



ENABLING RURAL AND AGRICULTURAL FINANCE FOR INCLUSIVE DEVELOPMENT IN THE PHILIPPINES

V. BRUCE J. TOLENTINO, PhD, et al.



A PUBLICATION OF THE
DEPARTMENT OF AGRICULTURE
AGRICULTURAL CREDIT POLICY COUNCIL

Book 1 RURAL AND AGRICULTURAL FINANCE AND DEVELOPMENT ISSUES

comprises papers that deal with financial systemwide reform issues that determine the health and development effectiveness of the rural and agriculture finance system

Book 2 THE RURAL BANKS

focuses on the rapid rise and fall of the multitude of small private banks that served as the principal delivery agents of subsidized loans to farming and rural enterprises under the government's Masagana 99 program and related directed credit programs

Book 3 FINANCIAL SECTOR REGULATION FOR RURAL AND AGRICULTURAL DEVELOPMENT

deals with the myriad, multiple, and recurring issues that arise from financial sector regulation. The papers on regulatory issues zero in on specific laws and regulations that influence the workings of the financial market in ways that are either harmful or helpful to development. The papers include suggestions on how the laws/rules/regulations can be modified to improve the working of the banks and other financial market players.

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BOOK 2

The Rural Banks



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AGRICULTURAL CREDIT POLICY COUNCIL

About the Author

Dr. V. Bruce J. Tolentino is a leading economic development expert with decades of experience in both the public and nonprofit sector locally and abroad.

He served as the ACPC's first executive director from 1987-1989, and currently serves as the Vice Chair of the Council, and member of the Monetary Board of the Bangko Sentral ng Pilipinas.



About DA-ACPC

The Agricultural Credit Policy Council, an attached agency of the Department of Agriculture, is the institution on agri-fishery credit and program development that promotes a sustainable and effective delivery of financial services to the countryside.

acpc.gov.ph

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Agricultural Credit Policy Council

Enabling Rural
and Agricultural
Finance for Inclusive
Development
in the Philippines

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Book 2: The Rural Banks



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Preface

Thirty-five years have passed since the Agricultural Credit Policy Council (ACPC) was created in 1986 through Executive Order 113, to replace the Presidential Committee on Agricultural Credit (PCAC) and the Technical Board of Agricultural Credit (TBAC). The move sought to synchronize all credit policies and programs in support of the Department of Agriculture's (DA) priority programs. The ACPC was also given the responsibility of reviewing and evaluating the economic soundness of all ongoing and proposed agricultural credit programs, whether for domestic or foreign funding, prior to approval.

Leading these efforts was Dr. V. Bruce J. Tolentino, who was appointed by then Agriculture Secretary Carlos G. Dominguez III as the Council's first Executive Director.

Today, the ACPC remains the country's premier government institution for program development and research on agri-fishery credit — a feat that would not have been possible without the expertise and dedication of our first Executive Director, whose vision of a sustainable rural finance system for farmers and fisherfolk served as the guiding principle of the Council. This three-part book series puts together in a convenient collection numerous research studies, policy briefs, and statements Dr. Tolentino produced while leading the ACPC.

While some advancements have been made since these papers were originally published, many of Dr. Tolentino's policy

recommendations remain relevant today, decades later: the “One DA” approach emphasizes a holistic transformation of the agriculture and fisheries sector, and the *Bangko Sentral ng Pilipinas* advocates for the financial inclusion of unserved and underserved sectors. It all comes together, as Dr. Tolentino now serves as a member of the Monetary Board and as Vice-Chair representative for the ACPC.

I speak on behalf of my agency when I say we are fortunate to call Dr. Tolentino our mentor and dear friend, and it is our hope that sharing his valuable insights to the world once more in this book series will continue to inspire innovation and reforms toward a healthy rural finance sector with prosperous farmers and fisherfolk.



Jocelyn Alma R. Badiola
Executive Director
Agricultural Credit Policy Council

Foreword

It came as a shock to me when I learned from our rural bankers in 1986 that they do not rely on their communities for deposits. It was easy to imagine that the Rural Banks Act of 1952, a law mandating a bank for every town in the country, would have fostered a close symbiosis with the communities they served. That did not happen, unfortunately, and to this day a major portion of our population remains unbanked.

My acquaintance with banking began in the mid 1960's when I was an Executive Trainee at a foreign bank and in the early 1980's as head of an agricultural development bank. I have cultivated a keen interest in rural banking and the role of finance in modernizing our agriculture. When I served as Secretary of Agriculture, my duties included chairing the Agricultural Credit Policy Council. Among my advocacies at this time was to work with the Central Bank to help strengthen agricultural finance. This led to a joint program between the Central Bank and the Ministry of Agriculture aimed at rationalizing rural banking. A Rural Bank Review and Rationalization Committee was organized.

During a seminar in 1987, I had the good fortune of meeting a young PhD graduate named Bruce Tolentino. When I found out his doctoral dissertation was on Central Bank policy and the rural banks, I asked Bruce to help the Ministry of Agriculture prepare a presentation to the Central Bank on rural banks and agricultural finance. Soon after, as the reform process progressed, I convinced Bruce to serve as the first Executive Director of the then newly established Agricultural Credit Policy Council (ACPC).

Since that time, Bruce and I worked together on many issues. I have always been impressed by his expertise and effectiveness in helping our rural communities. He has the ability of avoiding technical jargon and therefore his ideas reach the broadest audience.

This book series records four decades of Bruce's work in rural finance. I am fortunate to have closely observed this work and I am honored to endorse this book as indispensable to understanding the issues relating to agricultural finance.



A handwritten signature in black ink, appearing to read "Carlos G. Dominguez". The signature is fluid and cursive, with a long, sweeping tail.

Carlos G. Dominguez
Secretary
Department of Finance

Introduction

This book series is a three-volume compilation of papers, reports, and policy notes from close to four decades—a lifetime—of keen interest and hard work focused on the promotion of effective and efficient financial services in support of inclusive rural and agricultural development.

My interest in financial services for poverty alleviation began in my boyhood in Baguio, in Northern Philippines. To keep up with payments for my school tuition, my mother Florence had to turn, more times than she cared for, to the local moneylender. I observed the great pains my mother took to ensure that the moneylender would be paid back to avoid the hefty “5-6” interest charges from piling up. I will never forget that my mother’s sacrifices and the financial services rendered by informal moneylenders helped me get through early schooling.

In my twenties, I served as director of the Dansalan College Community Service (DCCS), a school-based rural and agricultural development program in Marawi and Lanao del Sur in Mindanao, Southern Philippines. The DCCS had programs in adult literacy, health and nutrition, agricultural extension, cooperatives development, and handicrafts enterprises.

There were only a few banks in the Lake Lanao area—isolated as the region was, and still is, from the rest of the country by geography and sociocultural barriers. Most financial services were embedded in the operations of suppliers, merchants, and transport entrepreneurs who did business in downtown

Marawi, which is linked to the cities of Iligan and Cagayan de Oro, the urban centers of Northern Mindanao. For financing, farmers and small entrepreneurs were completely dependent on their own savings and those of their families, or on advances from input and service suppliers who extracted payments due at harvest. While the suppliers gave these advances without requiring collateral or much paperwork, the applicable interest was quite hefty, and the threat of zero access to any financing at all in case of default was all too real.

The 1970s and early 1980s were the peak of the Philippine government's *Masagana 99* (Bountiful 99) program, aimed at dramatically raising the productivity of the rice sector and reducing poverty among farmers. The program delivered a package consisting of subsidized loans and technical assistance to farmers. The subsidized loans were financed by international development assistance and delivered through a national network of rural banks—private banks that had been granted virtual monopolies via the “one town, one bank” policy in specific rural municipalities. These were licensed by the Central Bank of the Philippines (CBP), subject to minimal capital and regulatory requirements, and had liberal access to CBP rediscounting.

Masagana 99 was a great success in raising rice sector productivity, principally by getting farmers to adopt new high-yielding seeds and the requisite soil nutrition and pest management technologies. However, the rural banks organized to distribute the subsidized loans became overly dependent on subsidized funding and were unable to generate savings from the public which would be intermediated into loans. Many of the rural banks turned to CBP's rediscount window. As inevitably the subsidies and easy rediscount funds dried up, the dependent rural banks fell into crisis.

The unwinding of the debt and transformation of the rural banks from subsidy-dependent entities to viable, independent intermediaries is a process that begun in the early 1980s and continues until today. I was fascinated and deeply interested in this process, and when an opportunity to enter graduate school and focus on rural finance opened in 1981, I grabbed it. At the University of the Philippines School of Economics and later at the East-West Center at the University of Hawaii, I studied the story of rural banks and wrote my doctoral dissertation on the evolving policy milieu that created the incentives and disincentives that rural banks faced and which shaped their operations, profitability, and contribution to rural and agricultural development.

Upon completion of graduate studies in 1986, I returned to the Philippines with the intent to teach at the then College of Economics of the University of the Philippines Los Baños (UPLB). At the time, UPLB was deeply engaged with the Ministry of Agriculture and Food (MAF), providing policy and technical advice to the new government led by President Corazon Aquino in the wake of the “People Power Revolution” that had just driven the dictator Ferdinand Marcos out of office. But the path to teaching had to wait.

I was asked by then MAF Minister Ramon Mitra and MAF Deputy Minister Carlos Dominguez III to suggest ways in which farmers could obtain more financing from the country’s banks. This led to my working closely with the National Agriculture and Fisheries Council (NAFC) and the Technical Board for Agricultural Credit (TBAC), two agencies attached to the Department of Agriculture (DA). The NAFC was the principal implementing arm of the *Masagana 99* program and TBAC had been organized to analyze the program’s financing aspects.

Two key measures that the MAF enacted to help enhance financial services for agriculture were, first, the implementation of a fast-track program to rehabilitate the rural banking industry, in partnership with the CBP; and, second, the creation of a new government agency—the Agricultural Credit Policy Council (ACPC)—in 1987. I served as the lead technical advisor for the Rural Bank Rationalization Program and was soon after appointed as the first executive director of the ACPC.

At the ACPC, the idea behind a great deal of my work was that banks should be deeply rooted in the communities they serve. Banks, being private businesses, operate by turning the life savings of individuals or families into loans. These loans are not simply given left and right. In fact, the bank must aggregate the deposits of many depositors to grant just one loan. This way, many depositors trust that the projects the banks lend to are profitable and the borrowers credit-worthy. The banks, therefore, have a dual obligation to (A) keep the money of depositors safe, and (B) lend to credit-worthy borrowers and projects. It was surprising to me that many communities did not make use of their local rural banks, and so a lot of my work has been focused on finding ways to strengthen the rural banking system so that it benefits the underserved and unbanked Filipinos in the agriculture sector.

I worked at the ACPC and concurrently at the Office of the Agriculture Secretary from 1987 to 1993. This early involvement in rural finance and agricultural development continued throughout my career in public service and international consulting. Because of my experience in the Philippines, I later had the opportunity to provide technical assistance on finance and development to various government agencies in Cambodia, Vietnam, Indonesia, Pakistan, Korea, Timor Leste, and Myanmar.

A key insight gleaned from my time in Mindanao, at the ACPC, abroad, and in the Philippines—and which is now clearer than ever from my vantage point at the Monetary Board of the *Bangko Sentral ng Pilipinas* (BSP)—is that cheap and easy credit will not solve all the problems in farming. The fundamentals must be attended to, and those fundamentals include good seeds, the right germplasm, proper irrigation, wise plant management, and, of course, good weather. All of these ingredients enable productive and profitable agriculture, which is necessary for a borrower to be deemed credit-worthy and a project viable for bank financing.

It then means that the many parts of government need to work together to ensure that the agriculture sector is strong and enables food security while assuring stable and dignified incomes for farmers. So, in 2021, again with the guidance of Mr. Dominguez—now Secretary of Finance—I have once more become directly and deeply engaged in policymaking and programming for rural and agricultural finance and the rural banks.

The papers, reports, and memos in this compilation are a record of the challenges, responses, successes, as well as failures in rural finance and intermediation over the course of my career. I am proud that advances have been made on some issues, but many other constraints remain unresolved. Indeed, some issues persist, since the policy and program environment continuously evolves, even as the tools that analysts and reformers work with improve with better knowledge.

Book I, entitled *Rural and Agricultural Finance and Development Issues*, comprises papers that deal with financial system-wide reform issues that determine the health and development effectiveness of the rural and agriculture finance

system. Attention is also given to the political economy of financial sector reforms and to the delicate balance between rural and agricultural development on one hand and financial sector viability on the other, for the healthy growth of the overall economy.

Book II, or *The Rural Banks*, focuses on the rapid rise and fall of the multitude of small private banks that served as the principal delivery agents of subsidized loans to farming and rural enterprises under the government's Masagana 99 program and related directed credit programs. Government policy and programs in the 1970s drove the rapid growth of these banks. As these supply-led policies and programs inevitably proved unsustainable, the subsidies and privileges for rural banks dried up. Many rural banks were unable to cope with the changes and closed shop. Some have thrived in a more market-oriented policy environment, taking advantage of their knowledge of the rural and agricultural economy, and still many others are struggling to transform and survive in the current economy.

Book III, or *Financial Sector Regulation for Rural and Agricultural Development*, deals with the myriad, multiple, and recurring issues that arise from financial sector regulation. Many regulations are well-intentioned, aimed at depressing loan interest rates, directing credit to sectors considered underserved or watering down qualification requirements for obtaining loans and other financial services. Such regulations ignore market realities and incentives and often do not achieve their intended goals. Often, regulations that attempt to constrain market forces end up being at least sustainable and at worst distortionary and a waste of precious public resources. The papers on regulatory issues thus zero in on specific laws and regulations that influence the workings of

the financial market in ways that are either harmful or helpful to development. The papers include suggestions on how the laws/rules/regulations can be modified to improve the working of the banks and other financial market players.

The bulk of the articles included in this compilation could not have been produced had I not had the good fortune of serving at the ACPC and the DA. These agencies enabled the focus and provided the technical and logistical support necessary to produce these works. I thank most especially the staff and officers of the ACPC, whose dedication and skills have continuously and significantly expanded financial services for farmers and fisherfolk.

A handwritten signature in black ink, consisting of a large, fluid, cursive loop followed by a vertical stroke and a horizontal tail.

V. Bruce J. Tolentino, PhD

Book 2:
The Rural Banks

CHAPTER 1

Rural banks and evolving banking strategy and policy in the Philippines¹

V. Bruce J. Tolentino, Eloisa Glindro, and Lorna Sombe²

Abstract

Since their inception in the post-World War 2 (WW2) era, the Philippines' many rural banks have been viewed—with high expectations—as special mechanisms designed to support rural and agricultural development. While the General Banking Law of 1948 (RA 337) and Central Bank Act of 1948 (RA 265) only listed “Rural Banks” as a specific class of banks, Rural Banks Act of 1952 (RA 720) specified that rural banks are “... organized with the specific mandate to support the expansion of the rural economy through accessible and affordable credit.”

¹ The views and opinions expressed in this paper are those of the authors and do not necessarily reflect those of the *Bangko Sentral ng Pilipinas* (BSP). The authors are grateful to Deputy Governor Chuchi Fonacier of the Financial Supervision Sector (FSS), Managing Director Lyn Javier of the Office of Supervisory Policy Sub-Sector, Director Mark Perez and his staff at the BSP Supervisory Data Center (SDC) for the data support, and to the excellent research assistance from Mr. Ferdinand S. Co of the Center for Monetary and Financial Policy and Ms. Jean Christine Armas of the Department of Economic Statistics.

² Member of the Monetary Board, Assistant Director of the Center for Monetary and Financial Studies, and Assistant Director of the Department of Supervisory Analytics, respectively, of the BSP.

This paper traces the historical performance of the Philippines' rural banks along with the evolution of banking regulation implemented by the Government, offering a perspective on how regulatory changes have altered the incentives facing rural banks and how these banks have adapted, with some thriving and many others failing.

Given the increasingly competitive business environment and the decline in the number of rural banks, these banks continue to have loan portfolios with the largest proportions lent to the rural and agricultural sectors. However, the scale of total lending by rural banks to the agricultural sector is minuscule compared with that provided by universal and commercial banks.

The special status accorded by law to rural banks has largely been eroded by financial crises that precipitated waves of financial liberalization and banking sector reforms implemented since the 1980s. Many of the milestone banking reforms were implemented after the creation of an independent *Bangko Sentral ng Pilipinas* in 1993. These reforms required more prudent and responsible governance procedures, more agile operations, and more judicious lending practices and capital preservation measures. Over time, the rural banking system may have outlived its original mandate and now requires a substantial review and significant retooling to become a stronger player in economic development.

JEL classification: E52, E58, G21

Keywords: rural finance, banking, monetary policy

Introduction

Since their inception in the post-WW2 era, the Philippines' rural banks have been viewed with high expectations as special mechanisms designed to support rural and agricultural development.

While Republic Act (RA) 337 (General Banking Law of 1948) and RA 265 (Central Bank Act of 1948) only listed “Rural Banks” as a specific class of banks, RA 720 or the Rural Bank Act of 1952 specified that rural banks are organized: *“To promote and expand the rural economy in an orderly and effective manner by providing the people of the rural communities with the means of facilitating and improving their productive activities, and to encourage cooperatives. Toward this end, the Government shall encourage and assist in the establishment of a system of rural banks which will place within easy reach and access of the people to credit facilities on reasonable terms.”*³

Moreover, RA 720 specified that the clientele of rural banks be largely subsistence farmers or small-scale merchants, to wit: *“Loans or advances extended by rural banks ... shall be primarily for the purpose of meeting the normal credit needs of any small farmer or farm family owning or cultivating, in the aggregate, not more than fifty hectares of land dedicated to agricultural production, as well as the normal credit needs of cooperatives and small merchants ... and the normal credit needs of small business enterprises whose capital investment does not exceed twenty-five thousand pesos and of essential rural enterprises or industries, other than those which are strictly agricultural in nature.”*⁴

³ Section 2, Republic Act 720 (1952)

⁴ Sections 5-6, Republic Act 720 (1952)

Thus, as early as 1952, RA 720 “... set the national policy of promoting and expanding the rural economy in an orderly and effective manner by providing rural communities with the means of facilitating and improving their productive activities and encouraging cooperatives. To expand the credit facilities available to the ordinary citizen in the countryside, rural banks were allowed to access the privilege of rediscounting their eligible papers with the Central Bank at preferential rates of interest. The Act also responded to the needs of small farmers and marginal merchants in the countryside for an alternative to usurious moneylenders at securing financial resources to fund their economic activities.”⁵

In 1993, the law governing central banking in the Philippines was extensively updated and revised, resulting in the passage of RA 7653 or the New Central Bank Act of 1993. RA 7353 (New Rural Banks Act) was also enacted, repealing RA 720 of 1952.

RA 7653 retained rural banks as a specific classification of banks. Also, RA 7353 largely maintained from the earlier law of 1952 the key mission of the rural banks: “... to make needed credit available and readily accessible in the rural areas on reasonable terms... providing adequate credit facilities to farmers and merchants, or to cooperatives of such farmers and merchants and in general, the people of the rural communities... primarily for the purpose of meeting the normal credit needs of farmers, fisherfolk or farm families owning or cultivating land dedicated to agricultural production as well as the normal credit needs of cooperatives and merchants... In granting of loans, the rural bank shall give preference to the application of farmers and merchants whose cash requirements are small... devote a portion of their loanable funds to meeting the normal credit needs of small business enterprises.”⁶

⁵ Pedro P. Tordilla Jr., “Regional Challenges of Central Banking,” in Vicente Valdepenas Jr. (Editor), *Central Banking in Challenging Times: The Philippine Experience*, BSP, Manila, 2000.

⁶ Sections 3-7, RA 7353 (1992)

Objectives

This paper attempts to explore several related questions:

- Has the system of rural banks in the Philippines met the high expectations set in law, initially stated in 1952 and reiterated in 1992 and 1993?
- What was the framework for policy and support for rural banks as implemented and enforced by the Central Bank of the Philippines from 1952 to 1993, and by the *Bangko Sentral ng Pilipinas* (BSP) since 1993?
- What are the essential differences in the policy framework and support mechanisms for rural banks before and after 1993, and in what ways did the policy and support framework determine the performance of the rural banks?

This paper is organized as follows: **Section 1** provides an overview of lending for the rural and agricultural sectors; **Section 2** traces the historical highlights of rural financing in the Philippines; **Section 3** examines the performance of the rural banking system over time; and **Section 4** traces the regulatory changes that unfolded over the years and offers perspectives on how these changes have altered the incentives facing rural banks and how, in turn, these banks have adapted.

1. Credit and Agricultural and Rural Development

*“... No country that is today rich got that way through tiny loans for people with tiny incomes.”
(Thomas Diether)⁷*

It is a long-held belief that the “adequate and low-interest” supply of agricultural credit is an important mechanism for rural and agricultural growth. Indeed commonplace are public as well as private strategies and programs featuring supply-driven credit programs for agricultural and rural activities. Over the past century, and particularly in the post-WW2 period, many such programs have been introduced across the globe, variously termed as interventions in agricultural credit, rural credit, agriculture and rural finance, microfinance, and most recently, “financial inclusion.” Each of these generations of supply-driven programs have featured incremental improvements in design related to targeting, management, graduation and sustainability, institutional development, and performance assessment.

It is clear, however, that finance is only one aspect among many in the complex dynamics of rapid and sustained agriculture and rural growth and of broader socioeconomic development. Neither the improved supply of loans nor facilitated financial services are singular keys to development but are among a broad set of endowments as well as policy and program interventions that will, collectively, foster inclusive and sustained economic wellbeing. A wealth of natural resources is an obvious endowment; public investments in productive infrastructure and knowledge is also crucial. Clear property

⁷ Thomas Diether, “A Second Look at Microfinance: The Sequence of Growth and Credit in Economic History,” Cato Institute, 2007.

rights and the rule of law, combined with efficient incentives for savings and investments, help complete the picture.

The Philippines was an early adopter of innovations and programs that featured supply-led credit programs and support for cooperatives and “self-help” groups. As early as 1900 when the Philippines was a colony of the United States, the wealthy Boston entrepreneur Edward Filene proposed to US President Theodore Roosevelt that cooperative banks be introduced to the Philippines as a development intervention.⁸

The Rural Banks Act of 1952 signaled the country’s early openness to supply-leading interventions, particularly for the rural and agricultural sectors considered populated with lower-income rural residents, farmers, and small-scale merchants. The creation of the rural banking system was considered a key step toward fulfilling the vision of social and financial inclusion of small farm households.

Yet since the creation of the rural banking system in 1952, progress and development in the rural and agricultural areas of the Philippines has far lagged behind that in the urban areas. The Philippines’ development path has been quite different from the pattern observed in its ASEAN neighbors. Whereas the key source of overall growth of most ASEAN countries shifted steadily from agriculture to manufacturing and then services, the Philippine economy saw strong growth in services while manufacturing grew sluggishly and agriculture stagnated.

⁸ David Roodman, “Due Diligence: An Impertinent Inquiry into Microfinance,” Center for Global Development, 2012.

Indeed, broad macro indicators of welfare suggest that the Philippines’ agricultural support strategies, including the many supply-led credit provision projects, did not achieve significant positive impact on the productivity and welfare of the rural population.

Overall economic growth is characterized by a reduction in the absolute share of agriculture in output and employment. The Philippine agriculture sector has remained mired in poor output growth, slow decline in employment, low productivity, and deep-rooted poverty (Figs. 1.1 to 1.3). Data compiled by the Philippine Statistics Authority (PSA) show that while poverty incidence has declined overall, such remains significantly higher in the agricultural sector compared to the national average, with poverty highest among farmers and fisherfolk (Table 1).

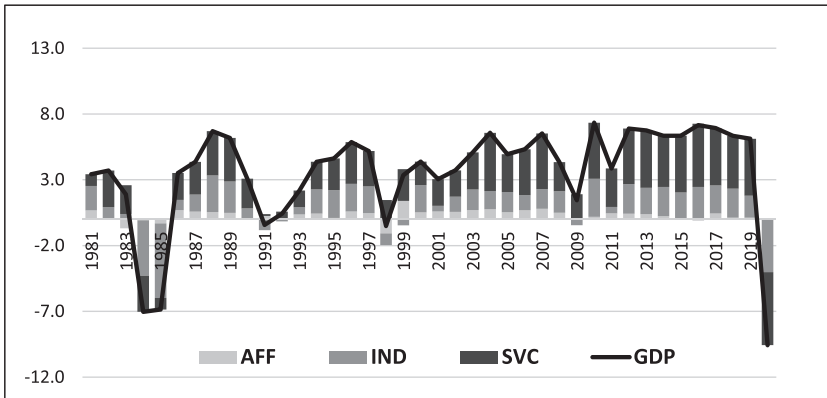


Figure 1.1. Contribution to GDP growth by industry (%), as performance indicator

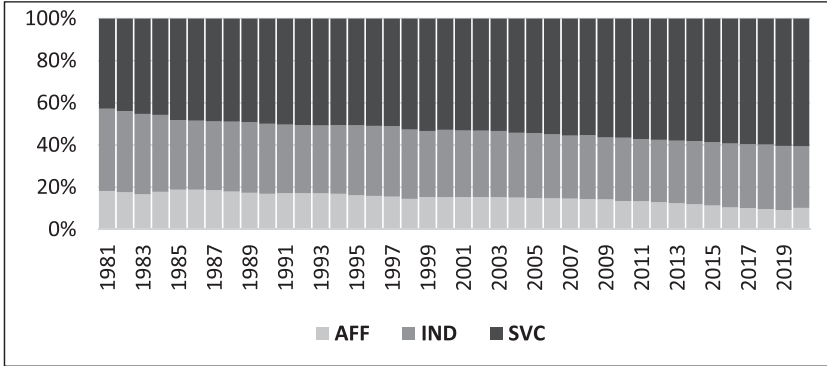


Figure 1.2. Share in GDP by industry (%), as performance indicator

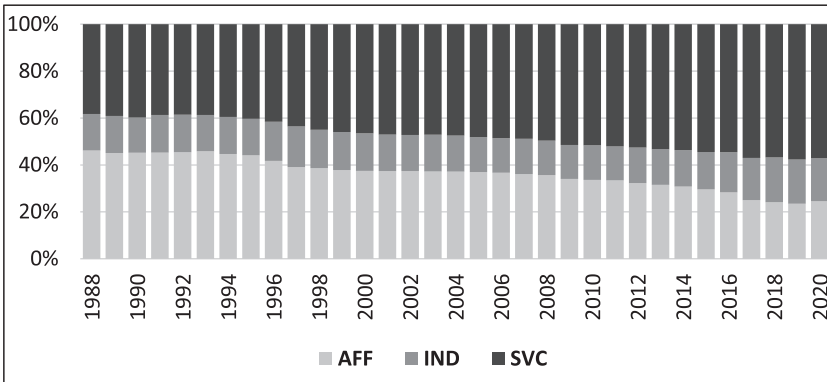


Figure 1.3. Share of employment by industry (%), as performance indicator
(Note: Employment is normalized into full-time equivalent.)

Table 1. Poverty incidence by sector

Sectors	2009		2012		2015 ^r		2018 ^u	
	Poverty incidence	C.V.	Poverty incidence	C.V.	Poverty incidence	C.V.	Poverty incidence	C.V.
Philippines	26.3	2.0	25.2	2.1	23.5	2.1	16.7	1.4
Farmers	38	2.1	38.3	2.5	40.8	2.1	31.6	1.7
Fishermen	41.3	4	39.2	4.7	36.9	5.1	26.2	3.5
Rural residents					34.0	2.1	24.5	1.4
Children	35.3	1.4	35.2	1.7	33.5	1.8	23.9	1.2
Self-employed and unpaid family workers	29.9	2	29	2.4	26.2	2.6	18.0	2.0
Women	25.7	1.6	25.6	1.9	23.9	2.1	16.6	1.3
Person(s) with disability							14.7	3.7
Youth	21.6	1.8	22.3	2.2	20.5	2.4	14.7	1.5
Migrants	16.8	2.1	16.6	2.6	14.4	2.6	8.8	1.7
Senior citizens	16.1	2.5	16.2	2.9	14.4	3.0	9.1	2.3
Urban residents	12.6	3.3	13	4.2	13.2	4.3	9.3	2.8

Note: Sectors are not mutually exclusive, i.e., there are overlaps across sectors.

(Source: Philippine Statistics Authority (2018))

2. Rural banks as a special class of banks in the Philippines

In the Philippines, rural banks were not included in the coverage of RA 265 (Central Bank Act of June 1948) or under RA 337 (General Banking Act of July 1948). Rural banks were created later under RA 720 in June 1952.

In August 1952, RA 821 created the Agricultural Credit and Cooperative Financing Administration,⁹ whose principal mandate was to assist small farmers and fisherfolk in securing “*liberal*” credit and to enable the creation of cooperative associations for efficient distribution of agricultural produce. These issuances were part of efforts to rapidly rebuild the Philippine economy following its devastation during WW2 and the declaration of Philippine Independence from the US in July 1946.

RA 720 (Rural Banks Act of 1952) declared the “*establishment of rural banking system designed to make needed credit available and readily accessible in the rural areas on reasonable terms.*” The supervisory function over rural banks was the remit of the Central Bank while the capacity building function was lodged with the then-Department of Agriculture and Natural Resources (DANR) and Department of Commerce (DC).

Rural banks were established principally as private corporations, with the government’s Rural Finance Corporation (RFC) serving as a standby investor. Should the share of private shareholdings fall short of the required 60% of the capital requirement, the RFC, upon approval of the Monetary Board of the CBP, may subscribe to the bank’s common stocks. The common stocks could be sold anytime at par to private citizens of the Philippines. In support of RA 720, CBP Circular No. 32 of 1 July 1952, stipulated the principles governing credit operations of rural banks, confining their lending to meeting short-term credit needs of small farmers and fisherfolk.¹⁰

⁹ Replaced Cooperatives Administration Office that was created under Commonwealth Act 565, as amended by Commonwealth Act 713.

¹⁰ Another important mechanism for the provision of credit and support services to agriculture relates to the enactment of Republic Act (R.A.) 3844 in 1963. The law created the Landbank of the Philippines (LBP), which was mandated to finance the acquisition and distribution of agricultural land.

The implementing guidelines embodied in CBP Circular 720 and the design of the public agricultural credit system catered to the short-term credit needs of small farmers. In 1965, the International Bank for Reconstruction and Development (IBRD) —now The World Bank—reported that only rural banks were able to infuse significant financing to the agriculture sector. However, the rural banks had limited medium-to-long term (MLT) financing, with only 4% (11 rural banks out of more than 300) recorded as having extended MLT loans. As private entities, rural banks were less inclined to engage in MLT lending due to inadequate loanable funds, lower interest rate, and unfamiliarity with the products and risks associated with longer-term financing. The report further noted that inadequate capital, poorly trained personnel, and mismanagement beleaguered the various government-sponsored credit programs.

Given its broad mandate to promote “... *rising level of production, employment, and real income,*” the CBP launched the first large-scale credit program for medium-to-long term (MLT) financing for agricultural development in 1965, borrowing a total of USD 8.3 million from the IBRD. The CBP’s Department of Rural Banks provided technical guidance and supervision over the lending activities of the conduit rural banks. The IBRD loan program supported acquisition of farm machineries, construction of irrigation pumps, and development of fisheries and livestock (IBRD Report, 1965).

The 2nd CBP-IBRD Rural Credit Program loan of USD 12.5 million was contracted in 1969. The range of activities qualified for financing was expanded to include storage facilities and farm transport. In 1974, a 3rd CBP-IBRD Rural Credit Program further increased the list of eligible sub-loan categories to include rural machinery repair shops and fish pens, among others.

The Philippine government was also pushing forward with programs to accelerate agrarian reform, enacting the Code of Agrarian Reform, establishing an Agrarian Reform Fund, and creating the Land Bank of the Philippines (LBP) in 1971.^{11,12} On 21 July 1973, Presidential Decree (P.D.) No. 251 increased the capital stock of the LBP to PHP 3 billion, required government agencies to make the LBP the official depository, and expanded the mandate of the LBP to include granting of loans to farmers' and fisherfolks' cooperatives/associations for agricultural production purposes.

