Government Credit Program and Policies

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Introduction

On October 8, 1993, the government, together with non-government organizations and people's organizations, established the Social Pact on Credit to respond to the inability of low-income people to access formal credit. In the past, the government created a large number of subsidized, directed credit programs that have failed to provide low-income people access to formal credit. The Social Pact on Credit became part of the government's Social Reform Agenda, a broad attempt to address the problem of poverty in the country. As an initial step,the Social Pact on Credit recommended the rationalization of the government's directed credit programs[3] . Thus, President Fidel Ramos issued Administrative Order No. 86 creating the National Credit Council (NCC) with the principal task of rationalizing all directed credit programs (DCPs).

This paper has a simple objective: to present a framework for rationalizing DCPs. The framework will provide the basis for rationalization and the steps to be taken to accomplish the task. The basis for rationalization is the credit programs' performance with respect to two criteria, namely: (a) effective outreach and (b) financial sustainability. The first is an equity criterion: the government's credit programs should reach the

3 *The directed credit programs are mostly subsidized credit programs in different sectors of the economy, e.g., agriculture, small enterprises, etc.*

targeted clientele, that is, the small borrowers and savers such as small farmers, microentrepreneurs, small fisherfolk, etc. The second is an efficiency criterion. The credit programs should be self-sustaining and free from hidden or overt subsidies.

The empirical studies conducted under the Credit Policy Improvement Program (CPIP)[4] , a technical assistance project under the NCC of the Department of Finance provide the motivation for the rationalization framework and the measures to be undertaken by the government to fulfill the mandate given by Administrative Order No. 86.

The government has a major reason for creating DCPs: the desire to provide the target clientele access to formal credit. The target clientele are small-scale borrowers, e.g., small farmers and fisherfolk, microentrepreneurs, etc., who have been excluded from the formal banking system because of high transaction cost of small loans, asymmetry of information in credit markets and perception of high credit risks. Thus, the small-scale borrowers rely almost completely on informal credit to finance their various activities[5] . Through the DCPs, the government hopes to give them a better alternative to the informal moneylenders.

The CPIP studies showed that DCPs have no effective outreach, that is, they were not able to reach the intended beneficiaries and worse, they could not expand to reach those beneficiaries. This means that they will simply remain as targeted credit programs without outreach, forever dependent on periodic budgetary releases and/or injection of donor funds.

Financial sustainability is a crucial criterion of a good credit program. Unless the credit program is financially sustainable, the government faces the fiscal burden of subsidizing DCPs that never reach the intended clientele but, ironically, use substantial public sector resources. The CPIP studies showed that DCPs are not financially sustainable. Loan recovery is dismally low and the programs require huge subsidies from the government and external donors for their continuing operation. One implication is that precious resources are wasted in meaningless credit subsidies which could have been used to build more rural roads, provide basic health and nutrition services and basic education, public goods which have a proven poverty-reducing effect.

Since rationalization of the DCPs will not be an easy task because of bureaucratic resistance and political expediency, the paper provides a policy framework and recommends the steps needed to rationalize the DCPs. The paper identifies the DCPs, the legal basis for their existence and the action to be taken by the government to terminate them.

The paper has four sections. Section II discusses the government's DCPs and credit policies toward targeted sectors: agriculture, small industry and the poor. Section III summarizes the results of several studies conducted by the CPIP. Section IV presents two important criteria for the rationalization of directed credit programs, namely: (a) effective outreach and (b) financial sustainability.

4 *Conducted under the direction of Dr. Llanto and Dr. Geron.*

5 *A handful of credit-granting non-government organizations barely makes a dent in their attempt to present small-scale borrowers an alternative to traditional moneylenders.*

Government Credit Programs and Credit Policies

The basic government financial and credit policy thrust is to use the market mechanism to allocate and price financial resources as well as promote and maintain a viable and sustainable financial market. However, the government implements a number of credit policies and credit programs that tend to undermine market-oriented financial and credit policies. The inconsistency arises from a lack of appreciation of the distortions in the credit markets created by subsidized credit programs, the failure of those programs to reach the targeted clientele and the huge fiscal burden they impose on the government. The lack of appreciation is compounded by the view that somehow, the targeted sectors should receive "special treatment" because of their economic vulnerability. Thus, without realizing that credit subsidies create incentive compatibility problems on the part of credit intermediaries, e.g., banks, and borrowers, the government embarks on a costly and misdirected subsidized credit program that does not really improve the lot of the "disadvantaged" sectors and even weakens the banking system.

Directed Credit Programs

The government implemented a supply-led credit policy in the 1970s and mid-1980s that attempted to direct the flow of credit resources to targeted sectors of the population for specific purposes. Thus, the government created a number of directed credit programs (DCPs) whose funding came from sources external to the implementing institutions, such as budgetary allocation, grants or loan proceeds from bilateral or multilateral donor organizations, and whose interest rates were subsidized. The most famous example of a subsidized DCP is the Masagana-99, a rice production program of the government. Under the program, special time deposits at below market rates were made available to rural banks for lending to small farmers. While the rice production program was responsible for huge production increases, these increases were achieved at great expense to the government, and of course, the taxpayers. A substantial portion of the subsidized loans never got paid and the rural banks that participated in the government's credit programs incurred high arrears with the Central Bank of the Philippines, the government institution used to channel loan funds to rural banks. The subsidized credit programs eventually displaced efforts to mobilize deposits as the rural banks became more dependent on cheap government loan funds[6].

With the liberalization and deregulation of financial markets in the 1980s, the government removed the cap on interest rates and transferred the function of providing development finance from the Central Bank to the Land Bank of the Philippines (LBP). In 1986, the Aquino administration abolished a number of subsidized DCPs in the agricultural sector. It consolidated 20 agricultural credit programs under the Comprehensive Agricultural Loan Fund (CALF) and established a credit guarantee fund for small farmer loans. The government believed that by absorbing as much as 85 percent of the loan default risks of small-scale borrowers who could not offer the usual collateral required by banks, a credit guarantee would encourage banks to lend to these borrowers,[7] .

The Aquino administration made it a policy to abolish direct lending by government non-financial agencies. Both the Department of Agriculture and the Agricultural Credit Policy Council tried to implement this policy in the agriculture sector. However, in other sectors, other government agencies continued to implement their respective subsidized credit programs. Congress also created subsidized DCPs, which added to the proliferation of programs.

- In 1987, Executive Order (E.O.) 158 created the "Tulong sa Tao Fund" (TST). This mandated the Department of Trade and Industry (DTI) to administer the TST Fund, which was used to provide credit to microentrepreneurs that created employment and enhanced income in the rural areas. The DTI prescribed the terms and conditions of the loans provided under the TST Fund.

- In 1987, E.O. 1097 created the Technology and Livelihood Resource Center (TLRC). The E.O. mandated the TLRC to provide livelihood opportunities to low income clients. This eventually led to the creation and implementation of more subsidized DCPs.

- In November 1988, Cabinet Resolution No. 29 was passed. The Resolution contained policy guidelines for government-sponsored livelihood programs and vested on the Departments of Agriculture, Trade and Industry, Labor

6 *See Llanto, 1993.*

7 *Ibid.*

and Employment, Education, Culture and Sports and Local Government the primary responsibility for implementing livelihood programs and projects. While only the Department of Social Welfare and Development (DSWD) was allowed to engage in direct lending, the Resolution allowed the other departments to implement livelihood programs. Thus, Cabinet Resolution No. 29 created the avenue to undermine the government's own market-oriented credit and financial policy, leading to a proliferation of subsidized credit programs by the end of the term of President Aquino.

- In 1991, the Overseas Workers (OW) Fund Act (Republic Act 7111) provided for livelihood projects of overseas workers at below market rates.

- In 1991, the Local Government Code (Republic Act 7160) enabled Local Government Units (LGUs) to secure loans from any bank and lending institution for livelihood projects and other economic enterprises.

- In 1992, the Countrywide Industrialization Fund (CIF), part of the pork barrel of legislators, provided ₱30 million to ₱40 million as financial assistance to local governments. The Countryside Industrialization Fund Office, which is attached to the DTI, made all the credit decisions and fund allocation.

- In 1995, Congress enacted into law Republic Act 7882. The law mandates government financial institutions (GFIs) to provide loans to women engaged in micro and cottage enterprises at the lower of banks' prime rates or 12 percent per annum. GFIs have to earmark five percent their loan portfolio for women engaged in micro and cottage enterprises. The Bureau of Small and Medium Business Development (BSMBD) of the DTI was tasked to implement the law.

- In 1995, Republic Act 7900 created the High Value Crops Development Fund with an initial ₱1 billion funded from the Comprehensive Agricultural Loan Fund (CALF). The Fund was managed by the LBP and the Development Bank of the Philippines (DBP). Part of the Fund was to be used for the provision of low-cost credit to small farmers and farmers' cooperatives.

