Philippine Rural Finance Apparent and Real Problems, With Some Possible Solutions

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PHILIPPINE RURAL FINANCE

Apparent and Real Problems, with Some Possible Solutions

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I. BACKGROUND

Directed credit programs are common phenomena in most developing countries. They continue to be implemented despite their inefficiencies and their ineffectiveness in reaching target beneficiaries. Like other developing countries, the Philippines has for many years been implementing subsidized directed credit programs to provide the rural poor with access to credit. The government relied on such programs to deal with the lack of formal financial services in rural areas rather than dealing with the underlying problems such as the systemic risks and high transaction costs associated with rural lending. These programs proliferated for specific commodities, depending on the specific priorities of the government at the time[2].

A 1997 survey conducted by the National Credit Council (NCC) and the Credit Policy Improvement Program (CPIP) revealed that there were 86 on-going directed credit programs (DCPs) implemented by several government entities in various sectors of the economy, almost half of which (38 DCPs) were in the agriculture sector[3]. Government Non-Financial Institutions (GNFIs) and Government-Owned and Controlled Corporations (GOCCs) implemented 55 programs while Government Financial Institutions (GFIs) handled 31 programs. The Departments of Agriculture and Agrarian Reform handled 20 directed credit programs, which directly targeted the agriculture sector.

Figure 1 portrays the 86 directed credit programs in terms of who funds, who owns them, how they are implemented, and what sector they target. The figure shows the complex structure of DCP implementation that made it difficult to trace the flow of funds from source to end-user. The modalities used in implementing DCPs resulted in large amounts of resource leakages that mainly flowed from weak accountability, poor repayment rates and hidden subsidies.

DCPs source their funds from budgetary allocations and donor loans and grants. Survey results showed that initial fund allocations for 63[4] of the 86 directed credit programs reported amounted to almost P40.5 billion ($764 million at P53 per $). This is equivalent to almost 2 percent of the gross domestic product (GDP) of the Philippines in 1996. About 40 percent of these programs (34 programs) are targeted towards the agricultural sector. Despite the amount of resources earmarked for the implementation of DCPs, most of the programs were reported to have very

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[1] With the assistance of Maria Piedad Geron and Paul Casuga

[2] Geron, Ma. Piedad (with assistance of Robert C. Vogel, Joselito S. Almario and Gilberto M. Llanto). "Market-based Credit Policies for Increased Access to Rural Finance ***(Annex ____)***."

[3] Llanto, Gilberto, Ma. Piedad S. Geron and Marie-Christine G. Tang. 1999. Directed Credit Programs: Issues and Framework for Reform. Manila, Philippines: Credit Policy Improvement Program, Department of Finance-National Credit Council.

[4] Of the 86 credit programs, only 4 programs have complete sets of data. Half of the rest of the programs generated only a basic set of data, while one-third did not submit financial information.

limited outreach. For 1995 to 1996, DCPs implemented by GNFIs reached an average of 22,721 beneficiaries per program. GFIs, on the other hand, were reported to reach an average of 38,332 per program.

Despite the proliferation of DCPs and the large amount of government and donor resources allotted for these programs, lack of access to credit by the basic (poor) sectors continued to be a major problem, especially in the rural areas. Continued implementation of DCPs resulted in waste of scarce government resources and major fiscal costs for the government.

Recent policy reforms

Realizing the failure, the Philippine government has recently moved away from the implementation of subsidized directed credit programs to the adoption and implementation of market-based credit policies to enhance access to credit. Using the assistance of the Credit Policy Improvement Program (CPIP), the National Credit Council was able to pursue and implement market-based credit policies and rationalize the implementation of subsidized directed credit programs. These policy reforms are geared towards the development of a viable and sustainable rural and microfinance market. **Table 1** shows the main reforms.

Table 1. Key Policy Reforms in Rural and Micro Finance

Policy Measures	Key Provisions
Issuance of the National Strategy for Microfinance (1997).	▪ Market orientation of interest rates. ▪ Rationalization of subsidized directed credit programs ▪ Donors primarily as providers of technical assistance, i.e., capacity building ▪ Recognition of savings mobilization as an integral part of successful microfinance programs
Enactment of the Social Reform and Poverty Alleviation Act, December 11, 1997	▪ Defining capacity building to exclude any and all forms of seed funding, equity infusion, and partnership funds from government to microfinance institutions ▪ Deletion of equity funding from the list of specific uses of the People's Development Trust Fund (PDTF), a trust fund created under the law aimed at funding capability building activities for MFIs ▪ Rationalization of directed credit and guarantee programs ▪ Emphasis on savings mobilization
Enactment of the Agricultural Fisheries Modernization Act (AFMA), December 22, 1997	▪ Phase-out of directed credit programs in the agriculture sector over a four year period (i.e., ending February 2002) ▪ Rationalization of loan guarantee programs ▪ Adoption of market-based interest rates ▪ Non-provision of credit subsidies ▪ Review of mandates and performance of government agencies and government financial institutions in light of the rationalization of directed credit programs
Issuance of EO138 (August 10, 1999)	▪ Non-participation of government non-financial

Policy Measures	Key Provisions
directing government agencies implementing credit programs to adopt the NCC Credit Policy Guidelines.	agencies in the implementation of credit programs ▪ Government financial institutions to be the main vehicle in the implementation of government credit programs ▪ Adoption of market-based financial and credit policies ▪ Increased participation of the private sector in the delivery of financial services
Approval of the design of the Agricultural Modernization Credit and Financing Program (AMCFP).	▪ No further implementation of directed credit programs by government non-financial agencies by end 2002 ▪ Limit lending decisions only to banks, viable cooperatives and microfinance NGOs ▪ Adoption of market-determined lending rates to enable conduits to cover their costs and achieve sustainability in the long run ▪ Focus of the Department of Agriculture on monitoring and evaluation of AMCFP, provision of infrastructure, institution building, research and extension and the provision of an appropriate policy environment conducive for increased private sector participation.
Establishment of the necessary framework for a more appropriate and effective regulation of deposit-taking cooperatives	▪ Formulation and adoption of the Standard Chart of Accounts for credit cooperatives (December 1999) ▪ Formulation of accompanying accounting manual (December 2000) ▪ Formulation and launching of the performance standards for credit cooperatives. (October 2002)
Enactment of the General Banking Act (GBA), May 23, 2000, which includes provisions mandating the Bangko Sentral ng Pilipinas (BSP) to recognize the unique nature of microfinance as it formulates banking policies and regulations.	▪ Lifting of the moratorium on branching, specifically for microfinance banks ▪ Issuance of BSP Circular 272 on January 30, 2001, implementing the microfinance provisions of the GBA ▪ Review of the examination process to reflect the special nature of microfinance, e.g., non-collateralized loans

In line with the foregoing policy reforms, the government stopped allocating budgetary funds to credit programs implemented by GNFIs beginning in 2000. As of July 31, 2002, 23 of the 90 directed credit programs[5] have already been terminated and another 23 have been transferred to GFIs for continued implementation.

Ten of the 63 directed credit programs in the agricultural sector have been terminated as of July 31, 2002. Of the total funds obligated/disbursed for the credit programs in the agriculture sector (P6.13 billion or US$115.1 million), about half have already been transferred to GFIs, while the

[5] The initial survey conducted in 1997 reported 86 directed credit programs. The inventory conducted in 2002 identified 4 more directed credit programs, increasing the total number to 90. These programs were initiated during the period 1997 to 2002, when the policy measures on DCP rationalization were still being formulated.

remaining amount is still with the agricultural non-financial agencies implementing directed credit programs.

As of September 2004, a total of P721 million from 12 terminated directed credit programs in the agriculture sector have been collected and deposited at the Bureau of Treasury. The rationalization of directed credit programs has also resulted in the conversion of loan funds into institutional capacity building funds.

Objectives of the present paper

With these developments as background, the **present** paper seeks to accomplish the following objectives:

- Report on the status of EO 138 implementation and the phase-out provisions of AFMA;
- Examine changes in the provision of financial services in rural areas during the reform period; and
- Assess the sufficiency of these policy measures in making the delivery of credit to the agricultural/rural sector more effective and efficient.

The paper discusses the specific peculiarities in rural financial markets and rural areas, e.g., systemic risks and undiversified character of local economies, to have a clearer understanding of key gaps in the enabling environment for rural finance. It identifies critical issues and key challenges for the government as it provides an enabling policy environment for greater private sector participation in the provision of rural financial services. Finally, it provides recommendations that will help in the formulation of an appropriate policy framework and strategy for rural finance.

Compliance with EO 138 and the phase out provisions mandated by AFMA

The Department of Agriculture and the Agricultural Credit Policy Council (ACPC) have joined efforts to phase out the directed credit programs (DCPs) as mandated by AFMA. All but a few very small DCPs have ceased to operate according to the ACPC. The Department of Budget and Management has ceased to provide new money to the DCPs scheduled for termination. The huge and worrisome fiscal deficit has convinced DBM to deny new money to those programs. In addition, NEDA ICC is now requiring NCC approval of all credit programs or credit components of public sector projects to be funded from official development assistance (ODA) sources. (**Annex A** provides details of the status of implementation of EO 138 and AFMA.)

However, policy makers must not lose sight of the danger that lack of full compliance might bring. It may encourage the creation of new targeted and subsidized credit programs administered by GNFIs. The penchant of politicians and even bureaucrats for supporting and creating populist programs notwithstanding doubts over their sustainability should never be underestimated.

The problems with these programs are well known. It is important to emphasize that subsidized directed credit programs impede the entry of sustainable private sector entities into rural finance as they find it difficult to compete with the subsidized interest rates offered by those programs. Even more detrimental is the risk of 'credit market pollution' arising from very poor loan recovery in traditional subsidized credit programs. Because of the political process entering into the allocation of subsidized credit, borrowers often come to feel that they have a right not only to receive such loans but also not to repay them[6]. Moreover, fiscal costs are further increased by high administrative costs due to targeting and lack of financial expertise within government non-financial institutions (GNFIs). Thus, efforts toward compliance can be most efficient and effective if they are focused wherever threats of new subsidized credit programs are perceived to be greatest.

Executive Order 138 mandated the transfer of the remaining cash balances of the terminated DCPs to GFIs. However, the transfer of the loan portfolios of terminated programs is another matter. The government financial institutions (GFIs) are not too eager to administer these programs because of high administrative costs and difficulties in loan recovery. Thus, typically, the transfer of the outstanding cash balance of DCPs is under a trust agreement between the GFI and the concerned GNFI. The transferred funds which are held in trust by the GFI can then be lent to target clientele upon the policy direction of the GNFI who insist on the ownership of the transferred funds. The compromise has somewhat diluted the intent of the market-based credit policies of EO 138 and AFMA because it has accommodated the lingering desire of GNFIs to have a role in credit allocation.

Furthermore, GNFIs are sometimes not keen to see these programs terminated or transferred because of the political attractiveness that caused their creation in the first place. Moreover, the amounts of money remaining in these programs are typically very small (due to high administrative costs and losses from loan non-recovery), so that dangers from lack of termination or transfer (and similarly the benefits from termination or transfer) are likewise small. The real danger is that the lack of compliance will encourage the creation of new targeted and subsidized credit programs administered by GNFIs.

Adverse consequences of subsidized credit and other politically motivated interventions in financial markets. The apparently plausible arguments that subsidized credit can help achieve all sorts of goals (e.g., promote production, reduce income inequality, offset other distortions, etc.) must constantly be countered because they appear so plausible as well as seeming so easy to implement compared to real solutions. The properties of fungibility and the role of transaction costs, among other market-based forces, must constantly be explained in that they inevitably undercut what subsidized credit and similar interventions are supposed to achieve. Even more important to explain is the resulting "credit market pollution" that arises from incentives of subsidized and targeted credit toward lax loan recovery that discourages the entry of private finance into rural areas.

Lack of consistent focus in the roles and functions of GFIs and GOCCs

The policy of a wholesaling role for GFIs in rural financial markets is clearly stated by Executive Order No. 138 and AFMA. The official policy also specifies retail lending to be the domain of private financial institutions. However, GFIs and government-owned and-controlled corporations (GOCCs) insist that they have to perform a retailing function for one reason or another. There is, therefore, a lack of consistent focus in the roles and functions of GFIs and GOCCs, especially where there is involvement in both wholesale and retail operations targeted to the same clientele. This results in distortion and confusion in the rural financial markets. Wholesaling and retailing require different financial expertise; and, more importantly, evidence worldwide indicates that serious conflicts of interest inevitably arise when a financial institution targets the same clients as the retail institutions to which it wholesales.

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[6] Robert Vogel. 2005. "From Agricultural Credit to Rural Finance: In Search of a New Paradigm for the Philippines." Unpublished paper.

Trends at both the Land Bank of the Philippines (LBP) and the Development Bank of the Philippines (DBP) toward wholesaling should thus be supported with retailing limited to clearly defined and distinct clienteles and operated on market-based principles (e.g., no interest rate subsidies). Furthermore, to avoid undermining deposit mobilization, GFIs should target their wholesaling operations as much as possible toward institutions that cannot mobilize deposits (e.g., non-financial cooperatives and NGOs engaged in micro-lending). When wholesaling to financial institutions that can mobilize deposits, e.g., rural banks, wholesaling rates should not discourage deposit mobilization. In other words, the wholesaling rates of the GFIs should not be subsidized.