Credit programs were also started by the Development Bank of the Philippines (DBP) and the LBP in 1976. DBP secured IBRD financing for its DBP-IBRD Grains Processing and Storage Project, while the LBP launched the Integrated Estate Development Program focused on mechanization. In 1978, PD 1467 created the Philippine Crop Insurance Corporation (PCIC), which *“shall provide insurance protection to farmers and fisherfolk against losses arising from natural disasters as well as plant diseases and pest infestation, initially to palay crops, and later to other crops.”*¹³

However, in 1979 when the first CBP-IBRD loan facility was exhausted, the level of farm mechanization was still below par, and a cohesive farm mechanization framework was still lacking (Reyes and Agabin, 1985). Many of the agricultural credit programs suffered from mismanagement. The sad state of rural finance was exacerbated by the international oil crises in 1979 and the balance of payments crisis in the early 1980s that plunged the economy into recession.

¹¹ RA 6389 created the Department of Agrarian Reform and RA 6390 established the Agrarian Reform Fund

¹² In September 1972, PD No. 2 declared the country under land reform program. In October of the same year, however, PD No 27 restricted the scope of land reform to tenanted rice and corn lands and set the retention limit at 7 hectares. Retrieved from <http://www.dar.gov.ph/about-us/agrarian-reform-history/>

¹³ Section 1 of PD 1947 issued on 11 June 1978. Retrieved from https://www.lawphil.net/statutes/presdecs/pd1978/pd_1467_1978.html

3. Rural banks and the Philippine financial system

3.1 Resource profile

While the total resources of the Philippine banking system have grown by leaps and bounds in the post-WW2 era, the share of rural banks remains a paltry sum. The same characterization extends to the shares of the rural banks in the financial system’s total loan portfolio and deposit liabilities (Fig. 2).

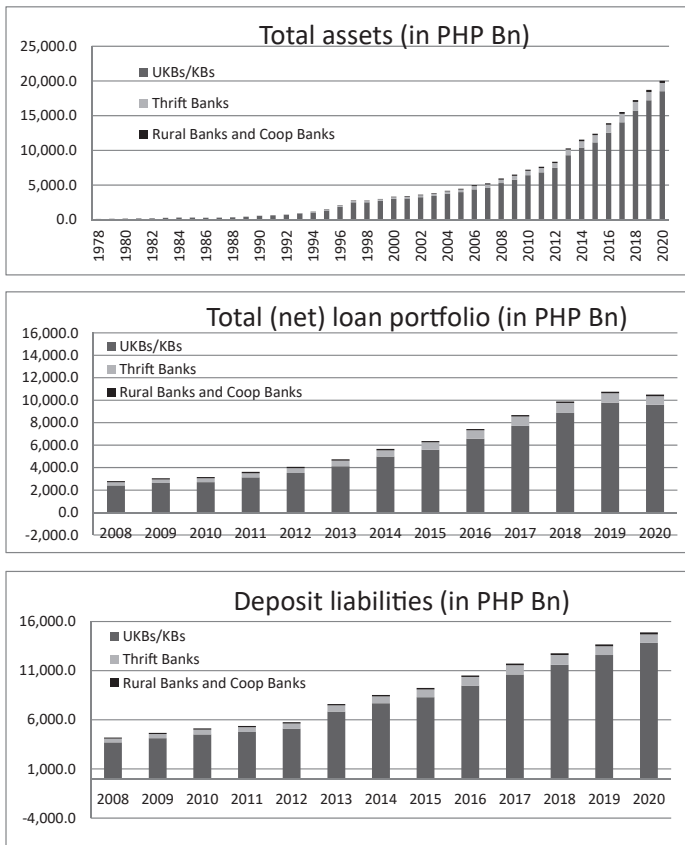


Figure 2. Profile of the rural banking system.
Source of data: Data Supervisory Analytics

Fig. 3 indicates that the combined loan portfolio and dues from banks account for about 83% of total assets of the rural banking system. Other assets and investment in securities are small, albeit the latter has been showing some recent growth.

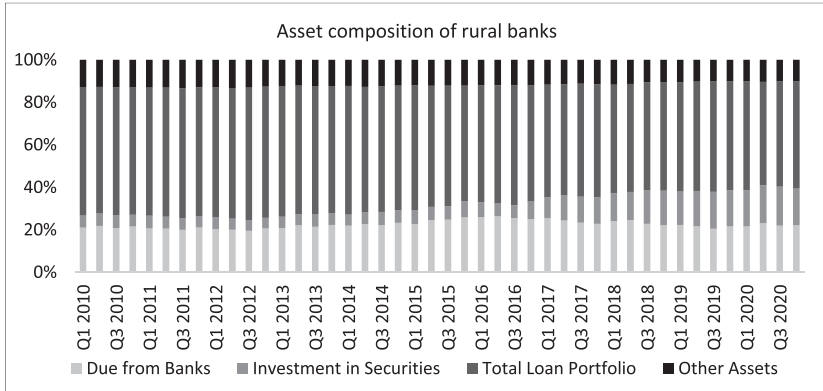


Figure 3. Asset composition of rural banks
Source of basic data: Data Supervisory Analytics

A much larger proportion of dues from banks is deposit in other banks (Fig. 4) while investment in securities were mostly held to maturity (Fig.5).

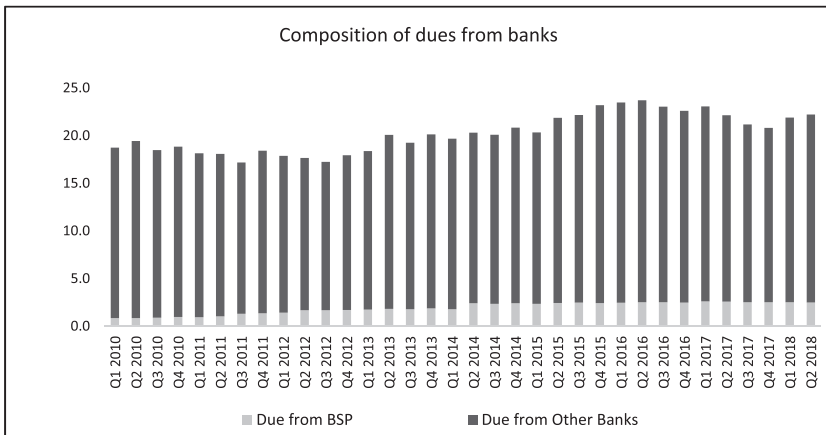


Figure 4. Composition of dues from banks

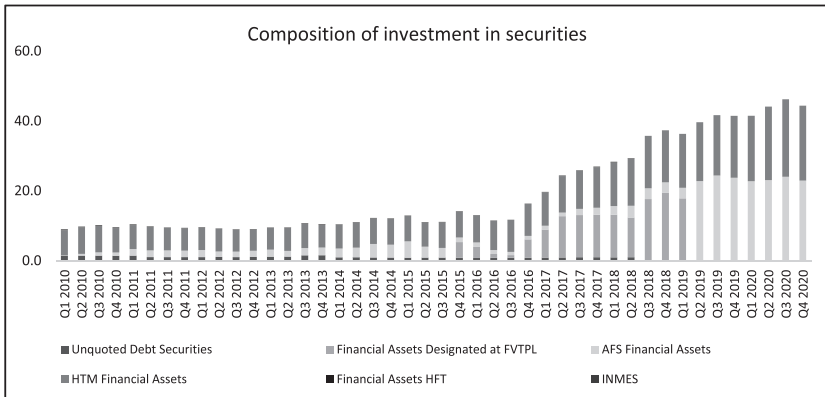


Figure 5. Composition of investment in securities
 Source of basic data: Data Supervisory Analytics

3.2 Physical distribution

The number of rural banks (in terms of head offices) fell from 931 in 1978 to 434 as of March 2021 (Fig. 6). However, the total number of rural bank branches and other offices has significantly expanded from 1,024 in 1978 to 3,313 as of March 2021. As weaker rural banks have shut down, some others have merged and still others were able to adjust to evolving regulations while successfully building their businesses.

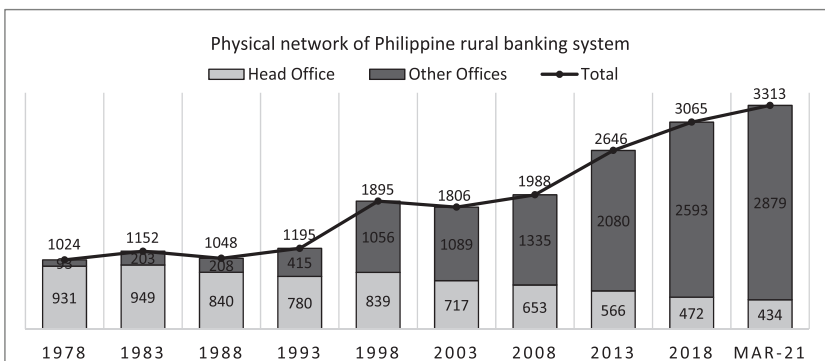


Figure 6. Physical network of Philippine rural banking system
 Source of basic data: Supervisory Data Center, 1993, 2005 Factbook Vol. 2

Rural and cooperative banks continue to comprise the largest proportion of head offices among BSP-supervised and -regulated banks (Fig. 7).

Rural and cooperative banks have the lowest share of regular branches but account for the bulk of existing branch-lite units.

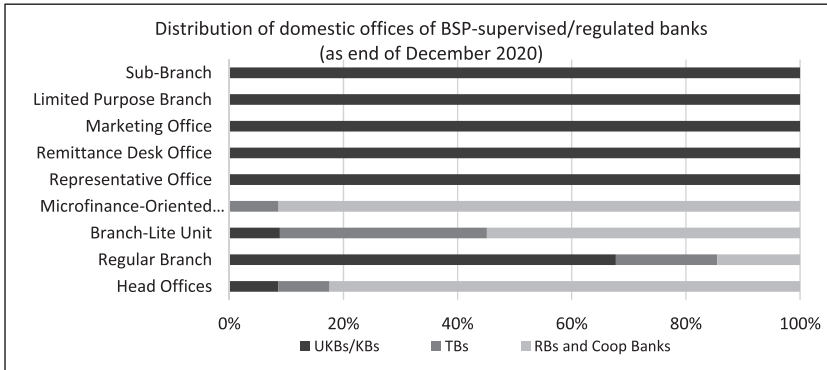


Figure 7. Distribution of domestic offices of BSP-supervised/regulated banks (as end of December 2020)

Source of basic data: Bangko Sentral ng Pilipinas;

<https://www.bsp.gov.ph/SitePages/Statistics/BSPhysicalNetwork.aspx>

Geographically, universal and commercial banks have the most extensive reach, particularly in more developed regions of the Philippines (Fig. 8).

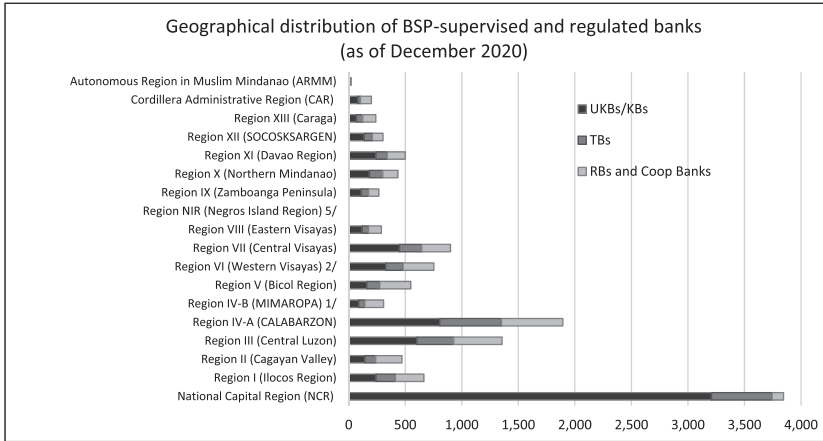


Figure 8. Geographical distribution of BSP-supervised and regulated banks (as of December 2020)

Source of basic data: Bangko Sentral ng Pilipinas;

<https://www.bsp.gov.ph/SitePages/Statistics/BSPhysicalNetwork.aspx>

3.3 Rediscounting availment

Over the decades from the 1970s to the early 2000s, Central Bank rediscounting—especially at below-market rates and light creditworthiness requirements in the 1970s and 1980s, was the major source of loanable funds for the rural and cooperative banks. As the Central Bank’s rediscounting window was made more market-oriented, there was a marked decline in rural bank availment of rediscounting loans, particularly with the reforms following the Asian financial crisis (Fig. 9).¹⁴ Troubled rural banks accounted for the bulk of the rediscounting availment after the Global Financial Crisis (Fig. 10).

¹⁴ The facility prior to 2013 had a budget ceiling of PHP 20 billion, which was raised to PHP 60 billion in 2009 in the aftermath of the GFC. The budget was scaled back to the pre-crisis level of PHP 20 billion in 2010.

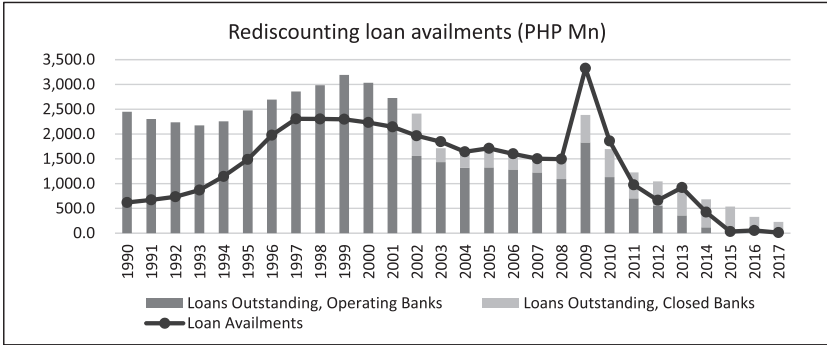


Figure 9. Rediscounting loan availments (PHP Mn)
 Source of basic data: BSP-Department of Loans and Credit (DLC)

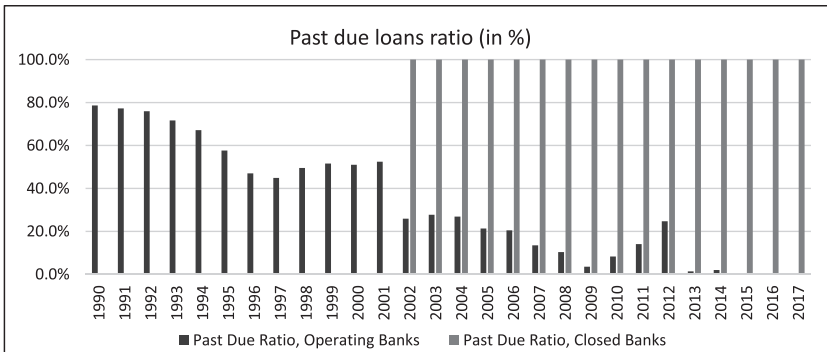


Figure 10. Past due loans ratio (in %)
 Source of basic data: BSP-Department of Loans and Credit (DLC)

3.4 CAMELS rating

The CAMELS system has been the principal regulatory tool of the Central Bank, enabling the scoring system of bank performance drawing from annual bank examinations. Rural banks, on average, have less than satisfactory CAMELS composite ratings.¹⁵ An encouraging development is the notable

¹⁵ A less-than-satisfactory rating means some degree of supervisory concern in one of more component areas. The CAMELS rating is a supervisory rating system originally developed in the United States to classify a bank's overall condition. CAMELS is the acronym for six key components of a bank's condition, namely, Capital adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity to market risk.

decline in rural banks with critically deficient ratings that require strong remedial measures. Rural banks with satisfactory to strong CAMELS ratings are a small but growing group (Fig. 11).

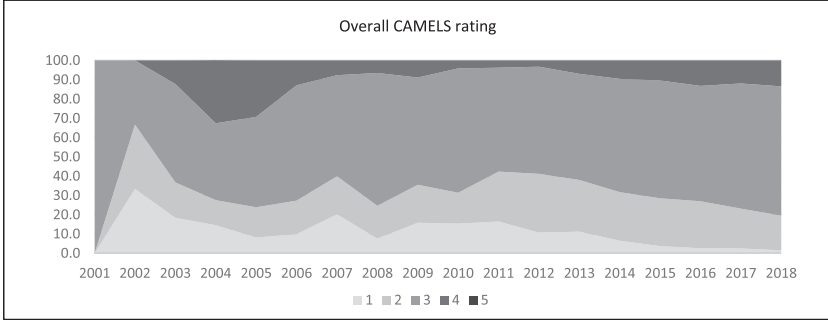
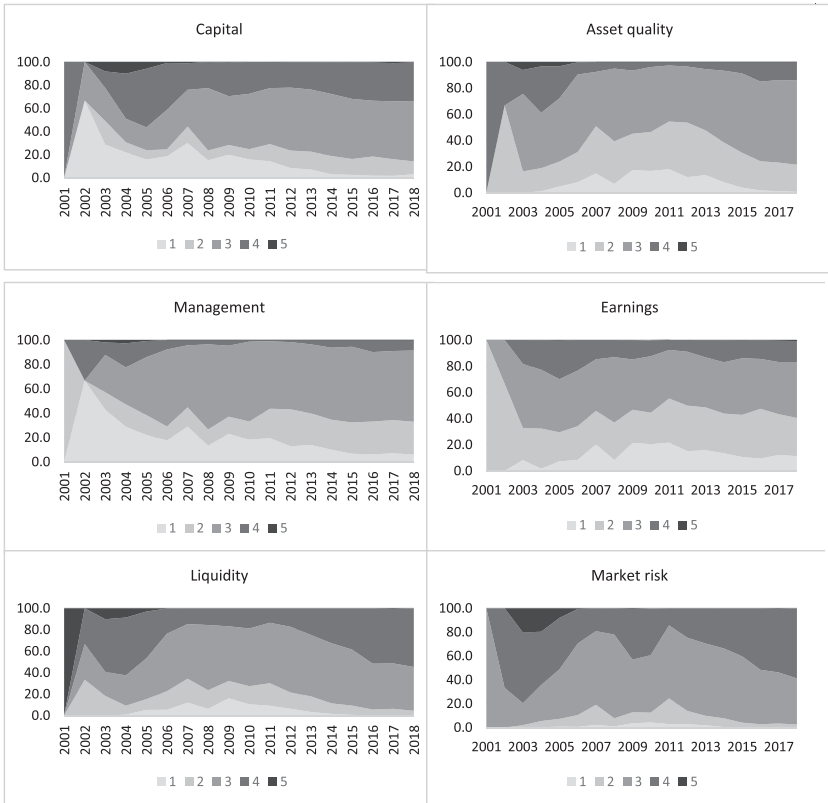


Figure 11. CAMELS ratings of rural banks



4. Evolution of regulatory framework on rural banks

The economic and regulatory terrain for banking has significantly changed since the creation of rural banks in 1952. The core of the more recent comprehensive banking reforms is the adaptation of global banking reform initiatives to local conditions. These include the implementation of “Basel III” reforms on capital requirements, leverage ratio, liquidity coverage ratio, and deeper capital requirements for domestic systemically important banks (D-SIBs).¹⁶ These significant changes in the regulatory framework have had profound implications on the operations of rural banks. As the banking system expands and matures, the traditional niche rural markets of rural banks face competitive pressures from the more buoyant, technologically agile, better-capitalized large banks.

4.1 Directed credit programs

The rules and regulations governing the establishment of a rural bank, as embodied in CB Circular 32 of 1952, were quite rudimentary. Interested parties were required to submit a letter to the CBP Governor, indicating their location, reason for the choice of location, products and industries in the area, names and citizenship of incorporators, and justification why such a bank is necessary.

¹⁶ Cognizant that financial stability as a shared responsibility embedded among regulators and the national government (the ultimate lender of last resort), an inter-agency cooperation mechanism was formalized through the creation of the Financial Stability Coordination Council, which consists of the BSP, Securities and Exchange Commission (SEC), Philippine Deposit Insurance Corporation (PDIC), Insurance Commission (IC), and the Department of Finance (DOF).

Under the early regulations, rural banks were limited to meeting the short-run (maximum 12 months) credit needs of small farmers and rural dwellers. Repayment schedules were synchronized with the harvesting and marketing periods of the crop. Borrowed funds were released directly to suppliers, minimizing any cash to be managed by the borrowers. The loan terms and conditions stipulated fixed interest of 12% per annum and a maximum loanable amount per crop or type of borrower, as well as acceptable collateral.¹⁷

The Circular also extended several privileges to rural banks. Those with assets worth less than PHP 500,000 were exempted from all kinds of taxes and charges, including the contribution to defray the cost of regulation implemented by the CBP. Moreover, rural banks would receive, at no cost to them, technical CBP assistance and notarial services for some loan documents.

Maximum interest rates on deposits were also mandated under CB circular 222 of 1966. Economic activities eligible for credit were also specified (Circular 237) and rediscount rates were stipulated.

Following the passage of RA 6390 that created the Agrarian Reform Fund, CBP Circular 334 (1971) mandated the participation of rural banks in extending supervised credit to agrarian reform beneficiaries (ARBs). The Agrarian Reform Guarantee Fund (ARGF) was created to guarantee 70% of any losses on loans extended by rural banks. Those that opted out of ARGF were required to extend loans with the same features to the extent of the government's contribution to its capital stock. As an incentive, all ARB loans were rediscountable.

¹⁷ The loan fetched at 12% per annum, unless a lower rate was prescribed by the Monetary Board. Specific conditions were set for loans for production of palay and corn; perishable crops; and livestock and fish; as well as loans to small merchants, rural industries, and cooperatives.

In February 1980, CB Circular 720 prescribed minimum capital requirements for new rural banks and a capital build-up program for existing rural banks. The minimum paid up capital was raised from PHP 100,000 to PHP 500,000. The capital build-up schedule for existing rural banks was flexible depending on the number of years in operation.¹⁸ The Circular was just one of a raft of reforms implemented in 1980 to 1981 that included introducing the new category of universal banks authorized to underwrite securities and take equity positions in enterprises; liberalizing interest rates; and sharply reducing the scope of selective credit allocation rules and programs in favor of rationing and according higher weight to economic criteria and promoting long-term planning (Fonacier, 2019).

The early years of the financial sector reforms were upended by the financial crisis that emerged with the “Dewey Dee” caper and the ensuing balance of payments problems of 1981. The crisis of confidence in the financial system and the economy paved the way for reforms that led to the closure and consolidation of the many affected banks. In 1984, the Philippines experienced the first conservatorship case and the first-ever merger of 14 rural banks (Fonacier, 2019).

4.2 Rural bank compliance with mandated credit for Agri-Agra

To further bolster support for agrarian reform, Presidential Decree (PD) 717 or the Agri-Agra Law was enacted on 29 May 1975. PD 717 required banks to allocate 15% of their

¹⁸ For rural banks with less than two years in operation, the required capital can be built up within 5 years. Those that have been in operation for 2–5 years are given 4 years to build up capital, while those that have been in operation for more than 5 years are given 3 years to complete the capital buildup.

loanable funds to agricultural projects and another 10% to agrarian reform beneficiaries (Reyes et al., 2015). The law also allowed banks to invest in government securities and other debt instruments as well as rediscount with the BSP eligible paper covering agrarian reform credits, instead of lending directly to agricultural projects and ARBs (Section 4, PD 717).

Medalla and Ravalo (1997) argued that until 1988, banks took advantage of PD 717's "alternative compliance" by investing in Treasury bills and masking the decline in direct credit to agriculture and ARBs. They found that between 1975 and 1996, compliance with PD 717 continuously declined, with the compounded annual growth of Agri-Agra loans at three percentage points lower than the annual growth of the total loan portfolio of domestic banks.

In 2009, RA 10000 (Agri-Agra Reform Credit Act) repealed PD 717. RA 10000 retained the mandatory credit allocation in PD 717 but the modes of alternative compliance were restricted to only the following: wholesale lending to and/or investments in accredited rural financial institutions (RFIs); investments in bonds declared eligible by the Department of Agriculture (DA) in consultation with the Department of Agrarian Reform (DAR); loans for construction and upgrading of Agri-Agra infrastructure; and loans to the National Food Authority (NFA) and NFA-registered warehousemen, millers, and wholesalers.

Compliance under RA 10000 was mixed to weak. As Table 2 shows, only rural banks and cooperative banks fully complied. In contrast, universal and commercial banks favored alternative compliance for the mandated agricultural credit and were noncompliant with the loans to ARBs.

The penalty for noncompliance with RA 10000 is 0.5% of the noncompliance/under-compliance amount. Some 90% of the penalty revenue are divided equally between the Agricultural Guarantee Fund Pool (AGFP) and the Philippine Crop Insurance Corporation (PCIC). The remaining 10% is retained by the BSP to cover its administrative expenses. As of January 2018, the total penalty imposed on banks amounted to PHP 7.4 billion.

Table 2. Direct compliance vs. alternative compliance
(as of 31 December 2020)

	Compliance with 10% AGRA				Compliance with 15% AGRI			
	All banks	UBs/ KBs	TBs	RCBs	All banks	UBs/ KBs	TBs	RCBs
PD 717								
2010	8.46	7.76	11.49	13.81	11.55	10.53	16.14	18.9
RA 10000								
2011	8.69	8.25	9.83	14.45	10.98	10.31	6.45	35.18
2012	2.08	1.02	4.93	28.49	21.71	20.03	34.14	52.30
2013	1.38	0.89	1.49	24.53	15.56	16.04	6.76	44.59
2014	1.46	0.99	1.71	18.47	15.21	15.28	8.62	34.21
2015	1.11	0.81	1.81	17.99	14.11	13.99	10.14	34.03
2016	1.02	0.74	1.92	16.44	12.81	12.75	9.21	28.79
2017	1.05	0.81	1.61	13.53	12.83	12.91	7.09	24.97
2018	1.17	0.99	1.27	11.18	13.08	13.18	7.48	24.03
2019	1.09	0.96	0.89	9.59	10.80	10.80	6.77	22.62
2020	1.00	0.88	0.95	9.69	9.00	9.01	6.40	16.30

Source: Financial Supervision Sector, Department of Supervisory Analytics, BSP

Allocating the total quota of 25% of all loanable funds to agricultural projects and ARBs is difficult to achieve. Moreover, the rapidly growing banking system meant that the total funds under quota was also rapidly growing. Given that the agriculture sector was growing at a much slower pace compared with the banks, compliance became increasingly difficult over time.

When queried, banks have pointed to a myriad of challenges and constraints to compliance with RA 10000. These include *“high operational costs of lending to farmers and fisherfolk, including agrarian reform beneficiaries (ARBs) and particularly in far-flung areas; banks’ general perception that farmers and ARBs poor credit risks due to their lack of and quality of collateral; agriculture’s vulnerability to typhoons/calamities; and price fluctuations of produce that often eats up any farm profits; banks’ lack of dedicated experts on agriculture and thus weak capacity and knowledge in lending to particularly smaller farmers; lack of credit and other information and difficulty of the larger financial institutions in connecting with and finding viable farmer/ARB borrowers; and portfolio risk diversification concerns among larger financial institutions.”*¹⁹

Espenilla (2013) reasoned that compulsory lending to Agri-Agra beneficiaries amidst more stringent BSP parameters on safe and sound banking practices and very high lending standards for banking institutions have driven banks to protect their balance sheet by internalizing the penalties instead.

¹⁹ Financing Agriculture in Philippines, The World Bank (June 2019).

4.4 Risk-based bank supervision

Since the mid-1990s, the BSP started aligning its supervision/regulations with international standards established by the Basel Committee on Banking Supervision. Heretofore, BSP risk regulation was largely confined to basic credit risk management and internal control. Bank supervision was increasingly extended beyond the traditional financial audit and compliance, shifting toward a more forward-looking view of risk management. The strengthened focus on risk management systems of supervised institutions is intended to enable banks to flexibly respond to changing opportunities and challenges in the face of global competition under a more deregulated environment and at a time of rapid technological advances.

While traditional bank supervision tended to micro-manage banks, the new approach is more focused on the assessment of the quality of risk management practices. Thus, banks are largely left to take on greater risks and explore opportunities for success so long as they demonstrate the ability to identify, measure, manage, and price those risks. The more liberal approach to supervision focuses on the quality of corporate governance in the supervised entities.

Strengthening banks' corporate governance has thus been the theme of some BSP regulations, e.g., Circular No. 130 of June 1997 required the board of directors of banks to, among others, adopt and maintain an adequate risk management policy; and Circular No. 145 of October 1997 required banks to develop and implement a compliance system and to appoint/designate a compliance officer.

In September 2001, the BSP issued Circular No. 296, which implemented the ‘fit and proper’ standards for directors and officers of banks and non-banks as mandated by the General Banking Law (GBL) of 2000. The same Circular also prescribed a mandatory orientation program on corporate governance for the board of directors of banks. In October 2003, Circular No. 410 provided the accreditation guidelines for banks’ external auditors.

In 2012, the corporate governance initiatives of the BSP were further refined and implemented in three phases. First, the BSP defined the ‘fit and proper’ standards and laid down its expectations of the governing boards of BSP-supervised financial institutions (BSFIs) through the issuance of Circular No. 749 on 12 February 2012. Second, the BSP established standards for a system of checks and balances covering compliance functions and internal audit through the issuance of Circular No. 747 (dated 6 February 2012) and 871 (dated 5 March 2015). Third, standards phased in by the BSP involved issuance of guidelines on managing key risk areas like credit, market, liquidity, and operational risks.

4.4.1 Risk-based capital adequacy ratio

In the 1990s, the major development in the banking industry was the worldwide implementation of the first Basel Accord, which set minimum capital standards of 8% for internationally active banks and 10% for the rest. The said international capital standards were set by the Basel Committee on Banking Supervision (BCBS). In the Philippines, the BSP adopted the risk-based capital adequacy framework in 2001, pursuant to Section 34 of the General Banking Law of 2000 through the

issuance of Circular No. 280. This initially covered capital requirements for credit risk and was known as Basel I. The guidelines on capital standards were applied to all types of banks. The BSP's risk-based capital adequacy framework was further enhanced with the issuance of Circular No. 360 in December 2002, which incorporated market risk into the framework.

In August 2006, BSP issued the implementing guidelines (Circular No. 538) of the revised *International Convergence of Capital Measurement and Capital Standards*, also known as Basel II. In addition to credit risk, the revised guidelines expanded the capital requirements to cover market and operational risks.

Thrift banks and rural banks were also covered by the risk-based capital adequacy framework effective 1 January 2012 under Circular No. 688—known as Basel 1.5. These important changes include an increase in risk weight on foreign currency-denominated exposures to the Philippine National Government and real and other properties acquired (ROPA). It also included capital requirement for operational risk using the Basic Indicator Approach (BIA).

4.4.2 Reforms in the establishment of new banks

In 1994, the Philippine banking and financial system was further liberalized through the enactment of RA 7721 (An Act Liberalizing the Entry and Scope of Operations of Foreign Banks in the Philippines). The liberalization sought to create a more competitive environment and encourage greater foreign participation through the increase in foreign ownership of up to 60% in domestic banks and the entry of new foreign bank

branches. In 2001, Circular No. 273 partially lifted the general moratorium on licensing of new thrift banks and rural banks to allow entry of microfinance-oriented banks. On 24 May 2013, RA 10574 allowed up to 60% foreign equity participation in rural banks. In 2014, RA 10641, which allowed the full entry of foreign banks, was signed into law.

Subsequently, the full lifting of the moratorium was carried out in two phases: the first phase allowed existing thrift banks to apply for a license to convert into a universal or commercial bank; while the second phase, which started in 2018, fully removed restrictions on the granting of new bank licenses and allowed the entry of more foreign capital into the domestic banking system.