Interest Rate Policy

The government has adopted the policy of market-determined interest rates under the financial reforms of the early 1980s. Interest rate ceilings on deposits and loans of various maturities and rediscounts have been lifted. In line with this policy, the Central Bank of the Philippines abolished the preferential pricing of credit to specific sectors and stopped providing the rural banks special time deposits at below-market rates of interest. The Bangko Sentral ng Pilipinas[8] (BSP) has adopted the policy of allowing interest rates to move freely in the financial market. In November 1994, the BSP issued a circular lifting the ceiling on lending rates for rediscounted papers covering agricultural production, cottage and small industries and financing of working capital.

8 *In 1993, Republic Act 7653 created the Bangko Sentral ng Pilipinas to replace the bankrupt Central Bank of the Philippines.*

However, despite the deregulation and liberalization of the financial markets, recent legislation has resurrected caps on lending rates:

> The Comprehensive Agrarian Reform Law (RA 6657, 1988) provides for preferential loans to small landowners, farmers and farmers' organizations.
> The Magna Carta for Small Farmers (RA 7607, 1992) mandates that lending rates to small farmers should not exceed 75 percent of prevailing market rates, inclusive of service charges.

These laws prevent the LBP, the government financial institution tasked with providing countryside credit, from adjusting its lending rates to the prevailing market rate. Thus, LBP had to subsidize its small farmer lending with its profits from commercial lending.

> Republic Act 7900, enacted to promote high-value crops, also stipulates the provision of low-cost credit for the promotion, production, processing and distribution of high-value crops.

By the same token, a number of DCPs, especially those funded out of government appropriations and congressional pork barrel that are directly implemented by government non-financial agencies, impose interest rates that are below the prevailing market rates.

Loan Guarantee Programs

With the adoption of market-based interest rates and the termination of direct lending by government non-financial agencies under E.O. 113 (issued by the Aquino administration), the government implemented loan guarantee programs in the agricultural sector. These programs were meant to entice banks to lend their own funds to small-scale borrowers. The loan guarantee program covers as much as 85 percent of the credit risks faced by financial institutions in providing credit to small agricultural borrowers and small and medium enterprises. Theoretically, the lending institution shares the remaining 15 percent of the credit risks. When a borrower defaults on his loan, the financial institution can call on the loan guarantee program to cover the outstanding loan of the defaulting borrower. In some (rare) instances, the loan guarantee also serves as collateral substitute for clients who cannot provide the collateral traditionally demanded by banks[9] .

E.O. 113 consolidated 20 DCPs in the agricultural sector into the Comprehensive Agricultural Loan Fund (CALF). The CALF acts as a loan guarantee fund for credit extended by private banks to small agricultural borrowers. At present, there are four guarantee programs:

- The Philippine Crop Insurance Corporation (PCIC)-CALF guarantee for production and production-related loans to small farmers[10] ;
- The Quedan Rural Credit and Guarantee Corporation (QUEDANCOR)[11] guarantee for quedan financing of grains for businessmen and farmer-groups;

9 The Guarantee Fund for Small and Medium Enterprises (GFSME) pioneered the provision of a loan guarantee for small-scale borrowers who could not provide the traditional collateral.

10 Orbeta, Lopez and Adams (1997) reported that the PCIC-CALF program is no longer being implemented. It ran out of funds in 1997.

11 Formerly known as Quedan Guarantee Fund Board.

- The Guarantee Fund for Small and Medium Enterprises (GFSME) guarantee for small and medium scale agricultural and agribusiness ventures; and
- The Small Business Guarantee and Finance Corporation (SBGFC) guarantee for the same types of clients as those of the GFSME.

The CALF provides funds to each of these programs, except the SBGFC. The SBGFC was created in January 1991 with the DBP and the LBP each providing ₱1 million in capital to the corporation.

Mandated Loan Allocation

At present, two laws mandate financial institutions to allocate a certain percentage of their loan portfolio to targeted sectors. These are the Agri-Agra Law (P.D. 717) and the Magna Carta for Small Enterprises (R.A. 6977). Presidential Decree (P.D.) 717, issued by President Marcos in 1975, directed banks to allocate 25 percent of their loan funds for agricultural lending, 15 percent of which should be allotted to general agricultural lending and 10 percent for agrarian reform beneficiaries. R.A. 6977, on the other hand, mandates banks to set aside the following percentages of their loan portfolio to small enterprises: at least five percent by the end of the first year of the effectivity of the law, 10 percent from the second to the fifth year, five percent on the sixth year, and declining thereafter. On July 22, 1997, the Magna Carta for Small Enterprises was amended mandating banks to set aside for another 10 years, at least six percent of their total loan portfolio for small enterprises and at least two percent of their loan portfolio for medium enterprises.

Policy Inconsistency

Clearly, there is policy inconsistency. The government, through the BSP, has ostensibly followed market-oriented financial and credit policies. However, the government, through Congress, has, at the same time, created a large number of subsidized DCPs for political reasons. Moreover, a number of government agencies have become involved in direct lending which is not their chief mandates. Interest rates were never free to move with the prevailing market conditions and mandated loan allocation has forced banks to allocate loan funds that did not reach the intended beneficiaries.

Findings of Recent Studies of the National Credit Council's Credit Policy Improvement Program (CPIP)

To assist the NCC in its task of rationalizing DCPs, the CPIP conducted a number of policy studies that would provide the necessary information and empirical basis for the rationalization of all DCPs. Three surveys and six studies have been completed by several consultants looking into the various aspects of DCPs. Four studies are in varying stages of completion. This section reports the main findings and conclusions of the completed surveys and studies.

The attached policy reform matrix (***Annex A***) provides a summary of the findings of the studies and the surveys.

Impact of Directed Credit Programs

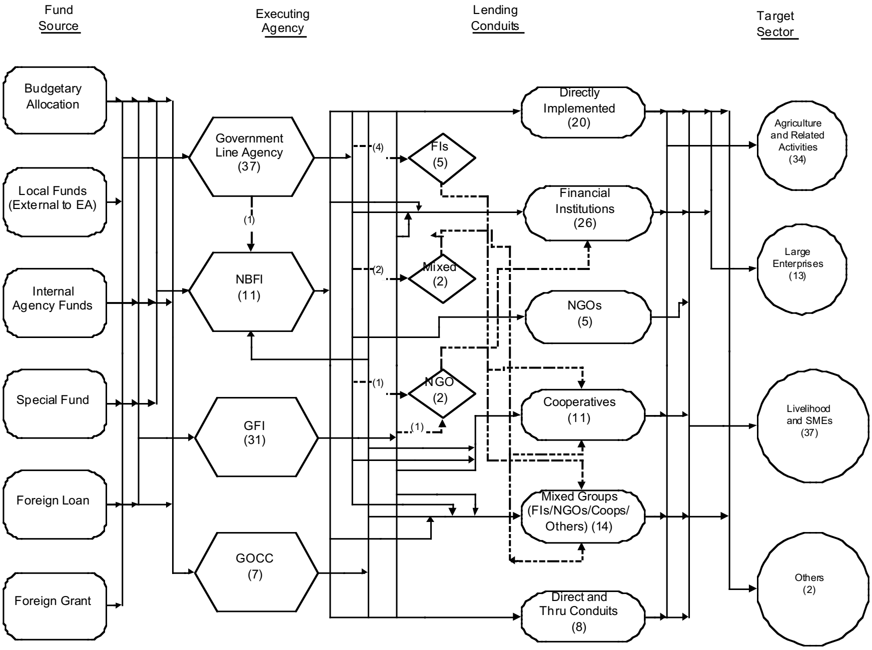
DCPs are credit programs targeted or directed toward a specific sector. Funding comes from sources external to the implementing organization. In most cases, these are either budgetary allocation, grants or loan proceeds from bilateral or multilateral donor organizations. Moreover, interest rates on DCP loans are below market rates[12] .

12 Llanto, Geron and Tang, 1997.

Llanto, Geron and Tang (1997) reported that there are currently 86 DCPs in various sectors of the economy[13] . There are 33 DCPs in the agricultural sector, 34 in industry, 15 specifically targeted at the poor, and four for salaried employees. Government non-financial institutions implement almost half of the 86 DCPs. Non-bank financial institutions implement almost 13 percent of the DCPs while government owned and controlled corporations and banking institutions implement six and 36 percent of the DCPs, respectively. The majority of DCPs source funds from budgetary allocation and donor loans and grants. In a number of cases, DCPs source funds from a combination of budgetary allocation, donor funds and internal agency funds. Limited data[14] show that initial fund allocation for 29 DCPs amounted to as much as ₱18 billion pesos. Given the fact that 86 DCPs are currently operating, one can conclude that the government has allocated and continues to allocate a very substantial amount of financial resources to reach the target clientele.

