "Bagong Kilusang Kaunlaran at Kabuhayan" - the "New Movement for Progress and Livelihood", was originally the KKK - a program of the Ministry of Human Settlements under Mrs. Imelda Marcos. It was notoriously ineffective and wasteful. The "new" prefix was added after the February 1986 revolution, signifying what the new managers say is a more responsible, more effective program.

The LBP. Although the Land Bank of the Philippines is the smallest of the four government-owned banks, it boasts the largest proportion of agricultural loans in its portfolio - about 14%. The LBP has also been quite profitable, primarily due to its successful commercial operations and because it could rely on a stable core of government deposits as a source of funds. The LBP has stated that it will henceforth subsidize its agricultural lending with its income from commercial operations, and also expand its programs of innovative lending coupled with training and organizational support for farmers. The LBP is also expanding its involvement with the rural banking system. As of December 5, 1986, the LBP has entered into a program with the Rural Bankers Association of the Philippines and the BKKK where the LBP will act as a lead bank for selected rural banks and lend them BKKK trust funds, while the BKKK provides monitoring and management support for the participating rural banks.

The BKKK. The New KKK has been very active in creating a more professional, responsible institution that promotes the development of livelihood opportunities for the poor. It is now exerting efforts to reduce its huge pool of collectibles, and establishing collection and loan monitoring mechanisms for current and future loans.

The PCIC. The Philippine Crop Insurance Corporation has been providing insurance cover for rice and corn. Such coverage is automatic with any loan from the banking system, and self-financed farmers may also opt for coverage. The total estimated

coverage is about 25% of all rice and corn farmers. Half of the premium for all covered farmers is paid for by government subsidy. The subsidy for crop insurance costs the government about P44M per year. Although there has been a clamor for the expansion of crop insurance coverage, PCIC management has been very cautious, being aware of the limitations in its capacity to handle an abrupt expansion in coverage, as well as the need for continued government subsidy for its operations.

The QGFB. The Quedan Guarantee Fund Board is a MAF-attached agency. The quedan system of guarantees for loans is based on the quedan, or warehouse receipt. The guarantees of 80% of the loan value are made on loans primarily to traders and millers who borrow from the banking system on the basis of grain stocks held in a bonded warehouse. The QGFB, in managing its relatively small capital base of P150M into coverage for loans totalling about four times that base, has compiled a 99% repayment record in its operations. The QGFB does not receive any government subsidies.

The GFSME. The Guarantee Fund for Small and Medium Enterprises has also compiled an impressive 99% repayment record in its operations of extending guarantee cover for loans made to agricultural ventures, largely by commercial and private development banks. Like the QGFB, the GFSME does not receive any subsidies from government. It has operated purely on the basis of earnings and investments from its capital base of about P450M. In extending its guarantee of 85% of the loan value, the GFSME

essentially repeats the project appraisal process undergone by the bank which originated the loan. Loans covered by GFSME guarantees are charged a premium (currently 2%) for the cover.

5.

CONCLUSIONS AND SOME NOTES ON GAPS  
IN THE GOVERNMENT'S CURRENT POLICY THRUST

Contrary to what is being said in the popular press, a good deal is currently being "done" by the government about agricultural credit. However, the process and the results of the current movements are not easily discernible nor even comprehensible by the public at large. The popular expectation is that any program to "rehabilitate" the rural banking system will immediately result in an increased flow of funds into the system, and a liberalization of bank and borrower access to such funds. It is often quite difficult to explain that the reforms currently underway are largely structural in character, and that the results are expected to be long-term in effect. For much too long the agricultural credit system has been used as a convenient device for the combined purposes of development and poverty-alleviation, with the result that the rural banking system in particular has become dependent on the government as its primary source of loanable funds. That dependence, combined with the confusion between loans and aid, has culminated in the current sorry state of the rural banking system.