Rural bank industry rationalization

In 1987, the CBP and the Ministry of Agriculture launched the Rural Bank Review and Rationalization Program (RBRRC). From 1987 to 1993, the CBP implemented the program with resolve. Many failing and weak rural banks were put under a rehabilitation and recapitalization programs, merged with other banks, and—if these measures failed—closed.

Overall, the RBRRC and subsequent strengthening programs for banks have been painstaking and long-drawn-out processes. When rural banks are found in distress, they are closely monitored and advised by the CBP through several cycles of annual formal examinations. Failing the close monitoring phase, ailing rural banks are put into formal rehabilitation programs. Only after the rehabilitation program fails, after a total of 3–6 years, is formal closure pursued.

In 1987, the year Circular 1143 was released, a total of 168 bank closures were handled by the CBP and the Philippine Deposit Insurance Corporation (PDIC).

As the BSP replaced the old CBP on 3 July 1993,²⁰ it started to restrict the granting of new bank licenses while encouraging existing rural banks to widen their reach and maximize the delivery of financial services especially in the unbanked or underserved areas. Circular No. 624 dated 13 October 2008 rationalized existing regulations on the establishment of banking offices to further improve the delivery of efficient banking services.

Table 3 shows the pattern and trend for rural bank composition over the past 35 years. In the early years of the RBRRC reform program between 1987 to 1992, there were many bank closures. The new Rural Bank Act of 1992 put the system on a new starting base. Over the years since 1993, there has been a steady decline in the number of rural bank head offices—from 780 in 1993 to 472 at the end of 2018. However, the total number of rural bank head offices plus branches has continued to grow, from 415 in 1993 to 3065 in 2018.

There has been definite consolidation in the rural banking industry, with the smaller, weaker rural banks falling by the wayside while the larger, stronger ones have grown.

²⁰ RA 7653 (signed 14 June 1993), or the New Central Bank Act

Table 3. Number of offices and industry turnover in rural and cooperative banks

Physical composition	1985	1987	1993	1998	2003	2008	2013	2018	2019
Head offices	904	850	780	826	765	703	566	472	451
Branches/ other offices	213	210	415	1,116	1,156	1,445	2,080	2,593	2,821
Total	1,117	1,060	1,195	1,942	1,921	2,148	2,646	3,065	3,272
Entry and exit of industry players									
New players	-	-	-	9	2	2	-	-	-
Bank closures	118	168	4	22	7	23	18	12	11

Sources: Annual Report of the Philippine Banking System (1985 and 1987); Report on the Philippine Financial System (various issues)

Concluding thoughts

The enactment of the Rural Banks Act of 1952 was accompanied by high expectations. In hindsight, it appears that the Philippines' rural and agricultural development strategy that was exceedingly reliant on expected benefits from an agricultural credit system did not perform as expected. The implementation of the strategy and rural credit program was marred by excessive cost and waste.

The amendment of the law in 1992 seems to have missed opportunities to broaden the scope and scale for rural banks that would have enabled them to adapt more effectively to emerging competitive forces. It was only in 2013 when higher foreign equity participation in rural banks was permitted and in 2014 when the full entry of foreign banks was allowed. The significant changes in the operating environment and

regulatory framework have had profound implications on the operations of smaller rural banks.

The special status accorded by law to rural banks has been diminished by the series of financial liberalization and banking sector reforms precipitated by waves of financial crises. These reforms required more prudent and responsible governance procedures, more agile operations, and more judicious lending practices. Over time, many rural banks seemed to have outlived the intent of the law. While the bigger rural banks affiliated with universal and commercial banks have grown stronger, the stand-alone rural banks that failed to innovate and adapt to changing times ran the risk of being decimated by competition. Thus, the rural banking system may need a fresh mandate that will encourage if not speed up their growth and maturity.

Three decades after the first major initiative to reform rural banks, the industry has now come to a position of relative strength and stability, while still somewhat saddled with constraints inherited from policies that prevailed before the mid-1980s. Today, rural banks have room to build on the relationships and market familiarity they have established with their rural communities. It is strategically possible for financial technology or *fintech* to enhance these relationships.

BSP statistics on financial inclusion²¹ show that around 34% of cities and municipalities of the country are still unbanked as of the third quarter of 2018. Remoteness is one of the main factors that limit people's access to formal financial institutions. Access to financial products and services in the country remains a huge challenge.

²¹ BSP website, *Financial Inclusion in the Philippines Dashboard Q3 2018*

Rural banks are well-positioned to respond to this challenge, given their geographic advantage and expansive network. As of end-December 2018, there were 472 rural banks²² with a collective network of 3,605 head offices and branches. While the larger banks are concentrated in highly urbanized and densely populated regions of the Philippines such as the National Capital Region (NCR), Region IV-A (CALABARZON),²³ and Central Luzon, there are rural banks that thrive in regions where there is less access to financial services. There are more rural banks compared with other bank types in Ilocos, Cagayan Valley, Region IV-B (MIMAROPA),²⁴ Bicol, Caraga, and Cordillera (Table 4).

Rural banks are also the frontrunners in the establishment of branch-lite units. Branch-lites were introduced to enable banks to establish a presence in areas where it is not economically feasible to set up a full-blown branch.²⁵ Out of 1,909 operating branch-lite units, 54% (or 1,012 branch-lites) are owned by rural banks.

²² The rural banking industry includes 25 cooperative banks with a network of 156 offices.

²³ CALABARZON is the acronym of the five provinces of Southern Tagalog Mainland consisting of Cavite, Laguna, Batangas, Rizal, and Quezon.

²⁴ MIMAROPA is the acronym of the five provinces of Southwestern Tagalog Region consisting of Mindoro (Occidental and Oriental), Marinduque, Romblon, and Palawan.

²⁵ Circular No. 987 dated 28 December 2017

Table 4. Regional distribution of Philippine bank offices
(as of end-December 2020)

Region	Universal and commercial banks (UKBs)	Thrift banks (TBs)	Rural and cooperative banks (RCBs)
National Capital Region (NCR)	3,209	536	101
Region I (Ilocos Region)	241	172	252
Region II (Cagayan Valley)	142	97	232
Region III (Central Luzon)	604	325	427
Region IV-A (CALABARZON)	805	545	543
Region IV-B (MIMAROPA) ^{1/}	87	55	167
Region V (Bicol Region)	161	113	275
Region VI (Western Visayas) ^{2/}	327	153	273
Region VII (Central Visayas)	449	196	255
Region VIII (Eastern Visayas)	119	57	113
Region IX (Zamboanga Peninsula)	111	65	90
Region X (Northern Mindanao)	184	117	133
Region XI (Davao Region)	241	99	160
Region XII (SOCCSKSARGEN)	136	73	95
Region XIII (Caraga)	69	56	115
Cordillera Administrative Region (CAR)	78	25	97
Autonomous Region in Muslim Mindanao (ARMM)	16	1	2
Nationwide	6,979	2,685	3,330

Source: Bangko Sentral ng Pilipinas

Clearly, there are opportunities and niches in rural and agricultural finance that rural banks are uniquely suited to exploit. The next reform must enable rural banks to shed the vestiges of their origins in supply-led finance and positively embrace the digital innovations enabled by the fourth Industrial Revolution.

As the banking system expands and matures, traditional niche rural markets of rural banks face competition pressures from the more buoyant and technologically agile bigger banks as well as more rigorous examination of their operations by the BSP. If the CAMELS profile is to be used as a gauge, unsatisfactory business conduct continues to hound many rural banks. Nonetheless, improvements are equally noted, which underlines the capacity and potential of rural banks to thrive under a new operating environment.

From significant handholding under the old CBP, rural banks must now contend with risk-based supervision, stronger competition, and rapidly changing technology. They need to capitalize on their unique knowledge of their local community to explore opportunities beyond their comfort zone. Since most rural banks lack scale, the costs attendant to technology adoption and regulatory compliance can only be spread across a relatively smaller customer base.

To flourish under a more competitive environment, greater efficiency is needed in core business lines through judicious management of operating expenses and expanding good quality loans. The overall economic conditions in rural communities are equally important for rural banks to thrive. Poor growth prospects of any bank's host community will also cripple expected returns relative to the cost of capital. While technology can bring down costs in the long run, rural banks can only thrive if their host communities also thrive. While rural banks can be catalysts of rural development, they cannot solely bear the burden of spurring growth when the absorptive capacity of their small rural client base is itself limited.

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CHAPTER 2

The Rural Bank Review and Rationalization Committee (RBRRC): The first major initiative to reform Philippine rural banks

V. Bruce J. Tolentino¹ and Magdalena S. Casuga

Immediately after the “People Power Revolution”² that installed Corazon C. Aquino into the Presidency on 25 February 1986, the Central Bank of the Philippines (CBP) and the Ministry of Agriculture and Food (MAF)³ began discussions on the reform of the rural banking system for the goal of ensuring efficient and adequate financial services for the agriculture sector. The MAF, led by Minister Ramon V. Mitra, Jr. and Deputy Minister Carlos G. Dominguez III, formulated a paper, *Agricultural Credit and Economic Development: An Agenda for Action*, and distributed this widely among policymakers and stakeholders.

¹ Member, the Monetary Board, Bangko Sentral ng Pilipinas (BSP), and first Executive Director of the Agricultural Credit Policy Council (ACPC), and Director of Research, ACPC. The excellent contribution of Mr. Francis De Leon, Bank Officer IV, BSP Supervisory Policy and Research Department (SPRD) to this paper is gratefully acknowledged.

² 22-25 February 1986

³ The Ministry of Agriculture and Food (MAF) was created under the “Freedom Constitution” enacted as part of the “People Power Revolution”. The MAF was later transformed into the Department of Agriculture (DA) under the 1987 Philippine Constitution.

During the same period, the CBP commissioned an internal report on rural and agricultural finance, Rediscount Policy and the Arrearages Problem, and submitted this to the Monetary Board on 27 August 1986. The report analyzed the impact of the rediscounting policy on the rapid growth of rural banks in its early phases, and at its later phases mounting arrearages that eventually saddled most rural banks. The report called for drastic action to reduce the arrearages and strengthen rural banks.

In September 1986, the MAF's call to action on agricultural credit, and the CBP's internal analysis on arrearages and rediscounting, came together in a path-breaking reform and rehabilitation program for rural banks, led by the Rural Bank Review and Rehabilitation Committee (RBRRC). This paper describes the RBRRC's creation, its analysis of the status of rural banks at the time, and the principles and strategy for the reform.

Historical context

Throughout the 1980s, in the context of a struggling macroeconomy, the CBP launched a wide-ranging series of actions to reform the Philippine financial system. The financial reforms began in earnest in July 1981 with the deregulation of bank interest rates. Except for short-term loans, all interest rates on deposits, deposit substitutes, and loans were freed from administrative ceilings. The reforms were clearly successful in producing substantial increases in the growth rates of savings and time deposits.⁴ The last remaining ceiling, that of short-term loan rates, was finally lifted in January 1983.

⁴ Eli M. Remolona and Mario B. Lamberte, "Financial Reforms and Balance-of-Payments Crisis: The Case of the Philippines: 1980-83," *Philippine Review of Economics and Business* 23 nos. 1 and 2 (March and June 1986): 101-41. <https://ideas.repec.org/a/phs/prejrn/v23y1986i1&2p101-141.html>

But in 1983-84, a crisis in the balance of payments (BOP) erupted. The depletion of the country's exchange reserves forced a moratorium on payments of the principal on all public and publicly guaranteed foreign debt. However, since the government hogged what remained of the foreign exchange in the financial system, the moratorium applied effectively to all foreign debt.

Many banks, large and small, were in weakened states. In July 1984, with the moratorium still standing, the country's largest savings bank⁵ had to close its doors for ten days after struggling through a series of runs. It reopened for a while, but then the CBP had to close it permanently due to an irreversible run. Deposits also fell sharply for six commercial banks—accounting for almost a fifth of the total assets of the domestic private commercial banking sector. Several smaller banks had to be shut down permanently. The turning point came with a highly disputed election that resulted in an abrupt change from the regime led by Ferdinand E. Marcos to the Presidency of Corazon C. Aquino.

The spirit of RA 720

Since its inception in the post-WW2 era, the Philippines' system of rural banks has been viewed with very high expectations as a special mechanism to support rural and agricultural development.

The Central Bank Act of 1948 (RA 265) and General Banking Act (RA 337) of the same year only listed rural banks as a specific

⁵ Banco Filipino Savings and Mortgage Bank

class of banks. Rural Banks Act of 1952 (RA 720) specified that rural banks are organized “...to promote and expand the rural economy in an orderly and effective manner by providing the people of the rural communities with the means of facilitating and improving their productive activities, and to encourage cooperatives. Toward this end, the Government shall encourage and assist in the establishment of a system of rural banks which will place within easy reach and access of the people to credit facilities on reasonable terms.”⁶

Moreover, RA 720 specified that the clientele of rural banks be largely subsistence farmers or small merchants: “...loans or advances extended by rural banks ... shall be primarily for the purpose of meeting the normal credit needs of any small farmer or farm family owning or cultivating, in the aggregate, not more than fifty hectares of land dedicated to agricultural production, as well as the normal credit needs of cooperatives and small merchants ... and the normal credit needs of small business enterprises whose capital investment does not exceed twenty-five thousand pesos and of essential rural enterprises or industries, other than those which are strictly agricultural in nature.”⁷

Thus, as early as 1952, RA 720:

“... set the national policy of promoting and expanding the rural economy in an orderly and effective manner by providing rural communities with the means of facilitating and improving their productive activities and encouraging cooperatives. To expand the credit facilities available to the ordinary citizen in the countryside, rural banks were

⁶ Section 2, RA 720

⁷ Sections 5–6, RA 720

*allowed to access the privilege of rediscounting their eligible papers with the Central Bank at preferential rates of interest. The Act also responded to the needs of small farmers and marginal merchants in the countryside for an alternative to usurious moneylenders at securing financial resources to fund their economic activities.”*⁸

The strong view, shared by many Philippine policymakers, of rural banks being key instruments of agricultural and rural development underlay the role assigned to these banks in the development strategies of the post-WW2 era up until the mid-1980s. The Philippines was an early adopter of innovations and programs that featured supply-led credit programs and support for cooperatives. In the early 1900s when the Philippines was a colony of the United States, wealthy Boston entrepreneur Edward Filene proposed to US President Theodore Roosevelt that cooperative banks be introduced to the Philippines as a development intervention.⁹

The Rural Banks Act of 1952 signaled the country's early openness to supply-leading interventions, particularly for the rural and agricultural areas considered populated with lower-income rural residents, farmers, and small-scale merchants. The creation of the rural banking system was seen as a key step toward fulfilling the vision of social and financial inclusion of small farm households.

⁸ Pedro P. Tordilla, Jr., “Regional Challenges of Central Banking,” in *Central Banking in Challenging Times: The Philippine Experience*, ed. Vicente B. Valdepeñas, Jr. (Manila: *Bangko Sentral ng Pilipinas*, 2000), 340-93.

⁹ David Roodman, *Due Diligence: An Impertinent Inquiry into Microfinance* (Washington, D.C.: Brookings Institution Press, 2012). <http://www.jstor.org/stable/10.7864/j.ctt1gpcdc8>.

In the Philippines, the “Rural Bank” and the “system of Rural Banks” were created by law under RA 720 of 1952, which declared the “*establishment of rural banking system designed to make needed credit available and readily accessible in the rural areas on reasonable terms.*” The supervisory function over rural banks was the remit of the CBP, and the capacity building function was lodged with the then-Department of Agriculture and Natural Resources (DANR) and Department of Commerce (DC).

Rural banks were established principally as private corporations, with the government’s Rehabilitation Finance Corporation (RFC) serving as a standby investor. The government created the RFC under RA 85 (An Act Creating the Rehabilitation Finance Corporation of 1946) to provide credit facilities for the development of agriculture, commerce, and industry and the reconstruction of properties damaged by the war.¹⁰

From 1952 through to the early 1980s, prevailing policies on rural banks were marked by liberal and low entry requirements, such as capital requirement of only half a million pesos (PHP 500,000) (Remolona and Lamberte, 1986). Should the share of private shareholdings fall short of the required 60% of the capital requirement, the RFC, upon approval of the Monetary Board of the CBP, can subscribe to the bank’s common stocks. These common stocks could be sold anytime at par value to private citizens of the Philippines.

Upon their establishment, rural banks were assured that competition in their operational areas would be kept low through a “one town, one rural bank” policy. Moreover, the CBP opened up liberal rediscounting facilities for the RBs, from where the rural banks could borrow at below-market rates.

¹⁰ In 1958, the RFC was reorganized into the Development Bank of the Philippines (DBP). The change in corporate name marked the shift from rehabilitation to broader activities.

As stated in the 1965 *International Bank for Reconstruction and Development (IBRD) Report*,¹¹ the agricultural credit system established by the government catered mostly to short-term credit needs of small farmers. Inadequate capital, poorly trained personnel, and mismanagement beleaguered the various government-sponsored credit programs. The report further noted that only rural banks were able to infuse significant financing to the agriculture sector. However, even rural banks had very limited medium-to-long term (MLT) financing for the sector. About 4% of rural banks then (11 out of more than 300) extended MLT loans. Rural banks, being predominantly private banks, were noted to be less inclined to engage in MLT lending due to inadequate financial resources, lower interest rate, and unfamiliarity with the products and risks associated with longer-term financing.

In pursuit of one of its broad mandates of “*promoting rising level of production, employment, and real income,*” the old CBP launched the first large-scale credit program for medium-to-long term (MLT) financing for agricultural development worth USD 8.3 million. It did so by commissioning the first loan to the Philippines from the IBRD—now The World Bank—worth USD 5 million in 1965.¹²

In the IBRD-financed project, rural banks were to provide counterpart fund worth USD 0.8 million while USD 2.5 million was to be sourced from farmers’ contributions. The CBP, through its Department of Rural Banks, provided technical guidance and supervision on the lending activities of the conduit rural banks. Under this arrangement, the rural

¹¹ IBRD, *Republic of the Philippines – Rural Credit Project*, Report No. TO-502a (Washington, DC: World Bank, 1965). <http://documents.worldbank.org/curated/en/803491468293428008/Philippines-Rural-Credit-Project>

¹² Amount of the loan was still considered relatively small because of the limited experience of rural banks in MLT and the need for guidance in loan administration as well as in training farmers.

banks bore the lending risk whereas the CBP assumed the foreign exchange risk. The credit facility supported acquisition of farm machineries, construction of irrigation pumps and development of fisheries and livestock (IBRD Report, 1965).

A larger second CBP-IBRD Rural Credit Program loan amounting to USD 12.5 million (excluding counterpart fund) was contracted in 1969. The range of activities qualified for financing was expanded to include storage facilities and farm transport. In 1974, the third CBP-IBRD Rural Credit Program further increased the list of eligible sub-loan categories to include repair shops and fish pens, among others.

By the end of the 1970s when the first CBP-IBRD loan facility was exhausted, the level of farm mechanization was still below par and a cohesive farm mechanization framework still lacking.¹³ Many rural banks and government-led agricultural credit programs suffered from mismanagement and failed to extend sufficient credit to farmers. The sad state of rural finance was exacerbated by the international oil crises in 1979 and the balance of payments crisis in the early 1980s that plunged the economy in a long period of deep recession.

The seeds of change

On 4 September 1986, the CBP Monetary Board (MB) convened to specifically review the state of agricultural credit financing in the country, including the various funds available for agricultural credit, credit delivery systems, problems in

¹³ Blanquita Y. Reyes and Meliza H. Agabin. 1985. A History of Credit Programs Supporting Agricultural Mechanization in the Philippines. *Journal of Philippine Development* 12 no. 1: 211-25. <https://serp-p.pids.gov.ph/serp-p/download.PHP?d=459&cs=1>

the system, and the changes needed to establish a system that would actually work. The MB at that time included CBP Governor Jose B. Fernandez, Jr., Minister of Finance Jaime V. Ongpin, Minister of Economic Planning Solita C. Monsod, Minister of Trade and Industry Jose A. Concepcion, Jr., and Private Sector Representative Jesus V. Ayala.

Invited to the meeting were Minister Ramon Mitra and Deputy Minister Carlos Dominguez of the MAF. They shared with the MB their views on the imperatives for financing for rural and agricultural growth, presenting their analysis in a MAF paper, *Agricultural Credit and Economic Development: An Agenda for Action*.

In its deliberations on agricultural credit financing, the MB was informed through analyses and recommendations made by the CBP and the MAF, including the CBP-administered Technical Board for Agricultural Credit (TBAC), later renamed the Agricultural Credit Policy Council (ACPC).¹⁴

The CBP report *Rediscount Policy and the Arrearages Problem* established certain realities: One, various special agricultural funds had been entrusted by the National Government to the CBP for administration in the belief that it was in the best position to deliver credit to farmers through the rural banking system, as rural banks are CBP-supervised entities. Two, despite CBP's careful watch, various problems had surfaced on the ground, among these the arrearages of rural banks. The MB thus concluded that the prevailing system then was not really working.

¹⁴ TBAC then was the implementing arm of the Presidential Committee on Agricultural Credit (PCAC) chaired by the CBP Governor and vice-chaired by the MAF Minister (PD 792, 4 September 1975). PCAC and TBAC were replaced by the Agricultural Credit Policy Council (ACPC), with the DA Secretary as Chair and the BSP Governor as Vice-Chair (EO 113, 24 December 1986). ACPC thereafter was attached to the DA (EO 116, 30 January 1987).

Based on the circulated MAF policy paper, the MB also established the need to revise PD 717 of 1975). Section 3 of PD 717 required all banks, whether government or private, to set aside at least 25% of their loanable funds for agricultural credit in general, out of which at least 10% of the loanable funds should be made available for agrarian reform credit to beneficiaries. It was observed that compliance by banks with the Agri-Agra program under PD 717 had resulted in an increase in intermediation cost as well as a decline in the quality of credit granted under the said regulation.

In view of the limitations of the existing agricultural credit system, the MB decided to approve the constitution of an inter-agency committee to consist of representatives of the Ministry of Finance (MOF), the National Economic and Development Authority (NEDA), the Ministry of Agriculture and Food (MAF), and the CBP. The MB likewise approved in principle the MAF proposal to consolidate all agriculture and agriculture-related funds into a Comprehensive Agricultural Loan Fund (CALF), provided there were no legal impediments.

Thus, in the ensuing meeting of 19 September 1986, the MB decided to amend the resolution of the 4 September 1986 meeting so as to include the Minister of Budget and Management and two representatives from the private sector as members of the inter-agency committee created under MB Resolution No. 853, to be referred to as the Rural Bank Review and Rehabilitation Committee (RBRRC).

The MB consequently approved the membership of the RBRRC, as shown in Table 1.

Table 1. Members of the Rural Bank Review and Rehabilitation Committee (RBRRC)*

Mr. Jesus V. Ayala <i>Member, Monetary Board</i> Central Bank of the Philippines	Chairman
Mr. Alberto G. Romulo <i>Minister</i> Ministry of Budget and Management	Member
Dr. Florian A. Alburo <i>Deputy Minister</i> National Economic and Development Authority	Member
Mr. Carlos G. Dominguez III <i>Deputy Minister</i> Ministry of Agriculture and Food	Member
Mr. Victor C. Macalincag <i>Deputy Minister</i> Ministry of Finance	Member
Mr. Eugenio C. Nierras, Jr. <i>Deputy Governor</i> Central Bank of the Philippines	Member
Ms. Carlota P. Valenzuela <i>Deputy Governor</i> Central Bank of the Philippines	Member
Mr. Manuel A. Lim, Jr. <i>Private Sector</i>	Member
Mr. Luis P. Lorenzo, Jr. <i>Private Sector</i>	Member

* Monetary Board Resolution No. 853 dated 19 September 1986

The RBRRC was supported by a Technical Working Group (TWG) headed by Dr. V. Bruce J. Tolentino¹⁵ and including Ms. M.S. Blancaver (secretary, seconded from the ACPC), Ms. L. Barcelon (technical assistant to Atty. J.V. Ayala), and Ms. Z. Reichert (technical assistant to Mr. C. Buenaventura).

¹⁵ V. Bruce J Tolentino had written his PhD *dissertation, Economics of Scale, Relative Efficiency, and Banking Policy in the Philippines*, at the University of Hawaii in 1986. On the basis of Tolentino's findings, MAF Deputy Minister Carlos Dominguez III provided Tolentino an opportunity to launch his dissertation recommendations into real-life practice.

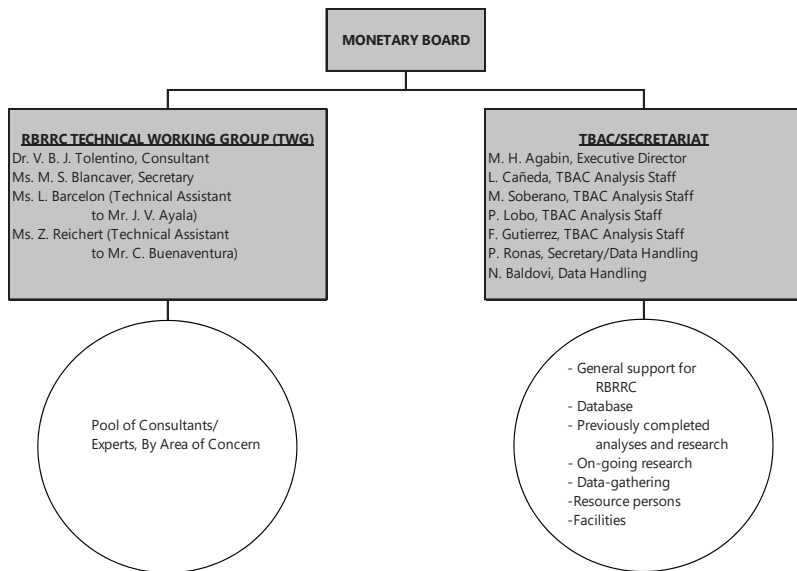


Figure 1. RBRRC's Organizational Chart and Staffing Pattern

Working with the RBRRC TWG were the CBP's Department of Rural Banks led by Special Assistant to the Governor Consolacion V. Odra and the Technical Board for Agricultural Credit (TBAC) headed by Executive Director Meliza H. Agabin.

In 1987, the TBAC was absorbed into the ACPC through Executive Order (EO) 113 of 1986 to assist the MAF in synchronizing all credit policies and programs in support of the MAF's priority programs.¹⁶ Under EO 113, the ACPC was also tasked to review and evaluate the economic soundness of all ongoing and proposed agricultural credit programs, whether for domestic or foreign funding, prior to approval.

¹⁶ Priority programs included land development/improvement and farm production; farm mechanization, production and supply of agricultural inputs, transportation and storage, processing, marketing and related activities, small farm financing, and resource mobilization.

Baseline assessment of rural banks

In February 1987, the RBRRC presented its baseline assessment on agricultural lending to the MB, concluding that the formal credit system (loans from the Philippine banking system) did not adequately support the twin goals of agricultural transformation and rural development. The average proportion of total formal loans channeled to agricultural production was only 9% from 1978 to 1985 (Table 2). Agriculture was deemed high-risk, long gestating, and high-cost relative to industry and commerce.

Table 2. Selected Agricultural Credit Indicators, 1978-1985

Year	Agricultural Loans Granted (P Billions)		Share of Agriculture to Total Loans (%)	Ratio of Agri Loans Granted to GVA ¹ (%)	Share of Rural Banks' to Total Agri Loans (%)
	Current	Real (1972=100)			
1978	12.4	5.7	7.4	22.3	19.2
1979	17.9	7.3	9.2	29.0	16.5
1980	20.9	7.5	9.2	30.2	15.5
1981	25.4	9.0	9.1	33.1	14.7
1982	27.3	9.0	8.2	32.2	15.8
1983	28.3	8.3	8.0	20.2	16.3
1984	27.1	5.0	8.1	19.4	12.4
1985	27.0	4.5	9.9	16.7	10.3
Average					
1978-85			8.6	25.4	15.1
1978-83			8.5	27.8	16.3
1984-85			9.0	18.0	11.4

¹Gross Value Added (GVA)

Source: Agricultural Credit Study, Technical Board for Agricultural Credit (TBAC)

The RBRRC likewise identified four key problems besetting the rural banking industry:

First, excessive exposure to the agriculture sector (around 84% of total loan portfolio) and high levels of past due loans (nearly 88% of total loan portfolio).¹⁷ Diversification of risk is essential in banking. Many past bank failures have been due to credit risk concentrations of some kind. It is essential for banks to prevent undue credit risk concentrations from excessive exposures to particular counterparties, industries, economic sectors, regions, or countries.¹⁸

Second, out of the PHP 3.1 billion CBP rediscounts to rural banks, about 83% were past due and in arrears.¹⁹ Rediscounting is a privilege of qualified banks that have an approved and active rediscounting line with the CBP to obtain loans or advances using eligible papers of its end-user borrowers as collaterals. It is a standing credit facility to help banks meet temporary liquidity needs by refinancing the loans they extend to their clients. The arrearages problem though was evidently short-circuiting the transmission mechanism of this monetary policy tool.

Third, out of the 867 operating rural banks at that time, 423 (49%) had insufficient capital.²⁰ Majority of these banks were deficient by at least PHP 400,000 from the minimum capital requirement of PHP 500,000.

¹⁷ Figures as of end-December 1985

¹⁸ The Bangko Sentral ng Pilipinas (BSP) would eventually establish the guidelines for managing large exposures and credit risk concentrations in line with its objective of strengthening risk management in the banking system (Circular No. 414 dated 13 January 2004).

¹⁹ Figures as of end-April 1986

²⁰ Figures as of end-September 1986

Though the CAMELS²¹ framework has yet to be introduced, the RBRRC assessment already had an appreciation of the fact that capital adequacy or availability ultimately determines the robustness of financial institutions to withstand shocks to their balance sheets. In that case, the 423 rural banks were not only experiencing heightened vulnerability to shocks but also facing varying degrees of insolvency (116 rural banks were running on negative net worth).

Lastly, rural banks were highly dependent on government rediscounting as a source of loanable funds. Rural banks recorded a 48% ratio of rediscounts to total loans, which was substantially higher than the 4% average for all banks. Meanwhile, the ratio of deposits to total loans of the rural banking industry stood at 49%, significantly lower compared with that of the entire banking system at 81%.²² These indicators could highlight excessive maturity mismatches and a need for more careful liquidity management. For instance, a low ratio of deposits to total loans might indicate potential liquidity stress in the rural banking industry and perhaps a loss of depositor and investor confidence in the long-term viability of the sector.

The principles-based reform package

The RBRRC proposed rehabilitation package was anchored on three core principles: (A) take a selective but meaningful stance on issues, (B) lay the foundation for long-term

²¹ The CAMELS rating is a supervisory rating system originally developed in the United States to classify a bank's overall condition. CAMELS is the acronym for six key components of a bank's condition, namely, Capital adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity to market risk.

²² Figures as of end-April 1986

independent viability of rural banking institutions, and (C) involve no new government budgetary (fiscal) outlays. On the whole, the proposed rehabilitation program had the following important features:

New additional private capital

First among equals was the infusion of new additional private capital in the form of cash from existing investors in rural banks. The immediate infusion by private investors of fresh capital must be equal to the deficiency in capital necessary to achieve the 10% minimum risk asset ratio or 10% of total arrearages to the CBP, whichever was higher, based on latest examination reports. Where necessary, the 20% ceiling on the voting equity in a rural bank by an individual family group would be waived for participating banks and the bank would be allowed to amend its articles of incorporation in order to increase its authorized capital.

Option for conversion or plan of payment

The second feature pertained to the conversion into temporary equity or plan of payment for existing rediscounting arrearages. With regards to the temporary government equity option, all supervised rediscounts in arrears to the CBP would be converted, at par value, into paid-in capital of the government in the form of common shares in the name of the Land Bank of the Philippines (LBP). The other option involved all supervised past due loans to borrowers would be covered by a plan of payment not exceeding ten years.²³ Covered accounts should be excluded from the computation of the past due ratio as long as the plan was complied with.