Llanto, Geron and Tang (1997) pointed out the limited outreach of DCPs. Using data from 15 reporting DCPs, the total number of clientele for the survey period 1995-1996 was only 618,443 or an average of around 40,000 beneficiaries per DCP. Average loan repayment rate was 71 percent indicating the enormous fiscal cost incurred by the government in continuing with DCPs. Llanto, Geron and Tang concluded that DCPs led to the waste of public resources, notwithstanding the valiant, but futile, attempts by civil servants to reach the target sector. ***Figure 1*** shows the complex implementation of DCPs. There are overlapping programs as well as duplication of agencies or organizations involved in these programs. The situation results in a waste of precious public sector resources.

Figure 1
Flow of Funds Chart for Directed Credit Programs



Taking the cue from the survey paper of Llanto, Geron and Tang, another study[15] evaluated the performance of 37 DCPs implemented by government non-financial agencies. Twenty-nine of the sample DCPs obtained funding from government sources while eight utilized loans or grants obtained from foreign sources such as the Asian Development Bank (ADB), the Overseas Economic Cooperation Fund (OECF)and the European Commission (EC).

13 *An earlier OECF (1995) study counted 111 government credit programs. However, it included the credit programs of the SSS and the GSIS for their members, which Llanto et. al. excluded because funding for the pension agencies' credit programs come from member contributions and not from budgetary allocation and donor funds.*

14 *Initial data provided by the agencies.*

15 *Lamberte, Casuga and Erfe, 1997.*

Overall, 10 of 31 reporting DCPs have low outreach and are inefficient. Twenty have high outreach but are inefficient. Seven are operationally efficient, that is, they are able to cover their administrative costs but not the cost of funds. None of the DCPs earns enough from lending operations to fully recover lending costs. Most of the DCPs can recover only about 50 percent of the total program costs. Credit programs funded out of congressional initiatives have low outreach and are not financially sustainable.

The government non-financial agencies are not concerned with sustainability or financial efficiency in implementing their respective DCPs. To achieve financial efficiency, these agencies would have to double the interest rate they charge on their loans or reduce operating costs. Finally, the government non-financial agencies lack the capacity to manage credit programs well. The credit programs they manage are supplementary to their primary activities or mandates.

Interest Rates and Directed Credit Programs

For implementing a plethora of DCPs, the government incurs large expenses in terms of interest rate and loan default subsidies. Llanto, Geron and Tang (1997) estimated that for 20 DCPs, subsidies amounted to ₱1.9 billion in 1996, consisting of ₱1.4 billion in interest subsidies and ₱507.3 million in loan default subsidies. The bulk of the subsidies were used to cover administrative and operating expenses and defaults on payments. Many of the end-users of the DCPs pay market interest rates but the conduits, that is, the financial institutions, cooperatives and NGOs, get the funds for on-lending at below market rates.

DCPs are burdened by large default subsidies, which indicate that many of these programs may not really be that effective in improving the lot of the poor.[16] Thus, Lim and Adams (1997) commented that overall, it remains a big question whether or not the costs generated by DCPs are commensurate to the benefits derived from them. Some estimates indicate that the entire amount of loans released through 20 reporting DCPs (₱14.4 billion in 1996) have an opportunity cost of at least ₱850 million.

DCPs also distort the financial system. Lim and Adams observed that DCPs weaken the financial system through the infusion of more costs into the system. In addition, they can discourage deposit mobilization through the presence of rediscounting facilities or loanable funds with non-market interest rates. Previous research showed the dependence of rural banks on the government's special time deposits and the subsidized rediscounting facility at the defunct Central Bank of the Philippines[17] .

Mandated Credit Programs and Financial Institutions

The government and Congress have maintained that mandating banks to set aside a certain portion of their loan portfolio for targeted sectors is an important credit policy. Thus, the Agri-Agra Law (P.D. 717) provided for loan quotas in favor of the agricultural sector and agrarian reform beneficiaries. Similarly, the Magna Carta for Small Enterprises (R.A. 6977) required banks to allocate at least five percent of their loan portfolio to small enterprises by the end of the first year of the

16 Lim and Adams, 1997.

17 Neri and Llanto, 1985.

effectivity of the law (1991), 10 percent from the end of the second year (1992) to the fifth year (1995), five percent by the end of the sixth year, and zero by the end of the seventh year. An amendment in May 1997 extended the Magna Carta to 2007 and included medium enterprises in the allocation. The amendment set aside eight percent of the loan portfolio, comprised of six percent for small and two percent for medium enterprises.

Medalla and Ravalo (1997) reported that as of March 1997, banks have provided ₱117 billion in credit to the agricultural sector. Total bank loans were, however, ₱55.2 billion short of the mandate or only 17 percent instead of the 25 percent mandated by P.D. 717. During 1975-1996, total loanable funds grew at an annual rate of 18.7 percent but agri-agra loan compliance grew only by 15.5 percent.

As of June 1997, banks have allocated 13 percent of their loan portfolio for credit to small and medium enterprises (SMEs). Medalla and Ravalo noted that while the allocation is five percent more than the mandated minimum of eight percent, about 86 percent of the allocation was in the form of "due from the Bangko Sentral ng Pilipinas" which were not actual funds lent out, but only funds set aside for future loans.

Have mandated credit programs, that is, the loan quota to agriculture, agrarian reform and small and medium enterprises, been instrumental in providing credit to the target clientele? The general finding is that thrift banks and foreign banks have lower rates of compliance with the mandated credit programs. Enforcement is weak and the penalties for compliance have not been imposed. However, it was noted that faithful compliance could have increased default costs and operating costs of banks. These costs would have been borne by depositors in terms of lower deposit rates, the banks in terms of lower profits and borrowers in terms of higher borrowing rates.

The problem with the present system of mandated credit programs is that the requirement is absolute for all types of banks. This unduly imposes an obligation on certain financial institutions that are not geared towards serving the target clientele. Banks that are weak in reaching the target clientele have the incentive to seek alternative compliance to the mandated credit program, such as the purchase of government securities in place of direct loans to agriculture and agrarian reform. Thus, Medalla and Ravalo suggested that a market-based system of compliance with the mandated credit allocation may be developed to lower the transaction costs for banks that are weak in serving the target clientele.

Under the proposed scheme, financial institutions that exceed their mandated percentages could "sell" their excess compliance to those institutions that fall short of the requirement. Banks that are able to reach the agrarian reform beneficiaries and meet more than the required credit allocation could securitize the loans, which other banks can trade in the secondary market. Proper pricing and due diligence on issuing banks could make the instruments tradable, thereby generating more liquidity in the system.

Microfinancing for the Poor

Microfinance has been considered an important tool for poverty alleviation. The experience of local microfinance institutions, that is, credit NGOs, rural banks and credit cooperatives shows its great potential for uplifting the lives of the poor. However, government non-bank institutions compete ineffectively and inefficiently with private sector microfinance institutions in providing microcredit to the poor.

Should government non-bank institutions extend microcredit to the poor? Are community-based, microcredit programs implemented by the government efficient tools for alleviating poverty? An evaluation of two microfinancing programs of two government departments suggests that government non-bank institutions should not be involved in extending credit to the poor.[18] The two programs were able to reach their target clientele, thanks to the vast network of social workers and barangay development officers in the field. Loan repayment rates ranged from 83 to 93 percent indicating good performance. However, the loans are either interest free or are given at below market interest rates which render the microfinance program unsustainable. The programs do not recover the costs of operation, administration and other costs, making them dependent on budgetary allocation and grants.

The implication is that government non-bank institutions cannot efficiently handle banking functions. They are not structured to operate like a bank. They also do not have the incentive to charge market interest rates on loans either because it is not politically feasible to do so or because they do not see the need for market-oriented lending rates since the government seems ever-ready to provide subsidies. Worse, they can easily succumb to political pressures to provide dole-outs to "constituents."

The hallmark of microenterprise finance loans is the innovative lending practices utilized to reach the clientele. The innovative practices enable microfinance institutions to provide small and unsecured (clean) loans based on informal financial information on the borrowers and on peer pressure for group loans. A microfinance institution with the appropriate screening, loan collection and monitoring techniques usually recover the loans and generate profits. However, there exist significant barriers for the use and expansion of innovative lending techniques and practices. This may apply specifically to microfinance institutions such as rural banks and cooperative banks that are supervised by the Bangko Sentral ng Pilipinas (BSP)[19] .

Barriers do exist. While the laws and BSP regulations do not prohibit small and unsecured loans, banks believe that the BSP is unclear about its views on loans supported by informal financial information. The banks believe that to engage in microlending activity brings them to operate "on the periphery of the law." They are, therefore, afraid that bank examiners would criticize them if they make such loans. The result is an inhibiting atmosphere that prevents the expansion of microfinance outreach.