Yet the equity consideration must weigh heavily in the government's calculus of agricultural credit policy design. After all, governments are expected to play a general developmental role which requires not only the exploitation of the full social benefit of economic activity, but also a redistributive responsibility. It is attention to the equity consideration that is still largely missing in Philippine agricultural credit policy. The gaps in attention may be summarized below in terms of complementary attention focussed on: (a) the special nature of the Rural Bank, and (b) the unique features of the cooperative credit union and the cooperative rural bank.

The Special Nature of the Rural Bank. In the impetus to reform the banking system, an objective that has been mentioned frequently is to eliminate any biases in the treatment between the various bank types, particularly those accorded to the Rural Banks. Yet the unique nature of the portfolio of the Rural Bank bears close inspection. The rural penetration and coverage of the rural banking system is unparalleled. In contrast to all the other bank types, Rural Bank portfolios are at least 85% rural and agricultural, with the majority of the loans going to small farmers and rural entrepreneurs. As small banks located in the most rural of areas, these banks operate where most commercial banks cannot enter due to their higher-cost structures. The rural banks are also thought to provide competition against local moneylenders and, in the process, the overall level of interest rates in the area is dampened.

Thus there are interrelated equity and efficiency reasons to enhance the operations, and preserve the income transfer features of the rural banking system. The key question that the past two decades of experience has taught us to ask, however, is: How can policy ensure that the subsidies meant for smallholder agriculture, when channeled through the rural banking system, are not captured by the banker?

The Unique Features of Cooperative Finance. While there have been cooperatives operating in the Philippines for at least the last forty years, in 1972 the government launched a massive program to organize and support cooperatives as focal points for community organization and rural development. Under this program, over 30,000 "pre-cooperatives" and full cooperatives were organized between 1972 and 1982. From that massive effort, a net total of approximately 5,000 successfully-operating cooperatives have remained. While there are no firm estimates available, there is evidence that many of these cooperatives are institutions performing vital production, marketing and financing functions in many Philippine communities. Since cooperatives, except for the Cooperative Rural Banks (currently numbering 29) are unregulated, there is no consolidated evidence on the financial flows that pass through these institutions.<sup>10</sup> The data

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10 Some opinions has been expressed that the success of many cooperatives in fact stem from their being unregulated. Related to this is also the comment that Rural Banks would be much more efficient if the were much less regulated by the Central Bank.

from some credit unions in particular, show that these are much larger than many Rural Banks.

The unique feature of cooperatives that needs to be pointed out is their inherent potential for meeting both efficiency and equity objectives of development finance. Researchers focussing on rural financial markets from the viewpoint of the "surplus school" point to the excess income and rent-generating capacity enjoyed by propertied actors in the rural financial market (Lamberte and Lim, 1986). These participants enjoy control over "specific assets" i.e. mills, warehouses, transport, land and who are thus better able to manipulate the economic variables surrounding their operations. They are thus in a much better position to extract the maximum private benefit from their enterprises. Since the control of cooperative operations is based on membership ("One man, one vote") and not on share ownership, the cooperative is thought to offer greater income opportunities for the less propertied (Floro, 1986).

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AGRICULTURAL PRODUCTION LOANS GRANTED, PROPORTION TO TOTAL LOANS,  
SHARE TO TOTAL AGRICULTURAL GROSS VALUE ADDED

