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Microfinance and Financial Institutions in Bukidnon

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1. INTRODUCTION

This report looks at the relationship between microfinance and financial institutions in Bukidnon within the context of the national and local (province) poverty conditions in the Philippines. The report examines government involvement in the provision of credit to low-income groups, and the importance and contributions of nongovernment microfinance providers. In particular, the report discusses the role and extent of microfinance in Bukidnon's financial system, analyzing the contributions of various financial institutions in the provision of microfinance services.

For the purposes of the report, the term "microfinance" encompasses any program or entity that provides credit or finance to individuals or small groups, regardless of whether the program or entity focuses on microenterprise development or includes the ultra poor in Philippine society among its clientele. In addition, the functioning of microfinance institutions (MFIs) in Bukidnon is examined in terms of how these institutions are recognized and regulated by the government. In the Philippines, MFIs are officially defined as entities that regularly lend funds or purchase receivables but do not generate funds other than accepting occasional deposits, issuing debt instruments on their own behalf, or issuing assignment or trust certificates or repurchase agreements.

1.1 BRIEF BACKGROUND ON BUKIDNON

Bukidnon is a landlocked province in Northern Mindanao, comprising 20 municipalities and 2 cities, Malaybalay and Valencia. Bukidnon has a land area of 829,378 hectares, making it the largest province in Northern Mindanao and the eighth largest in the country. The 2000 census reported that Bukidnon's population was about 1,059,355—split about 70 percent to 30 percent between rural and urban areas based on the 1995 census—and its average population density was 128 people per square kilometer. The province also has a relatively young population; the 2000

census reported that 42 percent of the population was between 0 and 14 years old, 55 percent was 15 to 64 years old, and less than 3 percent was over 65 years old.

Education is given high priority. The 2000 census indicated that only about 9 percent of children five years and older had not gone to school. The 1995 census also indicated that about 89 percent of children 10 years and older were literate. The 1995 census further indicated that the labor force comprised about 81 percent of the 593,000 people 18 and older, and of those, less than 5 percent were unemployed. These figures, however, do not reflect the substantial amount of underemployment in Bukidnon, given that many workers are engaged in agriculture where much of the work is seasonal. The people of Bukidnon still depend heavily on agriculture for their livelihoods. The 1995 census indicated that about 80 percent of the labor force was employed in agriculture (including hunting and forestry), about 13 percent worked in the services sector, 6 percent worked in trade areas, and the remainder were engaged in fishing; mining and quarrying; manufacturing; construction; and the electricity, gas, and water sectors.

1.2 POVERTY IN BUKIDNON

Poverty is chronic and endemic in Bukidnon. The incidence of poverty is high because Bukidnon is largely dependent on traditional forms of agriculture where incomes are substantially low. In fact, labor leaders in a 2002 dialogue with government officials estimated that the average farm laborer in Bukidnon was only paid 70 to 80 pesos a day—about US\$1.4 at the 2002 average exchange rate of 51.6 pesos per dollar (Mordeno 2002a). In addition, the seasonal nature of most of Bukidnon's farm work leaves much of the labor force without secure employment for a substantial part of the year.

A 1994 government survey on income and expenditures showed that 11 percent of families in Bukidnon had annual incomes of less than 20,000 pesos, 41 percent had incomes between 20,000 and 40,000 pesos, 17 percent had incomes between 40,000 and 60,000 pesos, and 30 percent had incomes higher than 60,000 pesos. In 1997 the government's National Statistical Coordination Board (NSCB) also reported that 48 percent of Bukidnon's population fell below the government-defined poverty threshold—a much higher share than the national average of 33 percent. Three years later, the NSCB reported that Bukidnon's share had fallen somewhat, to 38.9 percent, though this was still higher than the 34 percent national average at that time (NSCB 2000).

The rapid increase in the cultivation of sugar in Bukidnon, from 30,000 hectares in 2000 to almost 80,000 hectares in 2003, has had negative consequences on poverty in some sectors, particularly among plantation workers in sugar producing areas (Mordeno 2002b). Many subsistence farmers resorted to selling or leasing their lands and becoming plantation workers, but in doing so they were forced to plant corn and other crops on marginal lands to augment their incomes. Apart from significantly reducing areas planted with rice, corn, and other major crops like rubber and coffee (and impinging on forest lands), sugar cultivation requires virtually no labor between the planting and harvesting seasons—a period of up to a year. Exacerbating this problem is the low wage levels that are prevalent in the sugar industry. Plantation workers in most sugar producing areas have minimal opportunities for alternative employment, so employment arrangements tend to be disadvantageous for them. For example, a common arrangement in Bukidnon is the *pakyaw* (contract) system, whereby a group of 20 or more workers performs a specific job for a one-time fee divided equally among them that averages less

than 50 pesos per person per day—less than US\$1 per day at the 2003 average exchange rate of 54 pesos per dollar (Mordeno 2002b).

Sugar cultivation in the Philippines has been plagued with social unrest since the mid-1970s, when the martial law government of Ferdinand Marcos established a government monopoly. Prior to that, the Philippine sugar industry had prospered as a result of high world market prices and a preferential U.S. quota for Philippine sugar, but the industry began to flounder when world market prices crashed and the security of the U.S. quota was lost with the expiration of the Laurel–Langley Agreement in 1974. Problems worsened with the unspoken policy of the Marcos government to keep sugar prices down in the domestic market, and the rising incidence of insurgency in most sugar producing areas. Production fell from a high of 2.7 million tons in 1977 to a low of 1.3 million tons in 1987. Various efforts were undertaken by successive administrations after Marcos to reform and reinvigorate the industry, but these efforts did little to boost efficiency and productivity, especially in comparison with neighboring Thailand, a major competitor. The Philippine government has chosen to maintain high tariffs on sugar imports until 2010 to protect the industry and buy time for improvement; thereafter tariffs will gradually be reduced to a maximum of 5 percent.

1.3 POLICIES AND PROGRAMS FOR POVERTY REDUCTION IN THE PHILIPPINES

Poverty continues to be a significant development problem in the Philippines, particularly in rural areas. Government estimates in 1997 and 2000 indicated that over a third of the total population and half the rural population had insufficient income to satisfy food and other basic needs (NSCB 2000). While succeeding post-Marcos administrations have sought to promote equitable economic growth to alleviate poverty, success has been relatively disappointing in the Philippines compared with other Southeast Asian countries. Brunei, Malaysia, Singapore, and Thailand, for example, have substantially reduced their poverty rates by 1.4 to 2.0 percentage points per annum over a period of 20 years or so. The World Bank attributes the contrasting poor performance of the Philippines to a number of factors. Inability to sustain growth over long periods and persistent structural distortions in the economy, in particular, have prevented economic growth benefits from spilling over to the poor and have trapped many people in marginal and low paying occupations. The World Bank also pointed out that while most East Asian countries have substantially reduced income inequality over time, little improvement has been achieved in the Philippines (World Bank 1996).