Fitzgerald and others (1997) think that the current approach to bank examination in the Philippines focus too much on the primary or borrower-related risks associated with loans. There is little appreciation of secondary or product-related risks. Bank examiners do not develop risk profiles of individual products or services. They also do not formally appraise risk management systems of financial institutions. Microenterprise

18 *Gomez and Badiola, 1997.*

19 *Fitzgerald, et al. 1997.*

loans are new and different products for which bank examiners should develop risk evaluation skills and techniques. The lack of understanding of microenterprise loans both on the part of bank examiners and even the small banks themselves prevent the use of innovative lending practices that could efficiently and effectively reach the target clientele.

The lack of appropriate infrastructure for microfinance operations also poses as a barrier. To be profitable, microfinance institutions usually manage a very large portfolio of micro loans. The loan portfolio management system should track all activities related to outstanding loans, e.g., loan repayment, defaults, etc. Timely information permits the rapid identification of potentially bad loans and appropriate action on the part of both the bank examiners and financial institution. It seems that microfinance institutions have yet to develop the appropriate infrastructure for efficient microfinance operation[20] .

Loan Guarantee Programs for Small Scale Borrowers

Loan guarantee schemes have been used in the country to induce bank lending to small-scale borrowers. The schemes rest on several assumptions:[21] the credit markets are imperfect and exclude from borrowing firms and individuals that could use efficiently additional funds; banks are unwilling to provide loans to excluded borrowers because of perceived loan recovery risks arising from deficient loan collateral; and loan guarantee that covers a portion of loan recovery risks can stimulate bank lending to excluded borrowers.

The Department of Agriculture operates the Comprehensive Agricultural Loan Fund (CALF) as a loan guarantee scheme for small farmers. Quedan Corporation also implements several programs covering agricultural and fishery loans. The Guarantee Fund for Small and Medium Enterprises (GFSME) and the Small Business Guarantee and Finance Corporation (SBGFC) provide credit guarantee to small and medium enterprises.

The first comprehensive study on the impact of credit guarantee programs was done in 1991[22] . The overall conclusion was that the government's loan guarantee programs (CALF, Quedancor, GFSME) failed to stimulate banks to extend loans to excluded borrowers. The loan guarantee programs were also expensive to operate. In 1993, another assessment was conducted on the CALF. About 300 borrowers with and without CALF-guaranteed loans were studied. The finding was that there is little evidence that loan guarantees were a significant substitute for traditional forms of collateral.[23]

A survey in 1997 had more or less similar findings.[24] Loan guarantees had been ineffective in stimulating bank lending to excluded borrowers. These programs enjoy significant subsidies since operating expenses exceed loan guarantee fee receipts. For its part, the Department of Finance recommended the consolidation of some of these loan guarantee programs in 1994 to reduce duplication of programs and lower the overall costs of running these programs. This was after the Department of

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20 An earlier study called attention to this problem (Llanto, et al., 1996).

21 Adams, et al. 1998.

22 Llanto, Casuga and others, 1991.

23 Llanto and Magno, 1993.

24 Abiad, 1997.

25 De Ocampo and Navarro, 1994.

Finance noticed the proliferation of loan guarantee schemes. A 1993 study at the Department of Finance found that the government has infused some ₱5.6 billion in these programs with an average annual return on the capital invested, including guarantee fees and returns from investments, of less than three percent[25] .

The on-going study for the National Credit Council by Adams, Orbeta and Lopez has some preliminary findings. The social benefits of the loan guarantee programs appear to be negligible notwithstanding the substantial sums of money poured into the programs. The number of actual beneficiaries is miniscule compared to intended beneficiaries. The actual beneficiaries include even the unintended beneficiaries of the program, meaning those borrowers who are not excluded in the credit markets. The incentives of the programs appear perverse in the sense that guarantee institutions that earn substantial interest income from investments seem wary of expanding outreach that will expose the guarantee funds to higher loan default risks. Borrowers pay the guarantee fee to the banks. In turn, banks also benefit by transferring some of the default risks to the guarantee institutions. Finally, de-capitalization of the guarantee institutions is taking place because of low recoveries and the inadequacy of guarantee fees to cover operating and administrative costs. Only the interest earnings from the invested guarantee funds prevent the complete de-capitalization of the programs.

Toward a Policy Framework for Rationalization of Directed Credit Programs

In view of the country's experience with directed credit programs, we present in this section two criteria for rationalizing them.

Outreach and Financial Sustainability

The key policies in the credit market were implemented with the objective of providing financial resources to small borrowers in specifically identified sectors in the economy. These borrowers are those perceived to be non-bankable and therefore, do not have any access to formal sources of credit. They have been excluded from the formal credit markets for one reason or the other.

Regular banks perceive them to have high credit risks and therefore, exclude them from their list of clients. If ever banks decide to lend to them, they require tedious and cumbersome paperwork making their access to financial resources difficult and costly. Because of this, these borrowers often turn to informal sources of credit which provide them timely and convenient access to credit. The terms and conditions of the credit provided by the informal moneylender cater to the need of the small borrowers. However, moneylenders in general charge interest rates on loans that are enormously high. They also cater only to those that they know very well.

In view of this, governments have tinkered with the credit market through purposive intervention. They create and design credit programs for specifically targeted sectors. These programs are funded out of government resources either from budgetary allocation or from foreign loans or grants. In most cases, these programs are implemented by government line agencies that do not have any experience in making credit decisions. Interest rates charged on loans are also below the prevailing market rate and therefore, earnings from loans are not able to cover the costs of credit delivery, resulting in declining loanable funds over time. In most cases, repayment rates are also very low since beneficiaries often perceived these types of credit programs as dole-outs. This further contributes to the decline and eventual loss of loanable funds of a credit program. The creation of these programs therefore, has enormous fiscal implications. Given scarce government resources, the review of this type of government intervention became inevitable.

The result is a paradigm shift on the basic problem of the small borrowers' lack of access to credit resources. The new paradigm is based on the premise that the small-scale borrowers are creditworthy and that credit resources could be provided to the greatest number on a sustained basis under market principles. This can be done with appropriately designed credit products and market-oriented credit delivery mechanisms. This brings us to the two criteria of outreach and sustainability.

Outreach. The basic objective is to provide the small-scale borrowers access to credit resources. Outreach, therefore, refers to the type and number of clientele served by the credit program. It means that there should be a deliberate effort to reach the low-income clients or small-scale borrowers and to satisfy their credit demand. This is done through the design of products that caters to their specific demand and the use of appropriate lending technology[26]. Lending institutions providing this type of service should, therefore, have an intimate knowledge of the type of clientele they serve. This is necessary to be able to manage the risks that are associated with these clients and to deal with the lack of information on their economic behavior.

Average loan sizes for these types of loan clients are usually small (i.e. it starts from as low as ₱1,500 and moves to as high as ₱100,000). Likewise, because small-scale enterprises or borrowers do not have assets that can be used as collateral, loans are offered without requiring any collateral from the borrower. Instead, loan repayment schemes are designed in a manner that will encourage borrowers to pay on time. Various lending methodologies are employed to achieve this (e.g. loan repayment terms that match the household's cash flow, group lending methodology that use peer pressure to keep financial discipline among group members, etc.).

Lamberte et al (1997) formulated an outreach index (OI) which measures how well a DCP is reaching its ultimate target borrowers. The OI is computed in terms of average loan sizes and actual number of borrowers serviced compared to potential borrowers in the sector.[27] A DCP has a high level of outreach if the computed OI is equal to or greater than 1. If the computed OI is less than 1, the DCP is considered as having a low level of outreach.

26 *The credit-granting NGOs have developed effective and innovative lending techniques to reach small-scale borrowers.*

27 *See Annex 2 for the technical notes on measuring Outreach Index.*

Sustainability. To be able to reach the greatest number of target clientele, credit should be delivered on a self-sustaining basis. The credit program should be sustainable on its own terms and should not rely on artificially-priced, concessionary external funds (either from donors or from the government) which will not always be available in view of competing uses for those funds and the changing objectives of fund sources. The lending institution should cover the cost of administration and financial operations through the revenues generated from the provision of credit. To do this, self-sustaining lending institutions[28] employ efficient and effective lending methodologies. They also price their loan products according to the prevailing market conditions. This enables the lending institution to have a comfortable margin[29] that enables it to generate the surplus for expanding its operation. There is no substitute for sound and healthy financial operations to be able to effectively serve the market[30].

Sustainability of a credit program can be gleaned from the degree of efficiency of a DCP. Lamberte et al (1997, 1998) again developed the Cost Recovery Index (CRI) to measure the efficiency of a DCP. A DCP is considered cost efficient if the CRI is equal to or greater than 1; otherwise it is considered inefficient. ***Annex 2*** provides the technical notes for the Cost Recovery Index.