²³ Extended to 15 years by virtue of Circular 1172 (March 1988), one of two amendments of Circular 1143 (April 1987); the other was Circular 1153 (October 1987)

Repurchase of government equity

The third feature granted the privilege for existing investors to repurchase, under certain terms and conditions, temporary government equity. The private owners of the rural bank retained the right of first refusal²⁴ to the repurchase of the government's common stock in the bank. Should the owners elect to repurchase, they will enter into a repurchase program with the LBP for a maximum of ten years in equal annual installments. The LBP retained the option to exercise the appropriate rights accorded to it by stock ownership in the event that the rural bank was unable to comply with the repurchase schedule.

Rationalized rediscounting

The fourth and final feature set up a rationalized rediscounting system under terms and conditions that would reduce the dependence of rural banks on government sources for on-lending. Rural banks participating in the program would be allowed to rediscount with the CBP according to existing guidelines, subject to the following modifications: (A) to impose a penalty rate on loans with unremitted collections equal to the prevailing (current) rediscount rate plus 5%; (B) to increase the allowable maximum per rediscounting application; (C) to allow rural banks to impose a flexible penalty rate on past due loans (i.e., the difference between the rediscount rate at the time the rediscounted loan was granted and at the time of payment, or 5%, whichever is higher); (D) to reduce the total rediscount ceiling to 100% of net worth plus 50% of average time and savings deposits over a six-year period; (E) to reduce

²⁴ Right of first refusal is a contractual right, but not obligation, to enter into a business transaction with a person or company before anyone else can. If the entity with the right of first refusal declines to enter into a transaction, the owner of the asset who offered the right is free to open the bidding up to other interested parties.

the loan value of papers eligible for rediscounting from 80% to 60% over a six-year period; and (F) to raise the allowable rediscounting availment from 60% to 70% of repayments as applied to principal.

A bitter yet potent pill

On the basis of projections submitted by the RBRRC, the proposal was expected to raise more or less PHP 0.4 billion worth of new money from rural banks and PHP 1.7 billion from the government in the form of arrearages converted into equity.²⁵ The new additional investment of rural banks would serve as the eligibility ticket to the program and would indicate their commitment to their own banks.

On one hand, conversion of arrearages into equity would improve the liabilities status of rural banks and, together with the new capital input from private owners, would strengthen the solvency position of the banks (i.e., improved capacity to absorb bad debts). On the other hand, the conversion vehicle would ensure significant participation of the National Government in the reform process.

Meantime, the proposed mode of payment would improve the assets position of the rural banks, forming the basis for continued collection on past dues as well as the write-off for uncollectible. The repurchase of government equity agreement would set up the re-privatization of the concerned rural banks while the rationalized rediscounting, as mentioned, would reduce the dependence of rural banks on government-sourced funds for on-lending.

²⁵ The RBRRC estimated that as of end of 1986, there were 500 Rural Banks with arrearages from the CBP with about 300 to 350 Rural Banks needing rehabilitation (Dominguez 1988 as stated in Lim and Agabin 1993).

A conduit government bank

The LBP played an important role in the rural bank rehabilitation package. From the CBP's perspective, the LBP's participation could be effected by a transfer of the obligations of the participating rural banks to the LBP. As it was the precedent under CB Circular Nos. 649 (dated 16 January 1979) and 772 (dated 13 January 1981), the CBP granted the LBP a standby fund or loan from which the LBP drew the funds necessary for the conversion of rural bank arrearages into government equity. The loan to the LBP was non-interest bearing for a period of ten years and was free from all fees and assessments.

A negotiation process between the CBP and LBP would have to be established to determine (A) the value at which (rural bank to CBP) arrearages (e.g., CBP collectibles or assets) would be converted to LBP equity; (B) the value at which the LBP equity might be repurchased by private investors; and (C) the repurchase schedule (e.g., all-or-nothing or gradual) at which the LBP equity may be repurchased.

Program implementation under Circular 1143

The CBP issued Circular No. 1143 (dated 24 April 1987)²⁶ to govern the implementation of the program assisting the rural banks.²⁷ The salient features of the Circular are:

²⁶ Central Bank of the Philippines (CBP), 1987 *Annual Report: Major Economic Laws and Banking Regulations* (Manila: CBP, 1987): 328-33.

²⁷ Circular 1143 was amended by Circulars 1158 (October 1987) and 1172 (March 1988) essentially relaxing the entry requirement (i.e., capital infusion) and extending the plan of payment from 10 to 15 years.

Statement of policy

The program aimed to strengthen the rural banking system and place rural banks in a position to more adequately provide banking services to the rural sector through a capital build-up and conversion scheme and/or plan of payment for rural banks experiencing financial difficulty.

Qualification requirements

All rural banks with arrearages were considered eligible to participate under the program except those with serious irregularities based on examination findings of the CBP. Further, a rural bank desiring to participate in the program should file an application with the CBP's Supervision and Examination Sector (SES) Department III.

Fresh capital infusion

Upon approval of the application by the MB, new capital in cash equal to at least 10% of the rural bank's supervised credit arrearages with the CBP including accrued interest but excluding penalties—or an amount equal to the deficiency in capital of the bank required to achieve the minimum risk asset ratio, as determined in the latest examination report, whichever is higher—should be paid into the rural bank by private stockholders, including new and individual corporate stockholders, provided that another banking institution might invest as new corporate stockholders subject to existing regulations. Upon meeting this requirement, the participating rural bank might avail of the conversion scheme and/or plan of payment.

Conversion scheme

All arrearages under the conversion scheme might be converted into paid-in capital in the name of the LBP. Accrued interest on the arrearages might be covered by a plan of payment between the rural bank and the CBP on an equal annual amortization schedule over a period not exceeding ten years.²⁸

The shares of stock issued in the name of the LBP should be in the form of common shares, which should, in all cases, be limited to not more than 49% of the common stock. After that, any excess over 49% should be in the form of convertible preferred shares.

In case the conversion scheme would necessitate an increase in the bank's authorized capital, the rural bank should effect an amendment of its articles of incorporation to increase such authorized capital stock to an amount called for under the conversion scheme.

Plan of payment

The participating rural bank may enter into a plan of payment with the CBP even if it had not availed of the conversion scheme. In such case, the plan of payment might cover the rural bank's arrearages with the CBP on the following: (A) rediscounting obligations against both supervised and non-supervised credit papers, including accrued interest on supervised arrearages as of the date of conversion; (2) special time deposits by the CBP in the rural bank under special financing programs in arrears as of 31 December 1986; and (3) obligations incurred by the rural bank to the CBP under the CBP-IBRD lending program for mechanization.

²⁸ Extended to 15 years (Circular 1172)

The plan of payment should be on an equal monthly amortization schedule over a period not exceeding ten years.²⁹ If the rural bank had availed of the conversion scheme, the plan of payment should cover all unconverted past due obligations, including accrued interest on the supervised credit rediscounting arrearages as of the date of conversion of the principal amount. The plan should likewise be on an equal monthly amortization schedule over a period not exceeding ten years.

Industry rationalization

The RBRRC completed the formulation of the strategy and program for the rehabilitation of rural banks in 1987. From 1987 to 1993, the CBP implemented the program with resolve. Many rural banks were put under rehabilitation and recapitalization programs, merged with other banks, or, if these measures failed, closed.³⁰

Overall, the rehabilitation process for banks is painstaking and long-drawn-out. When rural banks are found in distress they are closely monitored and advised by the CBP through several cycles of annual formal examinations. Failing the close monitoring phase, ailing rural banks are put into formal rehabilitation programs. Only after the rehabilitation program fails, after a total of 3–6 years, is formal closure pursued.

²⁹ Extended to 15 years (Circular 1172)

³⁰ As of 31 March 1992, 489 Rural Banks entered into the program: 453 underwent rehabilitation and/or recapitalization while 3 were merged with other banks and 33 were placed under receivership. By end of 1992, the program enabled 431 Rural Banks to settle about PHP 800 million of the PHP 1.7 million arrearages and placed under plan of payment of PHP 700 million more. (Lim and Agabin 1993)

In 1987, the year when Circular 1143 was released, 168 bank closures were handled by the CBP and the Philippine Deposit Insurance Corporation (PDIC). Parallel to this, the *Masagana 99* program for rice and other special financing programs were phased out and integrated into the CALF.³¹

As the *Bangko Sentral ng Pilipinas* (BSP) replaced the old CBP on 3 July 1993,³² it started to restrict the granting of new bank licenses but at the same time push for existing rural banks to widen their reach and maximize delivery of financial services, especially among the unbanked or underserved areas. Circular No. 624 (dated 13 October 2008) rationalized existing regulations on the establishments of banking offices to further improve delivery of banking services.

Table 3 shows the pattern and trend for rural bank composition over the past 35 years. In the early years of the RBRRC reform program (between 1987 to 1992), there were many bank closures. The new Rural Bank Act of 1992 put the system on a new starting base. Since 1993, there has been a steady decline in the number of rural bank head offices: from 780 in 1993 to 472 at the end of 2018. However, the total number of rural bank head offices plus branches continued to grow, from 415 in 1993 to 3,065 in 2018.

Clearly there has been definite consolidation in the rural banking industry, with the smaller, weaker rural banks falling by the wayside while the larger, stronger rural banks have grown.

³¹ CBP Supervision and Examination Sector, 1987 *Annual Report of the Philippine Rural Banking System* (Manila: Central Bank of the Philippines, 1988).

³² RA 7653 (signed 14 June 1993) or the New Central Bank Act

**Table 3. Rural and Cooperative Banks:
Number of Offices and Industry Turnover**

Physical Composition	1985	1987	1993	1998	2003	2008	2013	2018
Head Offices	904	850	780	826	765	703	566	472
Branches/Other Offices	213	210	415	1,116	1,156	1,445	2,080	2,593
Total	1,117	1,060	1,195	,942	1,921	2,148	2,646	3,065
Entry and Exit of Industry Players								
New Players	-	-	-	9	2	1	-	-
Bank Closures	118	168	4	2	7	23	18	12

Sources: Annual Report of the Philippine Rural Banking System (1985 and 1987); Report on the Philippine Financial System (various issues)

Conclusion

The RBRRC got to work in 1986 immediately, impelled by the sense of historical urgency of the task shared between the CBP and MAF. Its sombre mood was said to be lightened a bit by an apocryphal story that circulated around rural bank circles of the time. It told of the prevailing viewpoints of the succeeding Central Bank Governors toward rural banks, each viewpoint reflecting the policy of each succeeding regime: “During the time of Governor Gregorio S Licaros (1970-81), whenever the rural banks had a problem, the Governor would say ‘*Tulongan*’ (Let us help!). Then, during the time of Governor Jaime C. Laya (1981-84), he would say ‘*Pag-aralan*’ (Let us study!). Finally, during the reform-heavy term of Governor Jose B. Fernandez, Jr. (1984-90), he would declare ‘*Isara*’ (Let us close!).”

The RBRRC initiative was the first to recognize the underlying problem in the “*Tuhungan, Pag-aralan, Isara*” anecdote of the period. That is, the country’s strategy of supply-led agricultural finance was not really working as evidenced by the rediscounting and arrearages problems, as well as by the excessive loan concentration risk and high incidence of past due loans in the agriculture sector.³³ Further, most rediscounting and directed credit programs of the National Government, especially the *Masagana 99* program for rice, were perceived by farmer beneficiaries not as a loan that must be repaid but as a dole out. As a result, loan proceeds were used for consumption purposes and not for working capital needs. On the whole, the supply-led finance resulted in fiscal hemorrhage.

Thus, the RBRRC and the ensuing rehabilitation program under CB Circular 1143 were pioneering. The RBRRC acted as the earliest form of “White Knight” to the rural bank industry, even ahead of PDIC’s purchase and assumption method,³⁴ and a more pleasant pill than its payoff method.³⁵ Meanwhile, the rehabilitation program predated the prompt corrective action (PCA) method of the BSP. Basically, the rehabilitation program was the earliest form of a structured early intervention and resolution approach that aimed to restore the financial health of banks that were at risk by limiting the deterioration in their health and preserving their capital levels.

Three decades after the first major initiative to reform Philippine rural banks, the industry has now come to a position of relative strength and stability, while still being

³³ V. Bruce J. Tolentino, *Agricultural Credit Policy: Some Lessons for Vietnam from the Philippines and Other Developing Countries*, 1991.

³⁴ The PDIC reorganizes the bank, typically by finding a willing merger partner who assumes (takes over) all of the failed bank’s liabilities so that no depositor or other creditor loses a centavo.

³⁵ The PDIC allows the bank to fail and pays off deposits up to the (P100,000 at that time) insurance limits.

somewhat saddled with constraints inherited from policies prevailing before the mid-1980s. Today, rural bankers have room to build on the relationship and market familiarity that they have established with their rural communities. It is strategically possible for financial technology or *fintech* to enhance relationships.

BSP statistics on financial inclusion³⁶ show that around 34% of the country's cities and municipalities are still unbanked as of the third quarter of 2018. Remoteness is one of the main factors that limit people's access to formal financial institutions. Access to financial products and services in the country remains a huge challenge.

Rural banks are well-positioned to respond to this challenge, given their geographic advantage and expansive network. As of end-December 2018, there were 472 Rural Banks³⁷ with a collective network of 3,605 head offices and branches. While the larger banks are concentrated in highly urbanized and densely populated regions of the Philippines such as the National Capital Region (NCR), Region IV-A (CALABARZON)³⁸ and Central Luzon, there are rural banks that thrive in regions where there is less access to financial services. In Ilocos, Cagayan Valley, Region IV-B (MIMAROPA),³⁹ Bicol, Caraga, and Cordillera, there are more rural banks compared with other bank types (Table 4).

³⁶ BSP website, *Financial Inclusion in the Philippines Dashboard Q3 2018*

³⁷ The rural banking industry includes 25 cooperative banks with a network of 156 offices.

³⁸ CALABARZON is the acronym of the five provinces of Southern Tagalog Mainland, namely, Cavite, Laguna, Batangas, Rizal and Quezon.

³⁹ MIMAROPA is the acronym of the five provinces of South-western Tagalog Region, namely, Mindoro (Occidental and Oriental), Marinduque, Romblon and Palawan.

Rural banks are also the frontrunners in the establishment of branch-lite units. Branch-lites were introduced to enable banks to have a presence in areas where it is not economically feasible to establish a full-blown branch.⁴⁰ Out of 1,909 operating branch-lite units, 54% (or 1,012 branch-lites) are owned by rural banks.

Table 4. Regional Distribution of Philippine Bank Offices
(As of End-December 2018)

Region	Universal & Commercial Banks (UKBs)	Thrift Banks (TBs)	Rural & Cooperative Banks (RCBs)
National Capital Region (NCR)	3,057	588	94
Region I (Ilocos Region)	224	164	233
Region II (Cagayan Valley)	137	87	201
Region III (Central Luzon)	565	323	398
Region IV-A (CALABARZON)	727	563	535
Region IV-B (MIMAROPA)	74	65	153
Region V (Bicol Region)	153	109	237
Region VI (Western Visayas)	314	149	241
Region VII (Central Visayas)	425	185	245
Region VIII (Eastern Visayas)	118	51	90
Region IX (Zamboanga Peninsula)	107	55	76
Region X (Northern Mindanao)	172	97	138
Region XI (Davao Region)	235	88	147
Region XII (SOCCSKSARGEN)	131	57	87
Region XIII (Caraga)	66	49	101
Cordillera Administrative Region (CAR)	74	26	86
Autonomous Region in Muslim Mindanao (ARMM)	15	1	3
Nationwide	6,594	2,657	3,065

Source: Bangko Sentral ng Pilipinas

⁴⁰ Circular No. 987 dated 28 December 2017

Clearly, there are opportunities and niches in rural and agricultural finance that rural banks are uniquely suited to exploit. To achieve this may require a new wave of reform similar to the step change enabled under the RBRRC in 1986-87. The next reform must enable the rural banks to shed the vestiges of their origins in supply-led finance and positively embrace the digital innovations enabled by the fourth Industrial Revolution.

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CHAPTER 3

Credit policy and rent-seeking among small banks in developing countries

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V. Bruce J. Tolentino¹

Since the early 1990s the focus of rural finance research has dramatically shifted from the narrow “farm-level impact of credit” to a broader concern which is the efficient operation of the rural financial market as a whole.² In such a wider context, dominant views on the financial intermediary’s role also change. In particular, small rural bankers are increasingly being perceived less as simple, one-way, passive conduits of funds from lenders to farmers and more as active, profit-maximizing firms and producers of loans and financial services (Von Pischke, 1978). As active participants in the rural financial market, the small bankers’ activities are non-neutral factors in the rural economy. However, their profit-maximizing activities are conditioned by policy: to the extent that policy

¹ Fellow, Center for Policy and Development Studies, University of the Philippines at Los Baños. Refer to Dr. Tolentino’s PhD dissertation, *Economies of Scale, Relative Efficiency and Banking Policy: An Application to the Philippines*, submitted to the University of Hawaii in August 1986.

² For comprehensive reviews on the shift in the “mindset” of rural financial market researchers, see David and Meyer (1979) for the initial narrow view and Adams (1983) for the “new view.”

affects the bankers' costs and revenues, then ultimately policy determines the flow and level of funds in the rural economy.

This paper attempts to model some aspects of the small LDC (less-developed country) bankers' profit-maximizing, decision-making processes in response to a range of policy actions. Part 1 lists the assumptions employed in the model and develops an initial exposition of the model in the absence of policy-engendered incentives or constraints. Parts 2 through 4 modify the initial model given the operation of policies affecting the bankers' costs and revenues, including: (A) cost-of-fund subsidies, (B) allocation of relending funds, (C) government equity participation, (D) loan allocation quotas, and (E) interest rate ceilings.

Initial model

Assumptions. As a first approximation, the following features apply: (A) the market is competitive, and therefore the price for output is determined in the market, and is seen by the representative price-taking firm as average revenue AR (equal to marginal revenue, MR). The prices of inputs into the firm's production function are determined in the market for factors; (B) the banker operates as a profit-maximizer; (C) there is no deliberate malfeasance on the part of either the banker or his customers/borrowers; (D) monitoring of banking activities by regulatory agencies is efficient; and (E) the banker does not expend efforts or costs to ensure that policy extends to and benefits his operations.³ The assumptions of "no malfeasance"

³ In other words, the small banker does not engage in "directly unproductive profit-seeking" activities in order to secure license and the like which entitle him to incentive and subsidy support. Of course, to the extent that directly unproductive profit-seeking (DUP) activities are undertaken, such activities increase the banker's costs and are also ultimately dissipated as deadweight losses to society. See Bhagwati (1984).

in C and efficient regulation in D will be relaxed in stages in the latter part of this section.

Policies. The specific policy measures considered for this model, as illustrated below in stages, affect the operations of the small banker via his cost and/or revenue structures. First to be considered are those that effectively reduce the banker's cost of operations: (A) reductions on the rediscount rate charged by the Central Bank on loans made to qualifying banks; (B) subsidies on both fixed and variable costs of operation; and (C) government equity contributions. Policies affecting the banker revenues are those which set interest rate ceilings and lending quotas.

The lender's optimum without subsidies

Initial examination focuses on the case of the lender operating without special support from the government. His costs are determined as follows:

$$(1) \quad C = r_1 L_1 + r_2 (q L_1) + H + m [L_1 (1 + q)]$$

where:

- C = total cost,
- r_1 = constant, average opportunity cost of "own" funds,
- L_1 = loan funds generated by the lender from internal - "own" sources,
- r_2 = rediscount rate charged by the Central Bank,
- q = government-set proportion of funds eligible for rediscounting,
- H = fixed costs of loan handling, and
- m = per unit variable cost of loan handling, broadly defined to include monitoring and other risk-reducing activities.

The lender operates to at least cover his average variable cost out of revenues, R . R is simply the product of the market rate of interest i^* and the total amount loaned out, $L_1(1 + q)$. His profit π is the difference between his revenues and cost, and will be at a maximum where the first-order conditions hold as:

$$\begin{aligned} \partial\pi/\partial[L_1(1 + q)] &= \partial R/\partial[L_1(1 + q)] \\ (2) \quad &- \partial C/\partial[L_1(1 + q)] = 0 \end{aligned}$$

or,

$$MR = MC$$

when the slopes of the total cost and total revenue curves are parallel or equal. The above unrestricted, pre-policy implementation optimum is illustrated in Fig. 1.

In the upper panel, the lender equates marginal revenue and marginal cost and lends out the optimal amount of loans L^* . Above L^* , the distance between the cost and revenue curves is at its maximum, and the lender is thus maximizing profit, equal to the area below the linear revenue line and above the convex (upward) cost function. In the lower panel, the lender responds to the market-determined price-interest rate i^* , and equates his MC with i^* , which is his marginal revenue. In the process, he generates profits, represented by the rectangle above average cost and below the price line, i^*qnm . Since the lender operates along his MC curve, and since he will not supply loans at interest rates below minimum AC when he can no longer cover at least his average variable cost, his effective supply curve is his MC curve above minimum AC . That is, his supply curve is $OminACpnMC$. When:

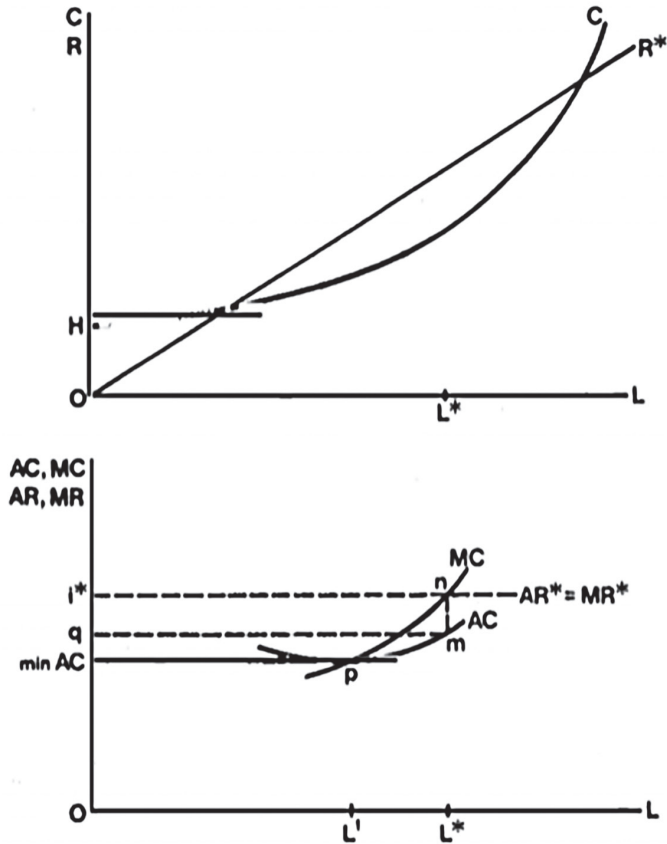


Figure 1. The unregulated optimum of the banking firm

$$i^* \leq \min AC,$$

then

$$L = 0.$$

However, when:

$$i^* \geq p,$$

then

$$L \geq L'.$$

Policies affecting lending costs

Allocation of special funds for re/ending, and the associated subsidies for costs related to the re/ending funds. One of the most popular and common programs (or set of programs) implemented by governments under the “supply-leading” strategy of rural finance is to allocate funds to banks for relending to some identified “priority” activity, crop, or agricultural product. The allocation of the relending funds is often accompanied by other incentives for participation, including: (a) lower interest rates on relending funds; (b) lower rediscounting rates on loan paper produced from relending funds; (c) greater proportions of loan papers eligible for rediscounting; and (d) subsidies on both fixed and variable costs of loan handling like training for staff, fees, licenses, permits, and taxes. The rationale for all the incentives is usually that the specialized programs requiring credit are relatively riskier or monitoring-intensive and are thus more costly. Without the incentives, it is believed that these activities will not be able to secure the credit that they “deserve.”

With the incentives, the lender’s cost function becomes:

$$\begin{aligned} (3) \quad C^e &= r_1 L_1 + r_2 (q L_1) + r_3 L_2 \\ &+ [r_2 (1-s) q L_2] + (1 - h) H \\ &+ m [L_1 (1 + q)] \\ &+ [(1 - n)m] [L_2 (1 + q)] \end{aligned}$$

where:

- L_2 = relending funds,
- r_3 = the rate on relending funds,
- s = discount given on the rediscount rate charged on loan papers generated from relending funds,
- h = per unit subsidy on H ,
- n = discount (subsidy) on variable handling cost,

and the other variables are defined as before. There is often a condition that the participating banks may only avail themselves of the subsidies s , h , and n so long as their size, represented by their total loan portfolio, does not exceed some government-set maximum, say,

where:

$$\sum_{i=1}^2 L_i \leq \text{max},$$

$$i = 1, 2.$$

The rationale behind the size criteria implies a popularly held notion that there is a positive relation between size, efficiency, and profitability and, therefore, support should generally be limited to small “infant” banks. Furthermore, the “social goals” of development funding are often thought to be of greater importance than lender profitability. So long as lending to the needy target sectors is accomplished, then the subsidies are a necessary cost of development.

The effect of the subsidies is illustrated in Fig. 2. The total cost function shifts downward, and so do the associated marginal and average cost functions. Given fixed prices, the lower total

and per unit costs result in greater profits. However, due to the criteria limiting the granting of subsidies only to banks of size

$$\sum_{j=1}^2 L_j^{max}$$

and smaller, the post-subsidy, effective total cost function C^e , as well as the subsidized average and marginal cost curves

$$AC^e \text{ and } MC^e,$$

are kinked at the loan output level l:

$$\sum_{j=1}^2 L_j^{max}. \text{ Under size } \sum_{j=1}^2 L_j^{max},$$

banker operates along the subsidized marginal and average cost curves

$$MC' \text{ and } AC'$$

Beyond the maximum size point, the banker operates along the unsubsidized AC and MC curves.

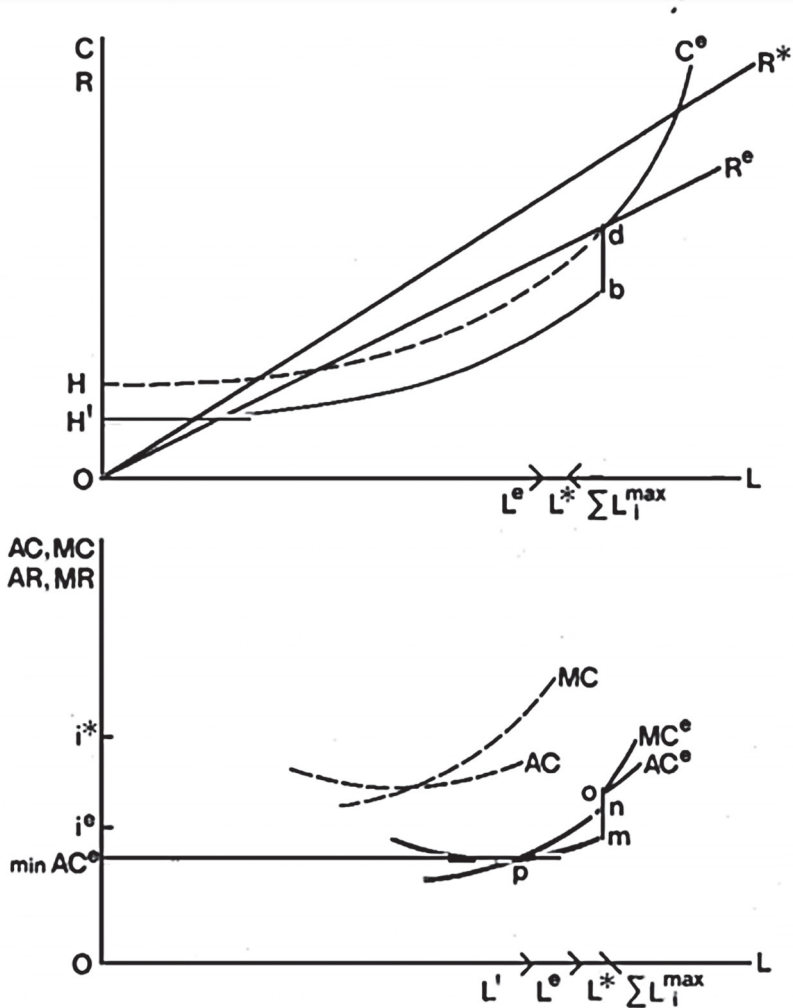


Figure 2. The Optimum of the small banker, given subsidies, a loan allocation quota and an interest rate ceiling

Policies principally affecting lender's revenues

The lender's revenues may be represented as the product of the interest rate and the quantity of loans given out. For simplicity, it is assumed that the lender's revenues are generated principally from loan operations, and revenues from other banking services like safety deposit rentals, transfer, and trust services are zero or negligible. Total revenue R is therefore:

$$R = i^*[L_1(1 + q) + L_2(1 + q)]$$

or

$$(4) \quad R = i^*[\sum_{i=1}^2 L_i (1 + q)]$$

where:

R = revenue, and

i^* = the single market lending rate,

and the other variables are as defined in previous sections.

Lending quotas. Often, regulation is enacted which decrees that a minimum proportion of loan funds must be allocated to agriculture or some other "policy favored" sector. The rationale behind such regulation is that lenders, if left on their own, will not lend to these sectors which often pose greater levels of risk, and thus require more loan monitoring and handling inputs.

Now, suppose policy is enacted with the purpose of diverting more funds to agriculture, by decree that at least some proportion α of all loan funds be allocated to agricultural loans. Where there are no differences in the rates charged for agriculture and those charged for non-agricultural loans, i.e., there is a single market rate, then the revenue function will be:

$$(5) \quad R = i^* \left[\alpha \sum_{i=1}^2 L_i \{1 + q\} \right] + i^* \left[(1 - \alpha) \left(\sum_{i=1}^2 L_i \{1 + q\} \right) \right].$$

where:

α = proportion of total loan funds required to be allocated to agriculture.

With the quota on loans to the priority sector in effect, and where the interest rates that may be charged in each market are equal, the lender's revenues are equal to those without the quota. However, to the extent that loans to the priority sector are indeed riskier or monitoring-intensive, then the lender's costs will rise, and his profits, given unchanging revenues, will fall.

Interest rate ceilings. The imposition of ceilings on lending rates on loans to favored sectors is often thought to be a necessary complement to the allocation measure, since the higher costs of handling associated with agricultural loans would cause lenders to charge agricultural borrowers correspondingly higher rates. Therefore, to "protect" agricultural borrowers, a ceiling say, i^{max} on agricultural loan rates is imposed. Given that ceiling, the lender's revenue function now becomes:

$$(6) \quad R^e = i^{max} [\alpha (\sum_{i=1}^2 L_i \{1 + q\})] \\ + i^* [(1 - \alpha) (\sum_{i=1}^2 L_i \{1 + q\})].$$

where:

R^e = effective total revenue with interest rate ceilings, and
 i^{max} = maximum lending rate on loans to agriculture.

Since $i^{max} < i^*$, then $R' < R$, revenues at given loan levels would be lower. With unchanging costs, profits will be lower. To the extent that loan handling costs on loans to the favored sector are higher, then profits will go down further.

The small banker's optimum given subsidies, a loan allocation quota, and an interest rate ceiling

The cost-reducing and revenue-controlling regulatory measures as enumerated above combine to form a powerful package of incentives which largely shape the actions of the profit-maximizing lender. The small banker's optimum, given the incentives and controls, is illustrated in the discussions following.

In panel (a) of Fig. 2, total revenue is a straight line from the origin R , the product of the loans given out L , and the market interest rate i^* . With the policy package, the applicable total revenue curve is R^e , the product of L and the effective interest rate i^e where:

$$i^e = R^e/L,$$

and R^e is determined as in Equation (6).