Even more problematic is the movement of some GOCCs (e.g., Quedancor and Small Business Guarantee and Finance Corporation (SBGFC)) away from their initial mandates (e.g., loan guarantees) toward retail lending in competition with the private sector. While competition in general is beneficial, this is not the case when it involves government institutions and is based on subsidized interest rates (together with possible lack of adequately aggressive loan recovery efforts). Especially problematic is the situation where GOCCs engaged in the delivery of credit services to target clientele are not adequately supervised, thus potentially allowing practices prejudicial to the government's fiscal situation as well as to the private sector when a GOCC engages in retail lending in direct competition to private financial institutions[7].

It is important for the oversight agencies, namely NEDA and DBM, but more importantly DOF, to exercise a strong oversight role over GFIs and GOCCs so that government credit programs may not unduly undermine efforts to encourage greater private sector participation in financial markets. The DOF, NEDA and DBM can work together in making sure GFIs and GOCCs adhere to official credit policy enunciated under the AFMA and EO 138. More specifically, like GFIs, such GOCCs should be encouraged to focus on wholesaling and should be brought clearly under EO 138, i.e., no retail lending with subsidized or below market interest rates.

Review of certain BSP policies

The Bangko Sentral ng Pilipinas (BSP) has taken important steps that effectively facilitate rural finance (e.g., its movement toward more effective implementation of risk-based supervision, its supportive interpretation of changes in the General Banking Act with respect to micro-finance, and its current efforts toward creating a better basis for more comprehensive and effective credit bureau databases). Nonetheless, there are two areas of BSP practice where further rationalization might facilitate the expansion of rural finance, namely policies with respect to branching and capital adequacy requirements. In fact, the BSP is currently reviewing and updating the circular on branching.

First, the BSP has introduced a moratorium on branching except for microfinance-oriented banks[8] and has required prior approval for opening new branches along with certain specific operational and security requirements – all of which raise the costs of establishing the small branches that are needed for sustainable banking operations in isolated rural areas.[9] Effective rural finance requires widespread rural branches to reduce transaction costs, especially in isolated rural areas.

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[7] According to a Quedancor official, 20 percent of the corporation's loan portfolio is devoted to loans to government employees while the bulk is focused on retail loans.

[8] BSP Circular 340 (Series of 2002) provides that "the general moratorium on the establishment of regular branches/other offices by banks that are not microfinance-oriented shall however remain".

[9] Restrictions on branching have in some cases been circumvented by purchasing banks or branches or even the licenses of those that have failed.

Doing such lending requires the ability to open small branches that may neither involve the same standards of physical security as large urban branches nor the same time-of-day of operation. In rural areas, travel times and travel-related expenses are potentially major components of transaction costs, especially if borrowers have to travel long distances from their towns or villages to find a bank branch, often over difficult terrain. Security requirements with respect to illumination, locks, alarm systems, and cash vaults and their timing devices may add significantly to the fixed costs of establishing a bank branch, and thereby make it prohibitively costly to establish small branches. Furthermore, bank branches must be open for at least six hours per day during the five-day banking week, which may not be consistent with the expected volume of business in the rural areas. Also, to be open on Saturday or Sunday or before 8:00 am or after 8:00 pm, which may coincide with the needs of potential rural customers (e.g., due to market days), requires approval of the BSP.

Such operational and security requirements are inconsistent with the basic tenets of risk-based supervision that operational decisions should be left to banks that are operating soundly and showing effective risk management capabilities. Risk-based supervision focuses on the capacity to manage risks, rather than on imposing arbitrary rules based on risk avoidance.

Second, apparently in efforts to ensure the financial soundness of certain types of banks, capital requirements are set differentially, as well as for the opening of branches in different types of localities[10]. These capital requirements not only restrict branching but also introduce various incentives that appear inconsistent with each other and encourage market fragmentation – in contrast with risk-based supervision that sees capital requirements as a mechanism to handle risks.

The focus of risk-based supervision is not only in identifying and monitoring risks facing individual financial institutions and the overall financial system, but also in analyzing the ability of regulated institutions to deal with these risks. BSP's main concern should be to focus on the adequacy of policies and procedures, their implementation and the systems used for monitoring and control, which are at the heart of a financial institution's ability to manage risk.[11]

Information as a public good

Information plays a key role in facilitating access to financial services in rural areas. Policy makers should take cognizance of the importance of information as a public good and the resulting role of the public sector in promoting transparency, including especially information about borrowers and about the performance of non-regulated lenders.

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[10] BSP Circular 340 (series of 2002) provides that "capital shall be assigned to each branch/loan collection and disbursement points (LCDPs) based on the type of bank that is trying to establish a branch". While the assigned amount of capital for each type of bank appears to be an arbitrary amount, BSP requires that applicant banks observe a risk-based capital adequacy ratio." Capital shall be assigned to each branch/LCDP to be established as follows: universal and commercial banks, P20 million; thrift banks and national cooperative banks, P5 million; rural banks and cooperative banks, P2.5 million. The risk-based capital adequacy ratio at the time of filing the application is not lower than 12 percent. Rural banks or local cooperative banks with unimpaired capital accounts of less than P10 million shall not be allowed to establish any branch/local collection and disbursement points. For details, please see BSP Circular 340.

[11] Tom Fitzgerald and Robert C. Vogel. "Moving Towards Risk-Based Supervision in Developing Economies," Harvard Institute for International Development, CAER II Discussion Paper No. 66, May 2000.

An increasing number of participants in the delivery of financial services, especially when there are new entrants and increased competition, can increase the danger of clients borrowing from several financial institutions simultaneously. If lenders are unaware of these multiple borrowings, this potential for over-borrowing can pose a serious threat to the viability of the financial institutions involved. In fact, there are already some MFIs in the Philippines complaining of multiple borrowing by some of their clients[12].

Lenders such as MFIs may perhaps share a negative list of borrowers but their self-interest may prevent them from sharing information on good borrowers. Without compulsion there is little incentive for an individual lender to contribute information to a credit bureau database, especially about good borrowers, without an assurance that all others will similarly contribute, with the result that private credit bureaus in the Philippines have only very limited outreach. The BSP itself requires information for its database only for loans greater than 1 million pesos, thereby failing to include most lending in rural areas and also, because of incompleteness, making the accuracy of the information submitted more difficult to check.

The experience of other countries with credit bureaus is instructive. Consumer lending has benefited greatly when credit bureaus provide information about the outstanding obligations and repayment histories of potential borrowers. This has been spreading to micro and rural finance, but progress has been slow because of especially difficult challenges in providing adequate coverage. Because of incentives inherent in information sharing, a given lender will not participate unless most other lenders also participate, so that compulsion is usually required, at least if rapid progress is desired.[13] Thus, in many countries, regulatory agencies require lenders to provide information about individual loans for supervisory purposes, but in some cases this is limited to larger loans and in others there are legal limits on sharing this information outside the regulatory agency[14].

The NCC and BSP have clearly recognized the need to take the initiative in the expansion of credit bureau databases to increase their effectiveness. The BSP is currently investigating the legal and operational requirements for making all regulated lenders supply information on all loans and for sharing this information with credit bureau databases in the private sector[15]. The availability of such information would increase the ease of assessing the creditworthiness of borrowers and should thereby greatly reduce the costs of lending to smaller borrowers in rural areas. Moreover, with the mass of information thereby available, non-regulated lenders (e.g.,

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[12] This was earlier experienced in Bolivia where it was seen that established MFIs had been confronted with problems of multiple borrowings by their clients with the entry of aggressive competitors new to microfinance that was undermining the viability of their operations. It was apparent that the pool of information available to these institutions was inadequate to determine the creditworthiness of borrowers who were engaging in this multiple borrowing. It was necessary to have credit bureaus that cover loans of all sizes and total loans outstanding, not just large loans or borrowers with past repayment problems, to detect such potential over-borrowing.

[13] A rural area in Guatemala near Lake Atitlan provides an exception where informal lenders collaborated successfully to form a voluntary credit bureau with broad coverage.

[14] Robert C. Vogel. "From Agricultural Credit to Rural Finance: In Search of a New Paradigm". Unpublished paper.

[15] According to the NCC, both houses of Congress are currently deliberating on a bill creating a credit bureau. Meanwhile, the Monetary Board of the BSP is inclined to set up an interim bureau pending passage of the bill.

credit cooperatives and NGO micro-lenders) should find it not only very attractive to participate voluntarily, but also to see the value of a reciprocal requirement to submit information to the database in order to have access.

Regulation of deposit-taking cooperatives

The main issues here are the need (a) to promote transparency and (b) later to undertake an analysis of the actual and potential role of the Cooperative Development Authority (CDA). Some years ago, an analysis of credit cooperatives by CPIP in support of the National Credit Council (NCC) found virtually no useful data available about the credit cooperative sector, neither its performance nor even its dimensions (e.g., its importance in rural areas). The CDA, tasked with both regulating and promoting credit cooperatives, had avoided the obvious conflict of interest involved in undertaking these two tasks simultaneously by choosing the more pleasant task of promoting and ignoring even the responsibility to maintain a comprehensive registry of cooperatives. The CPIP study also indicated the CDA's severe lack of capacity for regulation and supervision of credit cooperatives.

Instead of becoming ensnared in endless arguments about regulatory ideals and CDA enhancements, CPIP supported NCC by first developing a standard chart of accounts and performance indicators, with concurrence from the interested parties, and then moving toward implementation, so that informed decisions about regulation could be made based on an understanding of the dimensions of the sector.

In a process that is not yet complete it has already become clear that the potential of the credit cooperative sector cannot be ascertained without adequate and transparent data and information on governance. Effective implementation of the chart of accounts and performance indicators is a critical first step in determining the progress made to date by the credit cooperative sector and its future potential for providing rural financial services. Moreover, there can not be an appropriate regulatory framework for credit cooperatives without information on the configuration and performance of the sector.

This paper maintains that the effective implementation of the standard chart of accounts and performance indicators and the establishment of a transparent and complete registry of deposit-taking cooperatives are logical antecedents of attempts to define a new regulatory entity or restructure CDA through legislative changes[16]. Accurate information about the credit cooperative sector can lay the basis for an optimal approach to regulation, including new legislation to define either a new regulatory entity or a fully restructured CDA. However, without these advances, neither the progress made to date by the credit cooperatives nor its future potential for providing rural financial services can be ascertained[17].

After ensuring the availability of transparent and accessible information on credit cooperatives, the next step is to analyze the actual and potential role of CDA in the credit cooperative sector. Such an analysis should focus on separating fully the functions of promoting and regulating and

[16] There is a current Senate bill seeking to repeal the CDA Charter and refocus CDA's mandate toward effective regulation.

[17] NATTCO is presently conducting a survey of its membership. NCC-CPIP can collaborate with NATTCO in developing a database on all credit cooperatives in the country possibly through a survey.

that, to achieve satisfactory regulation, either a new regulatory entity would need to be formed or the CDA would need to be completely restructured and made to develop regulatory capacity[18].

Transparency of NGO operations

Prudential regulation for all types of microfinance institutions has become a major controversy in many other parts of the world, with substantial pressure to regulate all such institutions regardless of whether they take deposits from the public.[19] Many donors and some microfinance institutions themselves have been seeking such regulation. These donor agencies would like to have some other entity responsible for the task of monitoring and evaluating the microfinance institutions that they are supporting, while some microfinance institutions would like to have the added credibility that regulation can imply. However, according to international best practices as followed by most regulatory agencies and enunciated by the Bank for International Settlements in Basle, institutions that do not take deposits from the public should not be subject to prudential regulation.

The situation in the Philippines has been different, with little pressure to regulate microfinance NGOs. The NCC and BSP have maintained that so long as lenders do not take deposits from the general public, there is no clear argument that they need to be subject to prudential regulation and supervision. The NCC has already adopted a regulatory framework that specifically states that only deposit taking institutions will be under prudential regulation and supervision. However, the situation changes completely if such NGOs are in fact taking deposits6[26]. Transparency in accounting thus becomes crucial for the BSP to deal with the possibility that some NGO micro-lenders may be illegally taking deposits from the general public.

Moreover, it is better for the BSP (or some other agency) to focus supervision and needed corrective actions only on those NGO micro-lenders that are in fact taking deposits contrary to the law, rather than subjecting all NGO micro-lenders to more stringent regulatory requirements.[20]

The main issue, therefore, when it comes to NGO microfinance operations is not regulation but bringing transparency to NGOs involved in rural finance, especially in the disclosure of unauthorized deposit taking. As stated earlier, so long as lenders do not take deposits from the general public, there is no clear argument that they need to be subject to prudential regulation

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[18] Bangko Sentral ng Pilipinas might be interested in regulation and supervision of a few very large deposit-taking credit cooperatives whose adverse performance might introduce instability in the financial system. The capitalization of some of these very large credit cooperatives is even bigger than those of many tiny rural banks.

