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 3

Financial Sector Regulation for Rural and Agricultural Development

A PUBLICATION OF THE
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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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Book 3: Financial Sector Regulation for Rural and Agricultural Development

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San Miguel Avenue corner Shaw Boulevard,
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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.

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.

V. Bruce J. Tolentino, PhD

Book 3: Financial Sector Regulation for Rural and Agricultural Development

CHAPTER 1

Taal eruption, COVID-19, and the imperative of telecoms open access to deepen financial inclusion in the Philippines

V. Bruce J. Tolentino, M. Amanda T. Santos, and Valerie Valero[1]

In 2020, two cataclysmic events demonstrated the importance of open access to telecommunications (telecoms) services for financial inclusion: the eruption of Taal Volcano in January 2020, and the still ongoing COVID-19 pandemic. During times of upheaval such as these, access to better internet and telecoms services are essential for rapid recovery and effective transition to the "new economy" and the "new normal."

The Taal volcanic eruption

On 12 January 2020, Taal Volcano in Batangas Province erupted. Municipalities and provinces all around Taal Lake

[1] Independent Member of the Monetary Board, Executive Assistant, and Bank Officer, respectively, of the *Bangko Sentral ng Pilipinas* (Central Bank of the Philippines).

were evacuated as the phreatomagmatic eruption spewed volcanic ash across surrounding regions. The eruption shut down economic activity throughout an area 18–30 kilometers around Taal Lake for up to a month.

The eruption and the consequent economic disruption in the area caused deep concern it would lead to a broader and deeper pain for the Philippine economy. The region surrounding Taal Volcano includes the National Capital Region and the CALABARZON (Cavite, Laguna, Batangas, Rizal, Quezon) provinces—among the wealthiest and most economically active areas in the country. The Bangko Sentral ng Pilipinas (Central Bank of the Philippines) was particularly concerned banking and financial services in the region would be severely disrupted, causing downstream constraints to economic activity and human welfare.

Within a day or two after the eruption, the Bangko Sentral ng Pilipinas (BSP) immediately initiated efforts to assess the impact of the event on the banking system and financial services. The BSP's Financial Supervision Sector (FSS) undertook a quick survey to identify affected banks and bank branches, and to assess bank responses to mitigate the impact of the eruption and return to full-service status.

In the initial FSS surveys, 22 bank head offices and 355 other banking offices located within the 14-kilometer danger zone surrounding Taal were identified. Said banks closed operations on Monday, 13 January 2020, but by the following day, 246 of these had resumed operations.[2]

[2] Initial Report on the Status of Banks Operating in the Areas Affected by the Taal Volcano Eruption (Department of Supervisory Analytics, *Bangko Sentral ng Pilipinas*, 2020)

Data gathered from as early as the day after the eruption showed that, although clearing and settlement operations were suspended by the Philippine Clearing House Corporation (PCHC) on 13 January, Bancnet ATM and PCHC transactions were all settled with no issues by the following day.[3]

Disruption to financial services was not as serious as feared. Fortunately, the penetration of telecoms services in the NCR and CALABARZON are deepest in the country. Telecoms services in these regions were advanced enough to enable the banks to digitize, centralize, and electronically link their files and records. It was thus possible to serve customers of the closed branches in other operational branches nearby.

As the eruption ceased and economic activities in the region began to recover, telecoms and digital access facilitated a return to normal quite rapidly and seamlessly.

Two weeks after the eruption, all but 33 banks had resumed operations. Of the 589 ATMs serving the area, only 78 remained offline. The banks that remained closed successfully activated their business continuity plans (BCPs,) which included actions such as notifying clients on the nearest branch open, referring clients to their mobile and Web-based platforms, and temporarily moving banking personnel to other branches or offices to continue operations.[4]

[3] Initial Report on the Status of Banks Operating in the Areas Affected by the Taal Volcano Eruption (Department of Supervisory Analytics, *Bangko Sentral ng Pilipinas*, 2020)

[4] Status of Banks Operating in the Areas Affected by the Taal Volcano Eruption (Department of Supervisory Analytics, Bangko Sentral ng Pilipinas, 2020)

The COVID-19 pandemic

The pandemic caused by the SARS-COV-2 virus emerged in January 2020 in China, with the first affected individual in the Philippines identified by the end of the month. The number of cases in the Philippines rose steadily and, less than two months later, in mid-March, Metro Manila and other parts of the country were placed under general community quarantine—a lockdown.

Under the lockdown, all establishments—businesses, factories, offices, schools, restaurants, hotels, banks, and government offices—were closed, except for those providing the most essential services. Public transport was banned from service; even private transport was limited to essential trips and passengers.

As the lockdown dragged on, people who needed groceries, medicine, and other necessities began to discover remote shopping and delivery services. Many entrepreneurs and businesses started to offer their goods online, especially through Facebook and Instagram. Many started to use internet search and digital communication for marketing and, as their sales moved forward, tried using digital banking and payment services for the first time, significantly increasing their online transactions.

Data compiled from transactions in the Philippine payment system showed that from June 2019 to June 2020, PESONet large-volume transactions grew by 1.7 million, with a total value of PHP 153 billion. Retail InstaPay transactions grew even more, by a volume of 16 million and a value of PHP 79 billion.[5]

[5] PESONet and InstaPay Volume and Value as of 30 June 2020 (*Bangko Sentral ng Pilipinas*, 2020

By late July 2020, COVID-19 was still raging across the country and the globe; it became clear there is yet no end in sight to the pandemic. Experts had determined it will require the wide availability and use of vaccines to bring the corona virus under control. People will have to adjust to the "new normal" in which behavior and the demand for and consumption of goods and services have changed—likely just the beginning of a vast and long-lasting realignment of enterprises, industries, governance, and socioeconomic arrangements.

These changes in human needs and habits will require extensive improvements in telecoms and digital services. Is the Philippines ready to rise to the challenge?

The shackled potential of digital financial inclusion in the Philippines

The aftermath of the Taal volcanic eruption and the COVID-19 pandemic have shown that enhanced telecoms services, coupled with digital banking and finance, enable a much deeper and more resilient banking system and economy. In the areas of the Philippine archipelago where access to telecoms and digital services is best, populations have been better able to adjust to these disasters and disruptions. But much more needs to be done.

The Philippines is one of the most "wired" countries in the world. Filipinos use the internet for entertainment, shopping, business transactions, and to stay connected with family and friends worldwide. With 73 million internet users, internet penetration of 67%, and some 53% of the adult population

using the internet each day,[6] one would think that the Philippines ought to be served by faster and more accessible telecoms. Sadly, the country's internet connectivity lags quite far behind its neighbouring countries.

Across Southeast Asia, the Philippines ranks fifth out of eight countries (excluding Singapore and Brunei Darusallam) in internet connectivity, according to the TowersXchange survey in 2019. As of the third quarter of 2019, the country had only 17,850 cellular transmission towers, trailing behind Indonesia in first place with 95,556 and Vietnam in second with 90,000.[7]

The Philippines' Department of Information and Communications Technology (DICT) testified at a 2019 hearing of the House of Representatives that each of the country's cell towers serve an estimated 4,000 Filipinos (0.14 per 1,000 subscribers), a number far larger than those of other countries.

While the DICT has committed to helping build 50,000 new cell transmission towers over the next five years, the road to better telecoms has not been a smooth one. The country's complex geography, extreme weather conditions, and tedious franchise and permit acquisition laws (on average, 25 different licenses per site, with processing that can last up to nine months, and local government units often complicating the process)[8] have been a turn-off to prospective investors. A very high initial investment along with higher risks have sent them to other ASEAN countries instead.

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[6] Kemp, S. (2020). Digital 2020: The Philippines. https://datareportal.com/reports/digital-2020-philippines

[7] TowerXchange Asia Dossier 2019; TowerXchange: Journal of Record for the International Tower Industry, Issue 27 (November 2019).

[8] TowerXchange Asia Dossier 2019; TowerXchange: Journal of Record for the International Tower.

A report, From Analog to Digital: Philippine Policy and Emerging Internet Technologies, published by The Asia Foundation (TAF) in 2018,[9] found that while access to the internet is found to have positive socioeconomic effects on household income, about 61% of the Philippines' 23 million households remain unconnected. Forty-five percent of the country's total population of 103 million do not have access to a reliable internet connection. In addition, despite budget allocation from the Department of Education, 46,700 public schools nationwide are unable to connect to internet facilities in their communities.

Data from the BSP's Financial Inclusion Dashboard show that there are 1,124 (68.8%) local government units (LGUs) with a banking presence and 510 (31.2%) without. Out of these 510 LGUs, 435 (26.6%) have at least one form of financial access (e.g., cash agent, money service business, or remittance center). This means that most parts of the country are connected to a financial service in some way. However, this data does not show how many people actually use these financial services.

A key finding arising from recent experience is that there are so many barriers to entry into telecoms in the Philippines. Laws that require telecoms companies to have a franchise are outdated, requirements for access to satellite communications technology are unreasonable, and delays in the rollout of official guidelines and policy cause hesitation in potential investors.

Executive orders and legislation, such as the Ease of Doing Business Act (Republic Act (RA) 11032), can guide and

[9] Mirandilla-Santos MG, Brewer J, Faustino J. 2018. From Analog to Digital: Philippine Policy and Emerging Internet Technologies. Published by The Asia Foundation.

incentivize LGUs to expedite approval of necessary industry permits. The recent entry of a third telecoms operator and the issuance of the Common Tower Policy could potentially make the Philippine market more open and fertile. Developing numerous rural and remote regions as sites for transmission towers can bring growth and more opportunities to those areas.

BSP's advocacy on financial inclusion and access to telecoms services

With the passage of RA 11211 of 2019 amending the BSP charter, financial inclusion (FI) and its interrelated objectives of financial literacy and consumer protection have become a mandate for the BSP. Fulfilling this mandate requires the development of innovative digital and financial systems[10] especially because it is becoming more and more clear that inadequate access to telecoms services is a constraint to the achievement of BSP's FI goals.

In the 2000s, BSP adopted the test-and-learn approach to digital finance that allowed the entry of digital-native players, innovative business models, and emerging technologies. This paved the way for e-money, which the Philippines was the first in the world to adopt. E-money has proven pivotal in ensuring continued economic activity and government assistance during the pandemic. In relation to this, BSP also enabled e-Know Your Client (e-KYC) which gives the country's e-money issuers a more convenient way to on-board clients.

[10] *2019 Financial Inclusion Initiatives*. (*Bangko Sentral ng Pilipinas*, 2019).

The BSP's digitization agenda is supported by (A) the National Payment Systems Act (NPSA), which grants the BSP regulatory oversight on payment systems, and (B) the BSP-issued Circular No. 1033 of 2019, designed to streamline licensing requirements for financial institutions intending to offer electronic financial and payment services or EFPS.

Because of the country's archipelagic nature, hard-to-reach as well as high-risk areas make establishing brick-and-mortar financial access points difficult. The cost of infrastructure and the availability of resources like electricity and access roads also pose a challenge. The cost of building IT capacity is also frequently prohibitive for smaller financial institutions, especially those that service remote areas. The BSP has thus issued policies on branch-lite units (BLUs) and cash agent operations. To date, there are at least 17,000 cash agents operating in the country.

A strong financial infrastructure is also needed to increase the efficiency and reach of FI through digitization. For this, BSP has put its institutional resources toward the full implementation of PhilSys, the country's national ID system. A digital ID would standardize proof of identity, encouraging and enabling all Filipinos to have their own unique bank accounts and easily fulfill identification requirements for a wide range of digital financial services.

During the COVID-19 pandemic, a functioning digital ID system would have greatly helped expedite the delivery of government assistance, making disbursement of aid safer and more reliable. For instance, one of the main challenges in the distribution of the Special Amelioration Program (SAP) cash aid, particularly for the first tranche, was the lack of an updated database. This led to having some poor households being

excluded from SAP, as well as delays in distribution. The BSP has been coordinating with the Department of Social Welfare and Development (DSWD) on the second tranche, which will emphasize the use of account-based digital payouts of cash aid. BSP Governor Benjamin Diokno said that thriving in the COVID and post-COVID digital economy means putting in place the critical pillars of a robust digital infrastructure: digital skills, e-government, digital ID, and an enabling legal and regulatory framework. "All these have given new immediacy to the BSP's longstanding financial inclusion and digital transformation agenda for the financial sector," he said in a May 2020 FinTech Alliance Digital Forum.[11] BSP has thus organized an advocacy program focusing on improving access to telecoms services.

Roadmap of the FISC and BSP toward digital financial inclusion

The BSP heads the interagency Financial Inclusion Steering Committee (FISC), which oversees and directs the implementation of the National Strategy for Financial Inclusion (NSFI). Launched in 2015, the NSFI has grown in significance as the primary coordination and engagement platform between the public and private sectors, and the facilitator of a whole-of-government approach to promote FI initiatives. More importantly, the FISC has recently adopted digital finance as one of its key priority areas.