The horizontal axis shows the total of loan funds available to the small lender, made up of the various sources of such funds and their increase through rediscounting and relending. In the absence of the policy package, the banker would operate along the total cost curve HC and would find his profit-maximizing loan portfolio to be of total size L^* . With the operation of the incentives, the effective cost curve is the lower $H'C$, or (1

- $h)HabC$, which is kinked at the output level $\sum_{i=1}^2 L_i^{max}$ where

the subsidies may no longer be availed of. At $\sum_{i=1}^2 L_i^{max}$ and beyond, the banker must again operate along the higher cost

function. To induce the banker to move beyond $\sum_{i=1}^2 L_i^{max}$, he must receive compensation for the loss of the excess revenue = subsidy, represented by the area under R' and above $H' C$, less the area under R^e and above the pre-policy package cost curve HC .

In terms of the marginal and average costs in panel (b), the banker would operate along AC and MC in the absence of the incentive package. Given i^* , the banker will equate his marginal and average costs and produce the loans L^* , earning profits equal to the rectangle below the average revenue curve $AR = i^*$ and above the average cost curve AC . With the operation of the incentives, however, the banker's average and marginal cost curves shift to AC^e and MC^e . However, since the banker cannot enjoy the cost-reducing incentives from

the government at outputs above $\sum_{i=1}^2 L_i^{max}$, his effective AC and MC curves will be kinked at the points above $\sum_{i=1}^2 L_i^{max}$.

In order to induce him to move beyond $\sum_{i=1}^2 L_i^{max}$, he must be compensated for the loss of the additional profits (subsidy) that the move will entail.

Case A: The small banker's optimum with effective monitoring

As has been described, the small lender's optimum presumes that the monitoring of its operations by the regulatory authorities, among them the Central Bank (CB), is effective. That is, the prescribed minimum proportion of total funds loaned out is indeed allocated to agricultural loans at interest rates no higher than the ceiling rate. The banker will lend out to the favored sector only as much as he is forced to, since to exceed the minimum would result in greater costs and lower revenues and profits.

In this situation, the level of the ceiling lending rate and the maximum size criteria beyond which a small banker may no longer avail himself of subsidies become important policy variables which determine the banker's actions. In the discussion that follows, the size criteria are assumed as given and the effects of changes in the maximum interest rate chargeable on loans to the favored sector i^{max} are shown.

The lender responds to the effective lending rate i^e , which is determined by the combination of the market rate and the ceiling rate. The ceiling rate may be adjusted by the CB. As shown in Fig. 2, a ceiling rate that is set quite low, resulting in

the effective rate in the range: $i^e < \text{minimum } AC$ will result in the banker being unable to cover his costs of operation despite the availability of cost subsidies, and thus lead to a shutdown.

$$L^e = 0.$$

The banker will refuse to lend his own money and, thus, the loan funds provided by the government will not be allocated also. The low ceiling rate will therefore discourage rather than encourage business.

When the ceiling rate is set such that:

$$\text{minimum } AC \geq i^e < n,$$

then the banker will operate along his subsidized marginal cost curve and loan out:

$$L' \geq L^e \leq \sum_{i=1}^2 L_i^{max}$$

Therefore, the small bankers' optimum may be achieved at a size under the maximum possible subsidized size.

Finally, when the ceiling rate is set such that:

$$n \geq i^e < 0,$$

then the banker will be able to operate along the vertical portion of the kinked post-policy average and marginal cost curves AC' and MC' , and produce

$$L^e = \sum_{i=1}^2 L_i^{max}$$

The banker is now constrained from expansion by the size limitation $\sum_{i=1}^2 L_i^{max}$. To expand beyond $\sum_{i=1}^2 L_i^{max}$ would cause the banker to lose the subsidies granted by the CB. He will be forced to operate along the higher, unsubsidized portions of the average and marginal curves.

Case B: The small banker's optimum with ineffective monitoring

In the setting described above, as illustrated in Fig. 2, the lender's revenues are indeed reduced by the combined policies of lending quotas and rate ceilings. The lender's costs are also effectively cut by the subsidy and incentive structure. This result, however, assumes that the prescribed minimum proportion of loan funds is indeed lent to the target low-interest borrowers. When monitoring by the regulatory agencies of the banker's operations is poor, as is inevitably the case in most developing countries, the banker is often able to divert a greater proportion of his loan funds to unrestricted-interest, higher-earning instruments. Thus, the effective interest rate by which he operates rises. His revenues thus also rise. These increases approach the limit of the unrestricted market interest rate and the associated free-market revenue:

$$\begin{aligned} \text{and } i^e & \text{-----} > i^*, \\ R^e & \text{-----} > R^*, \end{aligned}$$

The small banker is also encouraged to acquire the maximum possible allocation of loan funds from the government, so he can maximize his placements in the higher-earning markets. In the context of Equation (6), the banker acts to reduce the size of (a), so as to earn more revenues from relatively more funds in the higher-interest market.

The result of the diversion of the agricultural loan funds to higher-interest instruments may be seen in Fig. 2 as a counter-clockwise rotation of the R^e curve, approaching the unrestricted R^* curve. Thus, there will be greater profits given costs. As was already demonstrated in the previous section, at effective interest rates of n and above, the banker will access

loan funds up to the limit of $\sum_{i=1}^2 L_i^{max}$.

Ineffective monitoring: “float stratagems.” The banker may preserve or even raise his revenues by resorting to timing-dependent stratagems, including:

- delaying the release of loan funds to borrowers and, in the interim, investing the loan funds in the unrestricted and therefore higher-earning non agricultural credit market, i.e., “float” strategies. In such a manner, the banker is able to raise the effective interest rate and thus his revenues.
- giving emphasis to speedy turnaround loan processing, which minimizes the period within which the loan is held by the low-paying borrower and maximizes the period within which the loan funds may again be floated at higher rates.

These factors induce the profit-maximizing lender to choose borrowers by criteria which will fulfill the lender’s float objectives: highly liquid borrowers, borrowers willing to receive loans late and pay up early, and projects of very short duration. A greater proportion of the total loan funds is also concentrated among a smaller number of borrowers, those which meet both the lender’s explicit and implicit lending criteria. These criteria, in effect, screen out the very class of

borrowers on behalf of whom the regulations were enacted. Finally, to the extent that the loans diverted to the unrestricted loan market incur lower costs related to loan handling and monitoring, then the lender's total costs are further reduced and his profits increased. In terms of equation (4), h and m , and therefore C^e , fall.

Equity contributions by government

Finally, there is a need to examine the policy of government in encouraging the organization of new banks and the expansion of existing banks by providing equity contributions. This is done to increase the level and flow of funds through the financial system, particularly to those sectors considered "priority areas." Such an equity contribution is often made available only up to some maximum, usually equal to that already internally generated by the lender. Given the contribution, the lender's pre-policy cost function (15) may be modified to become:

$$(7) \quad C^e = r_1 L_1 + r_2 [q(L_1 + L_3)] \\ + H + m [(L_1 + L_3) (1 + q)].$$

where:

L_3 = the equity contribution by government.

and,

$$L_3 = L_1, \\ L_3 \leq L_3^{max},$$

and the other variables are defined as above. L_3 max is some maximum to equity contributions set by government policy. For simplicity, the equity contribution of the government is considered costless to the lender and is thus not explicitly included in expression (3).

With equity from the government, the lender's capacity to lend has been increased in two ways: from the equity-sourced increase in loan funds, L_3 , and from the increase in rediscounted funds, since the proportion eligible for rediscounting has increased from:

$$\begin{aligned} & \text{to} && q(L_1 + L_2), \\ & && q(L_1 + L_2 + L_3), \\ & \text{or} && q\left(\sum_{i=1}^3 L_i\right). \end{aligned}$$

Given fixed prices, the lender's total costs, revenues, and profits must also increase. However, increases in costs and revenues are not directly proportional. Revenues increase faster than costs, since the equity funds are costless to the bankers. The equity, in effect, is a "free" loan from the government. As shown in Fig. 3, the lender's supply function of loans, or the marginal cost curve above average variable cost, shifts rightward and downward. Given the conditions in the illustration, the equity contribution shifts the lender's supply curve from

$$\text{MinAC}^e \text{ pno } \text{MC}^e \text{ to } \text{MinAC}^{e'} \text{ pno } \text{MC}^{e'}.$$

All subsidies and equities considered. When the equity contribution of government in Stage 1 is considered along with the various incentives of Stage 2, the cost function of the lender is finally

$$\begin{aligned}
 C(S + E) = & r_1 L_1 + r_3 L_3 + r_2 [q(L_1 + L_2)] \\
 & + [(1 - s) r_2] [L_3(1 + q)] + (1 - h) H \\
 (8) \quad & + m [L_1(1 + q) + L_2(1 + q)] \\
 & + (1 - n) m [L_3(1 + q)].
 \end{aligned}$$

Conclusion

The simple model sketched above shows the profit-maximizing decision-making process of the small banking firm in response to policy. Many of these policies have been enacted in various LDCs over at least the past two decades, all with the purpose of increasing the level and flow of loans to producers, particularly farmers. However, the experience with such programs has generally been disappointing. The increases in loan use, if any, have been much less than expected. CBs and outside donor agencies have been unable to decrease their support for the operations of small banks, and small bankers have been unwilling and unable to gain independence from external support.

The model sketched in this paper shows that, when the small banker is viewed as the profit-maximizing financial firm that it is, it is clear that the small banker has little incentive to rid itself of CB support. In the subsidy and incentive-dominated

policy structure, the small banker finds it more profitable to generate its revenues via government support, and not from its loan portfolio. The pyramiding structure of incentives and subsidies flowing from the CB to the small bankers provides virtually guaranteed, minimal-cost, and low-risk revenue for small bankers. Thus, any income from loan operations is incidental to the process of generating rents from the subsidies and incentives.

If the subsidy and incentive structures remain in place, then recent efforts exerted by many LDC governments to revitalize their rural financial markets via the removal of ceilings on interest rates may have effects completely different from those expected. Removing interest rate ceilings will only maximize the rents that small bankers may extract from their operations, as they will now be able to charge maximum rates on their loans. Therefore, the deregulation of interest rates must be accompanied by the dismantling of the subsidy and incentive structure. To encourage bankers to enlarge their loan operations and look upon their portfolio as their primary source of revenue, the link between banker's revenues and government subsidies must be broken and reoriented to loans.

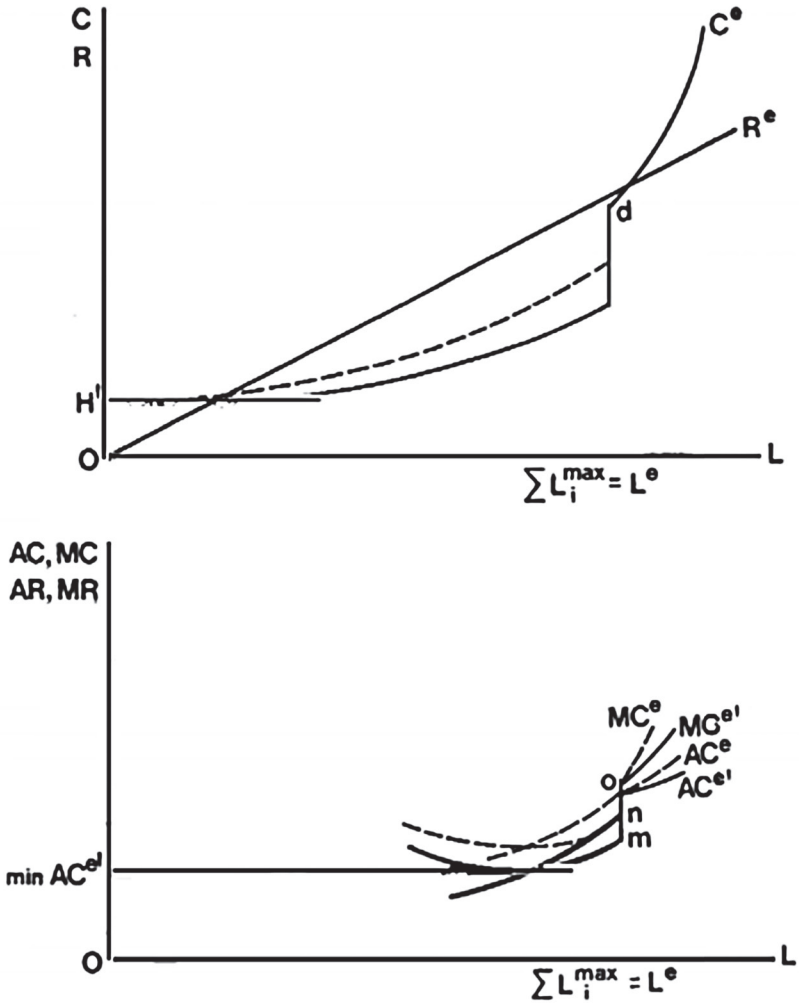


Figure 3. The small banker's optimum, with subsidies, an allocation quota, an interest rate ceiling and an equity contribution from government

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CHAPTER 4

ACPC cautions on the negative effects of total tax exemption and government equity infusion for rural banks¹

Policy Brief, Agricultural Credit Policy Council,
Vol. 2 No. 8 (16 October 1989)

The Agricultural Credit Policy Council (ACPC) shares the concerns of the authors of House Bill No. 22251 regarding the inadequate flow of funds to the countryside and believes in the need for a review of existing policies to identify whatever constraining policies remain.

The Bill contains both beneficial provisions and provisions counteractive to the thrusts of current financial reforms.

We especially laud the provision to exempt all qualified rural financial institutions from payment of the gross receipts tax. The gross receipts tax creates a form of double taxation of banks in addition to their corporate or income taxes.

We feel, however, that rural banks should not be exempted from the payment of all taxes and fees for a ten-year period

¹ Entered as Second-Class Mail at the Central Bank Post Office under Permit No. 222, dated 22 May 1989.

as provided in Sec. 5 of the proposed Bill. As we have noted in our comments on House Bills 19454 and 17418, an across-the-board tax exemption policy may boost rural banks' growth but bears negative effects on the national economy. First, tax preferences interfere with the income tax equity structure since some high-income earners would be paying proportionately less taxes than others. Second, tax exemptions result in revenue losses for the government because of uncollected income taxes. The government, to cover such revenue losses, may resort to foreign borrowings, inflationary finance, or tax increases. Third, tax exemptions are revenue shortfalls which are averse to government programs on public goods, such as infrastructure and support services.

Tax exemption as a form of fiscal incentive is also inconsistent with the 1986 Tax Reform Package which suggested, among others, the withdrawal of tax exemptions granted to certain industries. Given the same cost to the government plus the transparency feature, the preferability of a direct subsidy approach (for training and management skills upgrading) over tax exemptions should be considered.

Most importantly, Sec. 2 of the proposed Bill, which provides for the fresh infusion of equity by the government into qualified financial institutions, runs counter to the Rural Bank Rehabilitation Program. Rehabilitation requires a fresh capital infusion into the rural bank by private stockholders before the bank may participate in the program.

The purpose, of course, is to enjoin banks whose stockholders display financial strength and faith in the program. Under the program, capital assistance is also already provided to qualified banks through conversion of arrearages into LBP equity holdings.

REPUBLIC OF THE PHILIPPINES
 Department of Transportation and Communications
 POSTAL SERVICES OFFICE
 National Capital Region
 Legal Affairs Section
 1000 Manila

AGRICULTURAL CREDIT
 POLICY COUNCIL
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CHAPTER 5

The proposed scheme for the rehabilitation of rural banks

Staff of the Technical Board for
Agricultural Credit (17 July 1986)

Abstract

This paper analyzes the problems and proposed solutions offered for the rehabilitation of rural banks in the context of other monetary and financial reforms.

Present problems and issues of the rural banking system

1. Some 877 rural banks (80% of the total number) are at present either closed, under receivership, or disqualified from CB rediscounting privileges and other assistance due to:
 - their large arrears with the CB
 - lack of working capital
 - high past due on loan receivable assets
 - high cost and risk of small loans
 - problems of mismanagement and other inefficiencies

2. Rural bank arrears with the CB total PHP 3,041.2 million as of 31 December 1985 (Table 1), which is 2.2 times the systemwide capital accounts, as much as total deposit liabilities, and half of their volume of loans and discounts.

Table 1. Rural bank arrears as of 31 December 1985

	All rural banks		Average per rural bank
	Arrears (PHP Mn)	% of total loans outstanding	Arrears (PHP Mn)
CB rediscounts	2,597.40	80.4	2.96
Short-term deposits (STDs)	443.80	56.8	0.82
Total	3,041.20	75.8	3.78

3. About 71% of these arrears are related to past due loans granted for *Masagana 99*, other supervised credit programs, and previously restructured loans, for which retained earnings (REs) have not provided sufficient valuation reserves in the past.
4. The sudden lifting of tax exemption privilege in 1985, the deterioration of loan collections in the economy, the high cost of money, and the financial crises aggravated the high cost and liquidity problems of rural banks which were dealt the final blow when the CB rediscounting window was temporarily closed in 1985. These tax exemptions were recently restored, with the nontaxable ceilings raised up to the bank net worth of PHP 30 million, for a specified period of five years.

It must also be noted that the inability of many rural banks to cope with the crises has also been partly due to their smallness and weaknesses, resulting from management inadequacies and government policies that failed to encourage their growth/competition and inefficiency. Such policies include (1) government subsidies as equity and tax exemptions; (2) limiting the area of operations to the municipality; and (3) the previous restrictions of only one bank per municipality.

Some proposals on RB rehabilitation

The proposals of the Rural Bankers Association of the Philippines (RBAP), Mr. Bajada of United Coconut Planters Bank (UCPB), and Mr. Lamberte of PIDS¹ are not much different in approach. They involve (1) the conversion of arrears into government equity to be matched by new money infusion by rural banks; (2) lifting of restrictions on single family ownership; (3) availability of rediscounting facilities for rural banks; (4) longer restructuring period of bank's past due loan; (5) restoration of tax exemptions; and (5) allowing banks to undertake non-allied, non-financial services. The specific proposals are as follows:

On arrears and working capital

- Conversion of arrears to government equity. Both the Rural Bankers Association of the Philippines (RBAP) and Lamberte propose conversion into government

¹ Rationalization of Agricultural Credit by the Rural Bankers Association of the Philippines (RBAP), Mr. Noli Bajada's proposals per his letter to Mr. C. Dominguez on 18 April 1986; Mr. Mario Lamberte's Proposals to Strengthen the Rural Financial Market (RFM), a position paper submitted to the Task Force: 'Agriculture and Rural Development,' May 1986.

equity shares up to the unmatched common shares of participating banks; according to existing 1 to 1 ratio, with conversion in the form of preferred shares (RBAP); or in accordance with rural banks' 10-year capital buildup program, with conversion to common shares. Lamberte suggests further that the LBP sell these government-held common shares on behalf of CB to the public, in 5-year installments at the old rediscount rates. Bajada, on the other hand, prefers conversion into preferred shares issued to LBP, earning 2% p.a. redeemable in 10 years, to be matched by new capital infusion at 1 to 1 or 1 to 2 ratios.

- A ten-year restructuring period for arrearages not converted into equity (RBAP and Bajada). Bajada also proposes a grace period of 2 years.

On capital buildup

- Lifting of restrictions on 30% ownership of rural banks to any single-family circle (RBAP and Bajada). RBAP proposes a period of 5 years.
- Limit rural bank declaration of dividends to 50% of net income on 15% of paid-up capital, and only after providing all possible valuation reserves (Bajada).

On liquidity needs of rural banks

- Allow rediscounting with CB and participation in government credit programs (Bajada and Lamberte); and wholesale banking services of LBP (RBAP and Lamberte).

- Allow a longer restructuring period for past due loans granted by banks (Bajada proposes 10 years). Qualify as eligible for reserve on deposit liabilities; the “due from bank” account of rural bank and commercial bank deposits in rural banks (Bajada).

On improving income prospects of rural banks and measures to offset higher transaction costs and risks of small loans

- Restore tax exemptions from (a) gross receipts tax (GRT), (b) income tax on annual net profit, not to exceed 15% of its paid-up capital, and (c) exemption for other taxes (Bajada). RBAP proposes previous tax exemptions for a period of 5 years. Lamberte recognizes the need for a negative GRT tax incentive to cover higher transaction costs of small loans.
- Allow rural banks to undertake non-allied, non-financial activities such as trading and input dealership (Lamberte). REAP specifies investments in regional/provincial investment development corporations (IDCs) to be supported by LBP.

Proposed monetary reforms

Lamberte premises a rescue package under the following monetary regime:

- Freely floating interest rate policy.
- Limit CB rediscounting policy to control money supply rather than provide sources of loanable funds or to favor certain economic activities.

- Allow free entry into banking to foster competition through the lowering of prescribed capital requirement from PHP 0.5 million to 0.2 million, repealing the policy of having one rural bank per town, ownership, and liberalized branching policy.
- Repeal of the Agricultural Loan Quota Policy (PD 717) which unduly increases intermediation costs.
- Reorient LBP toward agriculture, specifically as (a) primarily wholesale lender to countryside banks; (b) retail lender in areas where private rural financial institutions are absent; and (c) administer, manage, and implement all treasury and foreign-funded agricultural loan programs.

Comments on previous rural bank rehabilitation proposals

Adverse effects of equity conversion. The sizeable conversion of arrears into government equity at this time will only aggravate policy inconsistencies and fragmentation of the financial structure, for the following reasons:

- A. We would be reverting to same old policy framework which we are trying to correct; where lower overhead costs of rural banks depended principally on fiscal incentives (government equity and tax exemptions) that, in turn, necessitated policies to limit their number, area of operations, and volume of tax-exempt loans so as to prevent their undue advantage over other banks. These fiscal incentives subsequently kept them small with the monopolistic inefficiencies in a municipality.

- B. It would thus be inconsistent with new policies lifting restrictions on entry and competition to increase the capital base of old rural banks through government equity. Not only would their loans have been forgiven, but instead these are turned into additional advantages over new ones or other types of banks that would begin operations in the same areas.
- C. It would thus harm private entrepreneurship in this country if government support is used to shift the burden of unprofitable loans and debts to the government, because no government can ever take the burden for all entrepreneurial failures in the economy. It can only provide the environment for entrepreneurs to recover, which indeed is all that private entrepreneurs expect. The present instance is unlike previous occasions where government equity support is given to rural banks in good economic standing in order to foster their growth.
- D. The scheme further aggravates government ownership and intervention in the entrepreneurial activities of the private sector. While Lamberte's proposed resale of such government equity to the private sector appears to solve the problem, it does not appreciate the fact that entrepreneurs, especially small ones, normally reserve the right to have a say or at least know who his partners or co-owners would be.
- E. The conversion of arrears up to the amount of unmatched common shares would still leave the substantial amount of CB loans in arrears. The rural bank total common stock of PHP 833.26 million is presently matched by PHP 181.68 million, which represents a matching of PHP 0.26 for every PHP 1 of private funded equity. CB loans-to-equity conversion of a total unmated amount of PHP

651.6 million would still leave arrears of PHP 2.3 billion in loans released through the CB rediscounting window.

- F. Arrears can be directly converted to equity in amounts up to that equal to STDs held; arrears on CB discounts would have to be assumed first by the national government or any government corporation before conversion to government equity, which would significantly increase the level of government debt and deficits.

Recall the basic premises of our macro economy that all incomes must be generated from employment and production, which is the only basis for exchange of goods between any two economic units, and the loaning capacity of every lender is always based on his resource and income capacity. Thus, STDs funded by taxes are real incomes, which is not the case for unpaid loans released through the CB rediscounting window.

The CB prints additional notes as liabilities against the income capacity of the government from taxation. Such notes are never intended for direct purchases of goods in the market but are always released to banks through CB discount of bank loan receivable assets. CB real incomes are earned principally from interests on CB loans. Necessarily, all CB loans must be repaid and answered for with real incomes of either banks (either from its lending operations or existing physical assets), CB-accumulated reserves, or tax-funded equity transfers of the National Government to the CB.

Conversion of CB arrears to equity would thus entail huge drawdown of incomes from these sources. On the other hand, restructuring of CB loan arrears would entail a mere adjustment in accounting entries to reschedule accrued incomes and receipts, reflecting the same commitment from banks to earn real incomes for loan repayment.

Need for consistency with other financial policies

The rescue package should be consistent with financial policies that govern the entire financial system.

- Thus, the proposed lifting of the 30% limit on single family ownership and eligibility of certain accounts as reserves and tax exemptions must be considered only when it is applicable to all banks, not just to give undue advantage to rural banks. Even the RBAP recognizes this need for fair competition by limiting its requests for a period of 5 years.
- The recently approved exception of rural banks from GRT would indeed give it competitive advantage over other banks, which can be corrected by repealing the GRT entirely, since it only unduly increases the cost of lending. Indeed, we are the only country that imposes this tax. Similarly, PD 717 implies a form of additional taxation of banks which should be repealed.
- The proposal for rural banks to undertake non-allied and nonfinancial activities (e.g., trading and investments in IDCs) will run counter to current regulations on the separation of banking and nonbanking functions, for which there is economic basis. Generally, banks incur running costs of liquidity (in deposit and CB loans) and depend on interest incomes. Therefore, they require loanable projects with stable profits, fast loan turnover, and prompt cash payments which must not be jeopardized by taking direct risks in production enterprises.

In the case of small farm enterprise, however, where there is a less clear demarcation between projects suitable for bank and nonbank financing and where nonfinancial activities can lower the small farm lending risk, the scheme might be explored provided that rural banks do not come to exercise monopolistic advantage over small farmers. One alternative would be to ensure equity participation of farmer-borrowers in such non-allied enterprises.

CB rediscounting and monetary policies

Some proposals on rural bank rehabilitation are inconsistent with proposed monetary policies, because of misunderstanding about the concept of the CB rediscounting function.

- Lamberte's suggestion to provide rural banks with a negative GRT incentive can be accomplished through the appropriately lower CB rediscount rate, which, in the first place, is a form of taxation on the incomes of banks for the service of CB in providing liquidity.

The CB rediscounting function is consistent with ordinary business practice where a rediscounting simply involves that of liquefying the present value of expected incomes from a receivable asset. Hence, the rate of rediscount must be accommodated by the expected unit incomes from the receivable asset and, one can only presume, to rediscount sound loans. Similarly, the CB rediscount rate must be less than the unit net spread of banks from its loan receivable assets. It follows logically therefore that the rediscount rate would be lower for the less profitable small farm loan due to its higher transaction costs and lending risks.

- In a broader context therefore, the CB rediscount rate structure is not meant to favor one activity over another. Rather, it directly reflects the relative profitability of loans in the different sectors of the economy. Lamberte's proposal to limit CB rediscounting policy to the control of money supply rather than use it to favor certain enterprises or provide the source of loanable funds would thus be inconsistent with his other proposals of recognizing the higher transaction cost of small loans and relieving the liquidity problems of banks through the CB rediscounting window.

Providing CB loans up to limits equal to sound bank loans receivable and assets does not cause excess money supply expansion precisely because, like all bank loans, CB rediscounting proceeds are matched by equivalent liabilities from expected incomes or existing collateral assets of banks, borrowers, or the CB itself. And no matter how low the rate might be, banks do not borrow simply to hold money but only do so when there are loanable prospects that would make the added costs worthwhile. Since financing costs are added to the price of goods, the total level of credits in the economy becomes limited by the extent to which accumulated interest costs can be accommodated within the market prices of goods and collaterals.

- As corollary, Lamberte's proposal that rediscounting arrearages not converted to equity shall be paid at the old rediscount rate would thus be conceptually inconsistent because the interest rate (of both CB and banks) must be related to the expected income returns during the period under consideration, so as not to distort the appropriate level of money supply relative to the economy's production capacity and market prices.

The proposed freely floating interest rate policy would thus preclude producers, investors, and even banks from committing themselves into entrepreneurial activities in the face of uncertain financing costs.

Our proposed approach for rehabilitation

We believe that rural bank rehabilitation must be justified and addressed for itself and not be used as a precondition to a new financial strategy for agriculture, which must be viable, regardless of the present condition of the institutions.

Reasons for rural bank rehabilitation

In this connection, the reasons for rehabilitating rural banks include the following:

- With their bankruptcy goes the accumulated subsidies granted as equities and tax exemptions since the 1950s.
- They represent the widest bank institutional network in the rural areas, reaching deeper in the hinterlands than any other types of banks; they cover three-fifths of the rural municipalities and cities in the country.
- They are the primary and most accessible source of institutional loans to farmers, having provided about 20% of total agricultural loans from 1973 to 1984, and some 60% of institutional credit to the small farming subsector. Failure to rehabilitate them would be a waste of institutional capacity, which the government nurtured since the 1950s.

- The immediate presence of countryside banks would moderate interest rates on informal loans to small farmers and relieve the severe financial supply pressures in the rural areas.
- It would be politically, socially, and morally unsound to allow so many private enterprises to fail for having cooperated with the government on its credit programs.

Need to redefine function of REs

An important consideration in the scheme of rehabilitation must be that with the expiration of tax exemption privileges in 5 years, rural banks would no longer be distinguishable from other banks in terms of its lower cost structure. Hence, previous small loans may no longer be profitable, and the functions of REs in the overall financial system would no longer be defined. Therefore, there is a need for them to evolve into any of the existing bank structural models (e.g., private development banks or PDBs, thrift banks) or any new model that the government might envision.

But it would be impractical to impose any single new model on all 1,117 rural banks, with different degrees of economic health, ownership goals, priorities, and different market conditions. Hence, rural banks should be given the option in preparing their individual rehabilitation programs.

Our proposed measures for rural bank rehabilitation

Treatment of arrears

- Accept foreclosed land assets of rural banks as payment of arrears on CB loans and STD to the extent possible, which CE can resell to LBP (on credit) for the Agrarian Reform Program. This way, part of the CB loans are immediately repaid by physical assets with market value. Also, it offers the government a way to redistribute land with less political resistance.
- Accept Land Bank bonds acquired by the rural banks in the course of their business or resulting from foreclosures. Such LBP bonds presently in their hands total at least PHP 0.35 million per bank; most of these were acquired as payment of due loans from the former landowners, who were affected by the land transfer operation of the government. For rural banks which hold LBP bonds and which correspondingly have outstanding past due obligations with the CB, this measure can wipe out some 17% of their arrears.
- Allow a long-term restructuring period for the balance of CB arrears and STDs, including accumulated interests of up to 10 to 20 years, with annual amortizations based on individually approved rehabilitation programs, waiving penalties to the extent possible. Provided that the repayment period is less than the corporate life of the rural bank and is economically feasible, the length of the restructuring period is less important than the repayment of loan arrears with new additional incomes to be generated in the economy.

Capital buildup

Within existing rules on the capital base and ownership of different banks, each rural bank should have the option on how to effect capital buildup according to its business plans in the future; as, for example, whether to evolve into a thrift bank or whether to issue additional common or preferred shares.

On providing liquidity

- Allow longer-term restructuring of past due loans granted by banks to make it easier for banks to collect these loans. The restructuring period of such loans need not be synchronized with the restructuring period of CB loan arrears but must be based on the income generation capacity of banks and borrowers, respectively.
- Encourage deposit mobilization as the first source of liquidity by setting deposit interest rates at lower levels than the CB rediscount rates making it therefore the cheapest source of liquidity for banks.
- Make CB rediscounting facilities available to as many sound loan receivable assets of banks, including rural banks. This CB function cannot be substituted by the LBP, which has to charge market interest rate on loans just as any other competitive bank.

On higher transaction costs/risk of small loans

An appropriate CB rediscount structure that will be profitable for banks in relation to the income potentials in the different types of loans, including small farm loans. This way, all other banks have the option to grant small loans.

On improving income prospects and ability for risk-taking for small rural loans

As demonstrated by the cooperative banking systems of The Netherlands and Korea, there are significant benefits in having small unit banks specialize in household and small farmer loans, especially at this stage of our economic development. Rural banks opting to continue along this specialization may be given the following incentives:

- A. Rural bank purchase of equity shares in LBP on 5- to 10-year installments, up to the extent of their volume of non-collateralized small farm loans.