The administration of Corazon Aquino implemented several initiatives to liberalize the financial sector and promote rural growth when it took over from Ferdinand Marcos in 1986: the entry of new commercial banks and restrictions on establishing rural branches were lifted; government departments were given authority to implement livelihood programs and projects; the developmental role of nongovernmental organizations (NGOs) was supported; various tax and import incentives were introduced for small- and medium-sized enterprises (SMEs), particularly those that located in less developed areas; and a law was enacted to assist rural *barangays* (villages) and business enterprises by simplifying regulations, making financing available and providing access to government services and assistance.

The major focus of poverty alleviation initiatives under the Aquino administration was low-income municipalities. The *Tulong sa Tao* (Help for the People) program targeted the

poorest (5th and 6th class) municipalities in the delivery of much-needed social and economic services. Another intervention, the *Tulong sa Tao* NGO Microcredit Program, partnered with NGOs in providing credit assistance to disadvantaged groups.

When Fidel Ramos took over leadership in 1992, a number of explicit poverty-reducing initiatives were implemented, focusing in particular on improved efficiency and targeting of services. The Ramos administration also created a “Presidential Commission to Fight Poverty,” which established major initiatives such as the Social Pact on Credit in 1993 and the Social Reform Agenda in 1994.

The Social Pact on Credit—which drew together a multisector group of banks, government institutions, cooperatives, and farmer groups—not only acknowledged the weakness of the existing financial system in meeting the credit needs of poverty groups but also promoted interest for banks to explore alternative means of delivering credit to the poor. The pact also led to the creation of a National Credit Council (NCC) in 1993, which was given the task of coordinating the various credit programs offered by the government.

The Social Reform Agenda incorporated the government’s five major strategies to address poverty: (1) promoting and sustaining economic growth to create employment and livelihood opportunities; (2) sustaining growth based on people-friendly strategies; (3) expanding social services to provide minimum basic needs; (4) fostering sustainable income-generating community projects; and (5) building the capacity of poor people to help themselves. The agenda focused primarily on the country’s 20 poorest provinces and on providing the marginalized sectors in these provinces with the services necessary to satisfy their minimum basic needs. One of the agenda’s major projects was the Comprehensive Integrated Delivery of Social Services (CIDSS) program under the Department of Social Welfare and Development (DSWD), which was implemented as a grassroots strategy to address shortfalls in meeting the minimum basic needs of disadvantaged families and communities. CIDSS provided poor families and communities with opportunities to identify their minimum basic needs and other priorities and to develop their capacities to act on these needs and priorities.

In 1997, microfinance became more prominent in the government’s poverty alleviation strategies. That year the NCC, for example, underscored the importance of microfinance in the broader financial system, stating that it played a key role in poverty alleviation. In addition, the Social Reform and Poverty Alleviation Act of 1977, which created the National Anti-Poverty Commission, also emphasized the value of microfinance in combating poverty. The act’s main objectives were (1) to institutionalize the Social Reform Agenda; (2) to strengthen the capacity of the People’s Credit and Finance Corporation, a subsidiary of the Land Bank of the Philippines, to deliver microfinance services for the exclusive use of the poor; and (3) to establish a People’s Development Trust Fund to provide various types of support and assistance to MFIs and microenterprises through the assistance of local government units.

When Joseph Estrada became president in 1998, his administration instituted the National Anti-Poverty Action Agenda (NAAA). Its major priorities were equitable and sustainable economic development, empowerment of the people, effective and efficient delivery of public goods and basic social services, and focused targeting. NAAA also aimed to strengthen partnerships between the government, civil society, and the private sector to facilitate focused and sustained national efforts to improve the country’s poverty situation. Under NAAA, the *Lingap Para sa Mahirap* (Care for the Poor) program identified the 100 poorest families in each province and city, designating them as target beneficiaries for a comprehensive set of

government services to satisfy minimum basic needs. The government allocated 2.5 billion pesos to fund services including the provision of food, nutrition, and medical assistance; livelihood development; socialized housing; rural waterworks; protective services for children and youth; and price supports for rice and corn.

A popular uprising forced Estrada to relinquish the presidency to Gloria Macapagal-Arroyo in 2001. The new administration's poverty agenda emphasizes free enterprise, modernized agriculture, and the disadvantaged. The primary program under this agenda is *Kapit Bisig Laban sa Kahirapan* (Hand-in-Hand Against Poverty) or KALAHI. Focusing on the country's poorest barangays and municipalities, KALAHI aims to channel a greater share of the country's resources to poor people and to develop their access to public services by increasing opportunities for participation in governance; increasing social protection, including protection against violence; developing employment and livelihood opportunities; redistributing land and credit resources; and expanding human development services.

Most studies assessing government poverty programs agree that they have had little success (World Bank 1996; Reyes and Del Valle 1998; Mandap 2002; Reyes 2002). A wide range of safety net programs aimed at reducing poverty, including employment creation, food subsidies, livelihood programs, and credit assistance, had proliferated in the 1970s and 1980s, but the World Bank concluded that many of these programs were ineffective and in most cases were poorly targeted. Despite receiving priority under successive administrations, safety net programs were either unsustainable or their intended benefits were not fully realized. The implementation of poverty programs was also hindered by economic, political, and social disturbances; natural disasters; failure to release funds or delays in doing so; changes in government spending priorities; and misappropriate or wasteful use of funds (Mandap 2002; Reyes 2002).

2. GOVERNMENT INVOLVEMENT IN EXTENDING CREDIT TO LOW-INCOME GROUPS

For the past 30 years, the Philippine government has been active in extending credit to low-income groups, particularly through microfinancing. Involvement has also taken many forms, including lending directly to the poor; channeling funds through MFIs, particularly NGOs; providing technical assistance and credit guarantees to MFIs; encouraging linkages between banks and MFIs, implementing directed credit schemes through the banking system; and providing assistance and incentives to banks engaged in microfinancing.

The government has a history of involvement in providing direct credit to borrowers, albeit with varied effectiveness. In 1995, for example, the National Credit Council identified 111 government credit programs. It was found, however, that only 13 of these programs were targeted to the ultra poor, and only 4 of those 13 included significant outreach (Llanto et al. 1996). The government has also utilized MFIs, particularly NGOs, as credit conduits. For example, the People's Credit and Finance Corporation (PCFC) and the National Livelihood Support Fund of the Land Bank use NGOs and other MFIs to channel funds to target beneficiaries.