[11] Caraballo, M. Fintech firms urged to take part in 'new economy. The Manila Times (21 May 2020). Retrieved from https://www.manilatimes.net/2020/05/21/business/business-top/fintech-firms-urged-to-take-part-in-new-economy/726196/

The BSP has also extended membership in the FISC to other agencies with relevant and significant FI work. This broadened membership will strengthen coordination across relevant government agencies and facilitate implementation of the NSFI.

A new and important member of the FISC is the DICT. As a FISC member, the DICT will be able to provide expertise and perspective on digital connectivity for the effective promotion of FI in the country. The BSP will work closely with the DICT on initiatives that enable inclusive policies on telecoms and internet services that facilitate FI. This includes the update of Executive Order (EO) 467 (1988) to facilitate and enable inclusive access of Filipinos to satellite technology.

To support the Philippines' vision of a financially inclusive economy and country, the BSP has drawn up a three-year digital payments transformation road map which aims to direct at least 50% of retail payments to a digital platform by 2023. It also aims for at least 60% of adult Filipinos having and using a financial transactions account by 2023.

To "walk the talk," the BSP has itself adopted more open-access approaches and advanced digital technologies in its own corporate operations. For example, on specific workdays, BSP employees who want to access goods and services from concessionaires, food vendors, and other outlets operating at the BSP offices are encouraged to use digital payment apps such as Gcash and PayMaya in their transactions.

The BSP has also joined forces with the Department of Transportation (DoTr) in rolling out cashless and contactless forms of payment for fares in Metro Manila's sprawling transport system and has issued a policy (Circular 1055) to establish interoperability in QR-driven payment services.

Indeed, there is much to accomplish to afford each Filipino, especially those in far-flung and isolated areas of the archipelago, access to telecoms, the internet, and digital services. The payoff from the achievement of such accomplishment will be a lasting, inclusive progress for all.

The eruption of Taal Volcano and the ongoing COVID-19 pandemic will be followed by more emergencies and challenges, natural and man-made. The resilience of the Philippine economy and of the Filipino people will be strengthened by inclusive finance, enabled by open access to improved telecoms, internet services, and digital finance. The BSP and the Philippine Government must overcome this challenge.

CHAPTER 2

Policy statement: Subsidized credit is but a complementary form of assistance for small farmers and agrarian reform beneficiaries

Policy Brief No. 88-07
Agricultural Credit Policy Council
(12 February 1988)

Summary

Provision of credit is not a self-sufficient form of assistance for small farmers and agrarian reform beneficiaries. Before credit assistance can be useful, the viability of agriculture must be assured by rational, coordinated policies and programs of productivity enhancement, rural infrastructure, agricultural trade, foreign exchange, research, and extension. Then the equitable sharing of the gains from agricultural business must be assured via the strengthening of farmers' organization and cooperatives. Organization also reduces the monitoring, information, and physical collateral requirements which make lending to small farmers costly

and prohibitive. Such prerequisites can be provided by the government as a normal part of public service. In fact, should these prerequisites be fulfilled, rural finance will grow and develop on its own.

Discussion

A common feature of the flood of proposals, prescriptions, and advice on measures to assist the Philippines' small farmers and to ensure the "success" of the agrarian reform program is the provision of subsidized credit. The proposal is admittedly appealing. It is claimed that loans will enable borrowers to purchase the inputs they need. In more fortunate cases, loans will also cover the consumption requirements of poor farmers and new landowners. The loans thus allow borrowers to launch productive enterprises or expand their existing businesses. Their incomes increase. They are able to pay their debts. Progress and development are accelerated.

Is the scenario of credit-initiated development as described above plausible? Is it complete? Realistic? Accurate?

The scenario does seem plausible, but it is unrealistic and incomplete. It does not consider very large and very critical aspects of the problem of poverty and development. It is short-sighted and lacks a vision of the context of the small farmer's life and livelihood. As a strategy, it will not last, since it does not provide for a shift in the dominant economic relationships which keep the small farmer poor.

The context of the small farmer's life and livelihood

To assess the supposed effectiveness of credit as priority assistance for the poor, let us assume (very heroically) that somehow, there is enough money (borrowed, generated, or printed) to finance all of the credit requirements of small farmers.[1] We have to make this assumption since the whole problem of raising the huge finances required for cheap credit programs is a large set by itself. Let us also assume that the private banks and all the government books and agencies can handle, efficiently, effectively, and honestly, the gargantuan task of lending to AND COLLECTING from small farmers and agrarian reform beneficiaries.[2] With these two assumptions, let's say the loans are made, and the small borrowers receive the money. What happens now, considering the economic context of the small farmer?

In his daily life and livelihood, which are inextricably intertwined, the farmer relates with, among others, the following economic agents: the landlord, the seed dealer, the inputs (fertilizer, pesticides, feeds, tools) supplier, the farm equipment dealer, the owner of the rental tractor, the sari-sari store owner, the owner of the thresher, the rice miller, the warehouse owner, the jeepney or truck operator, the local moneylender, and, finally, the banker.

[1] Simple arithmetic shows us how heroic this assumption is. There are an estimated 2.6 million agrarian reform beneficiaries (not even counting the small, poor farmers).If all of them are provided with loans, say a small, in fact minimal, amount of PHP 10,000.00 each per year, PHP 26 billion would be needed, and only for the first cycle. How about the requirements of succeeding (and growing) cycles? How about the cost of administration? How about the cost of default? How about the cost of foreign exchange? How about the cost of bureaucratic inefficiency? How about the cost of graft and corruption?

[2] Again, this is a very heroic assumption. The Philippines' historical experience in administering credit programs—starting from the Agricultural Credit Administration of the 1950s to the sixties, up to the FACOMAS, *Masagana 99* and the forty-five other special credit programs, the sorry state of the rural bank system and of the plights of the Philippine National Bank and the Development Bank of the Philippines in the recent past—demonstrates the government's sheer incapability in the efficient, effective, and honest implementation of credit programs.

How does the typical small farmer relate with these economic agents? Three characteristics of the relationship are predominant:

- First, the relationship and the set of transactions between the agents and the farmer is not necessarily monetized. The landlord, the farm equipment rental businessman, the warehouse owner, the miller, and the other rural entrepreneurs do not necessarily require cash in advance for their services or goods. They often accept promises of a given share of the farmer's produce, given in kind, at harvest time. A relationship of barter is thus prevalent.

- Second, the above economic agents are typically a few businessmen and entrepreneurs. Usually there is only one or very few such businessmen in a given community. These entrepreneurs thus have some monopolistic or oligopolistic power and therefore can command greater-than-usual profits from the sale of their goods and services.

- Third, the economic agents the farmer deals with are typically not independent, separate entities. These agents perform multiple, mutually subsidizing roles. The local landlord is also often the moneylender, truck and thresher operator, and owner of the sari-sari store. He controls the transactions and sets the prices across the board. He can give a loan at a high interest rate, sell overpriced inputs, and under price the in-kind payment. The nominal interest rate and margin he charges may be "reasonable" separately but, put together, the effective interest rates and margins are quite large.

The combined effects of these three characteristics of transactions in which the small farmer is engaged practically guarantee that the small farmer is at an extreme disadvantage. He has very little economic power. In the economist's terms, the small farmer does not possess the "specific assets" (land, wealth, warehouses, rice mills, large farm equipment) which provide him with the leverage and the bargaining and negotiating power necessary to extract the most reasonable (and fair) terms from the transactions into which he must enter. Any strategies meant to increase the incomes of small farmers and of agrarian reform beneficiaries that are not preceded by actions where the economic power of the dominant agents is reduced and that of the small farmer increased, will last for only a moment in history and inevitably fail.

The credit programs which have been popularly proposed and outlined earlier will not add to the economic power of small farmers and will thus not result in a sustained increase in their incomes. Even assuming that the large mass of such credit gets into the hands of the farmers, the unchanged relationships of power will result in the eventual erosion and transfer of any benefits away from the farmer to the miller, the banker, the landlord, the storeowner, the moneylender, and other dominant agents of the rural economy.

It must be emphasized that said credit programs implemented without a concomitant change in the relationships of economic power surrounding the small farmers and agrarian reform beneficiaries will only result in:

- The utter failure of the credit program due to non-repayment;

- The distorted distribution of the benefits of the program, since the dominant economic agents (traders, landowners/moneylenders, millers, warehouse owners, and bankers) will end up capturing most of the benefits of the credit program; and

- Finally and tragically, the beneficiaries who will in general be unable to repay the loans will find themselves saddled with debt and a poor credit record, adding to the unfortunate and false myth that they are shiftless, irresponsible, and afflicted with the much-maligned "dole-out" mentality.

The prerequisites to credit

These twin principal prerequisites must be fulfilled so that the farmers and agrarian reform beneficiaries can enjoy the fruits of their efforts and for credit programs to be of any help: (A) first, the elements that increase the productivity and profitability of agriculture are stimulated and/or provided, and (b) the balance of economic power between the small farmer and other agents in the rural economy are shifted in favor of the farmer.

How must these prerequisites be fulfilled? First and foremost, we begin with land redistribution, coupled with land rent reduction—the critical initial stages of agrarian reform. The cost of agricultural inputs has to be made competitive, and so efforts must be made to ensure that domestic prices of inputs are consistent with world market prices. The efficacy of domestic producers of fertilizers and pesticides must be improved, else such inputs will be imported at lower cost. Production infrastructure—farm-to-market roads, irrigation, ports, drying areas, public silos, and warehouses—

must be built. Productivity-enhancing services—extension, management assistance, training, research, and rainmaking—must be provided.

Organization is crucial

The critical strategy which will shift the balance of economic and bargaining power in favor of the farmers, however, is organization. Organization has been found to dramatically increase repayment rates in group credit programs due to reductions in information and monitoring costs and the partial substitution of physical collateral with peer or social collateral. Without organization, the benefits arising from increases in productivity and reductions in cost will not remain with the farmers unless they can share in the control of the farm business. It is in the value-addition from processing, storage, and marketing, over and above actual production, that most agricultural income is made. The small farmers must thus be assisted so they are organized and able to pool their meager resources, gaining bargaining and negotiating strength in numbers.

Empirical evidence clearly shows that farmers' associations, cooperatives, credit unions, self-help groups, nongovernment/private voluntary organizations, and other alternative structures and institutions can concentrate and harness the diffused and individually negligible powers of small farmers and the poor. These organizations then serve as the vehicles that enable the organized farmers and the poor to eventually gain substantial participation in those elements of agriculture which heretofore had only worked to fully extract any surplus from the farmers' production activities. Credit unions lend their members' surplus funds and collect minimal margins. Marketing cooperatives enable members to purchase inputs

at lower cost and sell their produce at higher profits. Farmer-owned warehouses minimize storage costs and allow the farmer to hold on to their stocks in anticipation of product price increases during off-season. Furthermore, the participation of farmers in these activities increases competition and drives prices down through the entire economy.

Only when the agricultural sector becomes profitable, and that profit accrues equitably across farmers, can credit programs work. Small farmers will then be capable of using credit productivity and of saving, recycling, and reinvesting the increased income. The critical linkage of the above-listed priorities with rural finance is that, once these prior inputs are assured, private credit will naturally flow toward farmers and the rural sector.

CHAPTER 3

The savings and deposit performance of Philippine rural households: Advanced vs. backward areas

Raquel B. Clar de Jesus and V. Bruce J. Tolentino[1]

Introduction

The urgent need for the mobilization of rural savings in developing countries is well-emphasized in rural finance literature (Adams, 1978; Srinivasan and Meyer, 1986). Two decades of experience with a policy of cheap agricultural credit has resulted in the near depletion of government resources, compelling policymakers to extensively promote the mobilization of private deposits and other capital build-up mechanisms, particularly among rural banks under rehabilitation.

[1] Project Evaluation Officer V, Agricultural Credit Policy Council, and Undersecretary for Policy and Planning, Department of Agriculture, Philippines, respectively. May 1990. The authors acknowledge the valuable comments of Dr. Richard Meyer (Ohio State University), Emmanuel Esguerra (ACPC), and Aniceto Orbeta (ACPC); and the assistance of Rebec Fernandez, Josefina Gutierrez, and Cristina Lopez in the data processing.

Financial savings and development

The growing efforts in savings mobilization rest on the recognition of the critical role that savings performs in the process of economic development. The macroeconomic role of savings is embodied in the familiar Keynesian principle: planned saving (S) and planned investment (I) must be equal, (S = I), if there is to be equilibrium in the level of income and output. Thus, savings enhances economic growth directly by converting resources into capital and indirectly through the changes in technology brought about when new capital is put to use (Snyder,1974).

In addition, savings are held in either monetary or non-monetary forms. The former is usually kept as bank deposits, and is thus significant for effective financial intermediation. Aside from currency in circulation and deposit substitutes of commercial banks, financialized or monetary savings constitutes the monetary aggregate M3, where M3/GNP measures the extent of monetization or "financial deepening" of an economy.

Savings mobilization research

A successful savings mobilization exercise requires the thorough knowledge of the savings and deposit performance/ behavior of households. Unfortunately, such exercises have often been restricted by data and estimation problems. For instance, the lack of household survey data has confined most analyses to aggregate savings, the estimation of which is quite vulnerable to aggregation bias. Moreover, most studies have utilized bank deposits as a measure of savings not only for its importance as an indicator of financial deepening but also for the relative ease in collecting the needed information from

secondary sources. The issue on the proportion of savings that flow through financial institutions has continuously stirred the interest of most economic researchers.