[19] For a detailed review of this debate, see Robert C. Vogel, "Regulatory and Supervisory Trends in Micro-Banking: Examining Experiences in the Philippines and in Latin America," Asia-Pacific Economic Community, July 2002.

26. In this regard, the BSP has recently called the attention of some microfinance NGOs with relatively large operations. They were warned about possible violation of the General Banking Act prohibiting non-regulated entities from collecting savings from the public.

[20] To allow NGO micro-lenders without prudential regulation or supervision to take deposits in isolated rural areas where there are no banks (or even credit cooperatives), as is sometimes suggested by donor agencies among others, could place the savings of the poor in greatest jeopardy.

and supervision. Nonetheless, transparent information is crucial in order for donors and government agencies as well as private lenders and investors to be able to make informed decisions in allocating their funds to rural lenders with greatest potential[21].

Information about the "safety and soundness" (i.e., financial performance) of non-regulated lenders includes the need to have standardized accounting in order for this information to be comparable across lenders and over time. Such information is crucial for donor agencies and government entities (e.g., LBP and DBP) as well as private lenders and investors to make informed decisions about which of these non-regulated lenders deserve funding.[22] This indicates the need for a common chart of accounts for microfinance NGOs and for transparency of information[23]. The NCC with support from CPIP has been promoting such transparency for non-regulated lenders for some time now.

The adoption of a standard chart of accounts (comparable to that used by regulated banks and by credit cooperatives) and appropriate performance indicators has two dimensions – from the "demand side" for transparent information by encouraging funding agencies (e.g., international donors and government entities such as LBP and DBP) to require standardized accounting and performance indicators for rural lenders to be eligible for funding, and from the "supply side" for transparent information by showing lenders with aspirations to expand their rural outreach the advantages of this specific approach to transparency.[24]

Dealing with systemic risks

The main challenge in rural finance is the inability of lenders to deal with systemic risks in rural areas. Typical rural lenders have not developed or found approaches to overcome the systemic risks arising from the undiversified nature of local economies. Small- small-scale farmers have tried to diversify their risks as far as possible through family members engaging in non-farm activities, including those who send remittances from Philippine cities and even from foreign countries.[25]

However, notwithstanding the diversification efforts of small-scale farmers and most other rural residents, especially low-income ones, rural areas themselves remain largely undiversified economies. In fact, the typically undiversified nature of rural areas presents a major challenge to

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[21] The Philippine Microfinance Council of the Philippines in collaboration with the NCC and CPIP has supported the implementation of standardized accounting and performance indicators for its members.

[22] Data available for NGO micro-lenders show much slower growth in rural lending than is shown by rural banks. This is due largely to the fact that many successful NGO micro-lenders convert to rural banks, facilitated not only by the relatively low capital requirement for rural banks but also because the costs of conversion have been reduced for those NGO micro-lenders that have already adopted the recommended standardized accounting and performance indicators.

[23] The NCC and CPIP have recently collaborated on the preparation of chart of accounts for credit cooperatives.

[24] Data available for NGO micro-lenders show much slower growth in rural lending than is shown by rural banks. This is due largely to the fact that some successful NGO micro-lenders convert to rural banks, facilitated not only by the relatively low capital requirement for rural banks but also because the costs of conversion have been reduced for those NGO micro-lenders that have already adopted the recommended standardized accounting and performance indicators.

[25] Two important misconceptions surrounding remittances are discussed briefly elsewhere.

most rural residents – even shopkeepers in a rural town will be adversely affected if the major product (e.g., rice) suffers a decline in price or loss of output due to adverse weather or insect pests. Thus, a rural lender does not escape this lack of diversification by lending to shopkeepers rather than to farmers.

A widespread belief is that the main challenges to be overcome in rural finance involve the differing financial products and services that are required, especially for agricultural producers. This is shown by the mistake often made by lenders unaware of key rural economic realities to offer loan products that conform to their concept of the overriding importance of a typical agricultural cycle. As a consequence, these lenders are likely to offer loans with repayment obligations deferred until harvest, that is, with significant grace periods for both principal and interest. This practice, however, ignores one of the guiding principles of successful micro-lending – the need for a lender to maintain close contact with its borrowers through frequent, albeit small, repayments, something that can readily be handled by typical small-scale but diversified farmers. Such mistaken approaches have often led to the mistaken conclusion that successful rural lending is extremely difficult if not impossible.

To ameliorate these potential negative impacts, <u>all-risk crop insurance</u> has often been proposed, especially as part of the traditional agricultural credit approach. However, where such crop insurance has been implemented the costs have typically been extremely high, in part because of the difficulties of administering large numbers of small contracts spread over wide areas, but more often because of problems of adverse selection and moral hazard.[26]

Some recent donor efforts to deal with risk in rural areas have attempted to avoid the administrative and moral hazard problems of traditional all-risk crop insurance for individual farmers by supporting the development of insurance based on weather conditions, but data requirements for the actuarial estimates necessary to price such insurance appropriately can be daunting, especially where there are a variety of microclimates.

Loan guarantee programs have also been a frequent part of the traditional agricultural credit approach to risk, and despite highly negative cost/benefit evaluations these continue to be supported by many international donor agencies.[27]

There are two basic problems that make loan guarantees unattractive as a solution to managing risks. First, starting from lending/borrowing relationship involving only the lender and the borrower, the loan guarantee adds a third party and thereby multiplies transaction costs. Moreover, these costs are not at all trivial when dealing with large numbers of small loans spread out in rural areas. Second, responsibility for loan collection is diluted by the existence of a third party. Guarantee agencies typically follow either of two paths: (1) requiring lenders to undertake all possible recovery actions, including going to court, so that in the future lenders refuse to participate in such costly (for them) programs; or (2) quickly paying all guarantee claims and thereby encouraging moral hazard behavior and soon exhausting their loan guarantee funds.

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[26] The Philippine Crop Insurance Corporation (PCIC) experience can be seen in this light. At its peak in 1991, rice and corn insurance covered around 336,000 farmers with sum insured reaching over 3 billion pesos and more than half-million hectares of crop. Crop insurance Coverage has since declined.

[27] Robert C. Vogel and Dale W Adams, "Costs and Benefits of Loan Guarantee Programs," and Michael Gudger, "Sustainability of Credit Guarantee Systems, "<u>The Financier: Analyses of Capital and Money Market Transactions</u>, February/May 1997. NCC/CPIP analytical studies have indicated a similar situation in the Philippines, and the movement of Philippine loan guarantee institutions toward providing credit rather than guarantees supports this.

The government established the Comprehensive Agriculture Loan Fund (CALF) in 1987 as a credit guarantee facility for small farmers' loans. The CALF guarantees up to 85 percent of the loan default of small farmer borrowers, with 15 percent to be absorbed by the lending bank. Several studies on the credit guarantee programs (Llanto et al. 1991; Llanto and Magno 1994) showed that this intervention scheme which sought to encourage private bank lending to small farmers did not result in more access to formal credit by small farmers, notwithstanding the intention of policymakers. Instead, banks stuck to their traditional clientele and continued to demand the traditional real estate mortgages or liquid financial instruments (e.g., government securities) as collateral.

More recently, a study done by Adams and others for NCC/CPIP study showed that there was little "additionality" (i.e., new borrowers resulting from the loan guarantee program) as lenders tended to simply put already existing borrowers under the program to collect the fees involved. Furthermore, the shifting focus of Philippine entities mandated to provide loan guarantees away from loan guarantees and toward lending provides added evidence that loan guarantees are not a useful risk management tool.

Nonetheless, there have been some successes in loan guarantees at the wholesale (or portfolio) level rather than the retail level, in which repayment by (not to) a retail lender is guaranteed. In this case, administrative (transaction) costs are not a major problem, as it is easier to evaluate only one borrower that is a financial institution rather than hundreds or even tens of thousands of retail borrowers. More importantly, the failure of a retail lender to repay loans to a wholesale lender is likely to immediately and permanently damage the reputation of the retail lender throughout the financial system. Guarantees at the wholesale level have shown notable success in Latin America, where Accion International affiliates that do not mobilize deposits have been able to expand their loan portfolios substantially by accessing funds from banks under loan guarantee arrangements, and, perhaps more importantly, have continued to access bank funds after the loan guarantee arrangement has expired.

Need for liquidity management

In finance, risks are dealt with by portfolio diversification, but for a local lender the opportunities for loan portfolio diversification are sharply limited. While a local lender has the advantage of an intimate knowledge of individual borrowers and the local economy, he faces the challenge of diversification which is likely to be reflected in difficulties in liquidity management. Thus, a local lender is likely to be left holding relatively large amounts of liquid assets and thereby curtailing local lending unless there is a reliable source of liquidity that the local lender may tap for the time when some local disaster strikes.

Successful rural banks in the Philippines often complain of excess liquidity resulting from highly successful deposit mobilization coupled with a lack of good lending opportunities.[28] In fact, the so-called lack of lending opportunities may reflect the undiversified nature of rural economies which really leads to lack of opportunities for effective loan portfolio diversification. Rural banks may thus end up holding substantial amount of liquid assets as their only way to deal with the systemic risks of the undiversified local areas where they operate.

This could, of course, be ameliorated by appropriate sources of temporary liquidity for rural banks that are facing temporary liquidity problems and not insolvency (where illiquidity is just

[28] The same may be true of successful rural credit cooperatives, but adequate information is not available to judge this.

the "tip of the insolvency iceberg"). In the Philippines, there seems to be no institution dedicated to providing this needed liquidity service – short-term loans to rural lenders that are temporarily short of liquidity but fully solvent in the longer run if this liquidity problem can be overcome.

BSP provides emergency liquidity to banks facing this kind of problem but the facility carries rather draconian conditions based on the premise that insolvency is indeed lurking (illiquidity is a symptom). On the other hand, the liquidity provided by LBP or DBP is based on refinancing loans to provide added liquidity on a longer-term basis rather than immediately on a temporary basis to confront a pending liquidity crisis due to some local emergency. While the LBP and DBP can potentially supply the needed liquidity, they are not currently geared for liquidity management but for providing wholesale term loans to private financial institutions. On the other hand, credit cooperative federations could potentially have a conflict of interest problem in supporting affiliates with temporary liquidity problem[29].

LBP or DBP or a federation of credit cooperatives could perhaps fulfill the function of providing liquidity to local lenders with temporary liquidity problems, but they must exhibit the appropriate degree of toughness in separating temporary liquidity shortages from pending insolvency.

An obvious solution to this problem of systemic risks in local areas could be to rely more heavily on nationwide financial institutions (e.g., large banks) to provide most rural loans since they have a comparative advantage in lending, at least with respect to portfolio diversification to avoid liquidity problems in times of local crises. However, providing rural loans does not seem attractive to most commercial banks[30]. More specifically, commercial bank lending in rural areas not only declined relative to their lending in urban areas and relative to local lenders but also failed to recover later even when rural deposits began to grow more rapidly than urban deposits. It appears that most nationwide commercial banks do not understand these local markets and have little expertise in delegating effectively to their rural branch offices.

Nonetheless, commercial banks may be unlikely to have many small branches in rural areas, especially isolated ones. As the data show, they have curtailed their rural lending (i.e., lending outside of Metro Manila, plus Cebu and Davao) since 1997 despite growing deposits in rural areas – which suggests that they see rural lending as excessively risky. This, in turn, may well be due to a lack of the necessary intimate knowledge of specific local areas (e.g., with rural branch managers all sent out from the head office rather than recruited locally) or a lack of effective delegation of lending decisions (e.g., branch managers have adequately high lending limits but no incentive to use them due to lack of performance payments for making large numbers of good loans).[31]

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[29] LBP claims that it is already providing emergency liquidity assistance to accredited rural banks. There is a need to investigate this more closely to determine the extent of utilization of this facility, to find out whether such assistance is able to address the problem of systemic risks in the agriculture sector, etc., in order to recommend specific measures sought by NCC.

[30] Moreover, in cases as disparate as Peru and the Philippines, commercial banks withdrew from rural lending in the late 1990s in the face of financial crises even though rural areas were in no way the source of the problem.

[31] The problem may also be, as discussed elsewhere, that these large nationwide banks had previously approached rural lending with inappropriate loan products based on an overriding focus on the agricultural cycle and a failure to appreciate the key principles of micro-lending – resulting in loan recovery problems.

There may be a need for refinancing mechanisms that can allow local financial institutions with limited geographical coverage to manage inevitable local shocks. The refinancing mechanisms should be market-based and demonstrate an ability to select for support only those local financial institutions momentarily needing liquidity but having the specialized knowledge of local conditions that provides the competitive advantage necessary for long-run sustainability. Such localized financial service providers can have a permanent advantage over rural branches of large geographically diversified financial institutions if these larger institutions cannot develop adequate information systems for monitoring and control in order to delegate effective responsibility to local managers. Nonetheless, such decentralization can be possible, as the BRI in Indonesia and the Agricultural Bank in Mongolia have demonstrated where the recently rehabilitated and privatized Agricultural Bank has been able to expand simultaneously its branch network and its profitability while reducing both administrative costs and overdue loans[32].