| Year    | Agriculture Loans |          |             |         | % Agri<br>loan to<br>total<br>Ins | % Agri<br>loan<br>to Agri<br>GVA | Agriculture Sector GVA    |               |          |
|---------|-------------------|----------|-------------|---------|-----------------------------------|----------------------------------|---------------------------|---------------|----------|
|         | Amount (PM)       |          | % Annual GR |         |                                   |                                  | % Agri<br>to total<br>GVA | Annual GR (%) |          |
|         | Current           | '72=100  | Current     | '72=100 |                                   |                                  |                           | Current       | 1972=100 |
| 1966    | 1,504.30          | -        | -           | -       | 18.0                              | -                                | -                         | -             |          |
| 1967    | 2,053.30          | 3,559.20 | 28.0        | -       | 19.1                              | 13.9                             | 41.7                      | -             |          |
| 1968    | 2,218.30          | 3,456.37 | 8.0         | (2.9)   | 13.5                              | 22.8                             | 29.0                      | (22.0)        |          |
| 1969    | 2,332.50          | 3,339.30 | 5.2         | (3.4)   | 13.2                              | 21.9                             | 29.4                      | 12.2          |          |
| 1970    | 2,851.10          | 3,562.09 | 22.2        | 6.7     | 12.5                              | 19.8                             | 28.4                      | 17.2          |          |
| 1971    | 3,226.00          | 3,373.42 | 13.2        | (5.3)   | 10.8                              | 19.3                             | 29.5                      | 25.3          |          |
| 1972    | 3,401.00          | 3,401.00 | 5.4         | 0.8     | 10.0                              | 20.1                             | 28.4                      | 8.5           |          |
| 1973    | 4,005.20          | 3,234.70 | 17.8        | (4.9)   | 8.3                               | 16.1                             | 29.1                      | 31.4          |          |
| 1974    | 5,928.80          | 3,524.43 | 48.0        | 9.0     | 6.9                               | 13.6                             | 29.5                      | 39.4          |          |
| 1975    | 7,942.50          | 4,383.28 | 34.0        | 24.4    | 6.6                               | 18.0                             | 28.8                      | 12.4          |          |
| 1976    | 8,223.60          | 4,326.39 | 3.5         | (1.3)   | 5.2                               | 21.3                             | 27.6                      | 13.3          |          |
| 1977    | 9,005.70          | 4,455.40 | 9.5         | 3.0     | 5.5                               | 19.7                             | 27.0                      | 11.6          |          |
| 1978    | 12,386.40         | 5,657.18 | 37.5        | 26.9    | 7.4                               | 19.0                             | 26.6                      | 12.8          |          |
| 1979    | 17,916.80         | 7,292.14 | 44.7        | 28.9    | 9.2                               | 22.3                             | 25.5                      | 17.3          |          |
| 1980    | 20,946.40         | 7,474.45 | 16.9        | 2.5     | 9.2                               | 29.0                             | 23.3                      | 11.2          |          |
| 1981    | 25,376.60         | 8,999.11 | 21.2        | 20.4    | 9.1                               | 30.2                             | 22.7                      | 12.4          |          |
| 1982    | 27,232.70         | 9,008.20 | 7.3         | 0.1     | 8.2                               | 33.1                             | 22.5                      | 10.6          |          |
| 1983    | 28,281.10         | 8,310.97 | 3.9         | (7.7)   | 8.0                               | 32.2                             | 22.0                      | 10.2          |          |
| 1984    | 27,070.10         | 5,047.60 | (4.3)       | (41.5)  | 8.1                               | 19.3                             | 25.4                      | 65.6          |          |
| 1985    | 27,002.10         | 4,474.80 | (0.3)       | (11.4)  | 9.9                               | 16.7                             | 26.5                      | 15.7          |          |
| Average |                   |          |             |         |                                   |                                  |                           |               |          |
| 1966-85 | 11,945.23         | 5,098.95 | 16.9        | 2.5     | 9.9                               | 21.5                             | 27.5                      | 16.9          |          |

Source: Technical Board for Agricultural Credit, Agricultural Credit Study, (1985).