In 1987, the Agricultural Credit Policy Council (ACPC) conducted a village-level survey to analyze the savings performance/behavior of rural households in areas where rural savings mobilization exercises were being implemented. The data from this survey generated significant information, including an area-wide comparison of savings performance, the focus of the present research.

Apart from the scarcity of studies that compare savings performance across areas in the country, the linkage between economic development and savings performance has remained to be a controversial issue. The arguments have centered mostly on the question of causality between savings and development. On the one hand, saving has been established as a precondition for growth (McKinnon, 1973), but on the other hand, the economic development of an area is also contributory to the increase in savings rates. The latter idea has not remained unchallenged and the present research is one bid towards this direction.

Objectives of this paper

The basic question which the study attempts to answer is: Does the level of the economic development of a given rural region or areas significantly affect the deposit performance of the households in that area? The study, therefore, hypothesizes that: the more developed an area is, the greater the level of savings/deposits of the households in the area.

The level of development of an area is revealed by the usual indicators: per capita income of the municipality, density per geographical area of infrastructure, size and density of the population, and health indicators e.g., incidence of malnutrition among the residents of the area, etc. The availability and accessibility of banking facilities is also thought to be positively related to deposit performance.

The study examines this data and, using some indicators, ranks or classifies the areas according to level of development. Specifically, the paper:

- Documents differences in the savings as well as deposit behavior/performance of rural households;

- Explains the disparities (if any) of the savings and deposit performance in relatively advanced and backward areas; and

- Derives some policy implications from the results of the study.

The paper is organized into seven sections. The first provides a brief introduction followed by a review of the available literature. The third section is devoted to the definition of some concepts and methods used in the analysis. Section 4 qualifies the model and outlines the estimation procedure while Section 5 provides some descriptive statistics of the household data. This is followed by a discussion of the results in Section 6 and finally, some conclusions and policy implications are provided in Section 7.

Review of relevant literature

The degree of development ("backwardness" and corollary "urbanization") of an area is often thought to have a bearing on the savings/deposit performance of its households. The linkage, however, is viewed as a chicken- and-egg controversy. While saving is considered as a precondition for economic growth, certain characteristics of a backward area (e.g., lack of infrastructure facilities, absence of banks) may deter rural households from increasing savings. Corollarily, factors that enhance urbanization may induce households to save more. The literature review that follows centers on studies that report relationships between savings and economic development. A complete review of research on savings vs. income can be found in Chan and Tolentino (1990). The interested reader is also referred to Magno and Tolentino (1990) for a review of studies on savings vs. interest rates/transactions cost of deposits.

The most comprehensive reviews of the theoretical and empirical literature on savings were done by Mikesell and Zinser (1973) and Arrieta (1988). The former examined the nature of the savings function specified far earlier by Keynes (1936), Duesenberry (1949), and Friedman (1957) in their income–savings models and empirical tests. Studies which tried to establish relationships between savings and income, foreign capital and domestic savings, interest rates and savings, exports and savings, and taxation and savings were analyzed by the authors.

Mikesell and Zinser noted that the non-Keynesian Savings Functions (i.e., Duesenberry's Relative Income Hypothesis, Friedman's Permanent Income Hypothesis, and Modigliani-

Ando-Brumberg's Life Cycle Hypothesis) concluded from their findings, based on budgetary surveys, that the average savings rate for higher-income groups is higher than that for lower-income groups. This implies that factors that increase the income of rural households tend to increase their savings rate.

The same conjecture can be derived from Gupta's (1970) findings. He classified the sample households by their urban and rural locations and revealed a "good deal of diversity" in their savings behavior. He found that the marginal propensity to save (MPS) tends to increase with per capita income in both locations but the MPS among urban households was higher than that of their rural counterparts. He noted further that for the urban households, the MPS out of permanent income was greater than the MPS out of transitory income. Gupta, therefore, states: "To the extent that saving of the two sectors responds to different factors and/or responds differently to the same set of factors, policy formulation for encouraging and mobilizing saving can be made more effective if we can identify these differences."

Working along the same hypothesis, Akhtar (1987) surmised that urbanization has a "push effect" on income, and therefore tends to increase the savings rate. He anticipated that "the higher income, greater opportunities for physical and financial investments, improved banking facilities, monetization, and social security coverage for employees as urbanization proceeds can all combine to generate higher financial savings in the economy." The results from his survey of 7,504 households in Pakistan, however, did not support his hypothesis. The inverse relationship observed between urbanization (represented by city size) and average financial saving rates favored the "pull factors", i.e., the cost-of-living

differences and the higher expenditure necessary to maintain a given standard of living as urbanization proceeds weakened the effect of urbanization on income. Akhtar's results supported Duesenberry's "demonstration effect" on consumption habits.

An explanation for this weakening effect of urbanization on income was provided by Mendershausen (1940). He tried to establish the relationship between savings and income in 51 US cities of different sizes with populations of differing racial origin, by measuring the communities' disposition to save (savings as a percent of income) and their savings power (amount of savings actually furnished by the community in percent of its actual income). The high income elasticity of savings of most groups led him to conclude that ceteris paribus: "the higher the cost of living, the lower the expected intensity of the community's disposition to save". He emphasized that consumption needs are more urgent than savings. Thus, "if the cost of living rises, families will allocate a larger part of their income to consumption expenditures, a lesser part to savings."

Three studies in the Philippines agreed with Akhtar's results. Lamberte and Lim (1987) examined the 1985 Family Income and Expenditure Survey data and revealed a disparity in savings rate between rural and urban households within the same income bracket (i.e., rural households have higher savings rate than urban households). Lamberte and Bautista (1989) noted, however, that the trend is true only among households in Regions I, V, and IX but the reverse pattern holds for Regions IV, VII, X, and XII.

Thus, the authors of the preceding studies advise that caution should be practiced in making generalized inferences or conclusions on the relative saving propensities of urban and

rural households since, apart from the lack of theoretical explanation for the observed higher saving rate among rural households vis-a-vis urban households, the pattern is not consistent in all regions.

Sicat (1984) likewise demonstrated regional savings rate differences in the country. In particular, Southern Luzon, Bicol, and Ilocos were dissaving during the period 1961–71, contributing to the whole nation's declining MPS. The decline was accounted for by inflationary pressures which increased consumption.

Wealth has often been suggested as an alternative variable for income and empirical evidence generally supports its significance in the analysis of household savings behavior (Snyder, 1974). However, due to problems with its measurement, most researchers had to resort to proxies. Wealth and income are also highly correlated and their analysis gives rise to estimation problems (Snyder, 1974).

The exact influence of wealth on household savings has not been fully established. Friend and Taubman (1966), for instance, obtained a negative significant effect of asset holdings (using past savings as proxy) on household savings. Snyder's (1974) measure of wealth (i.e., an index of housing characteristics and consumer durables ownership) yielded a positive relationship. Snyder concluded that wealthier families are "significantly more likely to save". Kelley and Williamson (1968) proxied wealth with land ownership and found that both the MPS and the average propensities to save (APS) of Indonesian farmers rose with the degree of land ownership. The same results were derived by Ong, Adams, and Singh (1976) among Taiwanese households with farm size as a measure for wealth. In Gupta's (1970) case, however, various measures of "current" and

"permanent wealth" (whose calculations he failed to describe) had insignificant effects on household savings.

The observed variations in savings rates across areas/regions suggest that savings is a function of a host of factors: income, wealth, interest rates, household demographic characteristics such as family size and dependency ratio, education, tastes, and habits. Even the impacts of these demographic factors are likely to vary with the level of economic development of the area (Kelley 1976).

While most studies have established the increasing effect of income on the savings rate of households, such results may also be misleading unless the income effect is isolated from the effects of other environmental factors which may either enhance (push) or weaken (pull) the effect of income. Sidori (1984) noted that a rise in personal income alone will not assure an increase in savings. He added further that a successful savings mobilization program depends on structural reforms in the agriculture sector. "Agrarian reform, land redistribution, rural extension, infrastructure, selective technology – all these help to increase agricultural incomes and represent the necessary conditions for agriculture to provide a growing surplus."

The more recent empirical researches on savings were assessed by Arrieta (1988) and the major findings of these researches as well as their implications to policy are enumerated in Table 1.

The data and some concepts

The survey data

The household survey conducted under the Rural Savings Mobilization Project (RSMP) of the ACPC, the Philippine Institute for Development Studies, and the Ohio State University provided the data for this study. The survey was conducted from September to November 1987 in 17 municipalities in the country. The selection of the areas depended on the location of the banks which agreed to participate in the program. These banks were selected based on an eligibility criteria which assures homogeneity, soundness of operations, and commitment of the management to participate (Appendix 1). The selection process yielded eight banks in Luzon, six in the Visayas, and three in Mindanao (Table 2).

The survey was administered through a structured questionnaire which covered information on the household's demographic characteristics, income and expenditures, wealth, deposits and borrowings, lending, and attitudes/perceptions towards saving and borrowing during the calendar year 1986.

Advanced vs. backward areas

The economic advancement of an area can be gauged by some indicators: its revenue and income class, the health index of its population, and the extent of infrastructure investment in the area. In the Philippines, no homogeneous indicator is available since different sources utilize differing indicators to serve specific classification needs.

This particular study classifies advanced and backward areas using a composite ranking of municipalities prepared by the Bureau of Agricultural Statistics (BAS), the National Nutrition Council (NNC), and the National Economic and Development Authority (NEDA). The resulting ranks were based on the 1988 Operation Timbang (OPT) results of the Department of Health (DOH) and the average of 1983 to 1986 municipal revenues expressed in per capita income (PCI) basis from data of the Department of Finance.

While a rising or a relatively greater level of PCI is commonly used as an indicator of economic development, the OPT ranking is subject to discussion. The OPT is a regular activity of the DOH which involves recording the weights of preschoolers to detect the prevalence of malnutrition. The results provide the basis for the Department's child-feeding program and for determining priority areas for nutrition (nutritionally depressed municipalities). Its use as an indicator for economic development is based on the correlation of the health status of the population with income, i.e., the lower the municipality is in the income ladder, the worse is the health condition (gauged by the prevalence of moderately and severely underweight, relative to age and height, preschoolers) of its population.

The BAS tried to improve on both criteria by adding the OPT rank of the NNC and the PCI rank of the NEDA and considered the sum as the composite rank of the municipality. The composite ranking, which thus takes into account both NNC and NEDA's criteria, is used in this analysis.

Household savings using the residual method

Household savings may variously be estimated by the residual method and the net worth method. Household savings may simply be the difference (residual) between household income and household expenditures. Savings may also be defined as the net positive change in the assets and liabilities (net worth) of the household.

To quantify savings using the net worth method requires that data on the assets and liabilities of the households be collected for at least two periods. This is not possible from the RSMP data since the collected information covered only the period 1986. The residual method is, therefore, used in this study.

Household net income refers to the income (net of production expenses) earned by the households during the reference period and includes income derived from all sources, namely agricultural production (crops, livestock and poultry raising, municipal and inland fishing, logging and gathering of minor forestry products); off-farm income (hired labor, fruit picking, rental of land, farm/fish machinery, and equipment); and non-farm income (tricycle driving, sari-sari store operations, construction, handicraft, practice of profession, pensions and grants, house rental, money lending, trading, and other income-earning activities).

Household expenditures include all expenses for the household's basic needs: food, shelter (rentals), and clothing. Also included are purchases of consumer durables and fixed assets (house, real estate, structures) made during the period.

Financial deposits

Financial deposits are simply the sum of the household's total deposits in banks and non-banks (Rotating Savings and Credit Associations or ROSCAs, cooperatives, etc.) during the period 1986. The descriptive statistics present patterns in outstanding financial deposits (stock concept) while the empirical analysis describes the results of both flow (deposits made during the period) and stock concepts. Financial holdings such as bonds, shares of stocks, and insurance premiums were excluded since these constitute only a negligible portion of the households' total assets.

The model and estimation procedure

The dependent variables

The dependent variables are total household saving (SAVE) and financial deposits (DEPO) for the year 1986. The former is simply the residual of household income and expenditures (surplus income) while the latter is defined as the total deposit flows of the household for the year 1986. The alternative financial deposits model regressed stock variables like wealth (instead of income) with the outstanding deposit balances of households.