Governments and donors should, thus, consider creating or supporting institutions that take an appropriate approach to helping local rural lenders with their liquidity management, especially during times of local crises.

What Data for the Banking System Show

Even though I wrote the initial draft of the data section, I am not too happy with how this fits in with several really important issues, especially the decline in commercial bank lending in rural areas and the need to deal with that problem. This also relates to informal finance, which fills much of the rural finance gap, and to the SME lending gap, which informal finance does not fill but the commercial banks could. Thus I think we need to re-think the organization involving this section and the one on risks, as well as the gaps. What do you think??? **:**[33] **(One approach may be to discuss the present situation using the available data before discussing the issues as the paper has done so far, We can have this section as part of the introductory section, some sort of state of rural lending discussion)**

Data on the Philippine banking system are not as meaningful as they might be for analyzing rural finance because of a lag of two or three years in the presentation of bank data by region and by types of agricultural activities.[34] Nonetheless, BSP data on the regional distribution of the net loan portfolio of the banking system shows clearly that lending by universal and commercial banks declined even in Metro Manila (NCR) after a peak in 1997, only surpassing that peak in 2002 and thereafter in 2003 (Table 1). Outside of Metro Manila the situation is far more dramatic, as net loan portfolio of universal and commercial banks continued to decline (at the rate of 6% per annum) after they reached their highest in 1997. In fact, by 2003 only in Region XII (Central Mindanao) did loans outstanding from universal and commercial banks surpass their 1997 peak ***(Table 2).***

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[32] Vogel, ibid.

[33] For reasons discussed elsewhere, there are as yet no comparable data for credit cooperatives and microfinance NGOs. Even more important, though not surprising, is the lack of data on informal finance in rural areas, except for the surveys done by ACPC showing that far more small farmers and fisherfolk borrow from informal sources than from formal ones.

While the overall contraction of the Philippine banking system is understandable in the wake of the widespread Asian financial crisis (which, however, affected the Philippines less than most other Asian countries) the relatively greater contraction outside of Metro Manila is more difficult to understand. Sharp devaluations of local currencies clearly favor tradable goods over non-tradable ones. Recognizing that agricultural goods are largely tradable, as well as being important, if not predominant, products of rural areas, the behavior of universal and commercial banks appears somewhat difficult to understand.

On the other hand, lending by rural and cooperative banks although in much lower magnitude exhibited a positive trend. Their net loan portfolio expanded at an average rate of about 18% per annum during 1993-2003. After 1997, while lending by other banks outside of NCR declined, rural and cooperative banks increased at an annual rate of 9%. This trend can be observed in all regions outside NCR except in Southern Mindanao where loans in 2003 of rural banks and cooperative banks dropped from 2002 levels ***(Table 1 and Table 2).***

Table 1. Net Loan Portfolio of the Banking System, As of End of Periods Indicated, In Billion Pesos

Bank Group	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Ave. Annual Growth
Philippines	**535.4**	**683.7**	**942.0**	**1,330.3**	**1,719.8**	**1,567.2**	**1,642.7**	**1,644.9**	**1,636.9**	**1,779.4**	**1,947.0**	**15.0%**
Universal and Commercial Banks	479.1	605.0	836.3	1,186.8	1,546.2	1,412.6	1,485.3	1,483.9	1,459.7	1,578.9	1,726.2	14.9%
Thrift Banks	44.1	64.2	86.4	117.4	138.4	117.2	132.1	131.5	136.0	152.6	166.4	15.6%
Rural and Cooperative Banks	12.2	14.5	19.3	26.1	35.1	37.4	25.3	29.5	41.2	48.0	54.4	18.2%
National Capital Region (NCR)	**426.1**	**539.0**	**748.6**	**1,075.6**	**1,407.5**	**1,293.8**	**1,405.8**	**1,401.9**	**1,380.7**	**1,543.7**	**1,711.7**	**16.1%**
Universal and Commercial Banks	393.7	494.3	687.7	988.8	1,305.3	1,207.8	1,302.5	1,304.2	1,281.5	1,418.4	1,564.5	16.0%
Thrift Banks	32.1	44.3	60.4	86.1	101.0	84.4	102.2	95.5	96.6	121.9	142.4	17.7%
Rural and Cooperative Banks	0.3	0.4	0.6	0.8	1.2	1.6	1.1	2.2	2.5	3.4	4.8	35.0%
Outside NCR	**109.3**	**144.7**	**193.4**	**254.6**	**312.2**	**273.4**	**236.8**	**243.1**	**256.3**	**235.7**	**235.3**	**9.4%**
Universal and Commercial Banks	85.4	110.7	148.7	198.0	240.9	204.7	182.8	179.7	178.2	160.5	161.7	8.1%
Thrift Banks	12.0	19.8	26.0	31.3	37.4	32.8	29.8	36.0	39.4	30.7	24.0	10.1%
Rural and Cooperative Banks	11.9	14.1	18.7	25.3	33.9	35.9	24.2	27.4	38.7	44.5	49.6	17.5%

Source: BSP website updated as of 28January 2005

Table 2. Net Loan Portfolio of the Banking System Outside of NCR, By Bank Type, By Region
As of end of Periods Indicated, In Billion Pesos

Bank Group	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Ave Annual Growth
REGION I – Ilocos	**5.3**	**7.7**	**10.9**	**13.5**	**15.2**	**15.5**	**11.5**	**11.1**	**12.6**	**14.9**	**11.8**	**10.6%**
Universal and Commercial Banks	3.7	5.0	6.8	8.3	9.0	7.8	7.5	7.2	6.7	8.8	6.3	7.6%
Thrift Banks	0.2	1.1	1.9	2.7	2.8	4.1	1.9	1.3	2.2	2.0	0.9	60.5%
Rural and Cooperative Banks	1.4	1.6	2.2	2.6	3.4	3.5	2.1	2.6	3.7	4.2	4.6	15.1%
REGION II - Cagayan Valley	**4.6**	**5.6**	**6.5**	**9.9**	**12.8**	**11.0**	**7.8**	**7.7**	**8.6**	**9.3**	**9.8**	**10.0%**
Universal and Commercial Banks	3.8	4.7	5.3	7.9	9.9	8.1	6.0	6.6	6.3	6.6	6.9	8.0%
Thrift Banks	0.2	0.2	0.3	0.4	0.4	0.2	0.2	0.1	0.1	0.3	0.3	15.9%
Rural and Cooperative Banks	0.6	0.7	1.0	1.5	2.5	2.6	1.6	0.9	2.2	2.4	2.6	25.0%
REGION III - Central Luzon 1/	**16.6**	**21.6**	**29.1**	**37.3**	**45.1**	**38.3**	**33.9**	**32.3**	**35.8**	**36.0**	**37.6**	**9.8%**
Universal and Commercial Banks	11.7	14.8	19.1	25.1	30.6	24.8	22.2	22.1	22.3	20.6	22.6	8.2%
Thrift Banks	2.8	4.4	6.6	7.8	8.9	7.5	7.2	5.6	6.4	6.8	5.7	10.1%
Rural and Cooperative Banks	2.1	2.5	3.3	4.3	5.6	6.0	4.5	4.6	7.1	8.6	9.3	18.0%
REGION IV – Southern Tagalog 1/	**17.4**	**23.7**	**32.9**	**42.2**	**55.1**	**48.3**	**40.1**	**37.4**	**42.1**	**0.0**	**0.0**	**13.8%**
Universal and Commercial Banks	9.7	13.5	20.4	25.3	32.9	29.1	25.2	24.5	25.6	0.0	0.0	15.2%
Thrift Banks	4.6	6.3	7.2	8.9	10.0	7.3	6.3	4.0	5.2	0.0	0.0	5.2%
Rural and Cooperative Banks	3.1	3.9	5.2	7.9	12.3	12.0	8.6	8.8	11.2	0.0	0.0	20.6%
REGION IV-A - Calabarzon 1/	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**37.0**	**33.3**	**-9.8%**
Universal and Commercial Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	19.9	16.3	-18.2%
Thrift Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.6	5.6	-0.9%
Rural and Cooperative Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.5	11.5	0.5%
REGION IV-B - Mimaropa 1/	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**4.2**	**4.7**	**13.0%**
Universal and Commercial Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.8	3.2	12.0%
Thrift Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.4	17.1%
Rural and Cooperative Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.1	1.2	14.4%
REGION V – Bicol	**4.3**	**5.6**	**7.3**	**10.2**	**10.8**	**9.6**	**8.0**	**9.5**	**10.4**	**9.9**	**10.2**	**10.6%**
Universal and Commercial Banks	3.6	4.5	6.1	8.5	8.6	7.3	6.2	6.9	7.4	6.3	6.2	7.4%
Thrift Banks	0.2	0.3	0.3	0.3	0.5	0.5	0.7	0.7	0.7	0.9	0.7	14.3%
Rural and Cooperative Banks	0.5	0.8	0.9	1.4	1.6	1.8	1.2	1.9	2.3	2.7	3.4	24.6%
REGION VI – Western Visayas	**13.7**	**15.4**	**20.1**	**23.8**	**27.0**	**22.2**	**20.0**	**19.5**	**19.7**	**18.4**	**18.4**	**3.9%**
Universal and Commercial Banks	11.6	12.5	16.7	21.1	23.5	18.3	17.1	16.1	15.0	12.6	13.7	3.0%
Thrift Banks	1.0	1.9	2.1	1.3	1.7	1.9	1.9	1.7	2.2	3.2	1.8	13.6%
Rural and Cooperative Banks	1.1	1.0	1.2	1.4	1.8	2.0	1.0	1.8	2.5	2.6	2.9	14.4%
REGION VII - Central Visayas	**18.8**	**25.1**	**35.8**	**47.5**	**59.9**	**51.2**	**49.3**	**50.3**	**49.5**	**44.0**	**43.4**	**10.4%**
Universal and Commercial Banks	16.4	21.6	31.3	42.0	53.1	44.8	42.9	44.5	42.9	36.0	36.2	10.2%
Thrift Banks	1.5	2.4	3.1	3.7	5.2	4.4	5.1	4.4	4.5	5.8	4.4	14.5%
Rural and Cooperative Banks	0.9	1.1	1.4	1.8	1.6	2.0	1.4	1.4	2.1	2.3	2.8	14.1%
REGION VIII – Eastern Visayas	**2.1**	**2.9**	**3.5**	**4.9**	**5.6**	**5.1**	**4.4**	**4.4**	**4.5**	**4.8**	**5.1**	**10.4%**
Universal and Commercial Banks	1.9	2.6	3.0	4.3	4.9	4.4	3.9	3.8	3.6	3.9	3.9	9.1%
Thrift Banks	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	59.5%
Rural and Cooperative Banks	0.3	0.3	0.4	0.5	0.5	0.6	0.3	0.5	0.7	0.7	0.9	16.5%

Bank Group	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Ave Annual Growth
REGION IX – Western Mindanao	**2.4**	**3.7**	**5.0**	**6.5**	**7.2**	**6.4**	**5.0**	**6.0**	**5.2**	**5.9**	**5.8**	**11.2%**
Universal and Commercial Banks	2.2	3.3	4.5	6.2	6.8	5.7	4.5	5.2	4.4	4.8	4.6	9.8%
Thrift Banks	0.0	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	50.4%
Rural and Cooperative Banks	0.2	0.2	0.2	0.3	0.4	0.6	0.3	0.7	0.6	1.0	1.0	26.0%
REGION X – Northern Mindanao	**8.9**	**12.1**	**15.4**	**18.0**	**21.2**	**17.9**	**16.8**	**15.1**	**16.2**	**13.9**	**15.9**	**7.3%**
Universal and Commercial Banks	7.6	10.2	12.8	14.7	17.8	14.6	14.1	12.6	13.1	10.1	11.6	6.0%
Thrift Banks	0.8	1.3	1.8	2.5	2.4	2.0	1.7	1.4	1.5	1.9	1.2	8.0%
Rural and Cooperative Banks	0.5	0.6	0.7	0.7	1.0	1.4	1.0	1.1	1.7	1.9	3.1	21.9%
REGION XI - Southern Mindanao	**10.8**	**15.2**	**20.0**	**29.7**	**39.3**	**35.8**	**28.8**	**27.1**	**27.9**	**24.1**	**20.0**	**9.2%**
Universal and Commercial Banks	9.3	12.5	16.3	24.9	32.9	29.9	23.8	22.5	23.2	19.1	17.1	9.0%
Thrift Banks	0.7	1.8	2.3	3.3	4.7	4.2	3.9	3.3	2.8	2.7	1.3	15.3%
Rural and Cooperative Banks	0.7	0.9	1.4	1.5	1.7	1.8	1.1	1.4	2.0	2.2	1.5	12.6%
REGION XII - Central Mindanao	**2.0**	**3.0**	**3.6**	**3.7**	**4.3**	**4.0**	**3.6**	**2.7**	**3.2**	**3.6**	**9.6**	**24.8%**
Universal and Commercial Banks	1.7	2.7	3.3	3.4	3.7	3.4	3.2	2.2	2.4	2.7	7.7	25.3%
Thrift Banks	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.4	238.4%
Rural and Cooperative Banks	0.3	0.3	0.3	0.3	0.5	0.5	0.3	0.5	0.7	0.8	1.5	23.6%
REGION XIII - Cordillera												
Administrative Region	**1.1**	**1.5**	**2.1**	**2.7**	**2.8**	**2.6**	**2.4**	**15.0**	**15.0**	**3.1**	**3.2**	**54.3%**
Universal and Commercial Banks	1.0	1.3	1.9	2.2	2.3	2.0	1.9	1.6	1.4	1.7	1.8	8.0%
Thrift Banks	0.0	0.0	0.0	0.1	0.1	0.1	0.2	12.9	13.0	0.6	0.4	714.1%
Rural and Cooperative Banks	0.2	0.2	0.2	0.4	0.4	0.4	0.3	0.5	0.7	0.8	0.9	23.5%
REGION XIV - Autonomous												
Region of Muslim Mindanao	**1.2**	**1.4**	**1.3**	**1.8**	**2.0**	**1.8**	**1.4**	**1.3**	**1.3**	**1.3**	**0.7**	**-2.9%**
Universal and Commercial Banks	1.1	1.4	1.2	1.7	1.9	1.7	1.4	1.2	1.3	1.3	0.6	-3.4%
Thrift Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-
Rural and Cooperative Banks	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	271.7%
REGIN XV - CARAGA	**0.0**	**0.0**	**0.0**	**2.9**	**4.0**	**3.7**	**3.7**	**3.6**	**4.3**	**5.4**	**5.7**	**11.2%**
Universal and Commercial Banks	0.0	0.0	0.0	2.4	3.1	2.8	3.0	2.6	2.7	3.3	3.1	4.4%
Thrift Banks	0.0	0.0	0.0	0.0	0.3	0.3	0.4	0.3	0.4	0.4	0.4	6.5%
Rural and Cooperative Banks	0.0	0.0	0.0	0.5	0.5	0.6	0.4	0.7	1.2	1.8	2.2	30.5%