Table 1 presents a list of all the DCPs with the corresponding OI and CRI for each program. Results show that most of the programs implemented by government non-financial agencies have low outreach and are inefficient. On the other hand, most of the DCPs implemented by government financial institutions are able to reach their target beneficiaries and are able to recover the costs incurred in implementing the program.

The criteria of Outreach and Sustainability and their underlying principles call for minimum government intervention in providing financial resources to the small borrowers. The former paradigm of earmarking government resources as loan funds to target clientele and providing these at below market rates through government agencies is no longer appropriate. Various studies have shown that this only leads to waste of scarce government resources and failure to reach the intended beneficiaries[31] .

Thus, using the criteria of outreach and sustainability the government can now re-examine its role in the credit markets and deploy its scarce resources where the marginal benefit to society will be greater than the marginal cost to it. In this regard, government should ensure that the policy environment in which banks and other lending institutions operate, should be conducive to the efficient operation of those institutions (e.g., an appropriate regulatory and supervisory framework for microfinance). The government can also provide resources for capability building of microfinance institutions to equip them with microfinance technologies that effectively and efficiently reach target clients. Aside from sponsoring training programs

28 *Institutions providing credit to the poor using the recent paradigm are called micro-finance institutions (MFIs). In the Philippines, these are comprised of the rural banks, the micro-credit NGOs, the credit unions and the cooperative rural banks.*

29 *Various studies have shown that micro-enterpreneurs' demand for loans are interest rate inelastic. They can afford to pay relatively high interest rates because micro-enterprises have high returns on their operations.*

30 *The Microfinance Coalition composed of various parties engaged in microfinance has recently completed a set of standards for outreach and sustainability. These standards spell out the various parameters that may be used by MFI management in making sure that it is effectively providing resources to its clients in the most efficient way.*

31 *See Gilberto M. Llanto, et al., "A Study of Housing Subsidies in the Philippines," a report prepared for the Housing and Urban Development Coordinating Council, 1997 for an analysis of the incidence of the government's subsidized housing program. The beneficiaries turned out to be the non-poor members of society.*

on relevant areas, e.g. financial analysis and management, management information systems etc., the government can facilitate exchange of information and experiences among banks and lending institutions that have successfully expanded outreach in a sustainable manner. This exchange may be used as venue for encouraging greater private sector involvement in the provision of financial services to small borrowers and savers.

Conclusion and Recommendations

The foregoing discussion provides ample evidence that the implementation of directed credit programs and loan guarantee programs results in a huge waste of scarce government resources. The provision of subsidies (either interest rate subsidies or default subsidies) creates enormous fiscal burden. These policies undermine the policy thrust of promoting a viable and sustainable financial system. Moreover, these programs do not adhere to the criteria of outreach and sustainability, which will ensure that access to credit for small and marginalized borrowers are met.

In view of these findings, there is an urgent need for government to seriously consider and implement a rationalization program for DCPs. Past policy pronouncement to terminate direct lending by government non-financial agencies was not fully implemented but instead resulted in the creation of additional credit programs. This was due to the lack of a program that spells out the specific actions that need to be undertaken by concerned agencies to implement the policy. The policy pronouncement did not identify any agency or government entity that would be responsible in implementing the policy. The creation of the National Credit Council is a clear response to this inadequacy.

The Policy Reform Matrix in ***Annex 1*** recommends specific steps to be undertaken by the National Credit Council in coordination with other concerned agencies to seriously implement a rationalization program for directed credit programs. The matrix outlines four broad policy strategies that must be pursued to ensure that the implementation of DCPs is rationalized. These policy strategies are:

- Rationalization of directed credit programs. The rationalization of DCPs should consider the two criteria of outreach and sustainability. Given these criteria and the findings of the various CPIP studies, it is recommended that the government should put a stop to the creation of DCPs. Likewise, given that GFIs are able to implement DCPs more efficiently compared to GNFAs, it is recommended that all DCPs, which cannot be terminated, be transferred to the GFIs. The following plan for the rationalization of DCPs may be considered:

  The rationalization plan should take place in two phases. The first phase will have two components and should focus on the programs implemented by GNFAs. The first component is the termination of inefficient DCPs funded from the national budget. The second component is the termination or phase-out of funding for inefficient DCPs that are externally funded. Since these programs are externally funded, this component presumes a review and possible renegotiation of the bases (e.g. loan agreements, MOA, etc.) of the different credit programs before termination takes place. It is recommended that the remaining loan funds of these programs be transferred to GFIs.

The second phase will include the DCPs implemented by government financial institutions. Since most of these programs are found to be implemented more efficiently compared to those implemented by GNFAs, it is recommended that GFIs be the vehicle for the delivery of government credit programs. To reduce transaction costs of the programs, GFIs should formulate and implement modes of credit delivery that would result in efficient program operations. Hence, to encourage the participation of private financial institutions in the delivery of credit services, it is recommended that the GFIs should move towards wholesale lending. Along this line, GFIs should be enjoined to develop institutional and financial linkages in the delivery of credit services.

- Adoption of market-based interest rate. To complement the efforts on rationalization of DCPs, interest rates to be charged by the GFIs on the credit programs should at least be market-based. They should, however, move towards the adoption of interest rates that cover their full financial and operational costs.

- Rationalization of loan guarantee programs. Given the inefficiency and non-additionality of government guarantee programs, it is recommended that these programs be terminated. The huge amount of resources being channeled to these programs may instead be used to finance the much-needed infrastructure for both urban and rural-based economic activities.

- Formulation and adoption of alternative mechanisms for the delivery of credit services. As credit programs are terminated, alternative mechanisms for the delivery of credit services should be established. This includes among other things, encouraging financial institutions to use innovative lending technologies. These technologies should allow small borrowers access to credit by tailoring lending practices to the borrowers' needs. In order to encourage private financial institutions to become involved in this type of lending, the government should provide a supportive policy environment. Among other things, this includes the establishment of an appropriate regulatory and supervisory environment.

Annex 1

Policy Reform Matrix for the Rationalization of Directed Credit Programs

Policy Thrust	Result of CPIP Studies	Proposed Policy Measures to be undertaken or Actions to be done
Rationalization of Directed Credit Programs	• Llanto, et al (1997) reported that there are 86 directed credit programs in all sectors. Thirty three are in the agriculture sector, 34 are in the industry sector, 15 are for the poor, and 4 are for salaried employees. • Lamberte, et al (1997) reported that of the 37 programs implemented by the GNFAs, 10 –have low outreach indices and are inefficient. In view of this, a huge amount of fiscal resources are wasted. **Table 1** shows the summary of the indicators for the various DCPs implemented by GNFIs. The table also provides the recommended measure for each of the DCPs. • Lamberte et al (1997) also showed that government non-financial agencies have focused more on outreach than on the efficiency of the DCPs they implement. The study mentioned that the efficiency index is a better indicator of the performance of DCPs since inefficient DCPs with high outreach indices are not sustainable. These DCPs would not be able to	• Termination of budgetary allocation for DCPs created by government line agencies through Department Orders. • Consolidate DCP funds into one Fund, to be located within a GFI (e.g. LBP, DBP, PCFC). Draw up the mechanics for the transfer and consolidation. • Draft a legislative bill to rationalize the implementation and further design and formulation of DCPs. The proposed bill should have an omnibus provision that will prevent line agencies from creating DCPs. It should also have a policy statement indicating the credit policy to be adopted to establish a viable and sustainable financial market (e.g. credit funds to be consolidated in a government financial institution, e.g. LBP for agriculture, PCFC for microfinance and DBP for SMEs; the GFIs will wholesale the credit funds). Alternatives to DCPs may be identified in the proposed bill.

Annex 1 cont.

Policy Thrust	Result of CPIP Studies	Proposed Policy Measures to be undertaken or Actions to be done
	provide services to their target beneficiaries in the future since their resources would eventually dry up.	• Review the Memoranda of Agreement and Loan Agreements of existing DCPs funded from multilateral and bilateral sources. If possible, renegotiate terms by consolidating remaining funds into one fund. • As mandated in RA 3845 (Agri-Modernization Act), draft and formulate the Agriculture Modernization Credit and Financing Program (AMCFP). The program should incorporate current credit policy guidelines. Among other things, RA 3845 mandates the phase-out of all DCPs in the agriculture sector within a four-year period. The funds coming from the phased-out DCPs will be transferred to the Agri-Modernization Credit and Financing Program (AMCFP).
Adoption of market-based interest rate policy	Adams and Lim (1997) studied the interest rate subsidies that went into 20 directed credit programs (DCPs). The selected DCPs are those that have disbursed loans worth more than ₱100 million each in 1996. Interest rate subsidies were measured by	• Formulation of a policy that defines the use of market-based interest rates. Specifically, this should define the GOP pass on rate of foreign-funded credit programs implemented by government financial institutions. The rate should ensure that the risks borne by

Annex 1 cont.