Table 1: Empirical tests of the interest responsiveness of savings and other related issues: a summary of results

Reference	Sample	Method of Estimation	Major Findings	Policy Implications
1. The hypothesis of a positive interest responsiveness of savings				
Fry (1978)	7 Asian Less Developed Countries (LDCs)	Estimating a domestic savings function by the two-stage least squares with country dummy variables method.	A 10% increase in the real rate of interest would raise the ratio of savings to GNP by 1.4–2.1%.	Financial conditions (i.e., higher real rates of interest) do matter to overall savings performance.
Yusuf and Peters (1984)	Korea	Estimating an aggregate savings function by the ordinary least squares method (the generalized least squares method was used to correct for serial correlation).	A 10% increase in the real rate of interest on time deposits would raise gross national savings by 11.57% and gross domestic savings by 5.03%.	Financial conditions do matter to aggregate savings performance.
Leite and Makonnen (1986)	6 African LDCs	Estimating a private savings function by the weighted least squares method using normalized variables to correct for heteroscedasticity.	The coefficient of real rates of interest is positive but significantly different from zero only in specifications that exclude the variable change in income.	Financial conditions do matter to overall private savings but the direct effect is apparently small.
Gupta (1984)	12 Asian LDCs	Estimating an aggregate savings function by the ordinary least squares method.	The hypothesis is rejected in all but four cases (Pakistan, the Philippines, Sri Lanka, and Thailand).	Financial conditions do not seem to matter to aggregate savings performance on a widespread basis.
Gupta (1984)	12 Asian LDCs	Estimating a financial savings function by the ordinary least squares method.	All of the coefficients significantly different from zero have the expected signs but, in quantitative terms, interest rates have a significant effect in only four countries (India, Korea, Pakistan, and Thailand). For eight LDCs, real and financial, savings are substitutes.	Financial conditions do seem to matter to the composition of savings in favor of financial savings, thus a financial liberalization policy may contribute to a more accelerated growth.
Ocampo et. al. (1985)	Columbia	Estimating an aggregate savings function by the Cochrane-Orchutt method to correct for autocorrelation.	The effect of the real rate of interest has a very low statistical significance though it is positive.	Financial conditions do not seem to matter to aggregate savings performance.

Reference	Sample	Method of Estimation	Major Findings	Policy Implications
Giovannini (1985)	7 Asian LDCs	Estimating a Keynesian-type savings function identical to the one used by Fry but excluding two observations corresponding to the post-Korean financial reform period.	The coefficient of the real rate interest is still positive but quantitatively less significant.	The hypothesis cannot be rejected but influential observations are important.
Giovannini (1985)	7 Asian LDCs	Estimating the same equation above over a longer period of time.	The coefficient of the real rates interest is negative but insignificant.	There does exist evidence not supporting the hypothesis.
Giovannini (1985)	18 LDCs	Estimating an equation in which the growth rate of consumption is an increasing (stochastic) function of the expected real rate of interest within the framework of a utility-maximizing behavior for each individual	The coefficient of the real rate of interest are significantly different from zero in the estimates with the instrumental variables method only in the cases of Jamaica, Burma, India, Greece, and Turkey.	The hypothesis of a high intertemporal substitutability in consumption-saving decisions is rejected.
2. The complementarity hypothesis				
Fry (1978)	10 Asian LDCs	Estimating a demand-for-money function by the two-stage least squares with country dummy variables method.	A significantly negative coefficient between money and the savings ratio is found.	Money and capital are not complementary assets, thus the hypothesis does not hold.
Gupta (1984)	25 Asian and Latin American LDCs	Estimating simultaneous equations model of finance and growth by the two-stage least square method.	Complementarity hypothesis is rejected for the full sample but not for all of the groups. If total effects are taken, the hypothesis is continued for low-inflation LDCs; the hypothesis is accepted whether total or direct effects are taken for high inflation LDCs only.	There is no widespread support to the complementarity hypothesis which, in addition, seems to be sensitive to the inflationary environment.
3. The financial deepening hypothesis				
Fry (1978)	10 Asian LDCs	Estimating demand-for-money function by the ordinary least squares with country dummy variables method.	A substitutional relationship between money and other financial assets is found.	Money is not the only financial repository of domestic savings, thus Shaw's debt-intermediation view does hold.

Reference	Sample	Method of Estimation	Major Findings	Policy Implications
Gupta (19840	25 Asian and Latin American LDCs	Estimating a simultaneous equations model of finance and growth by the two-stage least squares method.	The demand for financial assets in general seems to be highly inelastic with respect to changes in nominal rates of interest; in some cases, the total effect (reduced form estimates) can lead to quite different quantitative results from those suggested by the direct effect (structural form estimates). The effects of expected rate of inflation may qualitatively vary depending on whether the direct or the total effect is taken but all elasticities are quite small.	The demand for financial assets is relatively inelastic to variations in real rates of interest, thus financial liberalization policies can encourage financial deepening to a limited extent.
4. The cost of financial repression				
Fry (1980)	7 Asian LDCs	Estimating a three simultaneous-equation model which captures the short-and long-run effect of a change in real rates of interest on economic growth.	Around half a percentage point in economic growth is foregone for every one percentage point by which the real rate of interest is set below its equilibrium level.	Financial liberalization is a favorable device to enhance economic growth.
Gupta (1984)	Dominican Republic, El Salvador, Guatemala, Panama, the Philippines, Sri Lanka, and Venezuela	Generating the dynamic simulations for a number of endogenous variables (e.g., financial savings) which are then compared with the simulations based on alternative assumptions regarding the behavior of real rates of interest.	Time paths traced out by the dynamic historical and alternative simulations were found to be close to each other.	The direction of the performance of the variables concerned was not significantly affected by financial repression.

Table 2: RSMP survey areas

Island	Region	Province	Municipalities
Luzon	Region I	Pangasinan	Sual, Alaminos
	Region IV	Batangas	San Jose, Lipa City, Mataas na Kahoy
	Region V	Camarines Sur	Goa, San Jose, Tigaon
Visayas	Region VI	Iloilo	Sta. Barbara, Dumangas, Barotac Nuevo
	Region VII	Negros Oriental	Zamboangita, Siaton, Valencia
Mindanao	Region X	Misamis Oriental	Initao, El Salvador, Gitagum

The explanatory variables

1. Nominal income (NY) and wealth (W)

The nominal values of household income (and alternatively, wealth) were used in the analysis. Household income was derived from the household's net receipts from production and other sources of income recorded in the questionnaire. Wealth or net worth was computed from a balance sheet prepared for each household. Expected to influence the savings of the household and the amounts deposited by these households in banks, the anticipated relationship of income or wealth is positive (Snyder,1974).

2. Nominal Interest Rate (INT)

The nominal interest rates on savings deposits reported by the households were used in the analysis for both household savings and financial deposits. These rates were resorted to

since only two households reported outstanding balances on time deposits. The average interest rate for the area was imputed to households which failed to report interest rates.

3. Dependency Rate (DEP)

The dependency rate is simply the ratio of the declared number of dependents of the household relative to its total size. Based on previous savings studies, dependency rate is expected to exert a negative influence on household savings.

4. Education (EDUC)

As an explanatory variable of household savings and deposits, the effect of the number of years spent by the household head in school was tested in this study. The anticipated effect is positive, i.e., educated household heads, being more aware of banking operations and the benefits of keeping surplus funds in banks, would tend to save more and in financial forms.

5. Source of Income (INCTYPE)

To capture the effect of income source and the variability of agricultural income on household savings, two major sources of household income were examined. Income predominantly sourced from agriculture (50% of total income of the household) was assigned a value of 1 and those sourced largely from non-agriculture (50%), a value of 0.

6. Distance From Depository Bank (DIST)

To introduce a bank accessibility variable in the analysis, the distance (in kilometers) of the household from the depository bank was incorporated in the equation. Distance, as a direct

measure of transactions cost of household savings, is anticipated to have a positive effect on the non-financial component of total household savings (SAVE) and a negative effect on the financial component (DEPO). Thus, as the distance of the banks from the households increases, the households would tend to keep more surplus funds in their homes, lesser in the banks.

7. Number of Banks (NBANKS)

Another variable that may gauge bank accessibility is the number of banks existing in the municipality. The variable is expected to influence total household savings negatively and financial deposits positively. An increase in the number of banks is expected to reduce the surplus funds of the households (and/or increase their financial deposits) since households in areas with more banks are well exposed to financial intermediation processes, which may ultimately influence their decision to save in banks. Moreover, the variable also measures competition among banks and may explain specialization of a bank in a particular clientele group in the sample.

The econometric model

The general econometric model used in the analysis is based on the assumption that household saving is a two-staged decision process: the household decides on (a) how much to save and (b) how much to allocate to financial deposits. Thus, two econometric models were formulated: SAVE and DEPO. Two variants of the SAVE model were specified: one which does not consider bank accessibility (SAVE1) and another which does (SAVE2). Two variants of the DEPO model were considered further: DEPO1 using total deposits for the period (flow) and DEPO2 using outstanding deposit balances as of the period (stock).

These dependent variables are assumed to be functions of NY and alternatively W, INT, DEP, EDUC, and INCTYPE. To capture the effect of economic development of the area on both total household savings and financialized deposits, a dummy variable (DUM) was incorporated in the analysis. This dummy variable assumes a value of 1 if the municipality is ranked as "advanced" (based on the composite OPT and PCI rank) and 0 if otherwise.

The variables NBANKS and DIST were added to represent accessibility of the household to the banks in the area.

Econometrically, the regression equations can be specified as follows:

(1) $SAVE_1$ = f (NY, INT, DEP, EDUC, INCTYPE, DUM)
(2) $SAVE_2$ = f (NY, INT, DEP, EDUC, INCTYPE, DUM, DIST, NBANKS)
(3) $DEPO_1$ = f (NY, INT, DEP, EDUC, INCTYPE, DUM, DIST, NBANKS)
(4) $DEPO_2$ = f (W, INT, DEP, EDUC, INCTYPE, DUM, DIST, NBANKS)

where:

SAVE	refers to household savings
$DEPO_1$	refers to total financial deposits made during the year 1986
$DEPO_2$	refers to outstanding balances of financial deposits as of end of 1986
NY	refers to nominal income of the household
W	refers to wealth (net worth) of the household
INT	refers to nominal interest rate
DEP	refers to dependency ratio
EDUC	refers to the number of years spent in school by the household head

INCTYPE refers to the major source of income of the household (i.e., a dummy which takes the value of 1 when the predominant source of income (50%) is agriculture and 0 when the majority of the income is from non-agriculture)
DUM is a dummy variable for the economic development of the area (i.e., D=1 for advanced and D=0 for backward)
DIST refers to the distance of the households from their depository banks
NBANKS refers to the number of banks in the area

DUM was introduced as a shift or in the regression equation (additive form) and, when found to be significant, was also allowed to interact with the other explanatory variables which were suspected to change with economic development (multiplicative form). The resulting alternative econometric models are illustrated in Tables 3 and 3a. In all these models, a linear ordinary least squares (OLS) method was employed.

The introduction of DUM in a single regression equation can be used to test a variety of hypotheses:

(a) Whether households in the two areas start saving positively at the same income level and at the same rate (i.e., the equations are identical resulting to coincident regressions);

(b) Whether households in the two areas start saving positively at different income levels but at the same rate (i.e., the equations have different intercepts but the same slopes resulting to parallel regressions);

(c) Whether households in the two areas start saving positively at the same income level but at different rates (i.e., the equations have the same intercepts but different slopes resulting to concurrent regressions); and

(d) Whether households in the two areas start saving positively at entirely different income levels and at different rates (i.e., the equations have different intercepts and slopes resulting to dissimilar regressions).

In the additive form, the general regression equations are as follows:

(1) $SAVE_1 = b_0 + b_1\ NY + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ INCTYPE + b_6\ DUM$

(2) $SAVE_2 = b_0 + b_1\ NY + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ INCTYPE + b_6\ DUM + b_7\ DIST + b_8\ NBANKS$

(3) $DEPO_1 = b_0 + b_1\ NY + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ JNCTYPE + b_6\ DUM + b_7\ DIST + b\ NBANKS$

(4) $DEPO_2 = b_0 + b_1\ W + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ INCTYPE + b_6\ DUM + b_7\ DIST + b_8\ NBANKS$

In this form, a significant b_6 allows one to distinguish the intercepts between the two areas, hence differentiate the particular income level at which households start to save. To illustrate, for DUM = 0 (backward areas), households start to save at the intercept b_0 while for DUM =1 (advanced areas), household savings start at income levels equal to $b_0 + b_6$.

To identify the slope coefficients (or the magnitudes of the effects of the explanatory variables on the dependent variable) between the "advanced" and the "backward" areas, a regression equation which assumes homogeneous intercepts and differing slopes was specified (multiplicative form). In the multiplicative form, the SAVE and DEPO models are specified as follows:

(3) $SAVE = b_0 + b_1\ NY + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ INCTYPE + b_6\ NY*DUM + b_7\ INT*DUM + b_8\ DEP*DUM + b_9\ EDUC*DUM$

(4) $DEPO = b_0 + b_1\ NY + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ INCTYPE + b_6\ DIST + b_7\ NBANKS \bullet b_8\ NY*DUM + b_9\ INT*DUM + b_{10}\ DEP*DUM + b_{11}\ EDUC*DUM \bullet b_{12}\ NBANKS*DUM$

Note that when b_i's (i=6,7,8,9 in equation 3; i=8,9,10,11,12 in equation 4) are significant, the SAVE and DEPO models in equations 3 and 4 are transformed into:

(3') $SAVE = b_0 + (b_1 + b_6)\ NY + (b_2 + b_7)\ INT + (b_3 + b_8)\ DEP + (b_4 + b_9)\ EDUC + b_5\ INCTYPE$

(4') $DEPO = b_0 + (b_1 + b_8)\ NY + (b_2 + b_9)\ INT + (b_3 + b_{10})\ DEP + (b_4 + b_{11})\ EDUC + b_5\ INCTYPE + b_6\ DIST + (b_7 + b_{12})\ NBANKS$

Clearly, in equations 3' and 4', the slopes of the explanatory variables increase by an amount equal to the sum of their beta coefficients when specified alone and when allowed to interact with the dummy. This simply implies that the magnitude of the effects of economic development on household savings in the two areas may also vary.