To strengthen the capacity of MFIs, the government usually provides technical assistance and credit guarantees in addition to granting funds. For example, the PCFC provides credit at

preferential interest rates to NGOs using the Grameen Bank model for training and group formation activities. In addition, the Small Business Guarantee and Finance Corporation of the Department of Trade and Industry provides qualified SMEs, local and regional associations, and private and voluntary organizations and cooperatives with credit guarantees to stimulate the flow of credit to MFIs and encourage greater participation of financial institutions in the development of MFIs. Nevertheless, the government's credit programs, including those that were channeled through MFIs, have been criticized for being uncoordinated, ineffective, political, too expensive, unsustainable—and having leakages that lead to gross inefficiencies, financial market distortions, and weakening of private-sector innovation incentives (World Bank 1996; Llanto, Edgardo, and Callanta 1996).

The government also attempted to strengthen microfinance through the implementation of directed credit schemes. The 1975 *Agri-Agra* Law (which relates to agricultural credit and agrarian reform) required all banking institutions to set aside a minimum of 25 percent of their loan portfolio for agricultural credit, 10 percent of which had to go to agrarian reform beneficiaries. A subsequent amendment in 1995 exempted banks from these requirements as long as at least 5 percent of their loan portfolio was lent to farmer associations or cooperatives. In addition, the 1991 Magna Carta for Small Enterprises required that all lending institutions allocate a portion of their total loan portfolio for small enterprise credit. A subsequent amendment in 1997 mandated that at least 6 percent of the total loan portfolio be allocated to small enterprises, and at least 2 percent be allocated to medium enterprises.

The government (and its agencies) also provides various forms of assistance and incentives to banks involved in microfinance. The reserve requirement on deposits of rural and thrift banks, for example, is two percentage points lower than other commercial banks. Another incentive is that newly established rural and thrift banks are exempt from most taxes, charges, and fees for the first five years. The Central Bank also provides various forms of technical support to rural and cooperative banks, including the conduct of free training programs for bank personnel and the provision of free technical assistance for matters involving start-up and operational activities. In 2001, the Central Bank approved a partial lifting of the general moratorium on the licensing of new thrift and rural banks to allow the entry of microfinance-oriented banks. It also reconfigured its rediscounting facility to provide liquidity assistance aimed at supporting and promoting microfinance programs. For example, rural banks are allowed to rediscount eligible papers at preferential rates of interest and to secure loans against their assets in times of emergency or financial crisis.

The government has also encouraged linkages between commercial banks and MFIs as a means of improving financial services for the poor. A prominent example was the previously mentioned 1993 Social Pact on Credit. Crafted jointly by the government, various financial institutions, and other stakeholders, the pact led to the 1994 creation of the Bankers Association of the Philippines Credit Guarantee Corporation (BAPCGC) to address the credit needs of small borrowers. BAPCGC reportedly lent close to 800 million pesos for short-term working capital of microenterprises during its first three years of operation. Another government initiative that has promoted greater participation from commercial banks in the development of microfinance is tax exemptions given to the charitable foundations of commercial banks. The Bank of the Philippine Islands (BPI) Foundation, for example, reports that it has lent 60 million pesos to 2,000 borrowers since it started its re-lending program for start-up entrepreneurs in 1984, although reports indicate that the share of resources allocated to microfinance is minimal, indicating the venture's extremely cautious approach.

3. OVERVIEW OF NONGOVERNMENT MICROFINANCE PROVIDERS IN THE PHILIPPINES

Within the private commercial banking system, only the rural, thrift, and cooperative banks are actively engaged in providing microfinance services. Most large commercial banks do not extend loans to small borrowers, preferring instead to direct the bulk of their lending services to the formal sector of the economy, particularly in the form of large loans to large companies. However, most cooperative banks and many rural and thrift banks actively compete with MFIs and informal lenders in extending loans to small borrowers, particularly with small enterprises and few employees. Usually, the interest rates charged by these banks are much lower compared with the rates charged by informal lenders, but in these cases collateral (like real estate and durable goods) is required and loans are only approved for specific purposes to minimize risk. Recently, large commercial banks, notably the Bank of the Philippine Islands (BPI), have started to explore the possibility of full commercial financing of MFI operations without the benefit of a tax shelter. A few large banks have also taken the initiative to acquire small banks and are showing interest in using NGOs as partners in extending credit to low-income groups. It seems that competitive pressures are encouraging banks to consider microfinance as a means of attracting the savings potential of relatively untapped sections of the population.

The Philippines has a large number of NGOs, many of which provide microfinance services, particularly using the Grameen approach, which requires prospective borrowers to apply for membership undergo a qualifying procedure. Very few of these NGOs, however, have particularly large credit programs. Estimates from various studies indicate that NGOs serve a very small portion of the population in the areas in which they operate (Chua and Llanto 1995; Llanto et al. 1996). Most NGOs engaged in microfinance target poverty groups; studies show that few, however, have effectively reached the poor. Moreover, most NGO programs are a long way from operating sustainably, given their focus on assisting the most needy—and hence high risk groups—in society (Chua and Llanto 1995; Llanto et al. 1996). Most of them depend on grants and other subsidies to continue operating. NGOs in the Philippines are required to register with the Securities and Exchange Commission as nonstock and nonprofit organizations, and under the 2000 General Banking Law, such organizations are not permitted to accept savings or deposits of any form. NGOs are not even allowed to accept savings from members to build capital, so they depend on external funding sources for their lending programs. External funding is uncertain and limited, so the ability of NGOs to expand their lending outreach is also limited.

Nonstock savings and loan associations (NSSLAs) are also in the business of providing microfinance services. Supervised by the Central Bank, these associations provide services including both savings and credit, but their business must be confined to members. Only a few NSSLAs exist in the Philippines, and all are institution-based, catering to government employees.

Cooperatives and credit unions are other important sources of microfinance. The government grants them various incentives such as tax exemptions and financial assistance if they register with the Cooperative Development Authority (CDA) and fulfill its requirements, such as submitting annual reports and audited financial statements, attending management and

training programs, and undergoing monitoring to ensure compliance with the national Cooperative Code of 1990. On the whole, the benefits involved act as successful incentives for compliance. Credit cooperatives usually concentrate their activities on their membership, and membership is usually a prerequisite for loan eligibility. Few credit cooperatives explicitly target poverty groups, however. Some cooperatives, particularly those involving small entrepreneurs, require that applicants have an existing local business or provide proof of stable employment. The size and extent of lending usually depends on the financial capacity of the members, which in many cases severely hinders opportunities for expansion. Two of the recent foreign-funded cooperatives programs with microfinance components were the Canadian-funded Philippine Cooperative Development Assistance Program (PCDAP) and Socioeconomic Development through Cooperatives in the Philippines (SEDCOP), a follow-up to PCDAP. PCDAP sought to enhance social development of the Philippine private cooperative movement through the National Confederation of Cooperatives (NATCCO), while SEDCOP sought to improve the socioeconomic conditions of cooperative members by enhancing the performance and operations of grassroots cooperatives.

Since the 1980s, “lending investors” have emerged as a new source of microfinance. Lending investors are licensed by the Central Bank to operate as moneylenders with minimal regulatory requirements or supervision. Such investors are permitted to lend money to anyone, but they can only accept deposits from a maximum of 19 individuals. The rapid increase in this phenomenon since the early 1990s has spurred competition and led to reductions in interest rates in the informal finance sector.