Government equity contribution benefits rural banks mainly in their being able to save interests on the use of such funds. In contrast, rural bank ownership of a commercial bank/unibank such as the LBP provides it the opportunity to partake of the incomes in the more profitable commercial and industrial loans, which could cushion the rural banks risks in small farm loans. Rural bank capital base expands simultaneously with the appreciation of its stocks in commercial banks.

This scheme implies the following:

- The LBP can be gradually privatized in favor of specialized unit rural banks and no other.
- The benefit of the equity shares could accrue to rural banks even before its full payment, as long as it is up to date in its amortization payments.

- This requires that all LBP incomes are accrued to its reserves.
- The LBP need not be limited to agricultural loans but should explore as may be profitable as many diversified loans as possible.
- The scheme opens other possibilities for complementary business arrangements of rural banks and the APEX bank (in this case, LBP). For example, rural banks can refer bigger loans to LBP and vice-versa.
 - i. Availability of CB rediscounting facilities up to amounts equal to sound bank loans receivable and assets, to ensure that projects which are technically and economically feasible do not fail simply for lack of finances. It is an arithmetic necessity that a higher value of production calls for money supply (at the given money velocity of circulation) greater than existing levels.
 - ii. Stable bank lending rates would, in fact, be the natural course of bank lending operations since bank unit costs tend to decline when the volume of loans increases, provided there are no sudden decreed changes in deposit and CB rediscount rates, there are no liquidity restrictions, and there is free bank competition and vigorous economic activity.
 - iii. Use of the lowest bank lending rate possible to make as many economically feasible enterprises as possible. At the given cost of liquidity in the economy, the bank lending rate is defined

principally by the cost efficiency of bank operations and the volume of loans. Investments in productivity-raising technologies are likewise only made profitable by the level of loans. As we have seen in other countries, bank lending rates even tend to decline over time, after high volumes of loans have been achieved.

- B. Allow limited non-allied undertakings of rural banks related to the production and marketing ventures of participating small farm producer-borrowers. Since there is a relatively smaller degree of specialization in farm household activities, the universal banking concept for small unit banks and off- and non-farm activities of small farm households might be more suitable to the rural economy.

Support from the rest of the economy

Need to restore business profitability. To be sure, the ability of rural banks to generate the incomes required by their rehabilitation programs depend on their cost efficiency and loan volume expansion. In turn, this depends on other government measures to increase the volume of profitable loanable projects on the economy and to rehabilitate banks and enterprises burdened by heavy losses in recent years. The lending rate of some rural banks today are higher than necessary, to follow the high interest rates in the market because of the large gross spreads required by commercial and other banks.

Required monetary policies

The following sound monetary and financial policies play a significant role:

- Availability of CB rediscounting facilities to as many sound bank loans receivable and assets, to ensure that projects which are technically and economically feasible do not fail simply for lack of finances. It is an arithmetic necessity that a higher value of production calls for money supply (at the given money velocity of circulation) greater than existing levels.
- Stable bank lending rates would in fact be the natural course of bank lending operations, since bank unit costs tend to decline with larger volume of loans, provided there are no sudden decreed changes in deposit and CB rediscount rates, there are no liquidity restrictions, and there is free bank competition and vigorous economic activity.
- Use of the lowest bank lending rate possible to make as many economically feasible enterprises as possible. At the given cost of liquidity in the economy, the bank lending rate is defined principally by the cost efficiency of bank operations and the volume of loans. Investments in productivity-raising technologies are likewise only made profitable by the level of loans. As we have seen in other countries, bank lending rates even tend to decline over time when high volume of loans have been achieved.

CHAPTER 6

Deposit mobilization in rural banks: The impact of alternative strategies

Jocelyn Alma R. Badiola and V. Bruce J. Tolentino¹

Introduction

The financial intermediation process performs two important functions: savings² mobilization and credit allocation. Banks, to be effective financial intermediaries, should generate deposits and transform these into loans. Banks must thus complete the intermediation cycle by undertaking both functions in an effective and efficient financial market.

Supply-led finance: The experience

In the past two decades, however, financial intermediation in the Philippines and other less-developed countries (LDCs),

¹ Respectively, Project Development Officer V, Agricultural Credit Policy Council (ACPC) and Undersecretary for Policy and Planning, Department of Agriculture, 1990. The authors acknowledge the valuable comments of Dr. Richard Meyer and Dr. Aniceto Orbeta and the technical support provided by Ms. Victoria Pauline Enriquez.

² Savings and deposits are used interchangeably throughout the discussion.

particularly in the rural areas, was focused primarily on credit allocation as a strategy to spur agricultural development. The governments in these countries viewed rural financial policy as “supply-leading,” meaning, one of simply providing loans. It was widely held that rural households cannot save due to poverty. This led to the distorted perception that rural banks are mere sources of loans and not stewards of deposits. Thus, credit was priced cheaply at low interest rates in the expectation that low-income farmers would adopt more modern farming methods, increase their productivity, achieve higher income, and improve the quality of their lives. As a result, commodity-specific agricultural credit programs, such as *Masagana 99* for rice and *Bakahang Barangay* for livestock, dominated rural financial market policy and the portfolios of rural banks.

A critical consequence of this policy was the failure of rural banks to actively pursue savings mobilization, leaving the intermediation process less effective and efficient. While indeed the cheap credit strategy sought to alleviate the conditions of the rural poor, its effectiveness as a development tool was short-lived. Eventually, the policy failed as the supply of government funds for lending diminished and loan default rates rapidly grew, and the health of the Philippine rural banking system deteriorated (Adams, 1978; Graham, 1984; Tolentino, 1987a; Von Pischke, 1978).

Attempts at financial reform

Economists, policymakers, and even private bankers responded to the crisis in rural finance by instituting reforms in the rural financial market. One of these reforms included the suspension of direct lending by the government. Under the reforms, only financial institutions are encouraged to lend, the funds for which should be generated principally from private deposits

and not government resources. The Philippine government also pursued the rehabilitation of the rural banking system. Rural banks were urged to strengthen their resource base by mobilizing savings in the countryside and depend less on external sources for loanable funds.

Research results have come to support the finding that rural households can and do save, given the proper opportunities and incentives (Gupta,1970; Kelley and Williamson, 1968; Ong, et al.,1976; TBAC-UPBRF, 1981). Questions are now being raised in relation to this general finding, but answers are still unclear: Can rural banks mobilize savings? What are the most effective deposit mobilization strategies? What factors influence deposit mobilization?

The need for further empirical research is clear. The findings will help development planners and policymakers evolve strategies and policies to support savings mobilization by financial institutions, especially rural banks.

The Agricultural Credit Policy Council (ACPC) of the Philippines thus initiated the Rural Savings Mobilization Project, which seeks to determine the essential components of a successful savings mobilization program.

Specifically, this study aimed: 1) to determine the deposit performance of a select group of rural banks; and 2) to identify the factors that affect their deposit-generating performance, including the effectiveness of specific strategies and conditions. This study seeks to demonstrate the effectiveness of specific strategies in mobilizing deposits in the rural areas of the Philippines.

The results of the study are presented in this paper, divided into six sections: Section II presents the relevant issues; Section III describes the Philippine Rural Savings Mobilization Project (PRSMP); Section IV presents the results of the project, that is, the deposit performance of the sample banks vis-a-vis the saving strategies implemented; and Section V provides the summary, conclusions, and policy recommendations.

Issues raised

Studies on rural savings mobilization in LDCs address two major issues: (A) the effectiveness of mobilizing deposits in the rural areas; and (B) the determinants of a successful savings mobilization program.

How effective is deposit mobilization in the countryside?

Bankers have often doubted the effectiveness of rural savings mobilization because of the perception that rural households cannot save due to low incomes. However, recent research studies in several countries provide encouraging results.

In Peru, the Banco Nacional para las Cooperativas (BANCOOP) campaigned for savings deposits in two rural regions. Despite an adverse economic environment that consisted of a high inflation rate, negative real growth, and tight competition from other financial institutions, the savings campaign of BANCOOP was a success as it was able to attain a significant rise in its level of deposits. More importantly, BANCOOP's dependence on the government and international donors for subsidized funds was reportedly reduced and its

financial viability through increased profits and reduced loan delinquency significantly improved (Vogel, 1984).

Another successful case was the Banco Agricola of the Dominican Republic. Its savings accounts rose in number by a remarkable 287%—from 5,313 to 20,539—after less than a year of interventions encouraging savings deposits. The volume of its savings deposits also grew by 263%—from 1 million Dominican Peso (DOP) to DOP 4 million, while time deposits increased from DOP 2 million to DOP 3 million (Vasquez 1987).

Bangladesh's Agrani Bank reported increased volumes of deposits in the amount of TK 1.4 million during its campaign for deposits in 1986 through selected branches nationwide. This amount represented about 1% to over 8% of a branch's existing deposit base (Ahmed and Khaled, 1987).

In the Philippines, the Central Bank (CB) launched the National Savings for Progress Campaign in June 1973 to attract deposits from both urban and rural areas. Pre-campaign, monthly deposits averaged just PHP 60 million; in the post-campaign period, these averaged PHP 300 million, or a 92% total increase in the level of deposits of the total banking system. However, there have not been other studies that document specific saving schemes implemented by banks in the rural areas alone.

Similar experiences of successful deposit mobilization campaigns have been recounted by Indonesia, India, Nepal, Pakistan, Sri Lanka, Malaysia, Thailand, and the Fiji Islands in the Pacific (APRACA, 1985).

Clearly, substantial volumes of savings exist in the rural areas and that, under certain conditions, some of these savings will flow into financial institutions.

What are these conditions?

A successful savings mobilization program should reflect the needs and preferences of the rural population served (Akaah et al., 1987). Banks should evolve an effective strategy in terms of attracting substantial deposits from the rural household sector.

Khalily, Meyer, and Hushak (1987) came up with the following ingredients for a successful savings mobilization strategy:

- Better quality of banking services in which paperwork is reduced, procedures are simplified, and more cordial relationships between bank employees and depositors are pursued.
- A campaign or publicity drive to increase awareness of rural people about banking and savings.
- Innovative approaches to rural banking such as mobile banking, which is expected to reduce transaction costs for both depositors and banks and may even motivate rural women to hold deposits with banks; or a flexible interest rate policy so that interest rates can adjust more effectively to changes in inflation.
- Flexible banking hours, considering the erratic nature of rural economic activities.
- Additional incentives to depositors, such as prize bonds and greater access to loans.

- More incentives to bank employees in the form of cash bonus and promotions to encourage them to put more effort into seeking out clients and providing better service.

Some countries have implemented a combination of the factors listed above. In Peru, for example, the successful deposit mobilization program of BANCOOP was attributed to relatively high interest rates offered on time and savings deposits, the confidence of depositors in the financial institution, and good service provided by the bank staff (Vogel, 1984).

The Banco Agricola in the Dominican Republic traced its excellent deposit performance to the bank's vast network of branches, the strong bank-client relationship established through years of service, and an attractive savings gimmick in which quarterly raffles are held among depositors (Gonzales-Vega, 1987).

In Bangladesh, three savings models were tested: (a) the Tangible Incentive Model, in which prizes are given out to depositors; (b) the Marketing Model, in which house-to-house campaigns are conducted; and (c) the Employee Incentive Model, in which bonuses are given to bank personnel who brought in new accounts or additional deposits (Ahmed and Khaled, 1986).

In the Philippines, the national savings campaign cited earlier was done through nationwide advertising via television, newspapers, radio, and other channels. Regional savings drives, bank manager workshops on savings, and a savings project in schools were also undertaken in selected areas of the country.

While it is quite difficult to isolate the impact of these strategies on the level of deposits held by banks, Vogel (1986) attempted to analyze the extent to which the raising of interest rates and the promotion of banking services could have an influence on the deposit performance of BANCOOP in Peru. He tested an econometric model that included these two schemes as explanatory variables.

These variables were found to have had a significant positive impact on deposit mobilization, in addition to factors external to the bank such as income, inflation, attitudes of households, and literacy.

Similarly, an econometric model with the level of deposits as dependent variable was estimated in a study in Ghana, Africa. Among the explanatory variables were deposit interest rates and the attitudes of bank employees toward serving the financial needs of households. A positive and significant relationship between deposits and these factors was determined in a regression analysis.

In sum, the research results imply that rural areas have savings that can be mobilized through rural financial markets. For financial institutions to succeed as savings mobilization conduits, they should reflect the banking needs and preferences of the rural population served.

The success of any savings program would, thus, depend on a host of factors both financial and nonfinancial.

The Philippine Rural Savings Mobilization Project

The ACPC, an attached agency of the Department of Agriculture, initiated the Philippine Rural Savings Mobilization Project (PRSMP) as a study in 1987. It was implemented for a year, from January to December 1988, in six provinces: Batangas, Camarines Sur, and Pangasinan in Luzon; Iloilo and Negros Oriental in the Visayas; and Misamis Oriental in Mindanao.

The main objective of the study was to test specific saving schemes or strategies aimed at increasing the level of deposits held by rural banks in the country (ACPC, 1988). The schemes implemented included the following: (A) raising nominal interest rates on deposits, (B) offering rewards or prizes to depositors, (C) reducing depositor transaction costs through the mobile banking system, (D) providing incentives to bank staff, and (E) advertising or promoting deposit-handling services of banks.

A total of eighteen rural banks in the six provinces were selected as participants in the project. The banks were chosen based on a set of predetermined criteria that assures homogeneity, soundness of operations, and the commitment or willingness of bank management to participate in the project (see Annex A for more details).

From the rating profile set by the CB's Supervision and Examination Sector-Department III, these banks were classified as either average or strong in terms of their financial condition.

The selected banks were classified into either of two groups:

participating or *control*. The participating banks were tasked to implement any or a combination of the schemes outlined above. The control banks, on the other hand, were asked to operate as they usually did without any form of intervention from the project. This was done for purposes of comparison and for verifying the effects of the savings generation schemes.

To determine the progress of the savings strategies, a monitoring scheme was designed and installed in each bank. The banks were required to complete and submit monitoring report forms monthly. One staff member per bank was assigned to the task of completing and submitting the forms. Each bank was also required to submit its monthly financial statement. Members of the ACPC research team visited the banks on a quarterly basis to monitor their progress closely. Indicators monitored included volume of deposits by type of account, number of deposit accounts, volume of loans granted, and gross and net income of the bank.

Results of the study

Description of banks

Eighteen rural banks were chosen to participate in the project. As noted earlier, these banks were selected from six provinces across the three major island groups of the Philippines: Batangas, Camarines Sur, and Pangasinan in Luzon; Iloilo and Negros Oriental in the Visayas; and Misamis Oriental in Mindanao (See Annex A for the description of selection process). Six banks withdrew, however, leaving only twelve

banks, seven of which as participating and five as control.³ Camarines Sur and Batangas each had two remaining participating banks (one primary and the other alternate or secondary).

The actual names of the banks were replaced by letter codes to maintain confidentiality of the information presented (Table 1).

Annex B provides a background on the nature of the Philippine Rural Financial System, its structure, extent of rural outreach, and deposit and lending performance for the period 1982 to 1988.

While the bank selection process considered homogeneity across all banks in terms of asset size, net worth to risk asset ratio (RAR), and past due ratio (PDR), these banks differed widely with respect to the number of personnel employed, number of years in operation, extent of area served, and presence of other financial institutions within the areas served (Table 2). In addition, the managers of the banks were heterogeneous in terms of sex, age, educational attainment, and work experience (Table 3).

The saving schemes implemented

The strategies adopted by the participating banks were of three types: (1) schemes that motivated bank personnel to solicit deposits; (2) schemes that encouraged existing depositors to put in more savings, and strategies to attract new savers; and (3) advertising of the deposit handling service of the bank (Table 4).

³ Bank managers cited several reasons for their decisions to withdraw from the project, including: (a) unstable political and economic conditions that do not favor investment in the areas serviced by the bank; (b) the problem of loan collection which bank management would like to concentrate on rather than deposit mobilization; (c) unfavorable peace and order condition in the areas; and (d) labor problems (one bank was experiencing a labor strike at the time of project monitoring).

Batangas. In Batangas, two participating rural banks (Bank A and Bank B) implemented saving schemes that consisted of: (1) giving incentives to employees, (2) information drive through letters and house-to-house campaigns, (3) offering preferential rates on deposits to choice clients, and (4) giving raffle prizes to depositors.

In particular, Bank A targeted PHP 2 million worth of new deposits for the first quarter of the year and PHP 4 million thereafter. To reach these targets, the bank encouraged its personnel to attract new clients and activate dormant accounts through personal contact with the community and neighboring towns. As an incentive, bank employees were rewarded with gifts in cash and in kind.

Bank B, on the other hand, launched an information drive by sending deposit solicitation letters to both current and prospective clients and by conducting a person-to-person campaign with walk-in clients and neighbors of bank personnel and friends. This bank also provided rewards to employees who could solicit deposits. Specifically, a commission of 0.5% of time deposits beyond PHP 20,000 with a minimum term of 90 days was provided to the responsible staff member.

The interest rate on savings deposits was raised to 8%, which is 2–3% higher than those offered by commercial banks and thrift banks in the area. Time deposit rates were offered at 10% and an additional 0.5–1.5% was provided to accounts of more than PHP 20,000.00.

Camarines Sur. A savings campaign was launched by Bank C in the last quarter of 1987 that included a parade, bold streamers, prizes for depositors, and a slogan contest during its first day of implementation. Thereafter, the bank sent out

deposit solicitation letters to residents of the community. This was followed by personal visits by a team of attractive young ladies, called “Rural Savings Mobilizers,” hired by the bank to promote the savings campaign. As a culminating activity, a raffle draw was conducted on the first anniversary of the project.

Like Bank C, Bank D also launched an information campaign in early 1988 and put up streamers to promote savings consciousness among residents in the municipality. A house-to-house campaign and a raffle for new depositors were also held.

Iloilo. Bank E in Iloilo undertook an information campaign through radio broadcasts and newspaper advertisements. The bank also sent out deposit solicitation letters to prospective clients and put up billboards in strategic places across their service areas. Gifts were also given to clients.

Negros Oriental. The savings promotion campaign of Bank F mainly targeted residents that regularly receive dollar remittances from abroad. At the same time, a house-to-house campaign was also conducted targeting the following: (1) residents of Barangay Mayabon, a rice-farming village where economic activity has boomed after an irrigation system was built; and (2) friends of the bank’s stockholders and directors.

Misamis Oriental. Perhaps the most innovative approach to savings mobilization implemented by the project banks was the scheme adopted by Bank G in Misamis Oriental. The scheme consisted of bank personnel collecting deposits from clients (mostly small entrepreneurs) each market day in Barangay Cogon where much of the trading or commercial activities take place. The assigned staff member would drive

the bank's motorcycle and visit the barangay twice a week for at least an hour at a time. For withdrawals, a client fills out a withdrawal slip, gives this to the bank employee (entrusting the bank employee with his/her passbook), then goes to the bank in the afternoon to get the money. The client goes to the bank only if he/she makes a withdrawal; the bank employees handle the deposit transactions. This scheme minimized depositor transaction costs and provided easier access to the services of the bank.

Deposit performance

Volume of deposits. Of the seven rural banks that implemented saving strategies, five saw a growth in the level of their deposits in 1988 relative to their deposit levels in 1987 (Tables 4, 5, and 5A). The growth rates, in nominal terms, ranged from 8.1% to 62.8%. But these five banks were reduced to four when inflation was considered. The real growth rates varied from 1% to 48%.

Bank G in Misamis Oriental, which provided innovative mobile deposit services, posted the highest growth at 62.8%.⁴ The volume of deposits nearly doubled—from about PHP 1 million in 1987 to almost PHP 2 million in 1988. Besides the seemingly attractive saving scheme, a plus factor could have been the bank's reputation of stability, putting it reasonably ahead of the other banks. In contrast, the control bank (Bank L) in the province increased its deposits by only 11%, or a mere 1% growth, in real terms. Problems in management, particularly the long absence of the manager from the bank due to illness, could have contributed greatly to the bank's mediocre performance. In addition, bank employees explained

⁴ Unless otherwise specified, growth rates are in nominal terms.

that the bank's top priority was the collection of loans—the majority of which were past due—and resources were used primarily for this. There was thus no conscious effort to generate deposits from the community.

In Iloilo, Bank E generated more than PHP 1 million in deposits, up about 25% from a total volume of over PHP 4 million to nearly PHP 6 million. The manager noted that, if it were not for the bank robbery that took place in the last quarter of 1987 which tarnished their image as a secure bank, their deposit performance could have been much better. Not so far behind in terms of growth in deposits was the control bank in the province (Bank J), which achieved an increase of 26.4%. While no scheme was implemented, the manager explained that she always made it a point to adopt a personalized kind of service in her bank. A normal banking day would find her conversing with clients in the bank lobby.

Bank F in Negros Oriental raised its deposit level by 19.3%. This relatively small increase in deposits could probably be due to the bank's lack of commitment to the project as indicated by its delinquency in submitting data requirements and the lukewarm reception received by the ACPC project staff. In comparison, the control bank in the province (Bank K) experienced a 29.5% growth. When asked why this was so, the manager explained that the bank boasts of an established set of clients that it has maintained through its long period of operation. The manager added that the relatively high income-earning status of its service area compared to other municipalities in the province, including the area covered by the participating bank (Bank F), could also be a major factor in the larger volume of deposits the bank generated.

In Camarines Sur, Bank C achieved a deposit growth rate of 23.5%, a much better performance than that of Bank D that posted a growth rate of only 8.1% which, measured in real terms, was in fact -1.5%. The manager of Bank C explained that, in addition to the schemes they implemented, their image as being solvent, liquid, and therefore secure could have contributed to the increase in their deposits. The increase could have been higher without the strong typhoon in 1988 that brought destruction to the area. The manager of Bank D, on the other hand, explained that the minimal increase in its deposits could have been due to the lukewarm response of the public toward their savings campaign, which was, in turn, attributed to two devastating typhoons that ravaged the area in the last quarter of 1987 and in early 1988. As a result of these calamities, the bank became pessimistic about the campaign's outcome and therefore lost enthusiasm toward it. In fact, during one of their visits to the bank, the research team observed that Bank D's savings campaign was not as well-promoted as Bank C's.

Surprisingly, Bank I (the control bank in Camarines Sur) increased its deposits at an astounding rate (60% nominal, or 46.1% real) despite not having implemented any saving scheme. The manager of the bank cited two reasons for this: first, relative to these two banks, Bank I had been in existence for a much longer time and had, thus far, collected a set of faithful clients through the years. Second, the bank has never changed management since its inception unlike these two other banks. It has always adopted a conservative stance in management operations. Even its physical features can attest to this. While Banks C and D had air-conditioned offices, newly painted walls, and security guards standing by the doors, Bank I had none of these. It wanted to maintain an unassuming atmosphere where even the smallest farmer would feel free to

transact his financial requirements. The bank had consistently won the award granted by the Rural Bankers Association of the Philippines (RBAP) as the number one bank in the region.

While the rural banks in Camarines Sur, Iloilo, Negros Oriental, and Misamis Oriental experienced growth in their deposits, Banks A and B (participating banks) and even Bank H (control bank) in Batangas suffered declines. Following are the major factors that likely influenced these declines:

- **Lack of commitment toward the implementation of the project.** Though Banks A and B did extend deposit services as part of their regular functions, they were unable to assign a particular bank staff member to focus on the savings mobilization campaign fulltime. These banks were deeply involved in loan operations, especially in the collection of past due loans.
- **Availability of alternative sources of loanable funds, such as the Rediscounting Program of the Land Bank of the Philippines (LBP).** The availability of attractive sources of loans including the LBP Rediscounting Program must have discouraged these rural banks to actively campaign for deposits. The LBP program offers each rural bank as much as 85% of its promissory note at a rate of 8–12% per annum. As one manager put it, “why should we worry about deposit mobilization when we can always avail of funds from other sources at more attractive terms.” Private deposits were viewed by these banks as inadequate and erratic and, therefore, unreliable.
- **Negative perception about savings campaigns.** The managers of these banks shared the perception that savings campaigns only discourage people from

depositing in banks because such campaigns may only be viewed by the public as an indication that the bank is insolvent or illiquid and, therefore, unstable.

- **Heavy withdrawals from large transactions undertaken by bank clients, mostly agricultural entrepreneurs, in 1988.** The relatively higher prices of inputs or raw materials in 1988 caused larger capital requirements for these businessmen, thus triggering heavy withdrawals in order to maintain their business activities.
- **Presence of other financial institutions in the municipalities within which the banks operate.** Compared to the other project banks, the Batangas banks faced tighter competition from other financial institutions, especially large commercial banks (KBs) and private development banks (PDBs) (Table 2). Specifically, Bank A competed with four KBs and one PDB; Bank B with the extension office of a PDB and a credit union; and Bank H with the extension office of a PDB. The managers strongly believed that households preferred to keep their money in these KBs and PDBs, as these banks were perceived as more stable and secure.

Number and size of accounts. An uptrend in the number of deposit accounts was experienced by most banks under study (Table 6). The rates of increase, however, were not significant as the volume of deposits. In particular, the participating banks raised their deposit accounts by only 1%, from 29,210 in 1987 to 29,536 in 1988; the control banks experienced a decline from 25,378 to 25,268. This may imply that the project banks generated more deposits from old or existing clients than from newly recruited ones.

The average number of deposit accounts per bank was estimated as 4,219 for participating banks, 4,702 for control banks, and 4,420 for all banks in 1988.

With respect to the size of accounts, the participating banks maintained relatively small⁵ deposit accounts during the same period (Table 7). In particular, the size of deposits per account averaged PHP 1,382 for participating banks, PHP 968 for control banks, and PHP 1,198 for all banks. In real terms, these amounts were posted at PHP 170 for participating banks, PHP 118 for control banks, and PHP 147 for all banks. It is interesting to note that for the period 1982-1988, these banks consistently held small accounts. Indicatively, the type of clientele serviced by these banks were the small rural households.

Structure of deposits. Majority of the participant banks had a 60-40 and 70-30 savings-time deposit ratio in 1988 (Table 8). While time deposit accounts, by their nature, are held largely for investment purposes, savings deposits on the other hand, are maintained to facilitate transactions of households (Blanco and Meyer, 1988). A larger volume of transactions undertaken by households in 1988 is thus suggested. The managers of the rural banks in Batangas noted that the higher prices of production inputs during this period prompted their clients to withdraw large amounts from their savings accounts, thus indicating the importance of savings deposits for transaction purposes.

Type of clientele served. Individual clients comprised a large proportion (70–100%) of the clientele serviced by the project banks, compared with institutional clients (0–30%). While

⁵ The Central Bank defines a large account as that which represents at least 2% of total deposit liabilities.

Bank C in Camarines Sur catered to a 70-30 proportion of individual and institutional depositors, respectively, Bank F in Negros Oriental serviced individual clients only (Table 9).

Interest rates on deposits. To attract depositors, most of the participating banks, particularly those in Batangas, Negros Oriental, and Misamis Oriental, maintained higher interest rates on savings and time deposits relative to those offered by commercial banks in the areas (Table 10). Rates ranging from 5% to 8% on savings deposits and from 11% to 13% on time deposits were paid by the former in contrast to the latter's 4-4.5% on savings and 10-12% on time. Unfortunately, however, the extent to which these rates could have influenced the level of deposits generated by the participating banks could not be estimated due to data limitations.

Costs of deposit mobilization.⁶ Costs incurred in mobilizing deposits result from the following: (1) transactions with depositors, (2) record-keeping, and (3) advertisements and promotions.

Among participating banks, the total cost went above PHP 1 million, or an average of PHP 183,000 per bank in 1988 (Table 11). The bulk of the cost came from activities directly related to transactions with bank clients—from the opening of new accounts to over-the-counter transactions with depositors in making deposits and withdrawals—amounting to PHP 611,000, or PHP 87,000 per bank. Record-keeping accounted for 33% of total cost at PHP 359,000, or about PHP 60,000 per bank. Advertisements and promotions, amounting to PHP 132,000, comprised 12% of the total deposit mobilization cost.

⁶ The method used in estimating cost was derived from that of Untalan and Cuevas (1988). Variable expenses corresponding to the salaries paid to personnel involved and material costs incurred in advertisements and promotions were quantified.

Bank C in Camarines Sur incurred the greatest cost in the amount of PHP 410,000. This bank also spent a relatively large amount on deposit advertisements and promotions (PHP 35,000), following Bank A in Batangas that expended about PHP 51,000 for the same purpose. In contrast, deposit mobilization cost was lowest for Bank E in Iloilo in the amount of PHP 98,000. The least expensive advertisement and promotion scheme was that of Bank F in Negros Oriental, which spent just below PHP 10,000.

On a per-account basis, the total cost of mobilizing each deposit account, considering all banks, was PHP 40 (Table 12). Bank C in Camarines Sur incurred the highest cost per account (PHP 134), followed by Bank B in Batangas (PHP 100.14). The higher cost per deposit account of these banks can be explained by the relatively greater cost incurred with respect to the number of deposit accounts attracted. In contrast, Bank E in Iloilo and Bank G in Misamis Oriental posted a minimal cost per account at PHP 9.31 and PHP 16.12, respectively.

With respect to the cost-per-peso of deposit, PHP 0.029 was estimated for all banks (Table 13). This means that for every peso of deposit generated, the cost incurred was 2.9 centavos. This cost was lowest for Bank A in Batangas (PHP 0.013) followed by Bank E in Iloilo (PHP 0.017), Bank F in Negros Oriental (PHP 0.022), and Bank G in Misamis Oriental (PHP 0.029). The comparative advantage of these banks in raising a peso of deposit can be attributed to the larger deposit balances per account maintained in 1988. In contrast, Bank C in Camarines Sur incurred the highest cost at PHP 0.071.

Lending performance

Deposits and total loanable funds. The importance of deposits as an alternative source of loanable funds among the sample rural banks increased significantly from 1982 to 1988. Specifically, the proportion of deposits to total funds for lending rose from 25% in 1982 to 45% in 1988 for all banks (Table 14). Broken down, these were 26–46% for participating banks and 23–44% for control banks (Table 15). In contrast, the share of borrowings to these funds declined steadily to 32% in 1988 from 60% in 1982. These findings seemingly suggest banks' reduced dependence on government funds for lending, which, in the 1970s and early 1980s, was the preferred source of funds among rural banks.

Volume of loans. A majority of the sample rural banks (7 of 12) saw a growth in the volume of loans granted in 1988 from 1987 levels (Tables 16 and 17). In particular, four of the seven participating banks registered increases ranging from 5.1% to 24%. On the other hand, two of the five control banks posted increases of 7% and 14.5%. However, how much of these newly granted loans were sourced from deposits could not be determined due to data constraints.

For the period 1982-1988, total loans also increased at compounded growth rates ranging from 2.7% to 62.7%. With respect to the type of loans granted, the proportion of agricultural loans to total loans stood at 83% for all banks, 71% for participating banks, and 98% for control banks in 1988.

Similarly, the loan portfolio of these banks grew by 3.7% for participating banks and 4.6% for control banks in the same year, relative to 1987 levels (Table 18).

These findings are consistent with the general trend of the total banking system where by total farm production credit climbed by 29% in 1988 (ACPC Agricultural Credit Report, 1988).

Other indicators

Income of banks. For all banks, gross income rose by 7% in 1988 from 1987 levels, or at a compounded growth rate of 11% for the period 1982-1988 (Tables 19 and 20). However, net income declined to about PHP 2.9 million in 1988 from PHP 3.6 million in 1987 but grew at a compounded growth rate of 6% in 1982-1988. The relatively high rate of inflation (about 10%) in 1988 may have accounted for the decline in net income during the period, since expenses increased by almost 12% to about PHP 22 million in 1988 from PHP 19 million in 1987.

Total assets. Total bank assets grew by almost 11%, from PHP 140 million in 1987 to PHP 155 million in 1988. For the participating banks, total assets grew by almost 5% while for the control banks, about 8% for the period 1982-1988. The average value of assets was estimated at PHP 13 million for participating banks, PHP 11 million for control banks, and PHP 12 million for all banks in 1988 (Tables 21 and 22).