The test for dissimilar regressions (hypothesis d) was also done by introducing the variable DUM both in the additive and multiplicative forms, as follows:

(5) $SAVE = b_0 + b_1\ NY + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ INCTYPE + b_6\ DUM + b_7\ NY*DUM + b_8\ INT*DUM + b_9\ DEP*DUM + b_{10}\ EDUC*DUM$

(6) $DEPO = b_0 + b_1\ NY + b_2\ INT + b_3\ DEP + b_4\ EDUC + b_5\ INCTYPE + b_6\ DUM + b_7\ DIST + b_8\ NBANKS + b_9\ NY*DUM + b_{10}\ INT*DUM + b_{11}\ DEP*DUM + b_{12}\ EDUC*DUM + b_{13}\ NBANKS*DUM$

The analysis for the SAVE model was performed on a sample of 974 households (total sample excluding the outliers) while the DEPO model was done on the sample households with reported deposits in banks and non-bank institutions which totaled 158 households.

Table 3. Econometric models used in the analysis of household saving

Model	Dependent Variable	Explanatory Variable	Acronym Used	Expected Sign
SAVE1	Total Household Savings (residual)	Nominal Income	NY	+
		Interest Rates on Saving	INT	+
		Dependency Rate	DEP	-
		Education of the Household Head	EDUC	+
		Income Type	INCTYPE	+/-
		Economic Development of the area	DUM	+
SAVE2	Total Household Savings (residual)	Same as Model 1 (Plus)		
		Number of Banks in the municipality	NBANKS	-
		Distance of HH from depository banks	DIST	+

Table 3a: Econometric models used in the analysis of financial deposits

Model	Dependent Variable	Explanatory Variable	Acronym Used	Expected Sign
$DEPO_1$	Total deposits of the household during the year 1986 (flow concept)	Nominal Income	NY	+
		Interest Rates on Saving	INT	+
		Dependency Rate	DEP	-
		Education of the Household Head	EDUC	+
		Income Type	INCTYPE	+/-
		Economic Development of the area	DUM	+
		Number of Banks	NBANKS	+
		Distance from depository bank	DIST	-
$DEPO_2$	Outstanding deposit balances of households as of year end 1986 (stock concept)	Same variables as in DEPO I but substitutes wealth for nominal income	W	+

Descriptive statistics

Advanced and backward municipalities

Using the composite ranking of municipalities prepared by the BAS, the NNC, and the NEDA, nine municipalities emerged as "economically advanced" and eight as "economically backward". These municipalities are enumerated in Table 4.

Alaminos, Pangasinan ranked as the most advanced while San Jose, Camarines Sur, the least. All the sample municipalities

in the provinces of Pangasinan and Batangas emerged as economically advanced. In contrast, all three municipalities of Camarines Sur, namely San Jose, Tigaon, and Goa turned out as less advanced. One municipality each in Iloilo and Misamis Oriental—Barotac Nuevo and El Salvador, respectively—were also among the advanced areas.

Batangas' proximity to Metro Manila is a major factor behind its progress. Traditional commodities such as coconut, coffee, cacao, and black pepper grown in the area have large export potentials and draw relatively higher prices in the domestic markets.

Pangasinan has received adequate infrastructure support. It is linked to Metro Manila by well-paved roads. Among the six provinces, it has received the highest support in irrigation (32% of the total agricultural area is serviced by the National Irrigation Administration). The province produces sufficient volumes of palay and grows most of the tropical fruits and vegetables. These, among other factors, contribute to the relative progress of the municipalities in the province.

Selected demographic information

A total of 974 households were used in the analysis for total household savings. A little more than half came from advanced areas and about 44% from backward areas. In the financial deposits analysis, only 32% of the 158 households originated from backward areas and the remaining 68% from advanced. The distribution of these households by selected demographic information is discussed below.

Age of the household head. A significant number of the household heads are middle-aged: 28% are between ages 41 and 50 and 22% are between ages 51 and 60 (Table 5). The same pattern can be observed across the advanced–backward classification, showing that close to 60% are of the employable age (aged 21–50). The distribution of household heads by age ranges shows practically similar patterns in the advanced and backward areas.

Table 4. Classification of municipalities by level of economic development of area. [a/]

Provinces	"Advanced" Areas	"Backward" Areas
Batangas	Mataas na Kahoy San Jose Lipa	
Camarines Sur		San Jose Tigaon Goa
Iloilo	Barotac Nuevo	Sta. Barbara Dumangas
Pangasinan	Sual Alaminos	
Misamis Oriental	El Salvador	Gitagum Initao
Negros Oriental	Zamboangita Valencia	Siaton

[a/] Based on the composite ranking of municipalities (using Operation Timbang and Per Capita Income as indicators) prepared by the Bureau of Agricultural Statistics, the National Nutrition Council, and the National Economic and Development Authority. Please see Annex Table 2.

Table 5. Distribution of sample household heads by age, by level of economic development of area

Age range	All Areas		Advanced Areas		Backward Areas	
	No.	% to Total	No.	Col %	No.	Col %
<20	4	0.4	1	0.2	3	0.7
21-30	126	12.9	71	13.0	55	12.9
31-40	194	19.9	113	20.7	81	18.9
41-50	274	28.1	158	28.9	116	27.1
51-60	210	21.6	122	20.5	98	22.9
61-70	122	21.6	66	12.1	56	13.1
71 and above	44	4.5	25	4.6	19	4.4
TOTAL	**974**	**100.0**	**546**	**100.0**	**428**	**100.0**

Table 5a. Results of OLS Regression Model on HH Financial Savings (Transaction Costs)

Variables	Coefficient	T-Value
Intercept	-2445.609	-0.532
NBANKS	363.993	0.778
CLAS-1	1939.601	0.880
BDEN	-39758.000	-1.100
TRANS-1	-16.828	-1.057
IRPA	219.300	0.514
HH_GY	0.198	3.850***
EDUC	424.159	1.243
F-Ratio	3.149 **	
R-Squared	0.1281	
n (Sample Size)	158	

See footnotes in Table 3

Education of the household head. Less than 10% of household heads completed post-secondary studies (Table 6). Sixty-seven percent of them either reached or completed elementary while 21% made it to high school. Household heads who have received college and post-graduate studies are not well represented in the sample (Table 6).

A comparison of the proportions between advanced and backward areas (column percentages) reveals that the number of unschooled households is slightly higher in advanced areas (4.2%) than in the backward areas (3.5%). Also, the number of those who have reached college/post-college schooling does not vary much in the two areas (6.6% vs. 6.3%).

While it is expected that advanced areas will yield more college-educated respondents owing to the concentration of educational facilities in these areas, the data does not support this (Table 6). A large fraction (377 out of 652) of elementary-trained household heads are in the advanced areas, and the number of college-educated respondents in the advanced areas exceeds those in the backward areas by only nine households. There are 38 respondents (4% of the total) who did not receive formal schooling, with 23 of them residing in the advanced areas.

These correlations indicate that being in an advanced area may not necessarily guarantee a greater level of education for the household.

Table 6. Distribution of sample household heads by education, by level of economic development of area

Educational Attainment	All Areas		Advanced Areas		Backward Areas	
	No.	% to Total	No.	Col %	No.	Col %
No Formal Schooling	38	3.9	23	4.2	15	3.5
Elementary	652	66.9	377	69.0	275	64.3
High school	203	20.8	101	18.5	102	23.8
Vocational/ Certificate	18	1.8	9	1.6	9	2.1
College/ Post-College	63	6.5	36	6.6	27	6.3
TOTAL	**974**	**100.0**	**546**	**100.0**	**428**	**100.0**

Household size and number of dependents. On the average, six members comprised a household (Table 7). This pattern is consistent in both the advanced and backward areas.The average number of dependents in backward areas (five persons per household) is slightly larger than those in advanced areas (four persons per household).

Table 7. Average household size and number of dependents, by level of economic development of area

	All Areas	Advanced Areas	Backward Areas
Average Household Size	6	6	6
Average Number of Dependents	4	4	4

Occupation. Table 8 shows that two of the most prevalent income sources are agriculture-based, namely farming (44%) and hired farm labor (18%). Moreover, a greater number of households who have agricultural occupations (farming, fishing, livestock/poultry raising, and farm labor) are in the backward areas (77% collectively in backward vs. 62% in advanced).

Advanced areas, however, offer more varied and perhaps more remunerative opportunities, where the households are engaged in craft/business or are wage earners and livestock/poultry raisers. In addition, the number of households which derive income from non-agricultural sources, i.e., wage earners, craft/businessmen, professionals, grant/pension earners, and others is larger in the advanced areas (collectively sharing 38% of total) than in the backward municipalities (22%).

Noteworthy is the percentage of households with other income sources such as bet collecting, gambling, and rental of machinery/equipment. While representing only 6% of the total, their operations are declared as a major occupation particularly in advanced areas.

Professionals are clearly small in number, 0.1% of the total.

Table 8. Distribution of rural households by occupation, advanced vs. backward areas

Occupation	All Areas		Advanced Areas		Backward Areas	
	No.	% to Total	No.	Column %	No.	Column %
Farmers	430	44.1	208	38.1	222	51.9
Fishermen	53	5.4	26	4.8	27	6.3
Livestock/Poultry Raisers	11	1.1	9	1.6	2	0.5
Farm Laborers	172	17.7	93	17.0	79	18.5
Wage Earners	168	17.2	114	20.9	54	12.6
Craft/Businessmen	71	7.3	51	9.3	20	4.7
Professionals	1	0.1	0	0.0	1	0.2
Grant/Pension Earners	11	1.1	7	1.3	4	0.9
Others	57	5.9	38	7.0	19	4.4
TOTAL	**974**	**100.0**	**546**	**100.0**	**428**	**100.0**

Note: Totals may not add up due to rounding.

Households' income

In all areas, household income averaged at PHP 14,555 per household (Table 9). This is slightly below the average in advanced areas which was reported to be PHP 17,145 and a little above the reported average of PHP 11,252 per household in backward areas. The income differential between the advanced and backward areas is about PHP 6,000.

The highest average incomes were posted by livestock/poultry raisers and craft/businessmen (Table 10). Although farmers in advanced areas received better incomes, these lagged far behind those derived from other sources. Indeed, farmers earned the lowest incomes of PHP 11,250 over all areas, PHP 13,549 in advanced areas, and PHP 9,096 in backward areas.

As expected, average incomes in the advanced areas were generally higher than those in less progressive areas. Significant differentials in income are evident in almost all economic activities, except in fishing, hired labor, and other income sources.

Table 9. Average income of rural households, advanced vs. backward areas.

Economic Development Area	Reporting No.	Household % to Total	Total Amount (P000)	Income % Dist.	Average Income (P)
Advance Areas	546	56.06	9361	66.03	17145
Backward Areas	428	43.94	4816	33.97	11252
All Areas	974	100.00	14177	100.00	14555

Table 10. Average income of rural households by source, advanced vs. backward areas (in Pesos). [a/]

Income Sources	All Areas	Advanced Areas	Backward Areas
Farmers	11250	13549	9096
Fishermen	14914	15804	14057
Livestock/Poultry Raisers	34094	39109	11527
Hired Labor	11464	12493	10252
Wage Income	18958	20750	15175
Craft/Business	22534	24787	16791
Practice of Profession	21416		
Grant/Pension Earners	25029	33718	9822
Others	19659	19797	19382
All Sources	14555	17145	11252

[a/] Household incomes were classified according to the major income source of the household head divided by the number reported in each class.

Assets of rural households

Current, intermediate, and long-term assets. A standardized presentation of the assets and liabilities for a "typical household" is shown in Annex Tables 2–4. This was arrived at by creating a balance sheet for each household and averaging the various components of the balance sheet across households in all areas, in backward areas, and in advanced areas. Except in the aggregate asset categories (e.g., current, intermediate, long-term, and farm, non-farm, financial), the averages were based on the number of households reporting the type of asset. The aggregate asset types or sub-totals are simply the sum of the components. This procedure was used to balance the asset with the liability side. This particular section discusses only the asset portion.

In all areas, the average value of assets was PHP 124,223 per household (Table 11). Current assets (cash, savings deposits, non-bank deposits, and inventories of crops) were small compared to intermediate assets (livestock, farm equipment, consumer durables, vehicles, furniture, and time deposits) and long-term assets (fixed physical assets such as land, housing, and other structures). Intermediate and long-term assets were valued at a little over PHP 49,000 while the current assets averaged only PHP 15,304.

The assets of a "typical household" in advanced areas and in backward areas, however, averaged PHP 167,223 and PHP 82,627, respectively. Conspicuous are the higher market values for intermediate and long-term properties in advanced areas compared to those in backward areas.