1/ Region IV (Southern Tagalog) was divided into 2 regions while Aurora Province was integrated with Central Luzon per Executive Order No. 103 dated May 17, 2002

Source: BSP Website updated as of 28January2005

Total bank deposits continued to grow throughout the country (see **Table 3**), although much more strongly in all areas outside of Metro Manila, perhaps reflecting the relatively better performance of the tradable goods produced in rural areas.

Table 3. Total Deposits of the Philippine Banking System, By Region, 1997-2003 (in Billion Pesos)

	1997	1998	1999	2000	2001	2002	2003	Annual Growth rate
NCR	1,202.61	1,319.65	1,411.22	1,430.95	1,493.65	1,569.80	1,905.91	8%
Ilocos	27.51	31.69	30.82	39.16	45.52	68	56.15	15%
Cagayan Valley	12.33	13.51	14	16.06	19.06	20.31	21.8	10%
Central Luzon	68.78	74.17	75.71	90.66	106.96	114.12	123.88	10%
Southern Tagalog	103.08	105.02	108.42	130.47	151.52			10%
Region 4A						149.71	165.74	11%
Region 4B						10.58	11.05	4%
Bicol	15.38	17.53	17.6	21.19	23.24	25.82	28.03	11%
Western Visayas	38.57	44.19	45.38	54.52	64.57	66.45	71.99	11%
Central Visayas	67.2	76.28	92.14	104.91	116.73	120.39	130.22	12%
Eastern Visayas	10.64	11.62	11.66	14.22	16.08	18.99	20.11	11%
Western Mindanao	13.33	14.82	15.99	18.98	21.41	23.29	24.5	11%
Northern Mindanao	15.42	17.58	18.56	21.14	23.98	24.92	33.95	15%
Southern Mindanao	33.19	36.06	38.8	40.28	52.69	55.31	47.06	7%
Central Mindanao	5.6	6.1	6.43	6.91	8.65	9.11	24.05	36%
CAR	12.9	14.76	14.89	19.65	23.08	22.69	24.6	12%
ARMM	5.25	5.59	5.58	6.06	7.45	7.18	2.85	-4%
CARAGA	5.92	6.24	6.76	8.18	8.91	10.7	11.66	12%
GRAND TOTAL	1,637.69	1,794.81	1,913.96	2,023.34	2,183.50	2,317.38	2,703.53	9%

Source: www.bsp.gov.ph

Note: 1. Region 4 (Southern Tagalog) was divided into 2 regions while Aurora Province was integrated with Central Luzon per Executive Order 103 dated May 17, 2001

2. No available data yet for 2004

Moreover, loans outstanding from rural banks resumed their growth throughout the country after only a couple of years, being far higher in 2003 than in 1997 in almost every region of the country. Nonetheless, because of the much larger size of the universal and commercial bank sector, the growth in rural bank lending was not enough to compensate for the decline in universal and commercial bank lending in most regions.[35] As discussed in more detail in other sections of this paper, the large Philippine commercial and universal banks with branch networks throughout the country may in fact not have learned very well how to develop loan products appropriate for rural area or to delegate effectively to rural branch offices, thereby perceiving rural loans as the most risky part of their loan portfolios which overall had been stressed by the Asian financial crisis.

[35] In the other category, thrift banks, are largely inconsequential in lending outside of Metro Manila, surpassing rural banks in loans outstanding only in Region VII (Central Visayas).

The Asian financial crisis, among other factors, has also led to some consolidation in the Philippine banking system, with shrinkage in all categories of banks in the number of banks and, for most categories, in the number of branches. The commercial bank and thrift bank categories experienced the sharpest contractions, while in number of branches the universal banks and the rural bank categories actually increased slightly.

Since 2001, the earliest year for which such data are published by the BSP (**Table 4**), the number of persons served by each bank branch has risen slightly for the country as a whole, from somewhat over 10,000 per branch to almost 11,000. Much more dramatic are the differences around the country, from about 4,000 persons served on average by branches in Metro Manila to a range of some 8,500 to over 30,000 in other regions of the country.[36]

Table 4. Bank Density Ratio: No. of persons served by each banking office, by Region

	2001	2002	2003	Sept '04	Annual Growth rate
Philippines	10,351	10736	10,892	10,905	2%
National Capital Region (NCR)	3,990	4,167	4,190	4,174	2%
Outside NCR	13,799	14,239	14,491	14,533	2%
Region 1	11,393	11,611	11,671	11,654	1%
Region 2	13,995	14,691	14,527	14,309	1%
Region 3	9,984	10,392	10,417	10,432	1%
Region 4-Southern Tagalog					
Region 4A		8,084	8,364	8,485	2%
Region 4B		19,978	20,842	21,055	3%
Region 5	23,030	23,195	23,141	23,103	0%
Region 6	16,265	16,933	17,135	17,263	2%
Region 7	11,675	11,821	12,015	12,031	1%
Region 8	29,646	32,251	32,362	31,556	2%
Region 9	28,825	29,229	30,985	30,932	2%
Region 10	13,693	13,913	12,154	12,288	-3%
Region 11	14,757	15,956	24,095	24,213	20%
Region 12	38,359	38,691	17,261	17,652	-17%
Cordillera Autonomous Region (CAR)	13,932	13,966	14,266	13,959	0%
Autonomous Region of Muslim Mindanao (ARMM)	50,518	51,332	88,248	89,285	25%
CARAGA	22,145	22,439	23,410	22,248	0%

[36] Except perhaps for Metro Manila, this makes the BSP's limits on branching somewhat difficult to rationalize, unless the purpose is to shelter banks from competition that have been stressed by the Asian financial crisis (or other factors) in order to enhance their chances for survival. As discussed elsewhere in this paper, the approach to branching supported by risk-based supervision would be to allow unlimited branching by all banks that pass "safety and soundness" tests, including adequate risk management capabilities, with only notification of the BSP required for the opening of a new branch.

Source: www.bsp.gov.ph
Note: 1. The offices include head offices, branches, sub-branches, agencies, extension offices, savings agencies, money shops/sub-offices but exclude offices located in foreign countries.
2. Southern Tagalog Region was divided into 2 Regions while Aurora Province was integrated with Central Luzon per EO # 103 May 17, 2002.

As mentioned above, loans by type of economic activity and region are not available for recent years.[37] Moreover, almost all loans for agriculture are listed either under Metro Manila or with no breakdown, making them useless to understand credit access in rural areas.[38] Data on loans granted for the production of specific crops are likewise dated, but they do indicate the predominance of rice, sugar cane and livestock (including poultry), together with an array of fruits, vegetables and root crops for which there is no further breakdown. The breakdown of these data according to the types of institutions granting the loans reveals the relatively unimportant role of government-owned banks, even though these figures include wholesale as well as retail lending.

In total loans granted, the Land Bank of the Philippines has been consistently much smaller than the total even for rural banks, although the Development Bank of the Philippines is substantially larger. While for loans granted to the agricultural sector and, within that, for agricultural production, the Land Bank is far more important that the Development Bank of the Philippines, its amounts granted for agriculture in recent years have been less than 25 percent of the amounts granted by rural banks. Commercial and universal banks, of course, show much larger amounts of loans granted to the agricultural sector and even for agricultural production, while thrift bank amounts are about equal to those of rural banks.

Statistical tables available for rural banks show some improvement in their past due loans and non-performing loans in recent years, but with loan loss reserves continuing to provide far less than adequate coverage. However, the even more problematic number is the large amount of properties acquired due to non-repayment of loans (with no significant offsetting reserves) – a number that is not only as high as non-performing loans but is also rising. This further indicates the relative unimportance of collateral, relative to cash flow and character, in making good lending decisions and, as discussed elsewhere in the paper in greater detail, the difficulties involved in the use of rural land as collateral without major changes in enforcement practices.

Main gap in rural lending

The main gap in rural (and urban) lending is the inability of rural financial institutions to undertake small enterprise lending. It is more difficult than the typical micro-lending and is a major remaining challenge. Micro-lending may not be simple, especially to a banker imbued with traditional lending practices, but its basic principles are not too complicated – a willingness to charge interest rates high enough to cover costs combined with techniques that aim at reducing transaction costs. Crucial among proven micro-lending techniques is heavy reliance on cash flow and character in lending decision, with far less attention to formal collateral coupled with recognition that cash flows include all receipts and expenditure of the family and not just of the micro-enterprise (small farm).

[37] As indicated in notes to these tables, data since 2002 are based simply on projections from prior years and thus are not useful to understand the current situation and recent changes.

[38] As suggested in an earlier note, this may reflect where loans are booked and not where they are disbursed or where the activities financed are located.

Moving up-scale from micro to small not only increases loan size but also increases risks compared to the typically well-diversified micro-enterprise situation. The small enterprise normally looms large in the cash flows of its owner-family and thus requires careful analysis of the enterprise itself (e.g., its relative efficiency, its position in the market, future prospects for the product, etc.) in addition to greater attention to formal collateral, especially in the case where loans are relatively longer term as well as larger.

All these greatly increase the total costs of making a small enterprise loan compared to a micro-loan and may even raise the costs per peso lent. Moreover, since there is as yet no innovative recipe for small enterprise lending as clear as that for micro lending,[39] most efforts have been in the direction of improving credit bureau databases and of giving greater attention to collateral options such as personal (moveable) property, including the alternative of leasing when capital equipment is important. Governments and donors could pay more attention to these as well as helping lenders focus more on cash flow and character rather than retreating to traditional collateral-based lending.

It will be useful for Philippine authorities to give such efforts a high priority, specifically improving the basis for moveable property (chattel) mortgages (e.g., improving laws and registries) as well as alternatives such as leasing and factoring that can also increase the supply of finance for small enterprises.

Major contribution of informal finance. Informal finance makes a major contribution to rural finance in the Philippines, as in many other countries (including even the United States where input suppliers, harvesting, processing and marketing agents, etc., are thought to provide as much credit for agricultural producers as the formal banking system). The survey on small farmer credit access carried out periodically by ACPC shows the predominance of informal sources of credit in the Philippines, as over 60 percent of loans are secured from informal lenders in every survey from that in 1996-7 to the most recent in 2001-2. Nonetheless, there is a tendency for the percentage of loans from formal lenders to increase. It is also possible that the predominance of informal sources would not be so great if percentages were for amounts lent rather than number of loans. In any case, the supposed lack of access to credit by agricultural producers that is based on information covering only formal sources may greatly overstate the credit access problem.

Although included among informal lenders are traders, processors, input suppliers and so forth, their relative importance is not shown, nor is the volume of loans as compared to the numbers. Furthermore, these informal credit suppliers are likely to present special opportunities for greater efficiency in lending due to their intimate knowledge of the cash flows and reliability of their agricultural producer clients. This, in turn, provides an opportunity for formal lenders to reach agricultural producers by using input suppliers, marketing agents and processors as conduits in what is now popularly referred to as "value chain" relationships.

Need to emphasize that rural finance encompasses services beyond lending, especially deposit and remittance services. The importance of deposit mobilization is already well known in that it provides a service at least as important as credit for the rural population and also provides the vast majority of funding for sustainable financial intermediaries. The growth of bank deposits in

[39] Efforts are nonetheless underway (e.g., by the USAID-funded MABS project) to disseminate new approaches to small enterprise lending that they are developing.