Policy Thrust	Result of CPIP Studies	Proposed Policy Measures to be undertaken or Actions to be done
	comparing the interest rates used in these DCPs with the average 91-day and 182-day T-bill rates. The study reported that interest rates charged to the executing agencies are well below the market cost of funds. In most instances, DCPs have zero cost of funds, especially those funded from budgetary allocation. For the 20 programs, the study estimated interest subsidies to executing agencies amounting to ₱1.39 billion. This comprises 44.8 percent of the total interest subsidies for the 20 programs. The subsidies are mainly used to cover administrative and operating expenses, foreign exchange risk for monies derived in foreign currencies and guarantee fees that should have been paid the national government for programs funded externally. The sample programs channel credit funds to both financial (banks) and non-financial (cooperatives, NGOs, credit unions or self-help	the government are paid the appropriate premia by GFIs. The pass on rate of GFIs to participating financial institutions need not be defined since this is a bank decision. • Review and revise existing credit policy guidelines of the NCC to reflect current policy thrusts.

Annex 1 cont.

Policy Thrust	Result of CPIP Studies	Proposed Policy Measures to be undertaken or Actions to be done
	groups) institutions. The study reported that non-financial institutions get a higher amount of subsidies compared to the financial institutions. Only six of the 20 DCPs give subsidized interest rates to end-borrowers. Subsidies to end-borrowers are not very substantial due to financial liberalization and earnest moves to employ 'market rates.'	
Rationalization of Loan Guarantee Programs	In the survey of loan guarantee programs conducted by Abiad in early 1997, she reported that the existing guarantee programs (CALF, QUEDANCOR, PCIC and GFSME) incurred very high costs and did not provide any additionality. This was further substantiated by the findings of Adams and Orbeta (1998) showing that there is no additionality in lending that could be attributed to the implementation of loan guarantee programs. They also showed that with the existing structure of guarantee fees, a large percentage of the subsidies goes to the financial	• Given the requirements of the Agri-modernization Act to consolidate all guarantee programs in the agriculture sector, decide on the mechanism to be adopted for all guarantee programs, including those for SME loans. • Review the requirements of the existing system with the end view of facilitating the call on guarantee funds. The structure of fees currently being charged on guarantee programs should also be reviewed to ensure that guarantee subsidies decline over time. • Draft a legislative bill to consolidate guarantee programs and formulate the mechanics for the transfer.

Annex 1 cont.

Policy Thrust	Result of CPIP Studies	Proposed Policy Measures to be undertaken or Actions to be done
	institutions. They also noted that the borrowers pay the guarantee fees without any counterpart fee from the financial institutions.	
Expand and strengthen NCC's mandate in the formulation of savings and credit policies	Gadway (1997) identified the existence of funds from foreign sources for re-lending as one of the barriers to savings mobilization. He also mentioned a possible substitution between funds from rediscounting and funds from savings as sources of loanable funds for financial institutions.	• In view of the rationalization of DCPs, review the current mandate of the National Credit Council (NCC). Also, review the current mandate of the National Commission on Savings created through EO 364 (August 23, 1996) with the end view of merging the two instititutions. This is in light of the role of savings in the credit market. Savings policies need to be coordinated with credit policies. • Draft an executive measure that merges the NCC and the National Savings Commission as the council that would formulate the savings and credit policies in the country. In this regard, review current membership of both councils. The mandate of the proposed council should include, among other things, the formulation of consistent policies in the credit and

Policy Thrust	Result of CPIP Studies	Proposed Policy Measures to be undertaken or Actions to be done
		savings market. The proposed council should also be given the mandate to have a greater role and active participation in the Investment Coordinating Committee (ICC) and Development Budget Coordinating Committee (DBCC), especially in relation to foreign-funded credit programs.
Formulation and adoption of alternative mechanisms for the delivery of credit services	Esguerra and Lapar (forthcoming, 1998). Results of this study are expected to identify among other things, existing weaknesses and capability building needs of the various microfinance institutions. Arbuckle, Bhagwani et al reported that deposit-taking cooperatives have increased in number over the years. Credit cooperatives were observed to be viable alternatives in providing financial services to the basic sector. The study, however, found that these organizations are not being effectively supervised nor regulated. While the Cooperative Development Authority (CDA) is legally mandated to regulate	• Review and revise, if necessary, existing regulatory and supervisory measures that impede financial institutions from providing credit to the beneficiaries of DCPs (e.g. farmers, SMEs and microenterpreneurs) • Strengthen the role of the CDA in the regulation and supervision of deposit taking cooperatives • Formulate appropriate measures that would encourage savings mobilization as source of funds for financial institutions. • Provision of capability–building services to private and microfinance institutions to enable them to effectively deliver financial services to

Annex 1 cont.

Policy Thrust	Result of CPIP Studies	Proposed Policy Measures to be undertaken or Actions to be done
	them, the study found that uniform and consistent standards are not being applied to credit cooperatives and other deposit taking cooperatives. The study also reported that the regulatory and supervisory function of the CDA runs in conflict with its developmental function. In view of these, the study recommends that the CDA should ➢ focus on its supervision and regulation functions and delegate its developmental function to federations ➢ discontinue credit programs to cooperatives because of the conflicting objectives of regulation and credit extension ➢ initiate the reengineering of CDA's structure and processes to effectively carry out its regulatory function	their clients in a viable and sustainable manner. In this regard, the implementation mechanics for the use of the People's Development Trust Fund (PDTF) identified in the Poverty Act should be formulated. Accreditation criteria for availment from the PDTF should also be formulated. The standards being developed under the Developing Performance Standards Project of the USAID may be used as basis in formulating the accreditation criteria.

Annex 2

Notes on Computing Outreach Index (OI) and Cost Recovery Index (CRI)[1]

A. OUTREACH

Outreach is measured as a weighted average of two indices, namely: the reaching the target borrowers index (RTBI), which is the ratio of average loan size of the target sector as reported by other studies to the average loan size of the DCP being examined; and the credit extension index (CEI), which is the ratio of actual number of borrowers of a DCP in a given period to the potential number of borrowers that a DCP could reach given its limited resources. That is,

Outreach Index (OI) = w_1 RTBI + w_2 CEI

Where

RTBI = average loan in sector / average loan size;
CEI = no. of borrowers / no. of potential borrowers; and
w_1 w_2 = weights.

An RTBI > 1 implies that the DCP concerned is reaching its ultimate target borrowers because the average size of its loans is less than the average size of the loans of the basic sector the DCP is targeting. Conversely, if the RTBI < 1, then the DCP is not reaching its target borrowers because its average loan size is greater than the average loan size of the sector being targeted.

1 *Taken from Lamberte, et. al., "Assessment of the Role and Performance of Government Non-Financial Agencies in Implementing Directed Credit Programs," A report submitted to the Credit Policy Improvement Program, December 1997.*

Meanwhile, a CEI >1 implies that the DCP concerned is reaching the potential number of borrowers given its limited resources. Conversely, if CEI < 1, then the DCP is said to be servicing a number of borrowers below the potential number of borrowers that it could have reached, given its limited resources. Potential borrowers (PB) is computed as PB = [(total amount of loanable funds / average loan in sector) x 12/average loan maturity] for loan programs whose loans mature in less than one year; otherwise, the last term is dropped.

Giving equal weights to the RTBI and CEI (i.e., $w_1 = w_2 = 0.5$) and adding them will yield the DCP's outreach index (OI). A DCP is considered effective or having a high level of outreach if the computed OI is equal to or greater than 1; it is characterized as having a low outreach if the computed OI is less than 1.

B. EFFICIENCY

The CRI is defined as the ratio of income from lending to the total costs of lending. A CRI that is equal to or greater than 1 indicates that the DCP being investigated is efficient; otherwise, it is inefficient. An efficient DCP must, at the very least, recover its total costs. If the DCP recovers only its administrative cost and risk-induced cost, then it is considered only operationally efficient. The components of the CRI are further defined below.

Income from Lending

Income or revenue from lending refers to interest earnings and other fees earned by a DCP for extending loans to its borrowers. For each DCP, the study present two types of earnings in terms of interest rates. One, is the nominal effective interest rate on loans, which is equal to the unit price of the loan or the income per peso of loans outstanding. Computationally, this is equal to income from lending divided by the average loans outstanding during the period. The other is the posted interest rate, i.e., the interest rate charged by a DCP on its borrowers as announced by the GFI.

Total Costs of Lending

The components of total costs of lending are: administrative cost; risk-induced cost; cost of borrowed funds; and cost of equity capital.

Administrative Cost

Administrative cost refers to the direct cost in cash incurred by the GFI or GOCC in administering a DCP. This includes salaries and other benefits paid to full-time and part-time officers and staff of the DCP, maintenance and other operating expenses, depreciation allowance for equipment, training and seminar costs in case the credit program explicitly incorporates this activity in credit extension, and other administrative costs. The administrative cost by the average loans outstanding for the period.