One generalization is that households in both advanced and backward areas maintain lesser current assets (notably cash

and financialized deposits). However, the disparity in the average values for the two areas is not too large. Thus, as far as cash and financial deposits are concerned, household preferences in advanced areas do not vary much from those in backward areas. An explanation for this finding, however, requires further investigation.

Table 11. Average values of current, intermediate, and long-term assets of rural households, advanced vs. backward areas. [a/]

Asset Type	All Areas		Advanced Areas		Backward Areas	
	Amount	Col. %	Amount	Col %	Amount	Col %
Current Asset	15304.2	12.3	16947.7	10.1	15447.1	18.7
Intermediate Asset	49223.0	39.6	75601.3	45.2	22101.5	26.7
Long Term Asset	59696.0	48.1	74674.4	44.7	45078.8	54.6
TOTAL	**124223.2**	**100.0**	**167223.4**	**112.5**	**82627.4**	**100.0**

[a/] The figures refer to the sum of averages computed from the balance sheet of a "typical household" in all areas, in advanced areas, and in backward areas.

Farm, non-farm, and financial assets. Table 12 presents the average assets of rural households according to their functional use, i.e., farm, non-farm, and financial assets. The figures for this category differ slightly from those in Table 11 due to the additional averaging procedure performed on the constituents of farm/fish equipment, bank deposits, and non-bank deposits.

Financial assets have notably lower values compared to farm and non-farm assets (Table 12). Farmlands and residential properties obviously had the highest average market values, ranging from PHP 30,879 to PHP 39,814 for the former and PHP 13,411 to PHP 29,770 for the latter.

Bank deposits were not as large as the other forms of financial assets, notably non-bank deposits. This reflects the relative bias of households against formal depository institutions in favor of *paluwagans* and ROSCAs existing in the areas.

Table 12. Average value of assets of rural households, advanced vs. backward areas (in Pesos, as of 1986) [a/]

Asset Type	All Areas		Advanced Areas		Backward Areas	
	Value	Col. %	Value	Col %	No.	Col %
Farm Assets	44,789	45.3	54,570	44.4	36,600	47.6
Farm Land	34,190	34.6	39,814	32.4	30,879	40.1
Farm/Fish Equipment	2,615	2.6	3,371	2.7	1,831	2.4
Farm/Fish Structure	3,027	3.1	5,091	4.1	788	1.0
Livestock/Poultry	2,956	3.0	3,778	3.1	1,905	2.5
Crop Inventory	2,001	20	2,516	2.0	1,197	1.6
Non-Farm Assets	38,440	38.9	51,016	41.6	23,930	31.1
House	22,478	22.7	29,770	24.2	13,411	17.4
Vehicles	9,958	10.1	13,402	10.9	6,912	9.0
Furniture and Appliances	4,105	4.2	5,369	4.4	2,192	2.8
Other Valuables	1,899	1.9	2,475	2.0	1,414	1.8
Financial Assets	15,667	15.8	17,183	14.0	16,423	21.3
Cash	3,352	3.4	5,005	4.1	1,395	1.8
Bank Deposits	2,061	2.1	2,153	1.8	1,857	2.4
Non-Bank Deposits	5,108	5.2	4,030	3.3	9,006	11.7
Other Financial Holdings	2,876	2.9	2,855	2.3	2,905	3.8
Accounts Receivables	2,270	2.3	3,141	2.6	1,260	1.6
TOTAL ASSETS	**98,897**	**100.0**	**122,769**	**100.0**	**76,953**	**100.0**

a/ Sub-totals are the sum of the averages of the components.
***Note:** Figures do not tally with those reported in Table 11 due to the averaging procedure performed on the components of farm/fish equipment, bank deposits, and non- bank deposits*

Financialized deposits

The most common form of financial deposits are bank savings (Table 13). Some 77% of the total 157 depositor-households reported positive deposit balances. Non-bank depositors (of equity contributions or forced savings in *paluwagans*) numbered 21, representing about 13% of the total. There were 12 households with mixed deposits.

When deposit levels are examined, the percentage shares of deposits in banks increase to 90% (Table 14). Mixed deposits and non-bank deposits only shared a meager 6% and 4% of the total accumulated deposits, respectively. Volume-wise and by economic development category, the percentage distribution varies: mixed deposits and non-bank deposits constitute a larger proportion (13% and 7%, respectively) of the financial deposits of the households in backward areas. In all categories, however, households maintained an average of a little over PHP 1,800 in financialized savings (Table 15). The relatively larger averages of non-bank and mixed deposits in backward areas validate the popularity of non-traditional savings institutions as depository structures in less progressive areas.

The interest rates faced by the rural households vary only slightly in the given categories (Table 16). In advanced areas, the interest rate was pegged at 7.89% while in backward areas, it was slightly higher at 8.94%. In real terms, however, the households' return to their savings was only 4.4% and 5.3% for advanced and backward categories, respectively. Looking only at households with actual deposits, the nominal and real interest rates in advanced and backward areas do not deviate much from the average for all areas. The nominal rate in advanced areas is pegged at 8.02% while that in backward areas is slightly higher at 8.40%. Real interest rates, on the other hand, are 4.57% and 4.75% for advanced and backward, respectively.

Table 13. Distribution of rural households reporting financialized deposits by type, advanced vs. backward areas

Type	All Areas		Advanced Areas		Backward Areas	
	Number of HH	% to total	Number of HH	Column %	Number of HH	Column %
Bank Deposits Only	12479.0	79.0	86	78.9	38	79.2
Demand	0	0.0	0	0.0	0	0.0
Savings	121	77.1	85	78.0	36	75.0
Time	2	1.3	1	0.9	1 2.1	2.1
Others	1	0.6	0	0.0	1 2.1	2.1
Non-Bank Deposits Only	21	13.4	16	14.7	5	10.4
Both Bank and Non- Bank Deposits	12	7.6	7	6.4	5	10.4
Total	**157**	**100.0**	**109**	**100.0**	**48**	**100.0**

Table 14. Total values of financialized deposits of rural households by type, advanced vs. backward areas (Amounts in PHP 000)

Type	All Areas		Advanced Areas		Backward Areas	
	Amount	% to total	Amount	Column %	Amount	Column %
Bank Deposits Only	264,633	90.4	194,049	94.7	70,584	80.3
Demand	0	0.0	0	0.0	0	0.0
Savings	220,623	75.3	154,049	75.2	66,574	75.7
Time	44,000	15.0	40,000	19.5	4,000	4.6
Others	10	0.0	0	0.0	10	0.0
Non-Bank Deposits Only	11,765	4.0	5,992	2.9 6.6	5,773	6.6
Both Bank and Non-Bank Deposits	16,453	5.6	4,909	2.4	11,544	13.1
Total	**292,851**	**100.0**	**204,950**	**100.0**	**87,901**	**100.0**

Table 15. Total values of financialized deposits of rural households by type, advanced vs. backward areas (Amounts in PHP 000)

Type	All Areas	Advanced Areas	Backward Areas
Bank Deposits Only	2,134	2,256	1,857
Demand	0	0	0
Savings	1,823	1,812	1,849
Time	22,000	40,000	4,000
Others	10	0	10
Non-Bank Deposits Only	560	375	1,155
Both Bank and Non-Bank Deposits	1371	701	2309
Total	**1,865**	**1,880**	**1,831**

Note: The figures refer to averages of the households which report the particular type of deposits.

Table 16. Average nominal and real interest rates on savings deposits (in percent)

Economic Development Area	All Households [a/]			Depositor-Households [b/]		
	Number Reporting	Nominal Rate	Real Rate [c/]	Number Reporting	Nominal Rate	Real Rate [c/]
Advanced Areas	546	7.89	4.41	107	8.02	4.57
Backward Areas	428	8.94	5.34	51	8.40	4.75
ALL AREAS	974	8.35	4.82	158	8.15	4.62

[a/] The average interest rates on savings deposits of reporting households foreach area were imputed to non-reporting households.

[b/] By type of account, 153 reported they maintain savings deposits, only 2 reported time deposits and 2 others reported other types.

[c/] Nominal rates adjusted for inflation.

Regression results

The results of the regression analyses are shown in Tables 17 to 19. Table 17 enumerates the coefficients and T-values for the household saving models ($SAVE_1$ and $SAVE_2$). Table 18 provides the basis for comparing the magnitudes of the coefficients of the explanatory variables on residual household savings between advanced and backward areas while Table 19 shows the results of the regressions for the financialized deposit ($DEPO_1$ and $DEP0_2$) models.

Household savings model

Total household savings is influenced significantly by nominal income, dependency rate, education, income type, and the economic development of the area (Table 17). Except for income type and the economic development dummy, the effects of these factors are consistent in both models, i.e., $SAVE_1$ where the bank accessibility variables (DIST and NBANKS) are not considered and $SAVE_2$ where they are examined. In the latter model, the relationship between household saving and DIST was also significant.

The significance of the development dummy variable (DUM) supports the hypothesis put forward in this study, i.e., that the economic development of an area exerts an influence on the savings behavior of households, and thus provides a strong basis for the separate analyses of households in advanced vs. backward areas proposed in this study.[2]

For instance, households in advanced areas were dissaving

[2] The same results were obtained when Chow's Test was performed on separate regression equations for backward and advanced areas. The non-equality of parameter estimates in the two areas provide support for their separate analysis.

(intercept is negative) whereas households in backward areas had positive savings. The unexpected result reveals that in advanced areas (as interpreted in this study), households have to reach a certain "threshold" income before positive savings occur. Economic development, therefore, may not necessarily induce households to maintain surplus funds. Although opportunities for additional income and exposure to banking operations may have increased with progress and savings was anticipated to also increase, these did little in influencing the savings behavior of the households. It is possible that economic development instead exposed the households to a wide array of consumer/investment goods and services and magnified the pull factor on income as espoused by Akhtar (1987). To provide an example, households in Batangas (an advanced area) opt to invest their surplus funds in small-scale agribusiness projects rather than keep these funds unutilized or deposited in banks. Other factors (e.g., socioeconomic, tastes, attitudes) may have more bearing on household savings than economic development.

The results for income validate the positive influence that it exerts on total household savings. Regardless of location, the observed MPS out of nominal income is about 41% ($SAVE_1$) (Table 17). The MPS in advanced areas is much lower (36%) compared to that in backward areas: households in the latter save about 44 centavos for every peso of income (Table 18). The results imply that the marginal value of saving is greater for the poor than for the less poor.

The above results are consistent with Lamberte and Bautista's (1989) findings where a lower MPS (0.38) out of current income was observed for households in the National Capital Region compared to households in almost all regions. Within a region, however, the lower MPS for urban compared to rural families holds true only for Regions I, II, and IX.

The source of income also matters to rural households. The variable INCTYPE emerged to be significant in both models. The larger magnitude of the intercept for agricultural households implies a lower threshold level for residual savings among agricultural households compared to non-agricultural households.

The coefficient for education is unexpectedly negative and more pronounced in backward areas (the magnitude of the coefficient is larger in backward areas). Thus, more educated households tend to save less. Furthermore, they maintain lesser savings when they are located in backward areas.

Table 17. Regression results: Household saving model (additive model), DEPVAR = S, N=974. [a/]

Variables	SAVE 1		SAVE 2	
	Coefficient	T-value	Coefficient	T-value
Intercept	1652.15	0.88	-512.66	-0.26
NY	0.41	20.82*	0.42*	20.86*
INT	-299.64	-1.78	-119.80	-0.68
DEP	-2358.94	2.05*	-2461.11	2.14*
EDUC [b/]	-287.51	-3.88*	-272.35	3.68*
INCTYPE [c/]	1376.55	2.37*	1079.08	1.84
DUM [d/]	-1814.66	-305*	-1041.8	-1.56
NBANKS			-85.10 -	-1.66
DIST			109.95	2.67*
R^2	0.32		0.32	
F Value	75.97		58.89	
Prob> F	0.0001		0.0001	

[a/] The additive form introduces DUM as shiftor and assumes homogeneous slopes and different intercepts between advanced and backward areas.
[b/] Number of years spent in school.
[c/] Dummy variable which takes the value of 1 if the predominant source of income of the household is agriculture and 0 if otherwise.
[d/] Economic development dummy which takes the value of 1 if advanced and 0 if backward.
** significant variables at 5% significance level*

Table 17a. Regression results: Non-financial saving, DEPVAR = S, N = 974. [a/]

Variables	NON FINANCIAL SAVING	
	Coefficient	T-Value
Intercept	-206.04	-0.10
NY	0.41	19.41*
INT	-164.79	-0.88
DEP	-2581.67	2.12*
EDUC [b/]	-295.95	..379*
INCTYPE [c/]	1266.38	2.05*
DUM [d/]	-1408.13	1.99*
NBANKS	-48.16	-0.89
DIST	114.01	2.63*
R^2	0.30	
F Value	51.59	
Prob> F	0.0001	

[a/] The dependent variable is total household saving net of financial deposits.
[b/] Number of years spent in school.
[c/] Dummy variable which takes the value of 1 if the dominant source of incomeof the household is agriculture and 0 if otherwise.
[d/] Economic development dummy which takes the value of 1 if advanced and 0 if backward.
* significant variables at 5% significance level

While educated households are expected to increase savings because of the "awareness to-savings-institutions-and-savings-benefits "idea that goes with education, the results show otherwise. An explanation for this is the popular treatment of education as a form of savings. Because it enhances the ability to earn and reduces the precautionary motive of savings, rural households save in the form of education. Educated households in the sample have significantly greater schooling expenditures (Annex Table 6) hence, ceteris paribus their net income, and consequently, savings is low.