People also utilize pawnshops for credit, and with increased competition, the shops have loosened their requirements for collateral, accepting items like cell phones and calculators. Pawn shops tend to be popular because of their convenience and accessibility of funds, especially when it comes to emergencies.

Other informal but important sources of microfinancing include individual professional moneylenders, rotating credit and savings associations (ROSCAs), informal credit associations, suppliers, and traders.

4. MICROFINANCE AND BUKIDNON’S FINANCIAL SYSTEM

4.1 HOUSEHOLD CREDIT SOURCES IN URBAN AND AGRICULTURAL COMMUNITIES IN BUKIDNON

Borrowing is common to households in Bukidnon. People borrow small amounts for food and other household items. People also borrow in times of emergency, such as for medical care, children’s school fees, and celebrations like weddings. The first lending option is usually neighbors, friends, or relatives. Thereafter, borrowers approach recognized community loan providers, such as professional moneylenders, especially if they have borrowed from these sources in the past. People may also borrow from cooperative credit unions, NGOs, local ROSCAs, informal credit associations, suppliers, traders, pawnshops, and lending investors.

In evaluating the borrower's ability to pay, the potential lender consults friends, relatives, and neighbors as to borrowing history; assesses the borrower's capacity to repay a loan in terms of employment and assets; and considers the borrower's reason for needing the loan. If the lender is not a professional moneylender, it is likely that a major factor in approving a loan will be the strength of the mutual relationship between the borrower and the lender, especially in terms of possible reciprocity.

Interest charges are not usually imposed on loans of less than 100 pesos, and small loans rarely require collateral. They are generally secured based on the borrower's relationship with the lender, and the threat of societal and cultural sanctions in the event that the borrower defaults. Moreover, given the Filipino culture, the transaction induces a "debt of gratitude," implying that the borrower will be obliged to reciprocate in the future if asked.

Loan transactions are usually negotiated or finalized directly between the parties involved. For cost reasons, transactions rarely involve lawyers. To enforce loan repayments, professional moneylenders usually employ a combination of societal/cultural sanctions; threats of legal action; interest penalties; and stringent collection methods, such as weekly visits. They also use positive methods like offering increased credit limits in return for timely repayments. If the amount borrowed is more significant, some form of collateral will be required. The use of farmlands and other farm assets to secure loans is common in farming communities in Bukidnon. In the case of land, the lender will likely keep the certificate of title, despite the reality that by law ownership is defined by a person's legal claim to the land (seemingly this is not widely understood in rural communities). Regardless, borrowers in Bukidnon are likely to pay their debts faithfully given the negative consequences of defaulting—not least of which is the loss of their borrowing privileges, which they likely depend heavily on. Moreover, borrower may well depend on the lender for other things, such as farm inputs or marketing services.

Loans in agricultural communities are usually payable at harvest time, often in the form of the farmer's crop. It is common for traders and input dealers to extend fertilizer or farm machinery services to farmers on a charge-to-crop or payable-upon-harvest basis. Other modes of borrowing and payment schemes involve the lease/mortgage of farmlands and other farm assets, the release of which is contingent upon full debt repayment.

There are usually only a few professional moneylenders in agricultural communities in Bukidnon, creating monopolies and oligopolies. The factors of risk, the legal system, and the low prestige of lending as a profession deter people from entering the lending business. A 1998 government study concluded that unfavorable farming and macroeconomic conditions had made agricultural lending risky and unprofitable. The study also found that almost all government lending programs for farmers suffered from large, if not widespread, defaults, and farmers' inability to pay loans mainly resulted from crop damage and low harvests, unfavorable selling prices and poor marketing, and misuse of loan proceeds (Montemayor 2001). Further, costs and risk inherent in the legal system prevent it from offering a viable remedy for lenders, and government agencies tended not to help lenders because of the perception that they exploit their clients.

The Central Bank set a ceiling of 14 percent per annum for unsecured loans and 12 percent per annum for secured loans. These ceilings were lifted in 1982 after it was concluded that they were hindering development of the microcredit market. In particular, the restrictions discouraged entry into the lending business and caused many lenders to operate illegally in order to make a profit. This drove interest rates to notoriously high levels, prompting the reference to

informal lending as “five-six,” given the usual practice was to borrow five pesos at the beginning of the day and to repay six pesos at the end of the day.

The absence of competition combined with substantial risk has maintained high interest rates for agricultural lending in Bukidnon. As of 2004, rates range from 3 to 15 percent per month, keeping credit beyond the reach of a large segment of the community, and forcing many to borrow beyond their capacity to repay.

4.2 MICROFINANCE AND BUKIDNON’S FORMAL FINANCIAL SYSTEM

The formal financial system in Bukidnon includes all type of banks (commercial banks, including thrift, rural, cooperative, and government banks) and several nonbank financial intermediaries (NBFIs), meaning insurance companies, pawnshops, and lending investors. All but the commercial banks and insurance companies are important sources of microfinancing in Bukidnon.

4.2.1 The banking system

There are 47 banks in Bukidnon: 16 in Valencia, 9 in Malaybalay, 7 in Maramag, 3 in Quezon, 2 each in Don Carlos, Manolo Fortich, and San Fernando, and 1 each in Danggagan, Kalilangan, Kibawe, Lantapan, Pangantucan, and Sumilao. It is estimated that only about 10 (mostly rural) banks existed in the early 1980s. This figure fell with the closure of 5 rural banks in the 1980s and early 1990s, then rose again with the entry of new commercial banks after restrictions on opening branches were lifted by the Central Bank in the early 1990s.

Two government banks operate in Bukidnon, the Development Bank of the Philippines (DBP) and the Land Bank of the Philippines (LBP).¹ The DBP has a branch in Malaybalay, while the LBP has two branches in Malaybalay, one in Valencia, and field offices in Maramag and Don Carlos. The DBP provides medium to long-term credit to agricultural enterprises, and the LBP specializes in the delivery of rural credit, usually through farmer associations and cooperatives.

Banks in Bukidnon provide standard services, similar to commercial banks, such as accepting drafts and issuing letters of credit; dealing with debt; accepting or creating deposits; buying and selling foreign exchange; and extending credit and collecting payments for public utilities and government collection agencies. The banks offer a range of deposit instruments with diverse features and varied interest rates, targeting different income groups. Some of the commercial banks in Bukidnon, particularly in the cities of Valencia and Malaybalay, now employ automated teller machines.