Risk-Induced Cost

Risk-induced cost refers to the cost arising from loan losses that can be allocated to the period being examined. This can be measured in terms of the amount set aside by the GFI for possible loan losses. In the case of GOCCs which does not normally set aside an amount to cover probable loan losses, the cost of carrying out past due loans shall be used. Because loans that are past due forego some interest earnings, then the cost of carrying out past due loans is equal to the actual amount of past due loans multiplied by the lending rate. To convert the risk-induced cost into a unit cost, the risk-induced cost is divided by the average loans outstanding for the period being examined.

Cost of Borrowed Funds

Cost of borrowed funds refers to the actual interest expense and other fees including commitment fees, guarantee fees and foreign exchange risks, incurred by the GFI for funds borrowed from various sources to finance or augment the resources of a particular DCP. The unit cost of the borrowed funds is obtained by diving the interest expense and other fees on borrowed funds by the total amount borrowed.

Cost of Equity Capital

The cost of equity capital has three components. The first is the equity capital put up by the GFI for the DCP; that is, funds given or donated by the government or external donors to the DCP being implemented by the GFI for on-lending purposes. This is equivalent to program funds. (If program funds include an amount to cover administrative cost and other costs, then such program funds were adjusted to exclude these costs.) The second component includes all interest-free borrowed funds from any source for the DCP. The third component is the in-kind donations such as salaries for personnel and consultants, office space/rental, equipment, vehicles and others, received by the GFI for implementing the DCP.

There are two possible measures of the cost of equity capital. One is that the cost of equity capital may be set to the inflation rate of the period being considered, the reason being that the DCP concerned must always protect the real value of its equity capital. Alternatively, it may be equated to the annual average treasury bill (T-bill) rate. The inflation rate or T-bill rate immediately gives us an idea of the unit cost of equity capital.

Table 1
Summary Table of Twenty Credit Programs

GNFAs/ PROGRAM	IMPLEMENTING AGENCY	OI	AVE CRI	LEGAL BASIS	FUND SOURCE
Agriculture					
1. LBP 5-25-70 Countryside Partnership Financing Scheme	DAR	–	–	MOA	Budgetary Allocation + Internal LBP Fund
2. CARP-barangay marketing Center (CARP-BMC)	DAR	1.97	0.22	RA 7393	Budgetary Allocation
3. DAR-KMI Peasant Development Fund	DAR	1.63	0.07	MOA	Budgetary Allocation + Internal DBP Funds
4. DBP-DAR Financing Program for ARBs	DAR	2.10	0.00	MOA	Budgetary allocation
5. Integrated Rural Financing (IRF) Program	DA-ACPC	0.72	0.21	EO 116	Special Fund

RECOMMENDATION	MAJOR IMPEDIMENT	ACTION NEEDED	INTERIM MEASURE
Transfer credit component to LBP; DAR to continue providing TA to ARBs	MOA between DAR and LBP on cost-sharing	DAR to amend MOA to effect full transfer of program/ funds to LBP	Continue the CPS scheme until revised MOA on full transfer of program to LBP is drawn
Transfer credit component to LBP; DAR and Quedancor to provide TA	MOA between DAR and Quedancor indicating a 15 year program duration starting 1994	DAT to forge MOA to effect transfer of program's credit component to LBP	Quedancor to continue implementing the program pending evaluation of its performance; identify measures to fast-track loan recovery/collection
Transfer credit component to DBP; DAR to focus on provision of TA to ARBs	MOAs between DAR, KMI and DBP which provides for the release of a total of P104M to KMI from the Peasant Development Fund appropriated through DAR	DAR and KMI to amend MOA to effect full transfer of program to DBP	DBP to expedite utilization of P32.4M from the PDF which it administers together with KMI; KMI to continue implementing program to use up the P24M directly allocated to them for ARBs; Discontinue further fund releases to KMI
Transfer credit component to DBP; DAR to focus on provision of TA to ARBs	MOA between DAR and DBP	DAR to amend MOA to effect full transfer of program to DBP	DAR to continue implementing program as per existing MOA until full turnover of program to DBP is effected
Transfer to LBP	MOA between DA and LBP signed effecting the extension of the program up to year 2001	DA to amend MOA to effect full transfer of program	Continue present arrangement until full transfer is effected

Table 1 cont.

GNFAs/ PROGRAM	IMPLEMENTING AGENCY	OI	AVE CRI	LEGAL BASIS	FUND SOURCE
6. Development Assistance Program for Cooperatives and People's Organization (DAPCOPO)	DA-ACPC	12.74	0.19	MOA W/ ACPC	Special Fund
7. Expanded Cooperative Bank (CoopBank) Assistance Program	DA-ACPC	1.38	0.37	EO 116, Magna Carta for Small Farmers	Special Fund
8. Fisheries Sector Program (FSP)	DA-ACPC	1.13	0.34	DO/EO 116	–
9. Gintong Ani Program (GEP IV)- formerly, GPEP	DA-ACPC	3.41	0.00	EO 113, RA 7607, MOA	–
10. LBP/ACPC 5-25-70 Country Partnership Scheme (CPS)	DA-ACPC	2.05	0.00	MOA	–
11. Multi-Livestock Development Loan Program (MLDLP)	DA-BAI	1.61	0.16	DO	–
12. Central Cordillera Agricultural Program (CECAP)	DA-PMO/SCO	2.17	0.15	Financing Agreement with EEC	–
13. Earthquake Rehabilitation Program (ERP)	DA-PMO/SCO	–	–	Loan Agreement	–

RECOMMENDATION	MAJOR IMPEDIMENT	ACTION NEEDED	INTERIM MEASURE
Discontinue		This has been turned over to Quedancor. May need to evaluate QuedanCor's performance	
Transfer to LBP	As directed by the DA Secretary, this program will end in 1998		
Transfer to LBP and DBP	ACPC assigned by DA as fund manager; MOA between ACPC and GFIs signed to take effect up to year 2000	DA to revise MOA for full transfer of program to LBP	Continue present arrangement until transfer is effected
Transfer to LBP		DA to issue an administrative order and forge MOA to effect full transfer of credit component to LBP	Continue present arrangement until transfer is effected
Transfer to LBP	MOA between DA and LBP on co-sharing scheme	DA to amend MOA to effect full transfer of program to LBP	Continue present arrangement until transfer is effected
Transfer credit component to LBP		DA to forge MOA with LBP	
Transfer to LBP	MOA with EEC	DA to forge MOA with LBP on transfer of program; revise MOA with EEC	DA to coordinate with LBP; initiate renegotiation with EEC through NEDA; and draft new guidelines on credit component
Transfer to LBP	MOA with EEC	DA to forge MOA with LBP; revise MOA with EEC	DA to coordinate with LBP; initiate renegotiation with EEC through

Table 1 cont.

GNFAs/ PROGRAM	IMPLEMENTING AGENCY	OI	AVE CRI	LEGAL BASIS	FUND SOURCE
14. Southern Mindanao Agricultural Program (SMAP)	DA-PMO/SCO	1.1	0.06	MOA bet. RP, DA & EEC	–
15. Livelihood Enhancement for Agricultural Development (LEAD) 2000	DA-NAFC	1.97	0.00	EO	–
16. Cooperative Marketing Project (CMP)	CDA	0.57	0.32	RA 6938 RA 6939	–
17. Cooperative Support Fund (CSF)	CDA	8.13	0.12	RA 6939	–
18. Countrywide Development Funds (CDF)/Countryside Initiative Allocation (CIA) for Cooperative Development	CDA	0.51	0.23	RA 8174	
Salaried					
1. Workers Entrepreneurship Program (WEP)	DOLE-BLR	0.98	0.09	Department Order No. 26	Budgetary Allocation

RECOMMENDATION	MAJOR IMPEDIMENT	ACTION NEEDED	INTERIM MEASURE
			NEDA; and draft new guidelines on credit component
Transfer to LBP	MOA with EEC	DA to forge MOA with LBP; revise MOA with EEC	DA to coordinate with LBP; initiate renegotiation with EEC through NEDA; and draft new guidelines on credit component
Transfer to LBP/DBP		DA to issue and administrative order	DA/NAFC to coordinate with LBP/DBP
Discontinue		CDA to issue an administrative order terminating the program	CDA to consolidate all loan funds for cooperatives
Transfer to LBP		CDA to forge MOA with LBP	CDA to consolidate all loan funds for cooperatives
Discontinue		CDA to issue an administrative order	CDA to consolidate all loan funds for cooperatives
Discontinue credit component; BLR to focus on provision of TA to laborers/unions	None	DOLE to issue an administrative order; discontinue credit component of WODP	DOLE to identify appropriate FI which can cater to viable projects of laborers/unions

Table 1 cont.