Another explanation is the common notion that with education, rural households are exposed to a wide array of consumption goods. The exposure normally increases household expenditures on such goods, creating a strain on income (income substitution effect), and consequently, savings.

Also, education enables households to realize that the real interest rate on deposits is negative. Thus, the more educated shy away from bank deposits. The "money illusion" is lifted with greater schooling.

The number of dependents of the households exerts a significant negative influence on their savings behavior. Indeed, additional mouths to feed create a strain on the household's income, and therefore, on savings. The variable, however, loses its significance when it is made to interact with the development dummy (Table 18), thereby refuting Kelley's (1976) conjecture that the dependency rates of households vary with the level of economic development of the area. The cultural characteristics of rural families in the Philippines perhaps account for this result. Closely-knit and normally extended, these rural families are oftentimes undaunted by progress.

The bank accessibility variables (DIST and NBANKS) which were suspected to affect total household savings (of which financial deposit is a component) yielded interesting observations. The results, however, explained largely the behavior of the non-financial component of household savings which constituted the bulk of the total savings of the households.

Table 18. Regression results: Household saving model (multiplicative form), DEPVAR = S, N = 974. [a/]

Variables	SAVE 1		SAVE 2	
	Coefficient	T-value	Coefficient	T-value
Intercept	2546.45	1.28	135.47	0.06
NY	0.44	19.82*	0.45	19.96*
INT	-186.19	-1.08	-35.88	-0.20
DEP	-3001.10	-1.64	-2653.83	-1.46
EDUC [b/]	-575.84	-3.13*	-531.48	2.89*
INCTYPE [c/]	1166.89	2.00*	868.07	1.47
NBANKS			-91.81	-1.74
DIST			110.30	2.67*
NY*DUM	-0.08	2.87*	-0.09	3.13*
INT*DUM	-555.64	2.38*	-369.76	-1.53
DEP*DL1M	1156.46	0.53	510.75	0.23
EDUC*DUM	346.57	1.76	314.64	1.60
R^2	0.33		0.34	
F Value	52.42		44.32	
Prob> F	0.0001		0.0001	

[a/] The multiplicative form allows the DUM to interact with the other explanatory variables and assumes homogeneous intercepts but different slopes between the advanced and backward areas.

[b/] Number of years spent in school.

[c/] Dummy variable which takes the value of 1 if the predominant source of income of thehousehold is agriculture and 0 if otherwise.

[d/] Economic development dummy which takes the value of 1 if advanced and 0 if backward.

** significant variables at 5% significance level.*

Table 19. Regression results: Financial deposits model, DEPVAR = D, N = 158. [a/]

Variables	DEPO 1		DEPO 2	
	Coefficient	T-value	Coefficient	T-value
Intercept	-5587.98	-0.90	-1687.23	-0.52
NY/W	0.20	3.66*	0.01	2.68*
INT	215.74	0.50	292.18	1.22
DEP	439.93	0.08	1637.75	0.63
EDUC [b/]	463.54	1.33	-47.69	-0.28
INCTYPE [c/]	1816.51	0.82	-224.37	-0.22
DUM [d/]	1954.49	0.85	664.12	0.59
NBANKS	-170.65	-1.06	-128.52	-1.68
DIST	-16.16	0.16	-29.95	-0.50
R^2	0.12		0.08	
F Value	2.55		1.56	
Prob>F	0.0123		0.1421	

[a/] Regressions were run on only the depositor-sample (N = 158). No interaction between the development dummy and explanatory variables was performed since DUM was not significant
[b/] Number of years spent by the household head in school.
[c/] Dummy variable which takes the value of 1 if sourced from agriculture and 0 if sourcedfrom non-agriculture.
[d/] Economic development dummy which takes the value of 1 if advanced and 0 if backward.
** Significant variables at 5% level.*

For instance, DIST emerged as a highly significant variable that influences household savings positively. As banks are located farther from the households, the tendency for the household to keep their money/surplus funds in their homes increases.[3] The result shows that transactions costs (on deposits) also matter to rural households.

[3] The same result was obtained even among non-depositor households.

The effect of NBANKS on total household saving is negative. This result is not surprising since the total savings of the households is suspected to be dominated largely by non-financial forms and the model explains the behavior of these non-financial savings. The result can be interpreted as: increasing the number of banks in the area results to the reduction of surplus funds kept by the households in their homes. To validate this observation, the same explanatory variables were regressed with total savings net of financial deposits and the same results were obtained (Table 17a). However, these households may not necessarily keep the surplus funds in banks (as the results of the regressions on the depositor-sample would show) or maintain higher volumes of deposits.

Adding DIST and NBANKS to the household savings model causes the economic development variable (DUM) to lose its significance. Although inconclusive, the result may imply that an undeveloped financial structure mitigates against the positive effect of economic development on savings. The signs that were obtained for interest rates indicate the unexpected relationships and the T-values lack the required size for a 5% significance level (but satisfies a 10% level of significance) to allow any inferences or conclusions. Further empirical analysis, particularly on the appropriate interest rate to use, is suggested.

Owing to the cross section nature of the data, the R^2 is relatively low. The models explain only 33% of the variations in household savings.

Financial deposits model

The regressions on financial deposits yielded only income (NY) and alternatively, wealth (W) as the most important variable that influences the portfolio decisions of rural households (Table 19).

The effect of income (and wealth) underscored its importance not only in the household's decision to save but also in its decision to keep a portion of its surplus funds in financial forms. Households allocate 20% of their nominal income (or 1% of wealth) as deposits in banks. This also suggests that a certain threshold level of increased income must be reached prior to a household's decision to deposit in banks. Thus, smaller amounts of cash surpluses are kept in the household, while larger amounts are deposited in banks.

The distance of the household to the depository bank (another measure of bank accessibility) yielded the expected relationship but lacked the required level of significance. Households which were located farther from the banks saved less compared to households which had access to banks in terms of distance. Further empirical analysis is required to validate this relationship. The negative relationship between financial deposits and NBANKS shows that households may not necessarily deposit their surplus funds and/or increase their deposits as the number of banks in an area increases. A host of other factors, such as investment opportunities in the area, variability of income, tastes, etc. may affect their decision to save in financial forms and increase deposits in banks.

Conclusions and policy implications

The study clearly indicates that the effect of certain explanatory variables on the total savings of rural households differ in relatively advanced and backward areas. Thus, separate analyses of the savings behavior of households in areas of varying levels of economic development are warranted.

For certain areas in the Philippines, economic advancement does not necessarily induce households to maintain surplus funds. The effect of progress is suspected to be more pronounced on the consumption side, supporting the findings of other researchers like Akhtar (1987). Given this constraint, rural savings mobilization may be more effective if the financial/capital market is able to provide the households with investment opportunities that will sustain income increases, and/or provide sources of funds (e.g., loans) that will finance the increased consumption levels as the household moves from a "backward" to an "advanced" state. This seems consistent with the requirement for "financial deepening" complementary to the economic development process.

Income is confirmed as the major determinant of total household saving and household financialized deposits. In general, households save about 41% of their residual income and keep 20% (and alternatively 1% of wealth) as deposits in banks.

Households in backward areas are positive savers. They have higher MPS values out of nominal income (44 centavos per peso in backward vs. 36 centavos per peso in advanced), and are therefore more sensitive to income increases than the households in the advanced areas. Lower threshold income levels for saving were also observed in households whose incomes were derived from agriculture. These factors

underscore the importance of intensifying savings mobilization in backward (or alternatively, rural/agricultural) areas.

Considering the significant effect of dependency rates in reducing savings, rural savings strategies should be coupled with efforts that will maintain or minimize the existing dependency rates among rural households. This may be achieved through programs which rapidly reduce population growth rates and provide additional opportunities to dependent household members not only to augment but to reduce the strain that they cause on the family income.

Contrary to expectations, this study shows that interest rate increases and higher levels of education may not necessarily induce households to save out of income or keep these savings in financial forms. The former (interest rate) has one major implication on the savings mobilization efforts of banks. Banks should recognize the significance of other alternative strategies such as reducing the requirements, having accommodating personnel, fostering less formal transactions, and conducting raffles and promotions to encourage rural households to save and keep their money in banks. These strategies may prove more effective rather than pegging the interest rates a few percentage points higher.

Moreover, banks have to recognize that the level of schooling of households in the area plays an important role in their mobilization efforts. With greater levels of education, households are introduced to a range of profitable investments to choose from and may shy away from bank deposits if the real return to deposits is negative.

The analysis of household savings vs. bank accessibility variables yields an important, though remote, implication of the bank branching policy on rural savings mobilization. The reduction of the effect of economic development as a result

of adding DIST and NBANKS implies that increasing banks' accessibility to households (through increasing the number of banks and reducing the level of transactions costs) and improving the efficiency of the financial structure may be advantageous to rural savings mobilization efforts.

While the results of the financial deposits regressions proved disappointing, the household savings model yielded important results, to wit:

1. It validated the importance of several household-specific variables in explaining the savings behavior of rural households, namely household income and income source, dependency rate, and education. More often, providing households with more opportunities to augment income and reduce dependency of its members is a sure way of encouraging rural savings;

2. It revealed that in some areas in the Philippines, economic development, as defined in this study, may not necessarily increase savings or the financial deposits of rural households. As households are transformed from a "backward" to an "advanced" state during the development process, consumption levels also rise. Unless income increases are sufficient to finance increased consumption and provide additional surplus for savings, or the financial/capital market provides other sources of funds (e.g., loans) needed to smoothen consumption levels, savings mobilization may not be as effective. The influence of economic development on household savings, while clearly significant, still has to be defined.

3. It provided a rationale for savings mobilization even in "backward" rural areas. Households in "backward" areas are positive savers and their MPS out of income (44%) is definitely larger than the households in "advanced"

areas (36%). This rationale is necessary in view of the government's drive to "re-orient" rural-based banks towards strengthening their resources through the mobilization of private deposits rather than depending on government sources.

4. It confirmed the importance of increasing bank accessibility, particularly by reducing transactions costs, in increasing surplus funds of rural households. However, transforming these funds into financial forms requires additional efforts particularly from the banking sector. This aspect also requires further research.

5. The results also show that the general economic condition of the area is not the only factor that determines the effectiveness of rural savings mobilization efforts of banks. The bank management's desire and commitment to strengthen its resource base and the choice of the appropriate strategy are equally essential.

6. More importantly, the whole exercise underscored the challenging role which the government should take towards "backward areas". The dual-strategy adopted by the Department of Agriculture which aims to uplift the overall economic welfare in rural areas (through improvements in infrastructure, marketing, technology and extension, in the peace and order condition, and in the overall economic policy) in the long run and increase the income-generating capacity of households in the short run is, therefore, headed towards the right direction. There is also merit in the efforts to push for the improvement of the financial structure (e.g., the liberalization of the bank branching policy and the rehabilitation of rural banks). These activities may pay off more than other bank-focused exercises.