Bukidnon has one cooperative bank, the Bukidnon Cooperative Bank, which was registered with the Cooperative Development Authority in 1991, commenced operations in Malaybalay in 1992, and currently has branches in Malaybalay, Valencia, Quezon, Maramag, and Kalilangan. The bank provides services to the general public, but its business concentrates on its membership, which is open to all cooperatives in the bank’s operating area. Records of the

¹ The number of government banks operating in Bukidnon has fallen since the 1980s. The Philippine National Bank, which operates branches in Valencia and Malaybalay, reduced its share of government holdings to 46 percent in 1996 and therefore changed status from a government to a private bank with the approval of the Securities and Exchange Commission.

Cooperative Development Authority, as of 2002, indicate a reported member equity of 13.6 million pesos, capital of 6.6 million pesos, and annual turnover of 52.7 million pesos.

The Bukidnon Cooperative Bank and most of Bukidnon's rural and thrift banks are active in providing business and consumption loans to small enterprises, employees, and farmers. These loans are somewhat different from usual loans provided by large commercial banks. The amounts involved, for example, are relatively small (not more than 20,000 pesos). In addition, the method of collection may include schemes other than the borrower making repayments at the bank's office. Payments may occur as payroll deductions or regular collections from the borrower's residence or place of work. Such schemes may involve more paperwork, and in many instances the collateral or guarantees required will differ. A guarantor with a good credit record at the bank may be required, or the bank may accept a modest durable item, such as a motorcycle or television as collateral; the bank may require borrowers to meet with bank personnel or visit the bank regularly; membership in a cooperative or other community organization may be required as a loan prerequisite; or the bank may approve loans for specified purposes only. Some rural banks adopt the Grameen approach in some of their credit programs.

4.2.2 Lending investors

Records of the provincial government indicate that as of 2002 there were 50 lending investors in Bukidnon: 30 in Valencia, 5 in Malaybalay, 4 in Quezon, 2 in Don Carlos, 2 in San Fernando, and 1 each in 7 other towns. It is likely, however, that the actual number of investors is a lot higher, because many fail to register (to avoid paying taxes) or operate legally using other firms' licenses.²

There were only a few lending investors in Bukidnon in the 1980s, but numbers grew from the early 1990s. Lending investors only need a small (though highly accessible) office because most of their transactions are done at the homes or businesses of their customers, though they usually need to employ staff given the volume of transactions involved. They are mostly active in public places and offices, providing loans to employees, vendors, and small enterprises like *sari-sari* (neighborhood) stores. Loan amounts usually range from 500 to 10,000 pesos, though some investors lend higher amounts depending on the circumstances. The overall scale of business is much bigger for lending investors than for individual moneylenders. Some lending investors in Bukidnon are known to service more than 1,000 clients and to collect payments totaling over 80,000 pesos per day (an enormous sum considering the ordinary laborer earns less than 100 pesos per day). A few lending investors operate as a network, with branches in key towns and cities in Mindanao, Visayas, and as far as Luzon.

Lending investors seldom do business with farmers. They prefer to deal with salaried employees and small enterprises. Paperwork is minimal, and loans are quickly processed. Repayment rates are generally high for secure loans or loans with frequent (daily) repayments. Lending investors use a variety of methods to screen potential borrowers, including requiring applicants to get clearance to establish residence; gathering information about the applicant's

² The discussion in this section is limited to businesses with at least four employees. Smaller, informal (and in some cases illegal) lending investors operate along the lines of moneylenders, discussed separately.

credit history, requiring applicants to provide referrals, and requiring applicants to show proof of assets and income. Agreements determine loan and interest amounts, payment methods and schedules, guarantor requirements, penalties for lack of compliance, and details of items used as collateral. Enforcement methods include threats of legal action, garnisheeing wages, and paying frequent reminder visits. Positive incentives such as higher loan limits are also provided for timely and full repayment. Most lending investors use contracts to project the legal ramifications of defaulting on loan agreements, but few actually resort to legal action because Philippine courts are known to be slow in settling disputes, and lenders have no assurance of a judgment in their favor.

Lending investors that deal mostly with secured loans charge interest at rates of 3–7 percent per month. Those that deal primarily with unsecured loans charge interest at rates of 7–15 percent per month. These rates may appear high, but they reflect the level of costs and risk involved. Unsecured loans are particularly risky given macroeconomic instabilities and the prevalence of emergencies causing borrowers to default. Moreover, debt collection is generally an expensive endeavor. Many lending investors in Bukidnon employ large numbers of collectors who visit clients on a daily basis until loans are paid. Most clients are happy with this arrangement because it is easier for them to pay small amounts regularly, and they don't incur further costs or loss of time in making repayments.

Given the high costs of collection, lending investors in Bukidnon need a sufficiently large clientele to achieve economies of scale. It is quite common for a single collector employed by a lending investor to handle over 100 clients, though this also means higher operating costs. Increased competition and the need to achieve economies of scale has increased the inherent risks of investment lending because, under these conditions, lenders tend to approve riskier loans. The occurrence of bankruptcies is increasing, particularly for new businesses that lack track records. Nonetheless, competition has decreased the interest rates being charged and has provided small business with more options for credit. It is now not uncommon for small stores in the urban centers of Valencia to have loans with more than five lending investors.

To minimize their risk, lending investors generally do not provide start-up capital. The viability of a potential client's business is a key criterion for determining their ability to repay. Many lending investors in Bukidnon provide loans to street vendors, motorcycle drivers, and other members of the informal urban business sector if these operators have a permanent stall or place of business, and their business is deemed viable.

4.2.3 Pawnshops

As of 2001, Bukidnon reportedly had over 20 pawnshops, and a least one in each city and municipality. Shops are mostly located in areas of heavy pedestrian traffic or in areas where competitors have successfully developed a market. Pawnshops are inherently risky. There is a tendency for employees and clients to commit fraud, for robberies and theft to occur, and for problems to exist in disposing of confiscated items. Nevertheless, the pawnshop industry in Bukidnon has grown steadily in recent years. In the 1980s there were fewer than 10 pawnshops in Bukidnon; the number increased gradually in the 1990s, particularly in the centers of Valencia, Malaybalay, Don Carlos, and Quezon. As with investment lending, however, increased competition has forced many pawnshops to accept riskier clients.

Like pawnshops elsewhere, those in Bukidnon usually require collateral for loans. Interest charges usually range from 5 to 7 percent per month for the first three months. If items are not recovered within that timeframe, the borrower is given three more months to settle, but at

much higher interest rates, with the result that most items not recovered within three months are not recovered at all. Items not recovered after six months are confiscated by the pawnshop and sold, usually at auction. Pawnshops generally lend no more than 30 percent of the pawned item's value. Many pawnshops operating in Bukidnon are sole proprietors who personally run the operation, but many people prefer corporate pawnshops (such as Lhuillier and Montaña) because they are considered to be more stable, to have sufficient cash, and to be trustworthy in keeping the client's items safely until they are redeemed.

4.3 MICROFINANCE AND INFORMAL FINANCIAL INSTITUTIONS IN BUKIDNON

Cooperatives, NGOs, and informal credit associations are also important sources of microfinance in Bukidnon. These institutions are categorized as informal because they are not regulated by the Central Bank, as are formal banks and NBFIs, or by the Insurance Commission, as are insurance companies.