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NON-AGRICULTURAL LOANS GRANTED, PROPORTION TO TOTAL LOANS,  
SHARE TO TOTAL, NON-AGRICULTURE GVA

| Year    | Non-Agriculture Loans |           |             |         | % Non-Agri<br>loan to<br>total<br>Ins | % Non-Agri<br>loan to<br>non-Agri<br>GVA | Non-Agriculture Sector GVA    |               |          |
|---------|-----------------------|-----------|-------------|---------|---------------------------------------|--|-------------------------------|---------------|----------|
|         | Amount (PM)           |           | % Annual GR |         |                                       |  | % Non-Agri<br>to total<br>GDP | Annual GR (%) |          |
|         | Current               | '72=100   | Current     | '72=100 |                                       |  |                               | Current       | 1972=100 |
| 1966    | 7,324.00              | -         | -           | -       | 82.0                                  | -  | -                             | -             | -        |
| 1967    | 8,678.60              | 13,652.04 | 18.5        | -       | 80.9                                  | 45.2                                     | 58.4                          | -             | -        |
| 1968    | 14,225.10             | 21,108.62 | 63.9        | 54.6    | 86.5                                  | 39.3                                     | 71.0                          | 38.1          | 29.4     |
| 1969    | 15,321.00             | 21,497.12 | 7.7         | 1.8     | 86.8                                  | 58.4                                     | 70.7                          | 10.5          | 4.5      |
| 1970    | 20,040.30             | 24,499.14 | 30.8        | 14.0    | 87.6                                  | 51.5                                     | 71.6                          | 22.0          | 9.6      |
| 1971    | 26,767.90             | 28,650.22 | 33.6        | 17.0    | 89.2                                  | 56.7                                     | 70.5                          | 18.9          | 4.1      |
| 1972    | 30,607.40             | 30,607.40 | 14.3        | 6.8     | 90.0                                  | 66.2                                     | 71.6                          | 14.4          | 6.8      |
| 1973    | 44,436.60             | 37,635.81 | 45.2        | 23.0    | 91.7                                  | 59.7                                     | 70.9                          | 26.8          | 7.4      |
| 1974    | 79,673.90             | 51,502.20 | 79.3        | 36.8    | 93.0                                  | 63.4                                     | 70.5                          | 36.8          | 4.4      |
| 1975    | 112,525.50            | 67,239.62 | 41.2        | 30.6    | 93.4                                  | 97.5                                     | 71.2                          | 16.5          | 7.7      |
| 1976    | 149,432.00            | 81,661.29 | 32.8        | 21.5    | 94.8                                  | 114.9                                    | 72.4                          | 19.9          | 9.6      |
| 1977    | 153,904.90            | 78,303.18 | 3.0         | (4.1)   | 94.5                                  | 132.8                                    | 73.0                          | 14.9          | 7.0      |
| 1978    | 154,196.70            | 71,846.38 | 0.2         | (8.3)   | 92.6                                  | 118.1                                    | 73.4                          | 15.8          | 6.0      |
| 1979    | 176,577.00            | 71,399.05 | 14.5        | (0.6)   | 90.8                                  | 95.3                                     | 74.5                          | 24.2          | 7.8      |
| 1980    | 206,969.40            | 71,445.13 | 17.2        | 0.1     | 90.8                                  | 87.0                                     | 76.7                          | 25.4          | 7.0      |
| 1981    | 253,814.30            | 79,989.38 | 22.6        | 12.0    | 90.9                                  | 87.7                                     | 77.3                          | 16.3          | 6.1      |
| 1982    | 307,030.80            | 89,247.95 | 21.0        | 11.6    | 91.9                                  | 96.2                                     | 77.5                          | 11.9          | 3.2      |
| 1983    | 323,939.70            | 84,262.67 | 5.5         | (5.6)   | 92.0                                  | 102.3                                    | 78.0                          | 13.8          | 1.8      |
| 1984    | 309,058.90            | 53,782.11 | (4.6)       | (36.5)  | 92.0                                  | 75.0                                     | 74.6                          | 37.3          | (8.2)    |
| 1985    | 247,193.20            | 36,187.10 | (20.0)      | (32.7)  | 90.2                                  | 55.1                                     | 73.5                          | 12.2          | (6.3)    |
| Average |                       |           |             |         |                                       |  |                               |               |          |
| 1966-85 | 132,085.86            | 53,395.60 | 22.5        | 7.9     | 90.1                                  | 79.1                                     | 72.5                          | 20.9          | 6.0      |

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