Summary and conclusions

Savings mobilization plays a critical role in the financial intermediation process. Banks need to generate savings as a primary source of funds for lending. However, because of the supply-leading approach to rural development, rural banks neglected savings mobilization and focused largely on

credit allocation. In effect, the intermediation process became distorted and contributed to the inefficiency of the rural financial market. In view of these problems, financial reforms were put into place which included, among others, a program to encourage rural savings mobilization among banks in addition to credit allocation for an effective and efficient rural financial market.

This study was conducted to seek answers to questions such as: are there savings to be mobilized in the countryside? Can rural banks mobilize savings? What should banks do to mobilize savings? Although studies in other countries show that savings mobilization can be successful in the countryside, there has not been a major study in the Philippines that documented savings mobilization in the rural areas.

While this study is purely descriptive due to data constraints, it provides critical information for the study on Philippine rural financial markets.

It is argued here that banks can mobilize savings successfully in the rural areas under certain conditions including, i.e., an effective saving strategy, a favorable economic environment, and a strong commitment by bank management to the implementation of the strategy. Majority of the banks that implemented saving schemes experienced growth in their deposits. The strategy that attracted the most volume of deposits was that of the participating Bank G in Misamis Oriental. The scheme was one of “mobile banking,” in which bank staff members personally serviced the deposit and withdrawal requirements of clients, cutting down the transaction costs of depositors. The other schemes that successfully increased the volume of deposits of rural banks included intensive savings campaigns or information drives,

gimmicks that offered prizes to depositors (e.g., raffle draws), raising or maintaining interest rates at a level much higher than those offered by commercial banks and other large banks in nearby towns and cities, and giving incentives to bank employees to encourage them to solicit deposits from old or new clients. Strategies that required personal contact with the public seemed to have been most effective.

For banks that achieved either relatively small increases or negative growth rates in their deposit levels despite efforts to campaign for deposits, the following reasons were cited: (1) lack of commitment on the part of bank management to the implementation of the scheme; (2) adverse economic environment, such as a sharp decline in farm output or income as a result of calamities (e.g., typhoons) in the case of some banks in Camarines Sur, and high prices of inputs in the case of Batangas; (3) other attractive sources of loanable funds, such as the Rediscounting Program of the LBP which particularly affected the rural banks in Batangas; and (4) presence of other financial institutions in the service areas of the project banks that gave the latter tight competition in serving the financial needs of the target clientele.

While the successful banks may have been under the same economic scenario, it may be possible that these banks's strong commitment to the implementation of the schemes could have compensated for whatever adversities were present in the economy.

In addition, the better deposit performance of control banks relative to participating banks in some areas could have been due to the following: (1) the longer length of time the control bank has been in operation, which the public seemed to have equated with bank stability and security; and 2) greater rapport

of the control bank with the public. Put simply, the public seemed to have had more confidence in these control banks.

On other indicators such as bank income and bank assets, majority of the rural banks in this study experienced growth with regards to these variables. The extent, however, by which the improved deposit performance of banks may have influenced these indicators could not be determined due to data constraints.

In sum, there exists a substantial potential for financialized savings in the rural areas—savings which can be mobilized through rural financial markets. The extent to which this savings potential can be harnessed would depend on the savings opportunities and incentives made available to the public. A savings mobilization scheme will fail, however, if the bank does not have the confidence of the public, if it does not commit itself fully to the implementation of the saving strategy, or if the public itself is unresponsive due to generalized economic difficulties. This means that savings mobilization depends on both financial and nonfinancial factors that include bank stability and a favorable economic environment.

Table 1. RSM project banks

Provinces	Banks	
	Participating banks	Control banks
Batangas	Bank A Bank B	Bank H
Camarines Sur	Bank C Bank D	Bank I
Iloilo	Bank E	Bank J
Negros Oriental	Bank F	Bank K
Misamis Oriental	Bank G	Bank L

**For the purpose of confidentiality, the actual names of the banks are replaced by letter codes.*

Table 2. Profile of RSM banks

Bank	Date established	No. of years in operation	No. of areas served		No. of bank personnel	No. of banks/ similar institutions in the service area
			Municipality	Barangay		
1. Participating banks						
Bank A	May 1960	28	5	32	14	5
Bank B	Aug. 1978	9	10	72	14	2
Bank C	June 1960	28	8	34	14	4
Bank D	April 1974	14	1	29	10	0
Bank E	1960	28	13	81	6	0
Bank F	Feb. 1977	11	6	10	7	0
2. Control banks						
Bank H	Sept. 1975	11	1	16	6	2
Bank I	March 1966	22	6	67	7	0
Bank J	May 1966	22	12	85	10	0
Bank K	Jan. 1979	9	21	24	8	0
Bank L	April 1975	13	10	11	12	0

Table 3. Profile of bank managers of RSM banks

Bank	Age (years)	Sex	Educational attainment	No. of years in present position	Previous work experience	Time devoted to bank management
1. Participating banks						
Bank A	53	M	BS Accounting / Economics	21	Accountant	Full-time
Bank B	60	M	Bs Agriculture	9	Loan officer	Full-time
Bank C	44	F	BSBA Banking & Finance	11	Manager of another bank	Full-time
Bank D	48	M	BS Business Administration	13	PNB employee	Full-time
Bank E	25	M	BS Commerce	3	None	Full-time
Bank F	58	M	BS Commerce / Bachelor of Laws	10	Community devt. Officer	Full-time
2. Control banks						
Bank H	72	M	BS Education	12	Elementary school principal	Full-time
Bank I	41	F	BS Psychology	6	Cashier of same bank	Full-time
Bank J	46	F	BS Commerce	6	Dept. head of a private firm	Full-time
Bank K	55	F	BS Nursing	8	Rural health nurse	Full-time
Bank L	50	M	BS Commerce	12	Accounting clerk	Full-time

Table 4. Saving schemes implemented vs. volume of deposits

Rural bank	Nature of saving scheme	Date of implementation	Nominal ⁷			Real*		
			Volume of deposits (PHP 000)		Growth rate	Volume of deposits (PHP 000)		Growth rate
			as of end 1987	as of end 1988	%	as of end 1987	as of end 1988	%
Batangas								
BANK A	Offer rewards to employees upon reaching the rural bank's target deposit level; PHP 2 million for the first phase and PHP 4 million for the second phase.	August 1987 to January 1988 (1st phase) March 1988 to October 1988 (2nd phase)	18,993.2	18,568.0	(2.2)	2,559.70	2,280.40	(10.9)
BANK B	Information drive - mailing of deposit solicitation letters - personal contact with walk-in clients and neighbors	September 1987 to October 1988	3,620.7	3,462.9	(4.4)	488	425.3	(12.8)
	Offer incentives to employees with big solicitations	September 1987 to October 1988						
	Offering relatively higher rates on savings and time deposit accounts	September 1987 to October 1988						
	Offer raffle prizes to lucky depositors who can maintain a minimum daily balance of PHP 500 (for student accounts) and PHP 1000 (for general accounts)							
BANK H (control bank)			7,164.8	6,228.3	(13.1)	965.6	764.9	(20.8)

⁷ The term "nominal" refers to the actual volume of deposits reported by the bank while "real" is the nominal amount deflated by gross domestic product (GDP).

Rural bank	Nature of saving scheme	Date of implementation	Nominal			Real*		
			Volume of deposits (PHP 000)		Growth rate	Volume of deposits (PHP 000)		Growth rate
			as of end 1987	as of end 1988	%	as of end 1987	as of end 1988	%
Camarines Sur								
BANK C	Information drive Offer rewards and prizes to depositors	February 1988 to February 1989	4,620.3	5,706.7	23.5	622.7	700.8	12.5
BANK D	Information drive Offer raffle prizes to lucky bank depositors	December 1987 to March 1988 April 1988 to June 1988	2,507.2	2,710.0	8.1	337.9	332.8	(1.5)
BANK I (control bank)			2,697.9	4,324.1	60.3	363.6	531.1	46.1
Iloilo								
BANK E	Information drive Offer high interest rates on deposits Giving of gifts to clients during the holiday season		4,691.8	5,884.6	25.4	632.3	722.7	14.3
BANK J (control bank)			6,831.7	8,636.6	26.4	920.7	1060.6	15.2
Negros Oriental								
BANK F	Information drive - sending out of deposit solicitation letters to prospective clients particularly local residents working abroad - maintaining relatively higher rates of interest on deposits - house to house campaign	March 1988 to March 1989	2,108.4	2,515.6	19.3	284.1	308.9	8.7
BANK K (control bank)			1,751.7	2,269.2	29.5	236.1	278.7	18.0

Rural bank	Nature of saving scheme	Date of implementation	Nominal			Real*		
			Volume of deposits (PHP 000)		Growth rate	Volume of deposits (PHP 000)		Growth rate
			as of end 1987	as of end 1988	%	as of end 1987	as of end 1988	%
Misamis Oriental								
BANK G	Minimizing depositor transaction costs by assigning bank personnel to collect deposits from stockholders and borrowers in Brgy. Cogon where much of the trading commercial activities are being held	October 1987 to October 1988	1,204.7	1,961.2	62.8	162.4	240.9	48.3
BANK L (control bank)			1,174.1	1,298.1	10.6	158.2	159.4	0.8

Table 5. Nominal growth rate of total deposits (in percent), As at End of Year Indicated

YEAR	PARTICIPATING BANKS								CONTROL BANKS					
	Batangas		Cam. Sur		Iloilo	Neg. Or.	Mis. Or.	All Partici-	Batangas	Cam. Sur	Iloilo	Neg. Or.	Mis. Or.	All Partici-
	Bank A	Bank B	Bank C	Bank D	Bank E	Bank F	Bank G	pating Banks	Bank H	Bank I	Bank J	Bank K	Bank L	pating Banks
1983	13.9	65.0	24.1	6.4	(2.0)	8.2	53.9	19.7	84.7	20.0	19.2	32.6	67.0	44.9
1984	(6.4)	(15.4)	(18.5)	27.3	28.5	23.8	34.5	2.1	(25.9)	19.9	49.8	(21.6)	(18.8)	(1.4)
1985	37.2	(11.5)	(9.5)	12.7	(8.4)	29.0	(27.4)	10.0	14.8	3.2	(1.7)	6.7	17.6	5.2
1986*	69.0	29.8	30.8	(58.0)	28.5	34.4	13.0	27.0	117.4	(4.9)	9.2	15.6	(36.0)	33.8
1987	22.3	0.4	66.5	26.2	48.4	29.8	15.9	27.0	9.5	22.4	64.5	77.9	3.5	31.9
1988	(2.2)	(4.3)	23.5	8.1	25.4	19.3	62.8	8.1	(13.1)	60.3	26.4	29.5	10.6	16.0
Average Annual Rate	22.3	10.7	19.5	3.8	20.1	24.1	25.4	15.6	31.2	20.2	27.9	23.4	7.3	21.7

**Table 5A. Real growth rate of total deposits (in percent),
As at End of Year Indicated**

YEAR	PARTICIPATING BANKS								CONTROL BANKS					
	Batangas		Cam. Sur		Iloilo	Neg. Or.	Mis. Or.	All Partici-	Batangas	Cam. Sur	Iloilo	Neg. Or.	Mis. Or.	All Partici-
	Bank A	Bank B	Bank C	Bank D	Bank E	Bank F	Bank G	pating Banks	Bank H	Bank I	Bank J	Bank K	Bank L	pating Banks
1983	1.9	47.7	11.1	(4.8)	(12.3)	(3.2)	37.8	7.2	65.3	7.4	6.7	18.7	49.5	29.7
1984	(37.5)	(43.5)	(45.5)	(14.9)	(14.2)	(17.3)	(10.1)	(31.8)	(50.5)	(31.1)	0.0	(47.6)	(45.7)	(34.1)
1985	16.3	(25.0)	(23.2)	(4.7)	(22.3)	9.4	(38.5)	(6.7)	(2.7)	(19.3)	(16.7)	(9.5)	(0.3)	(10.8)
1986	67.2	28.4	29.4	(58.5)	27.1	33.0	11.7	25.6	114.9	21.0	8.0	14.2	(36.6)	32.3
1987	13.1	(7.1)	53.9	16.7	37.2	20.0	7.2	17.4	1.2	21.3	52.1	64.5	(4.4)	22.0
1988	(10.9)	(12.8)	12.5	(1.5)	14.3	8.8	48.3	(1.5)	(20.8)	46.0	15.2	18.0	0.8	5.7
Average Annual Rate	8.4	(2.0)	6.4	(11.3)	5.0	8.4	9.4	1.7	17.9	7.6	10.9	9.7	(6.1)	7.5

**Table 6. Number of deposit accounts in RSM banks
1982 - 1985**

	1982	1983	1984	1985	1986	1987	1988	
A. Participating Banks								
Batangas								
Bank A		6,413	5,218	5,242	5,594	6,039	6,270	6,418
Bank B		5,477	6,410	6,552	5,092	4,194	2,814	2,437
Camarines Sur								
Bank C		7,202	7,532	7,765	6,040	2,908	3,237	3,060
Bank D		6,555	7,292	4,604	2,831	2,087	1,883	1,734
Iloilo								
Bank E		9,330	9,330	8,365	9,597	10,244	9,908	10,500
Negros Oriental								
Bank F		1,161	1,200	1,317	1,435	1,507	1,642	1,753

	1982	1983	1984	1985	1986	1987	1988
Misamis Oriental							
Bank G	2,249	2,563	3,045	3,191	3,317	3,456	3,634
All Participating Banks	38,387	39,545	36,890	33,780	30,296	29,210	29,536
Average Number per Participating Bank	5,484	5,649	5,270	4,826	4,328	4,173	4,219
B. Control Banks							
Batangas							
Bank H	2,365	2,558	2,399	2,423	2,545	2,718	2,769
Camarines Sur							
Bank I	6,405	7,188	8,190	8,352	8,640	9,049	7,945
Iloilo							
Bank J	n.a	n.a	n.a	5,605	6,341	6,282	6,986
Negros Oriental							
Bank K	1,765	2,150	2,562	2,357	2,512	2,677	2,822
Misamis Oriental							
Bank L	2,282	2,515	2,738	2,763	2,872	3,009	2,986
All Controls Banks	12,817	14,411	15,889	21,500	22,910	23,735	23,508
Average Number per Control Bank	3,204	3,603	3,972	4,300	4,582	4,747	4,702
ALL BANKS	51,204	53,956	52,779	55,280	53,206	52,945	53,044
AVERAGE NUMBER PER BANK	4,655	4,905	4,798	4,607	4,434	4,412	4,420

**Table 7. Size of deposit account
Participating vs. Control
1982-1988**

Year	CONTROL BANKS		PARTICIPATING BANKS		ALL BANKS	
	Average Deposit per Account		Average Deposit per Account		Average Deposit per Account	
	Nominal	Year	Nominal	Year	Nominal	Year
1982	407.69 ^{a/}	118.50 ^{a/}	444.86	129.30	484.25 ^{a/}	140.75 ^{a/}
1983	564.10 ^{a/}	146.74 ^{a/}	526.93	137.07	584.75 ^{a/}	152.12 ^{a/}
1984	421.42 ^{a/}	73.24 ^{a/}	576.88	100.26	603.39 ^{a/}	104.86 ^{a/}
1985	517.15	76.20	693.00	102.11	624.61	92.04
1986	649.30	94.62	981.00	142.95	838.17	122.14
1987	826.64	111.40	1,292.23	174.15	1,083.51	146.02
1988	968.01	118.88	1,381.70	169.69	1,198.36	147.17

a/ excluding Iloilo Bank J because data for number of deposit accounts is unavailable.

**Table 8. Proportion of deposits, by type*
as of End of Years Indicated**

	1982		1983		1984		1985		1986		1987		1988	
	S	T	S	T	S	T	S	T	S	T	S	T	S	T
A. Participating Banks														
Batangas														
Bank A	69.9	30.1	62.9	37.1	64.0	36.0	59.9	40.1	59.4	40.6	55.6	44.4	55.3	44.7
Bank B	66.5	33.5	45.8	54.2	41.8	58.2	74.3	25.7	62.7	37.3	72.7	27.3	83.8	16.2
Camarines Sur														
Bank C	57.0	43.0	48.6	51.4	64.6	35.4	49.3	50.7	64.7	35.3	65.5	34.5	65.4	34.6
Bank D	51.8	48.2	47.1	52.9	37.5	62.5	29.8	70.2	63.7	36.3	56.4	43.6	76.0	24.0
Iloilo														
Bank E	88.8	11.2	91.8	8.2	91.9	8.1	92.1	7.9	86.3	13.7	89.8	10.2	93.7	6.3
Negros Oriental														
Bank F	76.5	23.5	70.2	29.8	70.0	30.0	79.9	20.1	65.8	34.2	70.2	29.8	64.3	35.7
Misamis Oriental														
Bank G	94.9	5.1	92.3	7.7	94.7	5.3	95.5	4.5	95.7	4.3	94.4	5.6	95.0	5.0

	1982		1983		1984		1985		1986		1987		1988	
	S	T	S	T	S	T	S	T	S	T	S	T	S	T
B. Control Banks														
Batangas														
Bank H	69.3	30.7	68.8	31.2	49.2	50.8	56.5	43.5	45.8	54.2	42.2	57.8	53.6	46.4
Camarines Sur														
Bank I	77.9	22.1	79.3	20.7	85.1	14.9	85.9	14.1	87.3	12.7	91.2	8.8	90.4	9.6
Iloilo														
Bank J	78.0	22.0	75.7	24.3	80.0	20.0	81.5	18.5	83.2	16.8	86.6	13.4	90.4	9.6
Negros Oriental														
Bank K	65.5	34.5	67.3	32.7	81.2	18.8	84.9	15.1	88.6	11.4	61.9	38.1	55.9	44.1
Misamis Oriental														
Bank L	87.6	12.4	89.8	10.2	79.8	20.2	91.4	8.6	91.0	9.0	88.3	11.7	93.2	6.8
ALL BANKS	70.3	29.7	65.2	34.8	65.1	34.9	65.8	34.2	66.1	33.9	66.2	33.8	71.6	28.4
*S = Savings T = Time														

Table 9. Type of clientele served

Bank	Relative Importance (in %)	
	Individual	Institutional
Participating Bank		
Bank A	90	10
Bank B	95	5
Bank C	70	30
Bank E	90	100
Bank F	100	-
Bank G	97	3
Control Bank		
Bank H	98	2
Bank I	99	1
Bank J	99	1
Bank K	90	10
Bank L	95	5

*Bank D (Camarines Sur) excluded due to incomplete data.

Table 10. Average interest rates on savings and time deposits of rural banks vs. commercial banks, by region (1988)

Province	Region	Interest Rate on Savings (%)		Interest Rate on Time (%)	
		Rural Bank ^{1/}	Comm'l Bank ^{2/}	Rural Bank ^{1/}	Comm'l Bank ^{2/}
Batangas (Region 3)		7.0	4.62	10.50	12.25
Cam. Sur (Region 5)		6.50	9.25	13.00	12.75
Iloilo (Region 6)		5.50	5.45	8.60	12.56
Neg. Oriental (Region 8)		6.00	4.64	13.20	10.18
Mis. Oriental (Region 10)		7.00	4.00	11.50	10.89

^{1/} Average interest rate offered by participating and control banks.

^{2/} Source: Countryside Banking Survey, ACPC, 1988.

Table 11. Deposit mobilization costs among participating banks (In Thousands of Pesos)

	All Banks		Bank A		Bank B		Bank C		Bank E		Bank F		Bank G	
	Pesos	%	Pesos	%	Pesos	%	Pesos	%	Pesos	%	Pesos	%	Pesos	%
Total	1103.4625	100.0	238.1967	100.0	244.8556	100.0	410.3615	100.0	97.8604	100.0	54.3687	100.0	58.6193	100.0
Transactions with Depositors	611.9662	55.6	87.9222	37.0	142.1994	58.3	310.5362	75.7	12.6490	13.0	27.3667	50.3	31.2927	53.4
Record-Keeping	359.3909	32.6	99.4362	41.7	87.3700	35.6	63.7034	15.5	73.9214	75.5	16.8032	31.0	18.1567	31.0
Ads and Promo	132.1054	11.9	50.8383	21.3	14.4862	5.9	36.1219	8.8	11.2900	11.5	10.1988	18.7	9.1699	15.6

*Bank D (Camarines Sur) excluded due to incomplete data.

Table 12. Cost per deposit account,* among participating banks**
(in P000)

	All Banks	Bank A	Bank B	Bank C	Bank E	Bank F	Bank G
Total	39.69	37.12	100.14	134.10	9.31	31.00	16.12
Transactions with Depositors	22.01	13.70	58.35	101.48	1.20	15.61	8.61
Record-Keeping	12.93	15.50	35.85	20.82	7.04	9.58	4.99
Ads and Promo	4.75	7.92	5.94	11.80	1.07	5.81	2.52

*Annual cost divided by number of accounts

**Bank D (Camarines Sur) excluded due to incomplete data.

Table 13. Cost per peso deposit,* among participating banks**
(in P000)

	All Banks	Bank A	Bank B	Bank C	Bank E	Bank F	Bank G
Total	0.029	0.013	0.070	0.071	0.017	0.022	0.029
Transactions with Depositors	0.016	0.005	0.041	0.054	0.002	0.011	0.016
Record-Keeping	0.009	0.005	0.025	0.011	0.013	0.007	0.009
Ads and Promo	0.004	0.003	0.004	0.006	0.002	0.004	0.004

*Annual cost divided by volume/amount of deposits.

**Bank D (Camarines Sur) excluded due to incomplete data.

Table 14. Structure of total loanable funds
among all RSM banks (in PHP 000)
1982 - 1988

Year	Deposits		Borrowings		Other Liabilities		Capital Accounts		TOTAL	
	AMT.	% to TOTAL	AMT.	% to TOTAL	AMT.	% to TOTAL	AMT.	% to TOTAL	AMT.	% to TOTAL
1982	24,795.4	25.2	59,407.6	60.3	1,041.5	1.0	13,321.2	13.5	98,565.7	100.0
1983	31,550.7	27.3	67,619.3	58.6	1,453.6	1.3	14,770.6	12.8	115,394.2	100.0
1984	31,846.5	29.7	57,147.7	53.3	2,262.0	2.1	16,020.4	14.9	107,276.6	100.0
1985	34,528.3	33.6	48,697.3	47.5	2,256.6	2.2	17,114.4	16.7	102,596.6	100.0
1986	44,595.7	39.7	46,983.4	41.8	2,182.6	1.9	18,631.1	16.6	112,392.8	100.0
1987	57,366.4	45.3	43,431.4	34.3	4,174.2	3.3	21,616.6	17.1	126,588.6	100.0
1988	63,566.0	45.6	44,895.0	32.2	9,370.0	6.7	21,679.7	15.5	139,510.7	100.0

Table 15. Structure of total loanable funds of participating vs. control banks (in PHP 000)
1982 - 1988

Year	PARTICIPATING BANKS										CONTROL BANKS									
	Deposits		Borrowings		Other Liabilities		Capital Accounts		TOTAL		Deposits		Borrowings		Other Liabilities		Capital Accounts		TOTAL	
	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL	AMT	% to TOTAL
1982	17,401.7	26.1	40,746.8	61.2	534.0	0.8	7,914.4	11.9	66,597.1	100.0	7,393.7	23.1	18,660.8	58.4	507.5	1.6	5,406.8	16.9	31,968.8	100.0
1983	20,837.6	27.7	44,712.3	59.4	841.3	1.1	8,903.5	11.8	75,294.6	100.0	10,713.1	26.7	22,907.0	57.1	612.3	1.5	5,867.1	14.7	40,099.5	100.0
1984	21,281.1	29.7	39,127.7	54.7	1,384.2	1.9	9,767.2	13.7	71,560.2	100.0	10,565.4	29.6	18,020.0	50.4	877.8	2.5	6,253.2	17.5	35,716.4	100.0
1985	23,409.5	34.7	32,206.7	47.8	1,466.0	2.2	10,310.3	15.3	67,392.5	100.0	11,118.8	31.6	16,490.6	46.8	790.6	2.3	6,804.1	19.3	35,204.1	100.0
1986	29,720.3	41.4	29,258.9	40.8	1,488.9	2.1	11,310.1	15.7	71,778.3	100.0	14,875.4	36.6	17,724.5	43.7	693.7	1.7	7,321.0	18.0	40,614.6	100.0
1987	37,746.1	47.4	25,387.5	31.9	2,698.7	3.4	13,785.8	17.3	79,618.1	100.0	19,620.3	41.8	18,043.9	38.4	1,475.5	3.1	7,830.8	16.7	46,970.5	100.0
1988	40,810.1	46.4	26,562.8	30.2	5,856.0	6.7	14,635.9	16.7	87,864.8	100.0	22,755.9	44.1	18,332.2	35.5	3,514.0	6.8	7,043.8	13.6	51,645.9	100.0

**Table 16. Volume of loans granted by participating vs. control banks
1987 - 1988**

	1987					1988					% Change		
	Agri		Non-Agri		Total	Agri		Non-Agri		Total	Agri	Non-Agri	Total
	Amount	%	Amount	%		Amount	%	Amount	%				
A. Participating Banks													
Batangas													
Bank A	15,462.2	94.7	865.0	5.3	16,327.2	16,300.4	95.0	865.0	5.0	17,165.4	5.4	0.0	5.1
Bank B	6,074.9	92.0	529.5	8.0	6,604.4	2,934.7	89.8	335.0	10.2	3,269.7	(51.7)	(36.7)	(50.5)
Camarines Sur													
Bank C	11,309.2	46.6	12,972.5	53.4	24,281.7	11,667.9	38.7	18,445.2	61.3	30,113.1	3.2	42.2	24.0
Bank D	397.4	23.8	1,268.9	76.2	1,666.3	127.6	39.7	193.5	60.3	321.1	(67.9)	(84.8)	(80.7)
Iloilo													
Bank E	14,404.0	96.2	567.5	3.8	14,971.5	16,491.3	90.1	1,810.0	9.9	18,301.3	14.5	218.9	22.2
Negros Oriental													
Bank F	1,792.8	91.9	158.9	8.1	1,951.7	1,431.5	97.4	38.7	2.6	1,470.2	(20.2)	(75.6)	(24.7)
Misamis Oriental													
Bank G	3,324.2	100.0	--	--	3,324.2	3,873.4	100.0	--	--	3,873.4	16.5	--	16.5
All participating Banks	52,764.7	76.3	16,362.3	23.7	69,127.0	52,826.8	70.9	21,687.4	29.1	74,514.2	0.1	32.5	7.8
B. Control Banks													
Batangas													
Bank H	65,053.7	99.0	625.0	1.0	65,678.7	35,256.1	100.0	--	--	35,256.1	(45.8)	(100.0)	(46.3)
Camarines Sur													
Bank I	5,502.7	88.8	690.9	11.2	6,193.6	5,848.9	95.3	287.6	4.7	6,136.5	6.3	(58.4)	(0.9)
Iloilo													
Bank J	8,778.2	96.3	341.0	3.7	9,119.2	10,103.5	96.8	333.8	3.2	10,437.3	15.1	(2.1)	14.5
Negros Oriental													
Bank K	6,675.3	89.9	746.8	10.1	7,422.1	4312.4	84.0	819.3	16.0	5,131.7	(35.4)	9.7	(30.9)
Misamis Oriental													
Bank L	3,296.6	100.0	--	--	3,296.6	3,527.8	100.0	--	--	3,527.8	7.0	--	7.0
All Controls Banks	89,306.5	97.4	2,403.7	2.6	91,710.2	59,048.7	97.6	1,440.7	2.4	60,489.4	(33.9)	(40.1)	(34.0)
ALL BANKS	142,071.2	88.3	18,766.0	11.7	160,837.2	111,875.5	82.9	23,128.1	17.1	135,003.6	(21.3)	23.2	(16.1)

Table 17. Volume of loans granted, by bank (1982-1988)

	PARTICIPATING BANKS							CONTROL BANKS					ALL BANKS
	Batangas		Camarines Sur		Iloilo	Neg. Or.	Mis. Or.	Batangas	Cam. Sur	Iloilo	Neg. Or.	Mis. Or.	
	Bank A	Bank B	Bank C	Bank D	Bank E	Bank F	Bank G	Bank H	Bank I	Bank J	Bank K	Bank L	
1982													
Agri	13,997.8	10,926.4	12,684.7	1090.1	n.a	1,230.0	4,438.8	6,229.5	6,690.2	52,26.2	3,335.3	7,628.3	73,477.3
Non-Agri	456.2	4,589.0	3,350.0	42.2	n.a	23.4	-	6.0	-	310.3	266.1	-	5043.2
Total	14,454.0	11,515.4	16,034.7	1,132.2	n.a	1,253.4	4,438.8	6,235.5	6,690.2	5,536.5	3,601.4	7,628.3	78,520.5
1983													
Agri	10,487.6	12,208.0	14,292.5	1,116.9	1,458.6	1,351.7	4,303.3	6,026.4	7,375.4	7,092.9	6,572.3	9,452.9	81,738.5
Non-Agri	873.0	2,448.5	3,384.7	26.2	147.0	24.5	-	-	437.2	219.2	484.2	-	8,044.5
Total	11,360.6	14,656.5	17,677.2	1,143.1	1,605.6	1,376.2	4,303.3	6,026.4	7,812.6	7,312.1	7,056.5	9,452.9	89,783.0
1984													
Agri	8,642.5	5,010.9	10,681.0	650.7	2,324.0	1,058.2	4,367.7	3,467.6	5,665.7	7,129.8	6,168.3	7,791.8	62,568.2
Non-Agri	1,865.2	1,791.1	3,145.7	16.0	-	78.6	-	-	1078.5	444.4	558.0	-	8,976.5
Total	10,207.7	6,802.0	13,826.7	665.7	2,324.0	1,136.8	4,367.7	3,467.6	6,744.2	7,574.2	6,726.3	7,791.8	71,544.7
1985													
Agri	8,290.4	3,784.5	11,367.2	105.5	4,390.4	1,163.7	4,117.0	2,617.4	4,659.8	8,092.4	6,626.1	6,481.1	61,695.5
Non-Agri	1,041.1	1,497.0	3,953.9	-	110.0	361.8	-	-	1941.0	252.7	558.0	-	9,715.5
Total	9,331.5	5,281.5	15,321.1	105.5	4,500.4	1,525.5	4,117.0	2,617.4	6,600.8	8,345.1	7,184.1	6,481.1	71,411.0
1986													
Agri	9,809.4	5,406.0	9,285.3	402.4	5,310.6	1,392.7	4,222.4	21,488.7	4,496.9	7,356.5	6,276.6	7,582.8	83,030.3
Non-Agri	1,447.9	813.5	5,612.3	-	36.0	352.2	-	7,895.6	1,697.3	172.0	585.2	-	18,612.0
Total	11,257.3	6,219.5	14,897.6	402.4	5,346.6	1,744.9	4,222.4	29,384.3	6,194.2	7,528.5	6,861.8	7,582.8	101,642.3
1987													
Agri	15,462.2	6075.2	11,309.2	397.4	14,404.0	1,792.8	3,324.2	65,053.7	5,502.7	8,778.2	6,675.3	3,296.6	142,071.2
Non-Agri	865.0	529.2	12,972.5	1,268.9	567.5	158.9	-	625.0	690.9	341.0	746.8	-	18,766.0
Total	16,327.2	6,604.4	24,281.7	1,666.3	14,971.5	1,951.7	3,324.2	65,678.7	6,193.6	9,119.2	7,422.1	3,296.6	160,837.2
1988													
Agri	16,300.4	3,934.7	11,667.9	127.6	16,491.3	1,431.5	3,873.4	35,256.1	5,848.9	10,103.5	4,312.4	3,527.8	111,875.5
Non-Agri	865.0	335.0	18,445.2	193.8	1,810.0	38.7	-	-	287.6	333.8	819.3	-	23,128.1
Total	17,165.4	3,269.7	30,113.1	321.1	18,301.3	1,470.2	3,873.4	35,256.1	6,136.5	10,437.3	5,131.7	3,527.8	135,003.6
Ave. Amount													
Agri	11,812.9	6,620.8	11,612.6	555.8	7,381.5	1,345.8	4,092.4	20,019.9	5,748.5	7,682.8	5,709.5	6,537.3	88,065.2
Non-Agri	1,059.1	1,143.4	7,266.3	309.2	534.1	148.3	-	2,842.2	1,022.1	296.2	573.9	-	13,183.7
Total	12,872.0	7,764.2	18,878.9	865.0	7,915.6	1,494.1	4,092.4	22,862.1	6,770.6	7,979.0	6,283.4	6,537.3	101,248.9
Compound Annual Growth Rate %													
Agri	2.6	(19.7)	-1.4	(30.1)	62.4	2.6	(2.2)	33.5	(2.2)	11.6	4.4	(12.1)	7.3
Non-Agri	11.2	(9.0)	32.9	28.9	65.2	8.7	-	0.0	-	1.2	20.6	0	28.9
Total	2.9	(18.9)	11.1	(18.9)	62.7	2.7	(2.2)	33.5	(1.4)	11.1	6.1	(12.1)	9.4