4.3.1 Cooperatives

In 1990 all cooperatives in the Philippines were placed under the supervision of the Cooperative Development Authority (CDA). Prior to that time, cooperatives were administered by various government agencies. When CDA commenced operations in Region 10 in 1991, it only inherited cooperatives from the Department of Agriculture, including those from Bukidnon that comprised fewer than 100 members. The number of cooperatives in Bukidnon rose sharply from the 1990s onwards, reaching over 1,000 by late 1995, in response to incentives from the Land Bank.

Thereafter, CDA tightened its monitoring of cooperatives because too many were nonfunctioning, implying that they were established to take advantage of the government's financial incentives. With the increased monitoring, the number of cooperatives in Bukidnon declined to about 700 in 1997. Numbers grew gradually thereafter, particularly with the introduction of the government's *Lingap Para sa Mahirap* (Care for the Poor) program in late 1998, but then contracted again during 2000–02.³

Cooperatives in Bukidnon exist across all sectors of the economy. CDA records indicate that as of the end of 2002, Bukidnon had 745 cooperatives within the following categories: multipurpose/nonagricultural (535), multipurpose/agricultural (136), consumers (22), credit (19), producers (13), services (9), federation (6), marketing (3), cooperative rural bank (1), and union (1). The records also indicate that the cooperative sector in Bukidnon includes a broad cross-section of groups: craftsmen; farmers; fishermen; irrigators; soldiers; women; workers; and neighborhood, religious, transport, and tribal groups. The majority of Bukidnon's cooperatives engage in some form of lending with their members. Agricultural cooperatives, in particular, are a major source of credit for farmers and other individuals involved in farming activities. Such individuals depend on a stable source of credit because it is likely the bulk of their incomes are earned at harvest times, leaving them without steady income for long periods.

Cooperatives in Bukidnon are attractive sources of credit because interest rates are usually less than 5 percent per month, which is lower than the rates charged by most MFIs (with

³ This information was obtained through interviews with the person in charge of the Bukidnon desk at CDA's regional office in Cagayan de Oro City.

the likely exception of NGOs and MFIs that disburse government and donor funds). The low rates mostly result from the strong commitment of many cooperatives to help their members. In addition, agricultural cooperatives may have access to low-interest credit through the Land Bank of the Philippines that can be used as production loans for individual members or to implement income-generating cooperative projects. Most of Bukidnon's cooperatives use member contributions to fund their lending programs, but some cooperatives targeted to farmers and women receive funding assistance from foreign donors and government agencies, mostly through NGOs. For example, the Philippine Development Assistance Programme—a coalition of NGOs in the Philippines and Canada—has funded credit programs for women and farmer cooperatives in Valencia and Impasugong.

Cooperatives in Bukidnon usually require applicants to submit a membership application, go through a qualifying process, and undergo training before they are accepted as members. As members, they are required to abide by the organization's policies, rules, and regulations; attend meetings, training, and various other activities; and contribute a fixed sum of money when a fellow member dies. Most cooperatives also require their members to contribute an initial amount of money, and to save small amounts regularly, for use as collateral against future loans. Most cooperatives require new members' savings to reach a certain level and be maintained for a certain period before they can borrow. In addition, a small percentage of each loan is set aside to build the member's capital within the cooperative, and a small service fee may be charged on loans. Cooperatives don't usually stipulate how loans can be used. Loans extended by cooperatives usually have a maturity limit, but terms are generally negotiable. Borrowers may choose the maturity date (within the limit), the payment schedule (whether daily, weekly, or monthly), and how repayments will be collected. Some cooperatives both receive repayments at their offices and collect payments at borrowers' homes or workplaces. Cooperatives enforce loan repayment using collateral (including borrower savings and cooperative refunds and dividends), societal/cultural sanctions, education initiatives, and higher loan limits for compliance. Collateral or guarantors are usually required for large loans.

Some cooperatives in Bukidnon offer loan products to their members, including emergency loans in the event of accidents, fire, hospitalization, illness, and theft. Some cooperatives also provide voluntary savings and term deposit services to members. Interest rates on these kinds of deposits is usually higher than the rates offered by commercial banks. Moreover, deposit earnings are tax-free. A few cooperatives bulk buy merchandise—such as rice, sugar, and cooking oil—for resale to members using credit schemes. Other schemes offered by cooperatives in Bukidnon include capital development, life insurance, education funds, and health care schemes.

4.3.2 Nongovernment organizations

Most NGOs in Bukidnon are engaged in microfinance activities (or have been at some time). This is limited to small credit programs, however, mainly because most NGOs are not in a position to develop such programs into profitable, sustainable enterprises. Like NGOs elsewhere, most NGOs in Bukidnon heavily depend on external funding sources, thereby limiting their ability to generate funds for their credit programs. Most NGOs in Bukidnon use the Grameen

approach for their credit programs.⁴ This approach requires membership in an organization as a prerequisite for credit. The use of membership as a qualifying criterion enables NGOs to establish a long-term relationship with participants and beneficiaries. Most NGOs use training programs, member savings, peer pressure, group guarantees, and the reward of higher loan limits to compel members to honor their financial obligations. Some NGOs also offer optional financial assistance schemes for education; life insurance; health insurance; and protection against death, sickness, and other emergencies.

A major drawback is the inability of most NGOs in Bukidnon (and elsewhere) to develop income-generating activities that would enable them to be self-sustaining. Many have difficulty maintaining their operations because their traditional sources of finance are no longer available. The government is no longer a reliable source of assistance given its own financial challenges, and foreign assistance is increasingly difficult to secure because of intense competition.⁵ No government agency tracks all NGOs, so it is difficult to determine the actual number operating in Bukidnon. The local office of the Department of Interior and Local Government in Malaybalay estimates the number to be about 150, but the NGOs themselves suggest that there are at most 20 active NGOs in Bukidnon.

Little NGO growth occurred during Marcos years. With the establishment of the Aquino government in 1986, accompanied by foreign assistance for NGOs, particularly from Australia, Canada, and Europe, numbers began to grow. Much of the assistance that Bukidnon NGOs received in the late 1980s was geared toward strengthening grassroots activities, particularly in the area of community organization. By the early 1990s, the focus shifted toward developing self-sustaining organizations, so most NGO activities were directed at enterprise development and income-generating activities until the late 1990s. With continued assistance from government and foreign sources, NGO numbers further increased in Bukidnon in the 1990s, but as of 1999 numbers declined sharply as funding contracted.

One of the notable successes of Bukidnon's NGOs is the widespread creation of cooperatives and associations, particularly those targeted to farmers and women. Many of these groups still function, albeit under difficult and precarious conditions. Bukidnon's NGOs have also contributed significantly to the public awareness of important issues such as environmental protection and the need to actively participate in local governance.