Philippine rural areas in recent years, in contrast to the relative stagnation in rural lending (except for rural banks), provides direct evidence of the importance of deposits in the Philippine context. In the Philippines, in Latin America and in various other parts of the world the importance of remittances has finally been recognized, not only in the foreign exchange provided but also as a major component of rural incomes.

Nonetheless, the primary role of remittances is different than is often thought, which may lead financial institutions to misplace the focus of their activities related to remittances. Remittances are not likely to end up as deposits in the accounts of recipients (for various reasons related mainly to risk, funds will normally be held by the senders until they need to be spent by the recipients). Remittances can nonetheless be used to introduce recipients to various other financial services, are likely to be an important source of fee income for financial institutions, and can also provide valuable information to the providers of remittance services (e.g. about cash flows of recipients and thus about possible lending opportunities). In addition, there are currently threats to efficient flows of remittances that are an unfortunate by-product of legitimate efforts to curtail money laundering and the financing of terrorism. These threats need to be recognized, clearly identified and dealt with.[40]

Conclusions and recommendations

The government has recognized the failure of subsidized, directed credit programs (DCPs) to provide small farmers and other small-scale borrowers access to formal credit. The government terminated the subsidized DCPs, tried to consolidate the remaining loan funds into the Agricultural Modernization Credit Financing Program (AMCFP) and asked the government financial institutions to implement the AMCFP as a wholesale lending program to address the credit financing needs of agriculture and the rural sector. There has been a significant shift in government rural finance policy: from a highly subsidized DCP approach to a market-oriented credit policy orientation through various issuances such as AFMA, EO 138, General Banking Law of 2000 and the National Strategy for Microfinance. Under the new rural finance policy framework, government financial institutions shall provide wholesale loans to private financial institutions, which shall on-lend to the end-borrowers. The government's role is to provide the enabling environment for greater private sector participation in the rural and microfinance markets. The key challenge is for the government financial institutions to work with private financial institutions in addressing the lack of access of small borrowers to formal credit.

This implies the need for special attention to the different policy and regulatory barriers that increase transaction costs and make rural lending prohibitive. Attending to the demand for a diversified range of financial products and services in rural areas is likely to require institutional diversity in rural areas (e.g., commercial banks, localized rural banks, credit cooperatives, non-profit microfinance providers, etc.) including a variety of informal arrangements such as ROSCAs and the financial services that can best be provided by agricultural processors, input suppliers and marketing agents. A primary objective of governments and donors should thus be to encourage all types of financial institutions and arrangements to compete on a "level playing field" for the various market niches that exist in rural areas.

This paper reviewed the post-reform situation in the rural financial markets. More specifically, it reported on the status of EO 138 implementation and the phase-out provisions of AFMA; examined changes in the provision of financial services in rural areas and assessed the sufficiency

[40] U.S. commercial banks are pleased to be asked to close the accounts of non-bank remittance services providers, as these competing providers can curtail the higher fees often charged by banks.

of these policy measures in making the delivery of credit to the agricultural/rural sector more effective and efficient.

The paper concludes that there has been substantial compliance with the market-based rural finance policy framework enunciated under AFMA, EO 138 and the National Strategy for Microfinance. Overall, there is greater private sector participation in rural and microfinance markets and a change in the government's approach to rural finance from direct intervention through subsidized credit programs to providing an enabling policy environment. There has been a definite improvement in the regulatory framework arising from the collaboration among BSP, NCC, and CPIP to implement risk-based supervision for banks, especially those engaged in microfinance and rural finance. Government through NCC and BSP should continue with efforts to strengthen the regulatory framework and support institutions that can address the issues identified in this paper (e.g., systemic risks and lack of diversification in rural economies).

The NCC has developed an appropriate market-based rural finance policy framework but the challenge is how to further strengthen it. The paper's discussion of various issues and gaps leads to specific measures for government action. In this respect, the paper submits the following recommendations for immediate action in the near future:

- Compliance efforts with the requirement of AFMA to terminate all agricultural subsidized credit programs should not be wasted on small programs where non-compliance is unlikely to have serious side effects, but rather can be most efficient and effective if focused where threats of new programs are perceived to be greatest. NCC, with support from CPIP, needs to continue its long-standing activities of closely monitoring relevant bills that are introduced in Congress, as well as the activities of government agencies that run counter to EO 138, AFMA and other policies that have been adopted to promote sustainable private participation in rural finance, and to bring these to the attention of the interested parties and the public in general through policy notes, workshops and support of the relevant NCC working groups.

- Trends at the Land Bank of the Philippines (LBP) and the Development Bank of the Philippines (DBP) toward wholesaling should be supported, with retailing limited to clearly defined and distinct clienteles and operated on market-based principles (e.g., no interest rate subsidies). To avoid undermining deposit mobilization, GFIs should target their wholesaling operations as much as possible toward institutions that cannot mobilize deposits (e.g., non-financial cooperatives and NGOs engaged in micro-lending) and, when wholesaling to financial institutions that can mobilize deposits (e.g., rural banks), wholesale lending rates should not discourage deposit mobilization (i.e., should not be subsidized). Regulatory conditions for GOCCs involved in financial intermediation should be strengthened (e.g., oversight by DOF, DBM and NEDA as well as SEC) or, better, made consistent with the situation for GFIs (i.e., placed under the BSP). Moreover, like GFIs, they should be encouraged to focus on wholesaling and should be brought clearly under EO 138 (i.e., no retail lending with subsidized below market interest rates).

- With the concurrence and collaboration of the BSP, undertake studies of the feasibility of allowing banks that are in full compliance with all BSP regulations, including capital adequacy, as well as showing appropriate risk management capabilities, to open branches without prior approval of the BSP but simply by notifying the BSP. Similarly, study all other branching requirements (e.g., minimum capital, security, hours of operations, etc.) with a view toward leaving such decisions with bank management for appropriately qualified banks.

- NCC and CPIP should continue to support the BSP strongly in its credit bureau database initiatives, specifically by supporting appropriate changes in relevant laws and assisting as necessary with securing appropriate technical assistance for the implementation of a comprehensive credit bureau database. NCC and BSP should likewise rally support for the passage of a bill that will establish a comprehensive credit information system in the country.

- The NCC and CPIP should continue to promote transparency for non-regulated lenders by supporting the implementation of standardized accounting and performance indicators, giving special attention to obtaining full support for transparency requirements from donor agencies and GFIs in their credit wholesaling activities. Furthermore, the status of NGO micro-lenders should be made transparent to the general public, including required external audits. One option would be to report required financial information to the Microfinance Council of the Philippines and encourage the NGO micro-lenders so reporting to display publicly some evidence of their compliance, thereby letting the general public know that other NGO micro-lenders have not complied.

- Effective implementation of the chart of accounts and performance indicators for credit cooperatives needs to be strongly promoted (including external audits), likely including large-scale technical assistance for credit cooperatives. With the transparency thereby provided, accurate information about the credit cooperative sector can lay the basis for an optimal approach to regulation, including new legislation to define either a new regulatory entity or a fully restructured CDA. Providing support to CDA before these crucial steps are taken is likely to be wasteful and may even delay an effective resolution of credit cooperative regulation.

- Localized rural financial institutions facing problems of lack of portfolio diversification typically would need sufficient liquidity to be able to deal with systemic risks. On the other hand, rural financial institutions which have successfully mobilized deposits, have excess liquidity that could be put to better use by other liquidity-constrained institutions had there been viable liquidity management mechanisms in the rural areas. Thus, there is a need to study existing institutions to analyze which, if any, could readily provide the liquidity management service required to meet systemic risks and loan diversification requirements, or determine if some new institution could better be created. Then, a program of technical support should be offered to implement the preferred option.

- Because of the decline in their rural lending and a seeming risk-averse attitude toward the rural areas, there is a need for bankers and policy makers to see examples of large nationwide banks with highly profitable rural lending operations. NCC/CPIP should thus renew earlier successful programs of foreign visits, this time focusing on visits to broadly-based banks that are successful rural lenders (e.g., the BRI's Unit Desas in Indonesia or Mongolia's Xaan (Agricultural) Bank. Afterwards, seminars could be offered to introduce techniques of effective delegation to branch managers, combined with programs of enhanced internal audit and financial controls, with possible subsequent support for technical assistance and training covering these topics.

- To make progress in filling the small lending gap, there is a need to focus efforts initially on improving options for collateral, specifically, improving the basis for moveable property (chattel) mortgages (e.g., improving laws and registries), as well as alternatives such as leasing and factoring that can also increase the supply of finance for small enterprises. Also, consider holding a conference where experts from around the world would be invited to provide brief (two page) summaries of papers that they would be willing deliver on this topic, with the best papers selected for presentation and discussion over a one or two day period.

- Rural finance is not just about providing rural clients access to credit. It also involves the provision of a variety of financial products and services such as deposit facilities, remittance, insurance and others. NCC, with support from CPIP, needs to carry out two studies: one on rural savings mobilization, at least up-dating a study that was done many years ago by the Agricultural Credit Policy Council; and the other on the potential impact of remittances on financial service providers in rural areas. In so far as possible, these studies should be done in conjunction with other Philippine agencies (e.g., the remittance study in conjunction with BSP). If the conclusions of these studies warrant (as anticipated), NCC/CPIP should proceed to disseminate the findings through the usual mechanisms (e.g., policy notes, workshops, NCC working groups, etc.) to mobilize support for the improvements in the policy environment that are identified by the studies.

- A much neglected area of rural finance is an understanding of the role of informal finance in addressing credit gaps in the rural areas. It is important to find out the extent of the complementary role between informal and formal finance. NCC, with support from CPIP, should carry out a survey of informal finance in Philippine rural areas that is adequate in depth and coverage to show more clearly the relative importance of formal and informal sources in supplying credit to agricultural producers -- and thereby identify more clearly whether there are in fact any credit supply gaps. Special attention should be given to "value chain" participants (e.g., traders, processors, input suppliers and so forth) to determine their relative importance and possible ways in which advantage can be taken of their special expertise (e.g., to provide lessons for or links with formal lenders). In so far as possible, this survey should be done in conjunction with other Philippine agencies (e.g., ACPC). If the conclusions warrant (as anticipated), NCC/CPIP should proceed to disseminate the findings through the usual mechanisms (e.g., policy notes, workshops, NCC working groups, etc.) so that policy makers can better understand credit supply gaps, if any, and rural finance participants can take advantage of innovative techniques identified by the survey.

July 28, 2005

Annex _____.
Rural Finance and Microfinance Reforms and Status of Terminated Subsidized Credit Programs[41]

1. In the seventies, the government followed a supply-driven and subsidized commodity-specific approach in agricultural lending. In the mid-eighties, the subsidized agricultural credit programs collapsed under the weight of poor loan collection and mounting arrears of small farmers and other countryside borrowers with the rural banks which were used by the government to channel credit to end-borrowers. The pressure of donors such as the World Bank

[41] The experience is amply recorded and analyzed in various studies done by the Agricultural Credit Policy Council and the Philippine Institute for Development Studies, among others. This paper draws from Gilberto M. Llanto, "Rural Finance and Developments in Philippine Rural Financial Markets: Issues and Policy Research Challenges" a study prepared for the Agricultural Credit Policy Council, January 31, 2004.

forced government to liberalize the financial markets in the 1980s. Interest rates were deregulated and the Central Bank of the Philippines gave up its development finance role. The World Bank's Agricultural Loan Fund was transferred to the Land Bank of the Philippines (LBP) and since then, the LBP has functioned as the government financial institution (GFI) tasked with delivering credit to the countryside.

2. Following reforms instituted in the financial markets in the mid-eighties, the government pursued a market-oriented agricultural credit policy. The government deregulated interest rates on deposits and loans and in 1987, terminated 20 subsidized agricultural credit programs and consolidated them into the Comprehensive Agricultural Loan Fund (CALF). The government used the CALF to encourage private banks to lend to small farmers by providing a guarantee cover of as much as 85% of the outstanding loan of the farmer-borrower. Upon loan default, the government would reimburse the private lending institution 85% of the outstanding loan (principal plus interest) of the small farmer. The Agricultural Credit Policy Council cautioned that credit guarantees were not enough to provide access to formal credit to small farmers and other small borrowers. Those borrowers would continue to face problems of access to formal credit for as long as there were economic policy biases against agriculture and rural areas and for as long as rural infrastructure and institutions remained deficient and inadequate.

3. Unfortunately, politicians and the government bureaucracy thought that creating more subsidized credit programs would solve the problem. In 1989, bowing to political pressure, the government introduced subsidized credit programs in the agriculture and non-agriculture sectors. In the non-agriculture sector, the Department of Trade and Industry created the Tulong sa Tao program with funding from donors to provide subsidized loans to small enterprises and other borrowers. The end result was the proliferation of subsidized credit programs in all sectors of the economy. By June 1998, there were nearly a hundred separate and fragmented subsidized (directed) credit programs (DCPs) more or less equally shared by the agricultural and non-agricultural sectors[42].