Table 18. Growth rate of loans outstanding
As at end of year indicated

PARTICIPATING BANKS						CONTROL BANKS					
Cam. Sur		Iloilo	Neg. Or.	Mis. Or.	All Partici-	Batangas	Cam. Sur	Iloilo	Neg. Or.	Mis. Or.	All Control Banks
Bank C	Bank D	Bank E	Bank F	Bank G	pating Banks	Bank H	Bank I	Bank J	Bank K	Bank L	
14.1	5.0	(12.8)	2.4	(2.2)	13.6	5.2	15.9	19.2	95.9	9.1	21.6
(17.7)	(21.5)	(25.3)	0.6	1.5	(13.7)	(32.5)	(6.9)	(7.4)	(4.7)	(8.9)	(11.7)
(10.3)	(30.8)	63.7	15.5	(5.7)	(11.4)	(21.2)	(3.3)	8.4	6.8	(6.7)	(8.4)
(14.0)	(24.5)	34.2	3.3	2.6	(0.9)	120.0	(2.8)	16.4	(4.5)	5.9	24.6
24.9	58.7	36.0	31.6	(4.9)	25.9	35.5	5.3	18.7	8.2	(11.9)	10.9
13.8	(10.9)	19.9	13.5	19.4	3.7	(0.1)	(0.9)	24.9	3.5	(8.5)	4.6

Table 19. Financial highlights for participating vs. control banks (in PHP 000)
1982-1988

Account	PARTICIPATING BANKS							Average Value Per bank	Compound Annual Growth Rate	CONTROL BANKS							Average Value Per bank	Compound Annual Growth Rate
	1982	1983	1984	1985	1986	1987	1988			1982	1983	1984	1985	1986	1987	1988		
Resources/Assets	69,383.6	78,700.9	75,552.5	70,232.8	74,800.2	83,807.3	91,808.5	77,755.1	4.8%	34,385.1	42,682.7	38,249.1	37,308.9	43,647.0	49,418.6	54,416.6	60,021.6	8.0%
Deposit Liabilities	17,401.7	20,837.6	21,281.1	23,409.5	29,720.3	37,746.1	40,810.1	27,315.2	15.3%	7,393.7	10,713.1	10,565.4	11,118.8	14,875.4	19,620.3	22,755.9	19,408.5	20.6%
Capital Accounts	7,914.4	8,903.5	9,767.2	10,310.3	11,310.1	13,785.8	14,635.9	10,946.8	10.8%	5,406.8	5,867.1	6,253.2	6,804.1	7,321.0	7,830.8	7,043.8	9,305.4	4.5%
Loan Portfolio	60,047.1	68,229.9	58,882.4	52,173.3	51,717.4	65,114.9	67,496.2	60,523.0	2.0%	30,961.8	37,640.0	33,241.5	30,445.4	37,924.0	42,041.9	43,958.7	51,242.7	6.0%
Gross Income	8,005.4	9,435.5	10,553.2	11,738.8	12,656.4	13,711.9	14,719.5	11,545.8	10.7%	4,179.3	4,858.9	5,634.5	6,470.6	7,363.6	7,587.5	7,944.6	8,807.8	11.3%
Expenses	6,878.1	8,611.2	9,340.6	10,561.3	11,320.3	11,402.5	11,679.1	9,970.4	9.2%	3,410.7	4,302.5	5,114.7	5,464.5	6,668.2	6,506.3	8,202.8	7,933.9	15.7%
Net Income	1,127.3	824.3	1,212.6	1,177.5	1,336.1	2,309.4	3,040.4	1,575.4	18.0%	768.6	556.4	519.8	1,006.1	695.4	1,081.2	(258.2)	873.9	7.1% ^d

**Table 20. Financial highlights for all RSM banks (in PHP 000)
1982 - 1988**

Account	1982	1983	1984	1985	1986	1987	1988	Average Value Per bank	Compound Annual Growth Rate
Resources	103,768.7	121,383.6	113,801.6	107,541.7	118,447.2	133,225.9	146,225.1	70,366.2	5.9%
Deposit Liabilities	24,795.4	31,550.7	31,846.5	34,528.3	44,595.7	57,366.4	63,566.0	24,020.8	17.0%
Capital Accounts	13,321.2	14,770.6	16,020.4	17,114.4	18,631.1	21,616.6	21,679.7	10,262.8	8.5%
Loan Portfolio	91,008.9	105,869.9	92,123.9	82,618.7	89,641.4	107,156.8	111,454.9	56,656.2	3.4%
Gross Income	12,184.7	14,294.4	16,187.7	18,209.4	20,020.0	21,299.4	22,664.1	10,405.0	10.9%
Expenses	10,288.8	12,913.7	14,455.3	16,025.8	17,988.5	17,908.8	19,881.9	9,121.9	11.6%
Net Income	1,895.9	1,380.7	1,732.4	2,183.6	2,031.5	3,390.6	2,782.2	1,283.1	6.6%

**Table 21. Average value of assets and liabilities of all banks (in PHP 000)
1982 - 1988**

INDICATOR	1982	1983	1984	1985	1986	1987	1988
TOTAL ASSETS	8,647.4	10,115.3	9,483.5	8,961.9	9,870.6	11,102.2	12,185.4
Cash	131.4	203.8	255.7	293.1	379.7	482.6	507.0
Check & Other Cash Items	6.0	7.7	6.1	7.2	21.2	34.6	43.9
Due from CB	58.4	91.9	130.2	130.4	212.8	258.5	319.9
Due from Banks	459.1	461.5	486.0	493.4	741.9	806.0	1,225.3
Loans & Discounts	7,423.8	8,693.2	7,524.6	6,845.5	7,270.7	8,673.0	9,017.7
Investment	170.3	166.5	542.5	616.5	692.4	296.2	328.7
Banking Hse., Furn., & Fix.	185.4	190.8	174.4	166.1	155.2	162.3	209.5

INDICATOR	1982	1983	1984	1985	1986	1987	1988
Other Real & Chattel Prop.	128.0	171.4	292.1	347.1	308.0	303.0	329.1
Other Assets	85.0	128.5	71.9	62.6	88.7	86.0	204.3
TOTAL LIABILITIES AND NETWORTH							
TOTAL LIABILITIES	7,537.3	8,884.4	8,148.4	7,535.7	8,318.0	9,300.8	10,378.8
Deposit Liabilities	2,066.3	2,629.2	2,653.9	2,877.4	3,716.3	4,780.5	5,297.2
Demand Deposits	---	---	---	---	---	---	---
Savings Deposits	1,452.9	1,714.7	1,728.5	1,893.2	2,457.4	3,164.9	3,790.7
Time Deposits	613.4	914.5	925.4	984.2	1,258.9	1,615.6	1,506.5
Non-Reserve Deposits	201.1	252.1	280.6	174.5	186.1	217.0	199.7
Due to Banks	0.3	19.7	4.7	31.7	82.8	38.1	14.8
Officers' & Managers' Checks	---	---	---	---	---	---	---
Unearned Income	188.5	206.3	244.2	220.2	286.8	274.7	292.7
Dividends Payable	44.0	40.7	18.9	17.4	31.6	61.4	67.2
Bills Payable	4,950.3	5,615.3	4,757.6	4,026.4	3,832.5	3,581.2	3,726.4
Other Liabilities	86.8	121.1	188.5	188.1	181.9	347.9	780.8
TOTAL NETWORTH	1,110.1	1,230.9	1,335.1	1,426.2	1,552.6	1,801.4	1,806.6
Capital Stock	712.7	758.6	803.7	819.4	875.3	898.1	978.5
Surplus, Res., & Undiv. Prof.	397.4	472.3	531.4	606.8	677.3	903.3	828.1

**Table 22. Average value of assets and liabilities of participating vs. control banks (in PHP 000)
1982 - 1988**

INDICATOR	PARTICIPATING BANKS							CONTROL BANKS						
	1982	1983	1984	1985	1986	1987	1988	1982	1983	1984	1985	1986	1987	1988
TOTAL ASSETS	9,911.9	11,243.0	10,793.1	10,033.1	10,685.7	11,972.5	13,115.6	6,876.9	8,536.5	7,649.8	7,461.8	8,729.4	9,883.6	10,883.3
Cash	164.4	217.5	278.5	304.3*	381.6	527.5	523.7	85.0	184.7	223.9	277.4	377.0	419.7	483.7
Check & Other Cash Items	3.8	6.7	4.3	4.1	33.8	32.8	53.7	9.2	8.9	8.5	11.5	3.5	37.2	30.2
Due from CB	64.6	105.8	128.0	134.9	245.5	302.4	363.1	49.6	72.5	133.3	124.1	166.9	197.2	259.5
Due from Banks	634.9	467.4	607.6	606.2	966.0	883.7	1,342.1	212.9	453.3	315.8	335.4	428.2	697.2	1,061.7
Loans & Discounts	8,401.5	9,631.7	8,279.7	7,278.3	7,241.4	9,123.5	9,454.6	6,055.2	7,379.2	6,467.4	6,239.6	7,311.7	8,042.2	8,406.2
Investment	162.8	157.7	808.9	946.6	1,074.8	386.6	389.9	180.8	178.8	169.6	154.2	157.1	169.5	243.0
Banking Hse., Furn., & Fix.	238.1	260.1	243.5	235.1	222.2	208.8	296.7	111.5	93.8	77.5	69.5	61.5	97.1	87.5
Other Real & Chattel Prop.	147.2	202.7	357.6	447.0	398.7	395.6	370.6	101.2	127.5	200.3	207.3	180.9	173.4	270.9
Other Assets	94.6	193.4	85.0	76.6	121.7	111.6	321.2	71.5	37.8	53.5	42.8	42.6	50.1	40.6
TOTAL LIABILITIES AND NETWORKTH														
TOTAL LIABILITIES	8,781.3	9,971.1	9,397.8	8,560.3	9,069.9	10,003.0	11,024.7	5,795.7	7,363.1	6,399.2	6,101.0	7,265.2	8,317.5	9,474.6
Deposit Liabilities	2,486.0	2,976.8	3,040.2	3,344.2	4,245.8	5,392.3	5,830.0	1,478.7	4,142.6	2,113.1	2,223.8	2,975.1	3,924.0	4,551.2
Demand Deposits	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Savings Deposits	1,689.5	1,782.0	1,859.5	2,018.9	2,762.7	3,493.7	3,993.5	1,121.7	1,620.5	1,545.2	1,717.1	2,030.1	2,704.5	3,506.8
Time Deposits	796.5	1,194.8	1,180.7	1,325.3	1,483.1	1,898.6	1,836.5	357.0	522.1	567.9	506.7	945.0	1,219.5	1,044.4
Non-Reserve Deposits	209.0	272.8	337.9	181.2	120.8	209.8	153.0	189.9	223.1	200.6	165.1	277.4	227.1	265.1
Due to Banks	0.0	2.0	2.0	1.4	135.9	2.3	19.6	0.8	44.4	8.4	74.0	8.5	88.3	8.3
Officers' & Managers' Checks	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Unearned Income	145.2	169.0	200.0	194.8	256.6	283.4	307.4	249.1	258.5	306.0	255.9	329.1	262.5	272.0
Dividends Payable	43.8	44.8	32.4	29.8	54.2	105.2	103.0	44.3	35.0	0.0	0.0	0.0	0.0	17.1
Bills Payable	5,821.0	6,385.5	5,587.6	4,599.5	4,043.9	3,624.5	3,775.1	3,731.4	4,537.0	3,595.5	3,224.1	3,536.4	3,520.5	3,658.2
Other Liabilities	76.3	120.2	197.7	209.4	212.7	385.5	836.6	101.5	122.5	175.6	158.1	138.7	295.1	702.7
TOTAL NETWORKTH	1,130.6	1,271.9	1,395.3	1,472.8	1,615.8	1,969.5	2,090.9	1,081.2	1,173.4	1,250.6	1,360.8	1,464.2	1,566.1	1,408.7
Capital Stock	728.0	777.4	844.7	859.2	922.9	958.1	1,095.9	691.2	732.1	746.2	763.7	808.8	814.2	814.2
Surplus, Res., & Undiv. Prof.	402.6	494.5	550.6	613.6	693.0	1,011.4	995.0	390.0	441.3	504.4	597.1	655.4	751.9	594.5

ANNEX A

The rural bank selection process

1. Eliminate all rural banks operating in Metro Manila and in other regional centers.
2. Exclude rural banks rated by the Central Bank's Supervision and Examination Sector (CB-SES) as weak.
3. Find homogenous banks in terms of asset size, net worth, risk assets ratio (RAR), and past due ratio (PDR). These are the banks with assets, RAR, and PDR within one standard deviation away from (below/above) the mean.

The 'homogeneity criteria' was thus set as: all operating rural banks outside of Metro Manila and other regional centers which have been rated by CB-SES III as strong or average and with:

- RAR of 10 to 42%;
- PDR of 16 to 44%; and
- Assets of PHP 0.9–19.8 million

Resulting number of candidate banks: total of 197

- Luzon: 115
 - Visayas: 49
 - Mindanao: 33
4. From among the 197 candidate banks, banks situated in contiguous areas which are accessible, peaceful, and orderly will be preferred. Once the possible areas of study are identified, candidate banks will be mapped out and from these banks, sample banks will be picked out.
 5. Finally, in consultation with the management of the pre-selected banks, 18 rural banks will be identified based on their willingness and commitment to be part of the program.

ANNEX B

The Philippine rural financial system, 1982-1988

Extent of banking services in the rural areas

The Philippine banking system is a network of commercial banks (KBs), savings/ mortgage banks (SMBs), private development banks (PDBs), stock savings and loan associations (SLAs), rural banks (RBs), and specialized government banks (SGBs). This diversity in banking institutions resulted from the government's efforts to develop the rural financial system.

However, the extent to which these banks reach out to the rural areas has not been very extensive, as seen in the decline in the number of banking institutions operating in the countryside (Annex Table 1). This decline is attributed largely to the break-down of the Philippine rural banking system. It can be recalled that a significant number of rural banks closed shop while others operated at impaired levels when the supply of cheap loanable funds from the government dwindled and when Central Bank (CB) rediscounting became limited in 1984. Specifically, the number of rural banking offices fell from 1,168 in 1981 to about 851 in 1987, of which only less than 300 were considered by the CB to be in good standing. What is even more disturbing is that the number of municipalities without a bank increased by almost 13% in a span of five years—from 577 in 1983 to 649 in 1987—leaving nearly half of the country's municipalities either unbanked or under banked (Annex Table 2).

Rural lending operations

With the decrease in the number of financial institutions operating in the rural areas, rural lending operations also slowed down. Total loans granted to these areas by all banks grew by a mere 2.7% for the period 1982-1988, in contrast to 19% for the period 1977-1981 (Annex Table 3). Moreover, the proportion of agricultural rediscount availments to total agricultural loans granted for all banks diminished from 32.3% in 1978 to 19.4% in 1986. This ratio declined more significantly among rural banks to 16.6% in 1986 from 66.4% in 1978 (Annex Table 4). To understand these results, one can recall that it was during the 1970s that the cheap credit policy was at its peak of implementation. It was therefore during this time that rural

banks had easy access to cheap government funds for lending. The early 1980s, on the other hand, witnessed the decline in the availability of these funds in addition to the downturn of the economy in 1983 all of which contributed to the nosedive in the level of agricultural loans.

Deposit mobilization performance

Despite a reduction in the extent of banking services in the countryside, the level of rural deposits⁸ increased fairly from about PHP 30 million in 1982 to a little more than PHP 76 million in 1988, or at a compounded growth rate of 17% (Annex Table 5). In real terms, the total volume of rural deposits grew by 6.5%, from PHP 132,000 in 1982 to PHP 192,000 in 1988 (Annex Table 6). This rise in deposits could be attributed mainly to commercial banks, as these accounted for 80% of total rural deposits. In particular, commercial bank deposits increased by 18% to PHP 61 million in 1988 from a level of PHP 22 million in 1982. On the other hand, the level of deposits in rural banks grew by only 13% and the proportion of their deposits to total deposits in all banks diminished steadily for the period 1982-1988. However, these results seem unlikely as regards rural savings mobilization because rural banks are expected—more than commercial banks—to provide the financing needs of rural households and agricultural entrepreneurs considering the proximity of rural banks to the target clientele.

The mediocre deposit performance of rural banks can be explained by problems in loan collection, liquidity, and solvency which most rural banks had to overcome during the period 1982-1988. To wit, the perception that no deposits can be generated from the countryside due to low rural incomes greatly influenced bank decisions with respect to rural deposit mobilization.

⁸ Rural deposits include deposits generated by rural-based banks in areas other than the regional centers of the country.

ANNEX TABLE 1
Number of banking offices and bank density ratios,
urban vs. rural (1977-1986)

Year	NO. OF BANKING OFFICES ^{a/}			BANK DENSITY RATIO ^{b/}		
	Phil	Rural	% Rural	Phil	Urban	% Urban
1977	2,660	1,957	74	16.8	7.6	20.0
1978	2,888	2,132	74	15.9	7.3	18.9
1979	3,188	2,343	73	14.8	6.8	17.6
1980	3,411	2,479	73	14.2	6.4	17.1
1981	3,538	2,506	71	14.0	5.9	17.3
1982	3,689	2,577	70	13.8	5.7	17.2
1983	3,822	2,635	69	13.6	5.5	17.3
1984	3,791	2,633	69	14.1	5.8	17.7
1985	3,594	2,525	70	15.2	6.5	18.9
1986	3,581	2,492	70	15.6	6.6	19.6

a/ Year-end totals.

b/ in thousands of inhabitants per banking office; the denominator is the year-end number of banking offices

Source: Meyer and Blanco (1988)

ANNEX TABLE 2
Number of municipalities, by number of banking offices,
urban vs. rural (1983-1986) ^{a/}

Year/Item	No. of Mun. Total ^{b/}	With > 1 Bank	With 1 Bank	With no Bank
1983				
RURAL	1423	225	621	577
URBAN	13	13	0	0
PHILIPPINES	1,436	238	621	577
1984				
RURAL	1,423	212	634	577
URBAN	13	13	0	0
PHILIPPINES	1,436	225	634	577
1985				
RURAL	1,461	201	615	645
URBAN	13	13	0	0
PHILIPPINES	1,474	214	615	645
1986				
RURAL	1,469	201	615	653
URBAN	13	13	0	0
PHILIPPINES	1,482	214	615	653

a/ The reporting of number of towns by number of banking offices began only in 1983

b/ In 1975, there were 1,461 municipalities in the Philippines. Note that for 1983-84, the totals reported are less than 1975 total, and for 1985-86 the totals are much greater. For the latter period, much of increase in the count of municipalities are accounted for by the Frontier of Regions, i.e., the Cagayan Valley (Region II) and the Mindanao Regions.

Source: Meyer and Blanco (1988)

ANNEX TABLE 3
Distribution of bank loans in rural areas, by institution (1977-1988)

YEAR	KBs	% to Total	TBs	% to Total	RBs	% to Total	SGBs	% to Total	TOTAL
1977	7,661.6	53.8	990.3	7.0	2,689.9	18.9	2,902.8	20.4	14,244.6
1978	8,965.2	5.4	1,272.5	7.6	3,265.2	19.6	3,157.6	19.0	16,660.5
1979	10,480.3	51.6	1,883.0	9.3	3,977.4	19.6	3,972.6	19.6	20,313.3
1980	12,079.9	51.6	2,082.4	8.9	4,470.3	19.1	4,775.1	20.4	23,407.7
1981	15,260.1	53.0	2,323.1	8.1	5,229.5	18.2	5,960.7	20.7	28,773.4
Compounded Annual Growth Rate (1977-1981)	18.8		23.8		18.1		19.7		19.2
1982	17,489.5	52.5	2,710.7	8.1	6,372.5	19.1	6,749.7 ^{a/}	20.3	33,322.4
1983	19,101.4	51.3	3,596.5	9.7	7,316.2	19.7	7,205.2	19.4	37,219.3
1984	16,679.9	50.1	2,570.0	7.7	6,728.8	20.2	7,296.4	21.9	33,275.1
1985	16,410.8	51.8	2,064.1	6.5	6,335.7	20.0	6,886.5	21.7	31,697.1
1986	18,293.0	54.0	2,373.0	7.0	6,451.0	19.0	6,789.0	20.0	33,906.0
1987	18,423.0	55.1	3,181.0	9.5	6,832.0	20.5	4,972.0	14.9	33,408.0
1988	22,883.0	58.4	3,678.0	9.4	7,495.0	19.1	5,100.0	13.0	39,156.0
Compounded Annual Growth Rate (%) (1982-1988)	4.6		5.2		2.7		(4.6)		2.7
<i>a/ excluding Region XII</i>									

ANNEX TABLE 4

Ratio of agricultural rediscount availments to agricultural loans granted,
by type of institution (1978-1984)

Type of Bank	Year								
	1978	1979	1980	1981	1982	1983	1984	1985	1986
Government Banks (PNB, DBP, LBP)	57.7	15.7	4.8	24.0	4.2	4.1	0.7	-	-
Private Commercial Banks	18	37.3	48.5	36.7	38.1	26.6	12.7	7.3	21.1
Thrift Banks	-	8.1	13.0	13.3	10.9	7.2	2.7	-	-
Rural Banks	66.4	67.8	70.8	68.9	73.7	69.3	35.4	22.2	16.6
ALL Banks	32.2	36.6	43.2	39.0	37	29.9	14.5	8.4	19.4

Source: Table 30 of TBAC. "Agricultural Credit Study: Tables and Annex Tables", 1985.

ANNEX TABLE 5

Volume of rural deposits, by type of institution (in PHP 000) (1982-1988)

YEAR	KBs		TBs		RBs		SGBs		Total	
	Amount	% To Total	Amount	% To Total	Amount	% To Total	Amount	% To Total	Amount	% To Total
1982	22,894	76.7	3,834	12.8	2,432	8.1	704	2.4	29,855	100.0
1983	26,284	76.1	4,500	13.0	2,934	8.5	837	2.4	34,555	100.0
1984	32,204	82.3	3,254	8.3	2,769	7.1	890	2.3	39,117	100.0
1985	35,241	80.7	4,628	10.6	2,903	6.6	916	2.1	43,688	100.0
1986	43,345	79.9	6,000	11.1	3,638	6.7	1,277	2.3	54,260	100.0
1987	47,380	79.5	6,560	11.0	4,370	7.3	1,315	2.2	59,625	100.0
1988	61,123	80.2	7,811	10.3	5,033	6.6	2,219	2.9	76,186	100.0
Compounded Annual Growth Rate (%) (1982-1988)	17.8		12.6		13.0		21.1		16.9	

ANNEX TABLE 6

Total rural deposits in banking institutions (in PHP Mn) (1982-1988)

Year	Volume of Total Deposits			
	Current Value	Annual % Change	Real Value	Annual % Change
1982	29,855		132.0	
1983	34,555	51.9	181.4	37.42
1984	39,117	13.20	136.6	(24.70)
1985	43,688	11.69	123.9	(9.30)
1986	54,260	24.20	152.7	23.24
1987	59,625	9.89	161.7	5.89
1988	76,186	27.78	192.1	18.80
Compounded Annual Growth Rate, 1982-1988	16.9		6.5	

Appendix: List of Acronyms

ACPC	Agricultural Credit Policy Council
ADB	Asian Development Bank
AGFP	Agricultural Guarantee Fund Pool
AGL	Agricultural Loan Fund
AITTP	Agro Industrial Transfer Program
ALF	Agricultural Loan Fund
ALPO	Agrarian Livelihood Program Office
AMCs	Agricultural Marketing Cooperatives
APRACA	Asia-Pacific Rural and Agricultural Credit Association
APS	average propensities to save
ARBs	Agrarian Reform Beneficiaries
ARGF	Agrarian Reform Guarantee Fund
ASEAN	Association of Southeast Asian Nations
ATM	automated teller machine
BACOD	Bureau of Agricultural Cooperatives Development
BAI	Bureau of Animal Industry
BANCOOP	Banco Nacional para las Cooperativas
BAS	Bureau of Agricultural Statistics
BCBS	Basel Committee on Banking Supervision
BCP	business continuity plans
BFAR	Bureau of Aquatic Resources
BIA	Basic Indicator Approach
BIR	Bureau of Internal Revenue
BKK	Balikatan sa Kabuhayan
BKKK	Bagong Kilusang Kabuhayan at Kaunlaran
BLU	branch-lite units
BSFIs	BSP-supervised financial institutions

BSP	Bangko Sentral ng Pilipinas <i>*also known as the Central Bank of the Philippines (CBP)</i>
CALABARZON	Cavite, Laguna, Batangas, Rizal, Quezon
CALF	Comprehensive Agricultural Loan Fund
CARE	Coastal Area Resource and Enterprise Development Program
CARP	Comprehensive Agrarian Reform Program
CB	Central Bank
CB-SES	Central Bank - Supervision and Examination Sector
CBP	Central Bank of the Philippines <i>*also known as the Bangko Sentral ng Pilipinas (BSP)</i>
CFP	Cotton Financing Program
CDLF	Cooperative Development Loan Fund
CGLF	Cooperative Guarantee and Loan Fund
CRB	cooperative rural banks
DA	Department of Agriculture <i>*formerly the Ministry of Agriculture and Food (MAF)</i>
DANR	Department of Agriculture and Natural Resources <i>*predecessor of the Department of Agriculture (DA)</i>
DAR	Department of Agrarian Reform
DBP	Development Bank of the Philippines
DC	Department of Commerce
DCCS	Dansalan College Community Service
DECS	Department of Education, Culture and Sports <i>*currently the Department of Education (DepEd)</i>
DICT	Department of Information and Communications Technology
DOF	Department of Finance
DOH	Department of Health
DOLE	Department of Labor and Employment
DOP	Dominican Peso
DoTr	Department of Transportation
DSWD	Department of Social Welfare and Development

DTI	Department of Trade and Industry
DTI-BSMBD	Department of Trade and Industry - Bureau of Small and Medium Business Development
DUP	directly unproductive profit-seeking
e-KYC	e-Know Your Client
EFPS	electronic financial and payment services
EO	Executive Order
FAO	Food and Agriculture Organization
FI	financial inclusion
FIELDS-SCFO	Financial Incentives for Economic Livelihood Development Scheme for Small Coconut Farmers' Organizations
FISC	Financial Inclusion Steering Committee
BSP-FSS	Bangko Sentral ng Pilipinas - Financial Supervision Sector
GBL	General Banking Law
GDP	Gross Domestic Product
GFSME	Guarantee Fund for Small and Medium Enterprises
GNP	Gross National Product
GOCC	Government-owned and controlled corporations
GRT	gross receipts tax
GSK	Gulayan sa Kalusugan
IAF-PVTA	Integrated Agricultural Financing: Philippine Virginia Tobacco Association
IBRD	International Bank for Reconstruction and Development
IC	Insurance Commission
IDCs	investment development corporations
IGLF	Industrial Guarantee and Loan Fund
IMF	International Monetary Fund
IRF	Integrated Rural Financing Program
IRPP	Intensified Rice Production Program
ISAs	Integrated Services Associations
IT	Information Technology

KASAKA-OSY	Kabataang Sakahan para sa Kaunlaran: Out of School Youth
KBs	commercial banks
KKK	Kilusang Kabuhayan Kaunlaran
LBP	Land Bank of the Philippines
LDCs	less developed countries
LEAD	Livelihood Enhancement for Agricultural Development Program
LGU	Local Government Unit
MAF	Ministry of Agriculture and Food <i>*currently the Department of Agriculture (DA)</i>
MASNAMARCO	Mallig Samahang Nayon Multipurpose Cooperative
MASS SPECC	Mindanao Alliance of Self-help Societies – Southern Philippines Educational Cooperative Center
MB	Monetary Board
MF	Ministry of Finance
MPS	marginal propensity/ies to save
NAFC	National Agriculture and Fisheries Council
NAMVESCO	National Market Vendors Cooperatives Service Federation, Inc.
NCR	National Capital Region
NEDA	National Economic and Development Authority
NFA	National Food Authority
NLSF	National Livelihood Support Fund
NNC	National Nutrition Council
NPSA	National Payment Systems Act
NRP	National Rootcrop Production Program
NSFI	National Strategy for Financial Inclusion
NSPP	National Soybean Production Program
OECF	Overseas Economic Cooperative Fund of Japan
OLS	ordinary least squares
OPT	Operation Timbang
OSU	The Ohio State University
PCA	Philippine Coconut Authority

PCA	prompt corrective action
PCAC	Presidential Committee on Agricultural Credit <i>*predecessor of the Agricultural Credit Policy Council (ACPC)</i>
PCHC	Philippine Clearing House Corporation
PCI	per capita income
PCIC	Philippine Crop Insurance Corporation
PD	Presidential Decree
PDBs	private development banks
PDIC	Philippine Deposit Insurance Corporation
PDR	past due ratio
PhilSys	Philippine Identification System
PHP	Philippine Peso
PIADP	Palawan Integrated Area Development Project
PIDS	Philippine Institute for Development Studies
PIH	Permanent Income Hypothesis
PRSMMP	Philippine Rural Savings Mobilization Project
PTA	Philippine Tobacco Authority
PVTA	Philippine Virginia Tobacco Association
PSA	Philippine Statistics Authority
QGFB	Quedan Guarantee Fund Board
RAR	risk asset ratio
RBAP	Rural Bankers Association of the Philippines
RBRRC	Rural Bank Review and Rationalization Committee
RBs	rural banks
RD\$	Dominican Peso
RFC	Rural Finance Corporation
RFC	Rehabilitation Finance Corporation
RFI	Rural Financial Institution
RFM	Rural Financial Market
ROPA	real and other properties acquired
ROSCA	Rotating Credit and Savings Association

ROSCAs	Rotating Savings and Credit Associations
RSM	Rural Savings Mobilization
RSMPI	Rural Savings Mobilization Project
SAP	Special Amelioration Program
SDC	Supervisory Data Center
SEC	Securities and Exchange Commission
SGBs	specialized government banks
SMBs	savings/mortgage banks
SN	Samahang Nayon
SPRD	Supervisory Policy and Research Development
SSLAs	stock savings and loan associations
SSS	Social Security System
STD	short-term debts
TAF	The Asia Foundation
TBAC	Technical Board of Agricultural Credit <i>*predecessor of the Agricultural Credit Policy Council (ACPC)</i>
TBs	thrift banks
TC	transactions costs
Tk	Bangladeshi Taka
TLDP	Taal Lake Development Program
TLRC	Technology and Livelihood Resources Center
UCPB	United Coconut Planters Bank
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UPBRF	UP Business Research Foundation, Inc.
UPLB	University of the Philippines Los Baños
USAID	United States Agency for International Development
USD	United States Dollar
YCF	Yellow Corn Fund