4.3.3 Informal credit associations

As previously mentioned, informal credit associations in Bukidnon cover a wide array from: neighborhood, religious, and tribal groups to employee, soldier, farmer, even groups formed by

⁴ For instance, the Bukidnon Integrated Network of Home Industries, an NGO based in Manolo Fortich, uses the Grameen approach for its districtwide lending program to ultrapoor women in several municipalities in the first district of Bukidnon.

⁵ The Philippine Development Assistance Programme (PDAP), which is funded by the Canadian International Development Agency, used to have a sizable organic rice farming program in Valencia in partnership with the Bukidnon Center for Sustainable Agriculture, but this has recently been scaled down significantly. The Philippine Australian Community Assistance Program (PACAP), which is managed by the Australian Agency for International Development, funded a number of community development initiatives in Bukidnon in the late 1980s and 1990s through local NGOs, but its presence since then has been minimal. Bukidnon was a priority area for the Philippine NGO Consortium for Rural Development (PhinCORD), funded by the Dutch government, but the program was discontinued a few years ago.

wives of armed Moro rebels. Cooperative credit unions that fail to maintain CDA requirements often continue to function as credit associations without the formal involvement of the CDA. Much variation exists in the methods employed by informal credit associations. Common examples include requiring members to abide by policies of the association, attend regular meetings, pay monthly or annual fees, contribute fixed sums when another member dies, save small amounts, serve as officers of the association or in various committees, and participating in the association activities.

Credit associations are required to register with the CDA, but even if they do not, their financial transactions are legally binding provided a valid contract exists. As with other MFIs in Bukidnon, informal credit associations tend not to resort to legal action, but instead use a combination of societal/cultural sanctions, education, incentives, and collateral to compel members to honor their financial obligations. Various methods are used to facilitate loan disbursement or income sharing to members. Loan amounts do not usually exceed 5,000 pesos because association loan capital is drawn from member savings and contributions. Interest rates can be surprisingly high, as much as 15 percent per month. Some associations charge high interest rates to offset delayed repayments and defaulted loans, others impose high rates to entice members and third parties to invest loan capital, still others prefer high interest charges to increase profit-sharing, and some members are willing to pay high interest rates if it means they can secure loans easily.

The strength of informal credit associations lies mainly in their physical and social proximity to members and in the scale economies achieved through the simplicity of the organizational structure in terms of minimal overhead (given modest infrastructure and the use of volunteer labor). The weaknesses include the inability to provide long-term credit or adopt more professional practices, little opportunity for growth, and weak legal foundations. The very nature of these associations—their informal status—is also a weakness because it limits their ability to modernize or expand their operations.

4.4 MICROFINANCE AND THE INFORMAL URBAN SECTOR IN BUKIDNON

The financial requirements of the informal economic sector differ significantly from those of the formal sector. Goods and services are the primary business focus, requiring small loans (as little as 500 pesos) as start-up and working capital. Trading opportunities can be very brief—such as during feast days or school graduations—where profits can also be quickly realized. Street vendors, for example, are known to borrow capital in the morning to buy inputs and repay their loans at the end of the day (Chua and Llanto 1995).

Because of these low capital requirements, the rate of return on equity in the informal sector can be very high, but it is likely that the income generated can only meet minimum daily needs. This severely limits the ability of informal sector operators to save, which—combined with the lack of physical assets that can be sold or used as collateral—makes such operators highly vulnerable in times of emergency and sickness. It is therefore important for informal-sector operators to have continuous access to credit as a means of generating cash for their daily business requirements, livelihood, and unplanned expenses (Chua and Llanto 1995). Because the informal sector operates outside the system of government benefits and regulation, few informal-sector operators have access to the credit services offered by the formal financial system. This forces many in the

informal sector to rely on highly accessible but comparatively expensive sources of credit, such as professional moneylenders.

Bukidnon has a thriving informal sector, particularly in the urban centers of Valencia, Malaybalay, Quezon, and Don Carlos. Most of the economic agents in this sector are engaged in marketing foodstuffs and other consumer goods (street vendors) and in the provision of various services (such as maintenance, carpentry, and cleaning services). The credit needs of the informal sector in Bukidnon are largely met from outside the formal financial system. This includes neighbors, relatives, friends, professional moneylenders, cooperative credit unions, NGOs, local ROSCAs, informal credit associations, suppliers, and traders. Within the formal financial system, only pawnshops and lending investors and a few rural and cooperative banks supply credit to the informal sector. Pawnshops and lending investors have adapted well to the informal sector because they are not closely supervised and regulated by the government.

An increasing number of informal-sector operators in Bukidnon have turned to pawnshops, professional moneylenders, and lending investors for credit, preferring these sources because they are considered faster and more accessible, especially for emergency needs. Further, collateral is usually not required by informal-sector lenders, and funds can be used for nonproduction purposes such as subsistence, hospitalization, and education. Interest charges from these sources, however, are comparatively high, usually ranging from 3 to 15 percent per month.

4.5 MICROFINANCE AND SOCIAL SECURITY COVERAGE IN BUKIDNON

Inadequate social protection from events associated with death, sickness, accident, unemployment, and even retirement is the main reason why borrowing money is commonplace in Bukidnon. People have to resort to borrowing—unless they have substantial savings or are adequately protected by insurance, which is highly unlikely in Bukidnon because of the high incidence of poverty.

Most workers receive social security coverage from the two government pension funds—the Government Service Insurance System (GSIS) and the Social Security System (SSS). All employers are required to register their employees with either the GSIS (for government workers) or the SSS (for private-sector employees). Both the GSIS and SSS provide life insurance, health insurance, retirement benefits, and minimal protection against disability and unemployment, in exchange for monthly contributions from both employees and employers. In addition to the SSS, private-sector workers benefit from a Mandatory Retirement Pay (MRP) provision that obliges all employers to pay retiring workers the equivalent of half a month's pay for each year of service (retail, service, and agricultural employers with 10 or fewer employees are exempt).

A final mandatory savings mechanism for workers is the Home Development Mutual Fund (Pag-IBIG), which covers SSS and GSIS members. The funds that are accumulated from the mandatory contributions of employees and employers are primarily used to finance housing loans, but balances are available at retirement or after employees have contributed for 20 years. However, the coverage ratio of the SSS and GSIS for the total labor force in Bukidnon is

estimated to be less than 30 percent.⁶ One explanation for this low ratio is that a large percentage of self-employed workers in Bukidnon have not registered with the SSS. Another is the tendency of many employers to hire workers on temporary contracts to avoid many of the benefits they are legally required to provide.