4. The Comprehensive Agricultural Loan Fund (CALF) failed to provide small borrowers greater access to formal credit. The government's intervention in the agricultural credit markets through the CALF did not have a significant impact on the problem of access to formal credit of small farmers/small scale borrowers. The credit guarantee schemes for the agriculture sector were found to be ineffective in increasing the flow of formal credit to small farmers based on evaluations conducted on the financial institutions' side (Llanto and others 1991) and the end-borrowers' side (Llanto and Magno 1994). The private banks used the loan guarantee offered by the government as additional security on top of the traditional collateral, e.g., real estate that they asked borrowers to provide. A hypothesis is that banks prefer to lend to their regular clientele, not the intended clients- the small farmers, believing that the government's guarantee facilities may not have adequate reserves to meet a sufficiently large claim (Esguerra 1996; Llanto and others 1991)[43].

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52. Llanto, Gilberto M. 2004. "Rural Finance and Developments in the Philippine Rural Financial Markets: Issues and Policy Research Challenges" paper prepared for the Agricultural Credit Policy Council. January 31.

[42] Llanto, Gilberto, Ma. Piedad S. Geron and Marie-Christine G. Tang. 1999. Directed Credit Programs: Issues and Framework for Reform. Manila, Philippines: Credit Policy Improvement Program, Department of Finance-National Credit Council.

[43] Llanto (January 2004) for an extensive discussion.

5. On the other hand, the subsidized, directed credit programs (DCPs) failed to achieve the desired result of providing access to formal credit by small farmers and other small-scale borrowers. Various studies by the Credit Policy Improvement Program of the National Credit Council (NCC-CPIP) in 1997 and 1998 and earlier by the Technical Board for Agricultural Credit/Agricultural Credit Policy Council documented the reasons for the failure. Those studies found out that DCPs were ineffective and inefficient. They were costly and a wasteful use of scarce government resources.

6. Thus, the government through the National Credit Council undertook a serious overhaul of the credit policies of the government in the late nineties[44]. The NCC-CPIP formulated a National Strategy for Microfinance in view of the emerging importance of microfinance in providing finance services to small scale clients, especially those who can not produce the collateral traditionally required by private banks. Congress supported the credit policy reform thrusts of the government by enacting into law the Agriculture and Fisheries and Modernization Act (AFMA) and the General Banking Law of 2000. The General Banking Law of 2000 laid the groundwork for developing an appropriate regulatory framework for the microfinance industry. To complement the credit policy reform in the AFMA, the government through the National Credit Council issued Executive Order Number 138 that terminated the subsidized directed credit programs in the non-agriculture sector and prohibited direct lending to target clients by government non-financial agencies.

7. National strategy for microfinance. The National Strategy for Microfinance provides the government's policy framework for microfinance as follows:

- Greater role of the private sector/microfinance institutions (MFIs) in the provision of financial services to small scale clients, e.g. micro-entrepreneurs, poor households;
- Enabling policy environment to facilitate private sector participation
- Market-oriented financial and credit policies
- Wholesale loans to MFIs by government financial institutions (GFIs) to private financial institutions for on-lending by the latter; and
- Prohibition to government (non-financial) line agencies to lend or implement credit guarantee programs.

8. Given this policy framework, the roles of various players in microfinance, are as follows:

- MFIs: to engage in sound, sustainable and viable microfinance intermediation;
- National Government through the National Credit Council (NCC): to provide a market-oriented financial and credit policy environment to promote efficient financial markets, and help private MFIs broaden and deepen their microfinance services;
- People's Credit and Finance Corporation (PCFC): to provide wholesale loans and technical assistance to the MFIs and support the development of innovative financial products/services for poor households/microenterprises;
- Government Financial Institutions (GFIs): to provide wholesale loans (including those sourced from foreign borrowings) to MFIs which do not have access to wholesale loans from private commercial banks;
- Commercial and other private banks: to provide wholesale funds and financial services to MFIs;

[44] With assistance from the Credit Policy Improvement Program (CPIP), a technical assistance project funded by the U.S. Agency for International Development (USAID),

- Non Governmental Organizations (NGOs): to provide technical assistance facilitating the linkage between the poor households/microenterprises and MFIs, community organizations and capacity building of the target clientele;
- Donors: to provide assistance to social preparation activities, and technical assistance that will lead to the broadening and deepening of microfinance services.

9. **General Banking Law of 2000**. The basic law that paved the way for the creation of the favorable environment for banks engaged in microfinance is the General Banking Law of 2000. The regulator, Bangko Sentral ng Pilipinas (BSP) has issued various circulars supporting the creation and strengthening of MFIs. The favorable environment has contributed to the rapid growth of outreach of MFIs as well as the strengthening of the microfinance programs of rural banks/cooperative rural banks/ microfinance-oriented banks. Credit cooperatives have a great potential in providing microfinance services to poor households. The government has taken steps to strengthen them through various projects such as development of standard chart of accounts and performance standards for cooperatives. The Cooperative Development Authority (CDA) is also being strengthened to act as an effective regulator of cooperatives. NGOs which are not regulated by any governmental body are being encouraged to observe a set of performance standards developed by the government and MFIs[45].

10. **Agriculture and Fisheries Modernization Act and EO 138.** The Agriculture and Fisheries Modernization Act (AFMA) of 1997 or RA 8435 was enacted into law which provides for, among other things, the phase out or termination of thirty-nine (39) directed credit programs (DCPs) including the CALF within a period of 4 years and the consequent consolidation of outstanding loan funds including new funds for on-lending into the Agro-Industry Modernization Credit and Financing Program (AMCFP).

11. The Agriculture and Fisheries Modernization Act (AFMA) of 1997 (RA 8435, Chapter 3) and Executive Order (EO) 138 issued in 1999 provide the policy framework for government credit/financing programs and the role of government. Key policies espoused by these legal issuances include: i) encouragement and promotion of the active participation of private banks and other financial institutions in rural/agricultural/micro financing; iii) charging market-based interest rates that would ensure recovery of costs, sustain availability of credit funds, and enhance outreach of financing to the target sector; and iv) longer grace periods for long-gestating agriculture and fisheries projects.

12. Under AFMA and EO 138, government non-financial agencies (GNFIs) are no longer allowed to implement credit programs or lend to target beneficiaries. The subsidized credit programs in the agriculture sector also known as directed credit programs or DCPs shall be terminated. The outstanding cash balances shall be pooled into the Agro-Industry Modernization Credit and Financing Program (AMCFP) and shall be turned over to government financial institutions (GFIs) which are mandated to manage and implement the AMCFP. The GFIs shall wholesale the consolidated loan funds under the AMCFP to private financial institutions which shall take care of lending directly to end-borrowers in the agriculture and rural sector.

13. Meanwhile, GNFIs and government-owned and-controlled corporations (GOCCs) engaged (or used to engage in credit delivery) are enjoined, particularly under EO 138, to focus on the provision of critical services such as rural infrastructure, as well as human and

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[45] See NCC-JBIC Pilot Study on Sustainable Microfinance for Poverty Reduction in the Philippines, a study prepared for the National Credit Council, Department of Finance, October 2004.

organizational infrastructure with end in view of making the agriculture and rural sector profitable. With respect to credit programs, GNFIs and GOCCs are directed to focus on the provision of capability building services to enhance credit delivery and undertake monitoring and evaluation particularly to make sure if targeted beneficiaries of the credit program are served.

14. The AMCFP would be the overall government credit program for the agricultural and rural sector, particularly the smallholders. AMCFP shall replace the different subsidized directed credit programs of the Department of Agriculture and consolidate credit delivery to small farmers and fisherfolk through private financial institutions. AMCFP is designed to be multi-track, multi-commodity, and basically market-driven. The Land Bank of the Philippines (LBP) and Quedan Credit and Guarantee Corporation (Quedancor) will wholesale the AMCFP funds to private financial institutions, including microfinance institutions which in turn, will on-lend to small farmers and other smallholders in the agriculture and rural sector.

15. The Development Bank of the Philippines (DBP) and in a very minor way, the Small Business Corporation, both government financial institutions, use private rural financial institutions to finance the small and medium rural enterprises. The People's Credit and Finance Corporation, a government-owned microfinance company provides microfinance loans and capacity building assistance to around microfinance institutions (MFIs)[46]. The MFIs in turn on-lend to microenterprises and poor households. Microfinance loans are mostly non-agricultural, working capital loans

16. In summary, the government has recognized the failure of subsidized, directed credit programs (DCPs) to provide small farmers and other small-scale borrowers access to formal credit. The government terminated the subsidized DCPs, tried to consolidate the remaining loan funds into the Agricultural Modernization Credit Financing Program (AMCFP) and asked the government financial institutions to implement the AMCFP as a wholesale lending program to address the credit financing needs of the agriculture and rural sector. Under the new credit policy framework, private financial institutions which receive wholesale loans from government financial institutions under the AMCFP shall on-lend to the end-borrowers. Thus, there is a significant shift in government rural finance policy: from a highly subsidized DCP approach to a market-oriented credit policy orientation through various issuances such as AFMA, EO 138, General Banking Law of 2000 and the National Strategy for Microfinance. Policy makers believed that government's role is to provide the enabling environment for greater private sector participation in the rural and microfinance credit markets. The key challenge is for the government financial institutions to work with private financial institutions in addressing the lack of access of small borrowers to formal credit.

2. Status of the termination of subsidized agricultural credit programs as mandated by AFMA and implementation of AMCFP

17. The Department of Agriculture (DA) issued Department Order No. 1 on May 3, 1999 which required all DCP implementing agencies and bureaus under DA to submit to ACPC their respective rationalization/phase-out plans, particularly the identification of possible legal and administrative impediments to the process. In compliance with the said order, the ACPC, Quedancor, the Bureau of Animal Industry, National Dairy Administration, National Agriculture

[46] As of March 31, 2004, the 196 MFI borrowers (called conduits) of PCFC have an aggregate outreach of 1,099,025 clients. See Gilberto M. Llanto, 2004. "Microfinance in the Philippines: Status, Issues and Challenges." Policy Notes Number 2004-10, Philippine Institute for Development Studies, November.

and Fishery Council and DA-Special Concerns Office submitted their plans for the phase-out of 23 of the 38 DA-DCPs.

18. However, the consolidation process of the DCPs under the DA moved at a very slow pace. There seemed to be some resistance by DCP implementers to turn over the loan funds to the AMCFP account with the Bureau of Treasury. One possible reason was the absence of guidelines and procedures for implementing the Department Order. It took two years (1998-2000) to review the legal and administrative arrangements of each DCP, to conduct consultative meetings with the DCP-implementing agencies and bureaus and to formulate rationalization/phase-out plans.

19. The government finally approved on March 11, 2003 the Department of Agriculture-Department of Finance-Department of Budget and Management Joint Circular No. 1 that spelled out the agreement among these three departments to phase out the agricultural DCPs as provided by the AFMA law. Immediately upon approval of DA-DoF-DBM Joint Circular No. 1, DA-Administrative Order No. 16 was issued and took effect on April 15, 2003, instructing all bureaus, agencies and corporations attached to the DA to implement the consolidation of the Department's DCPs into the AMCFP, and authorizing the ACPC Secretariat to undertake any and all necessary action to ensure the smooth and orderly implementation of the phase-out and turn over of the loan funds, pursuant to DA-DoF-DBM Joint Circular No. 1 of 2003.

20. While the government has put in place the necessary legal and administrative instruments (i.e., the AMCFP Implementing Guidelines, EO 138, Joint Circular No. 1 of 2003, DA Administrative Order No. 16 of 2003), the implementation of the phase out and other reforms in rural finance has been an arduous and slow task. The ACPC has to undergo protracted negotiations with the affected bureaus, agencies and corporations under the Department of Agriculture on the phase-out plans of each of these units, the consolidation of the outstanding loan funds into the AMCFP and the transfer of the management of said funds to private and government financial institutions, including viable NGOs and cooperatives/groups. The ACPC reports that some government non-financial agencies have taken a long time to summarize and consolidate their DCPs into the AMCFP. The information on outstanding funds and supporting records were not immediately made available. An important issue is the collection of outstanding DCP loan receivables. In the case of foreign-funded agricultural credit programs, that is, the European Union programs such as the Central Cordillera Agricultural Program, Upland Development Project and others, the EU delegation in the Philippines contended that it was the owner of those credit funds and thus, it resisted the consolidation of those funds to the AMCFP[47].

21. **Status of phase-out of DCPs**[48]. DCPs are defined as "credit projects, activities and programs targeted at a specific sector or sectors of the population, implemented by a government or quasi-government non-financial agency directly or indirectly through an executing agency, fund manager, administrator or conduit, and whose funding comes at least partly from government or public resources, appropriations, local or foreign grants to government, loan proceeds from any source, or which involve government guarantee." (AFMA Implementing Rules and Regulations, Rule 4.1.6).

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[47] Agricultural Credit Policy Council.

[48] The following paragraphs draw from Gilberto M. Llanto. 2005. "After DCPs, What? "**Policy Notes**, Philippine Institute for Development Studies. Draft.