GNFAs/ PROGRAM	IMPLEMENTING AGENCY	OI	AVE CRI	LEGAL BASIS	FUND SOURCE
2. Women Workers Entrepreneurship Development Program (WWEDP)	DOLE-BWYW	3.19	0.25	Department Order No. 26	Budgetary Allocation
Poor					
1. Micro Credit program for the Bottom Poor	DA-ACPC	1.09	0.32	EO/RA	Special Fund
2. Cooperative Development Loan Fund (CDLF)	CDA	1.96	0.55	RA 6938 RA 6939	Budgetary Allocation/ Foreign Loan/ Grant
3. Cooperative Rehabilitation and development Loan Fund (CRDLF)	CDA	3.12	0.22	RA 6939	Budgetary Allocation
4. Self-Employment Assistance - Kaunlaran Integrated Program (SEA-K)	DSWD	3.82	0.00	Section 10 RA 5416	Special Fund

RECOMMENDATION	MAJOR IMPEDIMENT	ACTION NEEDED	INTERIM MEASURE
Discontinue credit component; BWYW to provide TA to women workers	None	DOLE to issue an administrative order terminating the credit component of WODP	DOLE to forge MOA with DSWD for the integration of program with the latter's SEA-K Program; Identify appropriate FI which can cater to women's needs
Discontinue		DA to forge MOA with LBP	
Transfer to LBP		CDA to forge MOA with LBP	CDA to consolidate all loan funds for cooperatives and negotiate for its transfer to LBP
Transfer to LBP		CDA to forge MOA with LBP	CDA to consolidate all loan funds for cooperatives
Continue Level I (grant assistance) nut terminate lending operations (Levels II and III); DSWD to continue providing welfare assistance excluding credit	RA 5416 which authorizes DSWD to establish a Settlement and Revolving Fund and EO 123 "Reorganizing the MSSD into the DSWD" which authorizes it to continue the SEA program	DSWD to draft clear guidelines on grant component to support welfare program; forge MOA with appropriate FI on a financing program for disadvantaged groups, possibly using RSF as fund source; draft EO to redefine DSWD's function to exclude lending operations	SEA-K to integrate other lending programs catering to disadvantaged groups/poor in the interim; identify appropriate FI which can address needs of viable poor/disadvantaged groups; and recommend for an issuance which will amend EO 123

Table 1 cont.

GNFAs/ PROGRAM	IMPLEMENTING AGENCY	OI	AVE CRI	LEGAL BASIS	FUND SOURCE
5. Tulong sa Tao Program - Credit Program for the Poorest of the Poor (TST-CPPP)	DTI	0.27	0.27	MOA/EO	Foreign Grants
6. Tulong sa Tao Program -NGO-Microcredit Project II (TST-NGO-MCP II)	DTI	3.4	0.58	MOA/EO	Budgetary Allocation/ Foreign Loan/ Grant
7. Tulong sa Tao program - Subcontracting Financing Project (TST-Subcon)	DTI	–	–	MOA/EO	Budgetary Allocation

RECOMMENDATION	MAJOR IMPEDIMENT	ACTION NEEDED	INTERIM MEASURE
Transfer credit component to LBP; DTI to continue providing TA/IB using the Dutch grant assistance	Agreement between GOP and Netherlands Government indicating DTI as implementing agency	DTI to forge MOA with LBP on transfer of credit component; revise MOA with Netherlands Government	TST-PMO to continue implementing program operations and expedite loan collection until full transfer to appropriate body is done; Discuss with the Netherlands Government and undertake necessary changes on agreement
Transfer credit component to LBP; DTI to continue providing TA/IB using the Dutch grant assistance	Loan agreement between GOP and ADB explicitly indicating DTI as implementing agency	DTI to forge MOA with DBP on turnover of MCP funds and arrangements for loan repayment to ADB	TST-PMO to continue implementing program operations and expedite loan collection until full transfer to appropriate body is done; Discuss with ADB and undertake necessary changes on agreement
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Table 1a

Summary Information for DCPs Implemented by GFIs and GOCCs/NBFIs

SECTOR/ PROGRAM NAME	IMPLEMENT-ING AGENCY	OI	AVE CRI	LEGAL BASIS	FUND SOURCE
Agriculture					
I. GFIs					
1. 5-25-70 Financing Program (FP)	LBP	0.05	0.31	MOA agencies	CDF, government
2. Agricultural Loan Fund (ALF)	LBP	–	2.99	Loan Agreement	WB, BSP & USAID
3. Rural Finance Project (CLF II)	LBP	–	1.02	Loan Agreement	IBRD-WB
4. DBP-DAR Financing Program for ARBs	LBP	–	1.17	Loan Agreement	WB
5. ADB Industrial Forest Plantation Project (IFPP)	LBP	–	0.54	Loan Agreement	ADB
II. GOCCs/NBFIs					
6. Farm Level Grains Center (FLGC I)	Quedancor	0.06	0.21	LOI No. 704, MOA between NFA & Quedancor	Corporate Funds
7. Food and Agricultural Retail Enterprises (FARE)	Quedancor	0.15	0.27	LOI No. 1392; RA 7393 and GRCGC Board Res. #60	Corporate Funds
8. Coordinated Agricultural Marketing Production (CAMP)	Quedancor	0.04	0.95	RA 7393 and Board Resolution No. 25-93	Corporate Funds
9. NLSF Livelihood Credit Assistance Program for Agrarian reform Communities (LCAP for ARCs)	NLSF	0.55	0.04	No legal basis	Internal Funds
10. Community Empowerment Program (CEP)	TLRC	0.69	0.05	No legal basis	Corporate Funds
11. Agro-Industrial Transfer Program (AITTP)	TLRC	–	0.29	No legal basis	Foreign loan (OECF)
Small and Medium Enterprises (SMEs)					
I. GFIs					
1. Cottage Enterprises Finance Project (CEFP)	DBP	2.70	0.73	MOA (Germany & IBRD)	Foreign loan (KFW of
2. Damayan sa Pamumuhunan Program (DPP)	DBP	0.03	0.82	No legal basis	CDF of Sen. Butz Aquino & DBP Funds
3. Domestic Shipping Modernization Program (DSMP)	DBP	–	0.05	MOA	Foreign loan (OECF)
4. Environmental Infrastructure Support Credit Program (EISCP)	DBP	–	0.07	No legal basis	Foreign loan (OECF)
5. Industrial Guarantee and and Loan Fund (IGLF)	DBP	–	4.85	MOA	Foreign loan through NEDA

Table 1a cont.

SECTOR/ PROGRAM NAME	IMPLEMENT-ING AGENCY	OI	AVE CRI	LEGAL BASIS	FUND SOURCE
6. Industrial Investment Credit Program (IICP)	DBP	-	1.08	MOA	Foreign loan (IBRD)
7. Industrial Restructuring Program (IRP)	DBP	–	1.52	Loan Agreement	Foreign loan (IBRD)
8. Industrial and Support Services Expansion Program (ISSEP)	DBP	–	2.84	Loan Agreement	Foreign loan (OECF)
9. EXIM Japan Untied of Japan) Loan to DBP I (AJDF-JEXIM I)	DBP	–	1.33	Loan Agreement	Foreign loan (EXIMBANK)
10. EXIM Japan Untied of Japan) Loan to DBP II (AJDF-JEXIM II)	DBP	–	1.08	Loan Agreement	Foreign loan (EXIMBANK)
11. EXIM Japan Untied of Japan) Loan to DBP III (AJDF-JEXIM III)	DBP	–	7.10	Loan Agreement	Foreign loan (EXIMBANK)
12. Overseas Economic Cooperative Fund (OECF)	DBP	–	1.52	MOA	Foreign loan (OECF)
13. OECF Metro Cebu Development Project Phase II OECF-MCDP III	LBP	–	0.00	Loan Agreement	OECF
II. GOCCs/NBFIs					
14. Small Enterprise Financing Facility (SEFF)	SBGFC	–	0.44	No legal basis	SBGFC funds
15. Rediscounting Facility for Small Enterprises (RDFSE)	SBGFC	–	0.63	No legal basis	SBGFC funds
Poor					
I. GFIs					
1. Special Livelihood Assistance Program (SLFAP)	LBP	0.04	0.00	MOA	CDF, NGOs
2. OECF Rural Farmers and Agrarian Reform Support Credit Program (RASCP)	LBP	2.47	0.06	Loan Agreement	OECF
II. GOCCs/NBFIs					
3. Helping Individuals Reach Their Aspiration Through Microcredit Lending Program (HIRAM)	PCFC	1.21	0.45	MOA	NLSF Internal funds
4. ADB-IFAD Rural Finance Project (ADB-IFAD-RMFP)	PCFC	0.71	0.00	Project Agreement	ADB-IFAD
5. Special Direct Micro Lending Program (SDMLP)	TLRC	0.54	0.09	No legal basis	Corporate funds

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