With the exception of SSS and GSIS members, few in Bukidnon have insurance coverage for events like death, sickness, and accident. The average annual premium on the minimum policy at the top three life insurance companies servicing Bukidnon is at least 10,000 pesos per year,⁷ making the cost prohibitive for most (the average annual income for most Bukidnon households is less than 100,000 pesos). The government has also failed to provide insurance coverage to nonworkers in Bukidnon. The Philippine Congress passed a 1995 law that required the government's Philippine Health Insurance Corporation (PhilHealth) to provide mandatory health insurance coverage to all citizens. Nevertheless, PhilHealth has done little to assist most Bukidnon residents in financing health-related emergencies (though it has managed to enlist more enrollees in Bukidnon than in most other provinces). The benefits package involved is primarily for inpatient hospital care, which is not the highest priority for many poor families, and many local Bukidnon governments co-finance the required premium subsidies for the enrollees in the program.

Another unsuccessful government effort was the Bukidnon Health Insurance Program (BHIP), initiated in 1994 by the provincial government to provide Bukidnon residents with access to affordable and quality health care. For an annual premium of 720 pesos, members and beneficiaries were provided with free consultation, medicine, laboratory and diagnostic tests, dental services, doctors' fees, and hospitalization expenses. The program, however, was abandoned in 2001 after it was decided that the provincial government could no longer afford subsidy needed to maintain the program (about 65 percent of the program's costs).

5. CONCLUSION

Poverty is critical and prevalent in Bukidnon, where dependence on traditional agriculture, low levels of economic growth, and inequitable distribution of income have exacerbated its incidence. The Philippine government has emphasized microfinance in addressing poverty in recent years. Among the poverty initiatives undertaken are direct lending to the poor; channeling funds through MFIs, particularly NGOs; providing technical assistance and credit guarantees to MFIs; encouraging linkages between banks and microfinance institutions; implementing directed credit schemes through the banking system; and providing various types of assistance and incentives to banks engaged in microfinance.

Despite these efforts, success in reducing poverty has been limited throughout the Philippines, and in Bukidnon. Most government credit programs in Bukidnon channeled through NGOs and cooperatives have recently been terminated or scaled down considerably, and many

⁶ This rough estimate was obtained by dividing the total number of workers covered by the SSS and GSIS in Bukidnon (as indicated in the records of the SSS and GSIS regional offices in Cagayan de Oro City) by the estimated size of the labor force.

⁷ The top three life insurance companies are Philippine American Life, Insular Life, and Sun Life of Canada.

NGOs and cooperatives that received financial and technical assistance for credit activities from the government have either closed or are barely functioning. Government-directed credit schemes, assistance, and incentives have done little to actively involve Bukidnon's commercial banks in the provision of microfinance. Only rural, thrift, and cooperative banks actively lend funds to small enterprises, employees, and farmers, and even the involvement of these banks in microfinance is somewhat limited because of the qualifying barriers used to screen out high-risk borrowers.

A major explanation for the limited success of so many microfinance initiatives is that they were not market-driven. It is clear that most of the government's credit programs in Bukidnon were comparatively inefficient and costly, and only viable for any period of time because of heavy subsidization. Most private commercial banks in Bukidnon ignored credit schemes and government assistance and incentives because the schemes and incentives did not realistically address the problem of risk. Several studies have already pointed to the need for greater funding and cost efficiency to increase the likelihood of success of poverty alleviation programs (Collas-Monsod and Monsod 1999; Reyes and Del Valle 1998; Lipton and Ravallion 1995). But the government's budget deficit is a considerable obstacle and augurs further weakening of poverty alleviation programs.⁸ In this environment, the pragmatic approach is probably for the government to concentrate on regulating private-sector microfinance activities and on providing appropriate assistance and incentives as opposed to conducting its own initiatives. The need for effective regulation is particularly urgent, especially because some of the government's current microfinance policies are ambiguous and inconsistent with the promotion of microfinance—specifically, a policy environment supportive of efficient microfinance markets that incorporate active private MFI participation. Interest rate policy is a case in point: while the ceiling on interest rates was lifted by the Central Bank in 1982, the Supreme Court continues to judge rates over 12 percent per annum as unjustifiable.⁹ These conflicting interpretations should be urgently resolved because they undermine the stability of the microfinance market and increase risk, thereby forcing moneylenders to raise interest charges to the detriment of small lenders who depend on the availability of viable credit.

It is perhaps time for the government to focus more attention on pawnshops and professional moneylenders, and particularly on lending investors. Assistance and incentives to these institutions are important because they constitute the primary sources of microcredit for ordinary households and small enterprises in the Philippines. Any improvement in these operations, therefore, should positively affect the small borrowers they serve in terms of lower interest rates and increased credit services. The government also needs to recognize the contribution of these institutions rather than dismissing them as exploitative. The interest charges they impose reflect the associated risk and level of competition in the market. Where monopolies

⁸ For further details, see the Central Bank Governor's speech on the budget deficit at http://www.bsp.gov.ph/resources/gov's_speeches/speech_041604.htm.

⁹ For example, in *Medel et al. vs. Court of Appeals et al.*, GR. 131622, November 27, 1998, and in *Spouses Danilo Solangon and Ursula Solangon vs. Jose Avelino Salazar*, GR. 125994, June 29, 2001, the Supreme Court ruled that interest rates of 5.5 percent per month and 6 percent per month, respectively, were not usurious because the Central Bank had already lifted the ceiling on interest rates. However the court also decided that the rates were "iniquitous or unconscionable" and "outrageous and inordinate" and reduced them to 12 percent per annum.

and oligopolies arise, the government should not respond with unreasonable restrictions that only exacerbate the problem, but instead implement measures to encourage the entry of other MFIs.

It has been suggested that MFIs, including NGOs, could serve the poor more effectively if they were permitted to develop and institute their own savings deposit facilities. The rationale for this argument is that indebtedness cannot help the poor, and that their need for savings facilities may actually outweigh their need for credit services. The experience of Grameen banking, however, indicates that any savings scheme for the poor is unlikely to succeed without stringent controls, such as training programs, peer pressure, group guarantees, group accountability, the joint use of savings as collateral. This means that a sole savings facility for the poor would almost certainly fail.

The scheme used by lending investors, whereby they collect small, regular (daily) repayments from borrowers, is in fact one of the most successful methods of savings generation for the poor. Although these are in fact loans involving interest charges, they technically constitute enforced savings. Lower interest rates would certainly increase the “savings” effect of such schemes, however. Without the daily collection it is unlikely that these schemes would work because cash flows are highly vulnerable to macroeconomic instabilities and emergencies. Hence, encouraging successful, low-risk borrowing by the poor will require minimizing the inherent risks of micro-lending to enable lenders to offer schemes at significantly reduced interest rates.

One of the biggest challenges for the government in developing sources of microfinance is reducing the risks of agricultural and informal lending. Existing macro- and microeconomic conditions made lending in these sectors particularly risky, and have led to the establishment of monopolies or oligopolies. Without government measures to substantially reduce the risks of lending in these sectors, interest rates will remain at levels that prevent significant numbers of poor people in the Philippines from accessing much-needed microfinance.

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