22. An inventory done by ACPC on June 30, 2002 listed 38 DCPs under the Department of Agriculture with total loan funds of around P5.5 billion for consolidation into the AMCFP. Around 61% or roughly P3.4 billion of the total loan funds came from the government regular budgetary appropriations (GAA), representing fund balances of 16 credit programs of the DA implemented by the regional field units (RFUs), ACPC, Quedancor and/or Land Bank of the Philippines (LBP). Eight foreign-assisted credit programs that were identified for consolidation had total loan fund of about over P1 billion. **Table A-1** shows that most (24) of the identified DCPs already terminated as of the inventory period.

23. As of September 2004, a total of P721 million from 12 terminated DCPs have been collected and deposited at the AMCFP account with the Bureau of Treasury. ACPC efforts in rationalizing the credit programs also resulted in the conversion of loan funds into institutional capacity building funds, particularly those of the CALF-funded Integrated Rural Financing (IRF) Program implemented by the LBP and the EU-funded Central Cordillera Agricultural Program (CECAP) which ended in mid 2004. To date, ACPC continues to review loan documents and memorandums of agreement covering the remaining 'uncollected' DCP funds particularly those of credit programs implemented by the DA RFUs.

Table A-1. Loan Funds of Agricultural DCPs for Consolidation into the AMCFP, as of Inventory of June 30, 2002

	NAME OF DCP	Implementing Agency/GFI	Amount for consolidation (in P000)
A. GAA - funded terminated programs			
1	Grains Production Enhancement Program (GPEP)*	DA, LBP, Quedancor	86,507
2	Micro Credit Program/ Congressional Initiative Allocation (CIA)*	ACPC, Quedancor	24,088
3	Gintong Ani II- On Lending Program (GA II)*	DA, Quedancor	264,499
4	Gintong Ani II- on Lending Program/CIA*	ACPC	4,500
5	Rice and Corn Based Farming System – High Value Commercial Crops (RCBFS-HVCC)*	ACPC	56,760
6	Gintong Ani II/ Cooperation Program (GA)*	DA, LBP	127,460
7	Credit and Credit Guarantee Project Under the Poverty Alleviation Fund for Direct Assistance Farmers (PAFDAF)*	Quedancor	17,982
B. GAA - funded on-going programs			
8	Agricultural Competitiveness Enhancement Fund (ACEF)	DA	83,312
9	Rice and Corn Based Farming System*	Quedancor	445,600
10	Long Gestating Crop Production (LGCP)	Quedancor	30,000
11	Makamasa Corn	Quedancor	22,000
12	High Value Commercial Crops (HVCC)	Quedancor	208,568
13	Sugar Farm Modernization (SFM)	Quedancor	60,000
14	Local Government Unit (LGU)	Quedancor	74,579
15	Fisheries Integrated Livelihood Program (FILP)	Quedancor	54,580
16	DA - Banner Programs (various programs for rice, corn, high-value crops)	DA Regional Field Units	1,868,756
	SUB -TOTAL (GAA-funded DCPs)		***3,385,937***
C. CALF - funded terminated programs			
17	Agricultural Mechanization Financing Program – Fixed Assets Acquisition*	ACPC, LBP	10,000
18	Credit Cooperative Assistance Program (CCAP)*	ACPC, CoopBanks	16,689
19	Davao Livestock Development (DALID)	ACPC	10,000
20	Nueva Ecija Marketing Cooperative (NEMCOOP)	ACPC then Quedancor	35,000**
21	Grains Production Enhancement Program (GPEP)/ Expanded Cooperative Assistance Program (ExCBAP)/ Gintong Ani Program (GA)	ACPC then Quedancor	47,782**
22	Grains Production Enhancement Program (GPEP) for Cooperative Banks	ACPC then Quedancor	2,400**
23	Consolidated Terminated Programs	ACPC then Quedancor	384,009**
24	Cooperative Bank Formation Assistance Program	ACPC then Quedancor	497**
25	Micro Credit Program for the Bottom Poor	ACPC then Quedancor	4,922**
26	Development Assistance Program for Cooperatives and People Organization (DAPCOPO)*	ACPC then Quedancor	17,257**
D. CALF - funded on-going programs			

	NAME OF DCP	Implementing Agency/GFI	Amount for consolidation (in P000)
27	Integrated Rural Finance (IRF)***	ACPC, LBP	233,093
28	Innovative Financing Scheme (IFS)	ACPC, LBP	100,000
29	Ginintuang Masaganang Ani- Countryside Assistance for Rural Employment Services (GMA- CARES)	Quedancor	300,000
	SUB -TOTAL (CALF-funded DCPs)		***1,161,648***

	NAME OF DCP	Implementing Agency/GFI	Amount for consolidation (in P000)
E. Foreign - Assisted terminated DCPs			
30	Fisheries Sector Program*	ACPC, DBP, Quedancor, GFSME, PCIC	687,963
31	Development Assistance Program Cooperatives and People's Organizations	Quedancor	3,933
32	Establishment of Dairy Development Network in Selected Key Areas	National Dairy Authority	42,400
33	Catanduanes Agricultural Support Programme (CatAg)	DA then ARDCI	40,000
F. Foreign - Assisted on-going DCPs			
34	Multi Livestock Development and Livelihood Program (MLDLP)	Bureau of Animal Industry	245,800
35	Economic Self Reliance Caraballo & Southern Cordillera Agricultural Development Program (ERP-CASCADE)	DA	-
36	Central Cordillera Agricultural Program (CECAP)***	DA	11,653
37	Aurora Integrated Area Development Program (AIADP)	DA	9,044
38	Upland Development Program of Southern Mindanao (UDPSM)	DA	806
	SUB -TOTAL (Foreign-assisted DCPs)		***1,041,599***
	GRAND TOTAL		**5,589,183.96**

* DCPs consolidated into the AMCFP as of November 2004.

** Transferred to Quedancor pursuant to DA Administrative Order 10 dated June 18, 2002.

*** Credit funds have been converted to institutional capacity building (ICB) funds.

Source: Agricultural Credit Policy Council

24. **AMCFP Implementation**. Under the AFMA, DCPs shall be replaced by AMCFP, a single comprehensive government credit program, which aims to provide financing as well as cover the credit guarantee needs of the small agricultural sector. The AMCFP design approved by the ACPC Council, on 7 January 1999 and by NCC on 11 December 1998 called for government financial institutions (GFIs) to wholesale credit funds of the AMCFP to qualified private financial institutions (PFIs). PFIs shall in turn re-lend borrowed funds from the GFIs to target clients. The Land Bank of the Philippines and the Quedan Rural Credit and Guarantee Corporation (Quedancor) were the two GFIs tasked to implement the AMCFP.

25. In June 2003, Quedan Credit and Guarantee Corporation (Quedancor) obtained P300 million from AMCFP to wholesale loans in support of DA priority programs. After 15 months,

Quedancor has released a total of roughly P174 million to 33 private financial institutions, comprised of cooperatives and rural banks, in 9 regions (see **Table A-2**). There were 5,304 end-borrowers who reportedly used their loans for corn, sugarcane, rice, soybean, and other agriculture and fishery projects. It also gave a loan guarantee cover to loans amounting to P144.5 million loans provided by participating private banks to 156 small farmers

Table A-2. AMCFP: Amount of Loans Released by Quedancor, Number of Participating PFIs and End-borrowers As of September 30, 2004

REGION	No. of Participating PFIs	Amount Released (PM)	No. of end-beneficiaries
NCR*	1	25.30	91
I	1	0.08	25
II	3	6.50	580
III	1	3.00	300
IV		-	-
V		-	-
Total – Luzon	***6***	***34.88***	***996***
VI		-	
VII	5	12.50	388
VIII		-	-
Total – Visayas	***5***	***12.50***	***388***
IX	12	82.50	2,354
X	1	15.00	85
XI	1	10.00	-
XII		-	-
CARAGA	8	18.68	1,482
Total – Mindanao	***22***	***126.18***	***3,921***
GRAND TOTAL	**33**	**173.56**	**5,305**

* includes Bulacan, Cavite, Rizal and Occidental Mindoro
Source:Agricultural Credit Policy Council

26. To comply with the requirements of AFMA to provide financing to the agriculture sector, the Land Bank of the Philippines (LBP) provided loans to a growing number of clients. It had a cumulative total of around 1.3 million clients (beneficiaries) as of October 2004[49]. LBP loans under AFMA have been increasing at a nominal rate of 14% per annum and by the end of October 2004, it has granted a total of P64.7 billion of credit and technical assistance. On a yearly basis, it has released an average of about P16.1 billion of loans which benefited on average 331,733 farmers and fishers and generated 105,406 jobs (**Table A-3).**

[49] Land Bank did not report whether these are entirely new clients that were funded under the AMCFP. Some of these clients could be clients during the pre-AFMA/AMFCP period.

Table A-3. LBP AFMA Accomplishments, 2001 to 2004

	2001	2002	2003	Jan-Oct 2004	Total as of Oct 2004
Loans Granted (million pesos)	13,818	16,653	17,804	15,878	64,153
Capability Building Assistance (million pesos)	120	165	164	114	563
Number of Beneficiaries	323,940	362,810	308,450	288,476	1,283,676
Number of Jobs Generated	132,175	78,064	105,978	175,871	492,088
Loans as % of LBP portfolio*	13.0	14.8	15.5	14.3	14.4
Loans as % of priority sector loans**	34.2	29.7	27.7	29.6	29.9

*using average total LBP portfolio and total priority sector loans for 2001 and 2003
** Includes loans to farmers and fisherfolk, SMEs and micro-enterprises, agribusiness, LGU's agri-infrastructure projects, GOCC's agri-related projects, livelihood loans and environment-related projects.
Sources: Agricultural Credit Policy Council and LBP 2003 and 2002 Annual Reports.

27. AFMA loans released by LANDBANK as of October 2004 comprised at least 14% of its total loan portfolio. AFMA loans, on average, were roughly one-third of total loans to identified priority sectors composed of farmers and fisherfolk, SMEs and micro-enterprises, agribusiness, LGU's agri-infrastructure projects, GOCC's agri-related projects, livelihood loans and environment-related projects **(Table A-3).**

28. However, total loans granted to the agriculture sector pales in comparison to loans granted to other sectors. LBP loans to the agriculture and rural sector was still concentrated on low value-added rice production although livestock, high value crops and fisheries seem to be more promising in terms of value-added or contribution to domestic output. Marketing assistance loans were almost one-third of total loans granted. Post-harvest facilities and rural infrastructure loans were miniscule, with the bulk going to construction or improvement of rice mills and farm-to-market roads (**Table A-4**).

Table A-4. LBP AFMA LOAN RELEASES, by Component, 2001- 2004

	2001		2002		2003		January - October 2004		TOTAL (As of October 2004)	
	Loans Granted (PM)	Number of Benefi-ciaries	Loans Granted (PM)	Number of Benefi-ciaries	Loans Granted (PM)	Number of Benefi-ciaries	Loans Granted (PM)	Number of Benefi-ciaries	Loans Granted (PM)	Number of Benefi-ciaries
A. PRODUCTION, PROCESSING, MANUFACTURING	9,031	159,985	9,731	138,883	10,163	144,026	10,249	155,991	39,174	598,885
CROPS	5,095	99,730	5,147	94,240	5,508	103,767	3,758	71,170	19,508	368,907
a. Rice	2,039	45,488	1,991	39,493	2,280	45,898	1,524	35,033	7,834	165,912
b. Corn	274	7,586	259	7,048	248	8,493	164	3,835	945	26,962
c. HVCC	1,001	16,505	1,067	15,921	1,126	14,096	855	11,478	4,050	58,000
d. Other crops a/	1,780	30,151	1,829	31,778	1,855	35,280	1,214	20,824	6,678	118,033
LIVESTOCK	2,049	43,805	2,020	33,101	2,069	29,871	1,206	27,399	7,344	134,176
POULTRY	417	5,370	602	3,977	569	4,555	468	3,390	2,056	17,292
FISHERIES	701	5,381	863	5,750	779	4,682	485	2,905	2,829	18,718
AGRI COMMODITIES COMBINED							3,000	50,000	3,000	50,000
OTHERS b/	770	5,699	1,099	1,815	1,238	1,151	1,331	1,127	4,437	9,792
B. IRRIGATION	57	867	21	7,077	130	57	24	611	231	8,612
C. POST-HARVEST FACILITIES	62	3,094	500	6,459	602	1,858	349	1,558	1,514	12,969
D. OTHER INFRASTRUCTURE	395		156		489		278		1,317	
E. FARMERS/FISHERFOLK MARKETING ASSISTANCE SYSTEM	4,273	159,994	6,245	210,391	6,420	162,509	4,979	130,316	21,917	663,210
TOTAL (CREDIT ASSISTANCE)	13,818	323,940	16,653	362,810	17,804	308,450	15,878	288,476	64,153	1,283,676
F. CAPABILITY-BUILDING OF FARMERS AND FISHERFOLK ORGANIZATION AND LGUs (TECHNICAL ASSISTANCE)	82		165		164		114		525	

a/Sorghum, soybeans & feedgrains, abaca and other fibers, coconut, coffee and cacao, cotton, sugarcane, tobacco, etc.
b/ LBP - Agricultural services, pre harvest facilities, manufacturing/processing, other activity.
Source: Agricultural Credit Policy Council