Annex Table 1. Eligibility criteria for the selection of participating rural banks

1. Must be operating outside Metro Manila and other regional centers.
2. Must be classified 'strong' or 'average' in accordance with CB-SES III's Rating Profile for Rural Banks.
3. Must satisfy the homogeneity criteria as follows: (a) must have a net worth to risk asset ratio of 10 to 42%; (b) must have a past due ratio of 16 to 44%; and (c) must have assets of PHP 0.9 to PHP 19.8 million, based on the latest examination reports of the CB-SES III submitted not later than September 30, 1986.
4. Rural banks located in contiguous areas or are near each other will be preferred.
5. Must have operated continuously for at least five years as of 1 January 1987.*
6. Must be willing and committed to implement specific savings schemes or strategies, if a 'participating' bank; Must be willing to provide the research team with information/data on the rural bank's operations.*
7. Must commit at least one (1) bank staff to monitor RSM activities.*

** Determined during field visits and preliminary interviews with managers.*

Annex Table 2. Composite ranking of sample municipalities*

Municipality	Province	Composite Rank	Classification
Alaminos	Pangasinan	1453	Advanced
El Salvador	Misamis Oriental	1342	Advanced
Zamboangita	Negros Oriental	1186	Advanced
San Jose	Batangas	1179	Advanced
Mataas na Kahoy	Batangas	1178	Advanced
Lipa	Batangas	1121	Advanced
Valencia	Negros Oriental	1010	Advanced
Barotac Nuevo	Iloilo	939	Advanced
Sual	Pangasinan	888	Advanced
Siaton	Negros Oriental	770	Backward
Initao	Misamis Oriental	476	Backward
Dumangas	Iloilo	358	Backward
Gitagum	Misamis Oriental	296	Backward
Goa	Camarines Sur	274	Backward
Tigaon	Camarines Sur	149	Backward
Sta. Barbara	Iloilo	61	Backward
San Jose	Camarines Sur	59	Backward

**Based on Operation Timbang (OPT) and Per Capita Income (PCI) ranks of 1,639 cities and municipalities.*

Annex Table 3. All areas balance sheet as of December 1986

ASSETS				
Current Assets				
Cash		3,352.10		
Deposits		1,754.09		
Savings	1,754.09			
Demand	0.00			
Crop Inventory		2,000.54		
Outstanding Contribution/Savings in				
Non-Bank Institutions/informal Group		5,927.72		
Equity Contributions	963.89			
Non-Bank Savings	4,963.83			
Account Receivables		2,269.72		
Total Current Assets		15,304.17	15,304.17	
Intermediate Assets				
Livestock/Poultry		2,956.19		
Equipment		5,429.56		
Farm	2,406.16			
Fishing	3,023.30			
Time Deposits		22,000.00		
Consumer Durables		15,961.79		
Vehicle	9,958.47			
Furniture	4,104.57			
Other (Jewelry, Painting, Antique)	1,898.75			
Bond/Stocks/Insurance (Premium Paid)		2,876.00		
Total Intermediate Assets		49,223.00	49,223.00	
Long-term Assets				
Land		56,668.69		
Residential Lot/House	22,478.46			
Farm Lot	34,190.23			
Farm/Fishing Structures		3,027.31		
Total Long-term Assets		59,696.00	59,696.00	
TOTAL ASSETS			124,223.17	**124,223.17**

LIABILITIES				
Current Liabilities				
Outstanding Loans			29,307.75	
Formal Loans		15,306.94		
Production Loans	4,272.62			
Investment Loans	6,128.00			
Consumption Loans	4,906.32			
Informal Loans		14,000.81		
Production Loans	2,252.34			
Investment Loans	8,750.00			
Consumption Loans	2,998.47			
Accounts Payable			2,396.44	
Total Current Liabilities			31,704.19	31,704.19
CAPITAL (Total Asset-Total Liabilities)				
Capital (net worth)				92,518.98
TOTAL LIABILITIES AND CAPITAL				**124,223.17**

Annex Table 4. Advanced areas balance sheet as of December 1986

ASSETS			
Current Assets			
Cash		5,004.73	
Deposits		1,732.27	
Savings	1,732.27		
Demand	0.00		
Crop Inventory		2,516.14	
Outstanding Contribution/Savings in			
Non-Bank Institutions/informal Group		4,554.07	
Equity Contributions	572.50		
Non-Bank Savings	3,981.57		
Account Receivables		3,140.52	
Total Current Assets		16,947.73	16,947.73
Intermediate Assets			
Livestock/Poultry		3,777.87	
Equipment		7,722.28	
Farm	2,781.80		
Fishing	4,940.48		
Time Deposits		40,000.00	
Consumer Durables		21,246.19	
Vehicle	13,401.96		
Furniture	5,368.75		
Other (Jewelry, Painting, Antique)	2,475.48		
Bond/Stocks/Insurance (Premium Paid)		2,855.00	
Total Intermediate Assets		75,601.34	75,601.34
Long-Term Assets			
Land		69,583.76	
Residential Lot/House	29,769.59		
Farm Lot	39,814.17		
Farm/Fishing Structures		5,090.61	
Total Long-Term Assets		74,674.37	
TOTAL ASSETS		167,223.44	**167,223.44**

LIABILITIES				
Current Liabilities				
Outstanding Loans			40,256.70	
Formal Loans		17,541.72		
Production Loans	2,861.11			
Investment Loans	9,825.00			
Consumption Loans	4,855.61			
Informal Loans		22,714.98		
Production Loans	2,830.88			
Investment Loans	16,000.00			
Consumption Loans	3,884.10			
Accounts Payable			2,994.67	
Total Current Liabilities			43,251.37	4,631.03
CAPITAL (Total Asset-Total Liabilities)				
Capital (net worth)				162,592.4
TOTAL LIABILITIES AND CAPITAL				**167,223.4**

Annex Table 5. Backward areas balance sheet as of December 1986

ASSETS			
Current Assets			
Cash		1,395.38	
Deposits		1,803.20	
Savings	1,803.20		
Demand	0		
Crop Inventory		1,196.82	
Outstanding Contribution/Savings in			
Non-Bank Institutions/informal Group		9,792.08	
Equity Contributions	1,277.00		
Non-Bank Savings	8,515.08		
Account Receivables		1,259.60	
Total Current Assets		15,447.08	15,447.08
Intermediate Assets			
Livestock/Poultry		1,905.21	
Equipment		2,772.33	
Farm	2,008.58		
Fishing	763.75		
Time Deposits		4,000.00	
Consumer Durables		10,518.93	
Vehicle	6,912.31		
Furniture	2,192.32		
Other (Jewelry, Painting, Antique)	1,414.30		
Bond/Stocks/Insurance (Premium Paid)		2,905.00	
Total Intermediate Assets		22,101.47	22,101.47
Long-Term Assets			
Land		44,290.42	
Residential Lot/House	13,411.28		
Farm Lot	30,879.14		
Farm/Fishing Structures		788.41	
Total Long-term Assets		45,078.83	45,078.83
TOTAL ASSETS		82,627.38	**82,627.38**

LIABILITIES				
Current Liabilities				
Outstanding Loans			19,108.05	
Formal Loans		14,010.12		
Production Loans	5,331.25			
Investment Loans	3,663.33			
Consumption Loans	5,015.54			
Informal Loans		5,097.93		
Production Loans	2,080.93			
Investment Loans	1,500.00			
Consumption Loans	1,517.00			
Accounts Payable			1,200.00	
Total Current Liabilities			20,308.05	20,308.05
CAPITAL (Total Asset-Total Liabilities)				
Capital (net worth)				62,319.33
TOTAL LIABILITIES AND CAPITAL				**82,627.38**

Annex Table 6. Expenditures of rural households by educational background proportion to total (in percent)

Expenditure Item	Educational Background				
	Unschooled	Elementary Level	High School	Vocational	College/ Post College
Food	61.2	51.6	48.2	53.5	42.0
Clothing	3.8	3.6	4.3	2.9	4.1
Housing & Household Operation	1.3	3.1	1.8	1.7	5.0
Utilities	7.2	6.6	7.4	12.7	9.0
Consumer Durables	1.2	2.1	4.0	3.4	3.0
Education	6.5	11.4	13.5	9.6	17.0
Medical	4.3	5.6	2.9	2.7	9.0
Others	14.5	16.0	17.9	13.6	11.0

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CHAPTER 4

Supply-led finance is inconsistent with rural growth

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Introduction

In this brief, the Agricultural Credit Policy Council (ACPC) comments on House Resolutions (HRs) 253, 708, 111, 1119, and 1130.

The ACPC welcomes the filing of HR Nos. 253 (Urging an Immediate Inquiry, In Aid of Legislation, Into the Problems Encountered by the Country's Rural Banks); 708 (Directing the Committee on Banks to Make An Inquiry in Aid of Legislation on How Congress Could Help the Ailing Rural Banks and Better Effect Funding Support to People Residing in the Rural Areas); 1118(Directing the Appropriate Committee/s of the House of Representatives to Review, In Aid of Legislation, Existing Banking Regulations Pertinent to the Efficient Functioning of the Rural Financial Market and for the Monetary Board of the Central Bank to Recommend to Congress Possible Legislations and Measures to Develop the Rural Financial Market, Including Appropriations Thereof);

1119 (Urging the Central Bank of the Philippines to Redesign the Credit and Guarantee Schemes for Rural, Agricultural Development Purposes that Would Be Acceptable and Viable to Both the Borrowers and the Lenders); and 1130 (Directing the Appropriate Committee/s of the House of Representatives to Review, In Aid Of Legislation, the Existing Structure of the Philippine Financial System and to Urge the Central Bank to Recommend Legislative Actions to Bridge the Gap Between Credit and the People in the Rural Areas).

Misconceptions isolate intents of resolutions

We see the urgency and the necessity of the abovementioned HRs in view of the vital role the rural banking system plays in encouraging and mobilizing savings, and of the glaring truth that a great majority of these banks are experiencing serious problems in liquidity and profitability. We believe that the House inquiries will benefit rural financial intermediation in particular and rural development in general.

However, there are erroneous assumptions inherent in some of these Resolutions:

A. There is a misguided idea that government funds should always be available to rural banks.

Paragraph 3 of the preface to HR No. 253 states"...rural banks serve as vital and effective conduits for the flow of government loan funds intended for small-time farmers, fishermen, traders, and backyard entrepreneurs." Likewise, paragraph 2 of HR No. 708, directs the Committee on Banks to conduct an immediate inquiry "... to find out ways and means on how

the government could increase the liquidity of the rural banks all over the country." The same is echoed in HR No. 1013 when it directs the Central Bank (CB) of the Philippines, the Department of Agrarian Reform (DAR), and the Land Bank of the Philippines (LBP) to "find ways and means to infuse credits to the rural banks."

The primary function of rural banks, and of banks in general, is to generate deposits and to channel these funds to the most efficient investments, thereby promoting capital accumulation and rural development. Savings generation is important since there are many more savers than rural borrowers, and the availability of financially attractive outlets for savings deposits is much more important than formal credit sources to the lowest income households.

If "infusing credit to rural banks" means government lending a la supervised credit program, then the results are likely to be counter-productive. The cheap rediscount policy and readily available government funds in the past have unfortunately resulted in the dependence of rural banks on borrowings from the CB and the neglect of deposit mobilization. While the above statements in the HRs imply the importance of having government loan funds available for rural banks, the ACPC reiterates that the costs of such a policy far outweigh its benefits.

Therefore, we strongly oppose any government infusion of fresh credits, more so to reactivate closed rural banks, as suggested by HR No. 1013. Apart from liquidity problems, these rural banks were closed because of management irregularities. Government assistance to rural banks should be within the framework of the Rural Bank Rehabilitation Program of the CB.

B. Credit is not exclusively used for collateral-backed activities.

There is no truth to the statement in the fourth paragraph of the preface to HR No. 1119 that "… financial institutions have relied more on collaterals as a way of minimizing risks, which, more often than not, cannot be provided by borrowers from the rural areas." Paradoxically, this was true of the period when interest rate ceilings for both loans and deposits were instituted. Secured loans as a percentage of the total number of loans plunged in 1974 with the advent of *Masagana 99* and other supervised credit programs. However, from 1977 to 1987, unsecured loans—in terms of the total number of loans granted—generally increased, rising to around 30% of the total by 1987 despite the decline in both the relative and absolute importance of supervised lending programs.

We therefore attribute this increase to financial reforms instituted in the 1980s, which lessened the biases against small borrowers, and to the operations of the Comprehensive Agricultural Loan Fund (CALF) guarantee programs, which reduced risks in lending. The same reasons refute the statement in the opening paragraph of HR No. 1330 that, "...credit... is used exclusively to finance collateral-backed activities." which is obviously erroneous and ignores the operations of the guarantee system.

Learning from Presidential Decree (PD) 717, mandatory credit allocation suggested in HR No. 1013 directs the CB, the DAR, and the LBP "... to require the Rural Banks to support the farmers in granting them agricultural loans not exceeding 25% of their loanable funds."

The ACPC has continuously echoed the inadvisability of mandatory credit quotas (see ACPC Policy Statement dated 8 February 1989). Lending to specific clients does not work, since credit resources are fungible and banks will always exercise their credit judgment in evaluating a loan. A targeted client will only be rationed out unless his project is found viable by the bank. The experience of PD 717 is one specific example.

Let the flow of credit take its own course

Lastly, there is a provision in HR No. 1132 which urges the CB to direct commercial banks to adopt a "supply-leading stance" to enable small rural borrowers to gain more access to credit and find ways to expeditiously act on loan applications, supervise the use of credit, and collect on its loans without incurring a heavy overhead burden, as well as to invest in rural agricultural development projects/ industries. There is no valid basis for directing commercial banks to adopt such a stance since the profitability and viability of a project takes precedence over all criteria set by banks in granting a loan. Therefore, such a directive would only be ineffective as long as profitable projects in the rural areas do not exist.

The bottomline is to reduce the risks inherent in agricultural projects and to increase the profitability of the sector and the creditworthiness of farmer borrowers.

CHAPTER 5

Rural finance, cooperatives, and rural development: Current status and policy options[1]

V. Bruce J. Tolentino, Gilberto M. Llanto, and Raike R. Quinones[2]

In this paper, issues in rural finance and development—with emphasis on cooperatives and their role in rural financial markets—are discussed. To make the presentation simple, we decided to enumerate statements on these issues organized in five sections. Section I is an overview of the present rural credit situation; Section II discusses the present orientation of rural credit policy and the role of the government in rural financial markets; Section III summarizes some key observations on informal lenders; Section IV focuses on the role of cooperatives and associated policy thrusts. The last section states our recommendations.

1 Paper presented at the Department of Agriculture Nationwide Planning Workshop on 17-19 September 1987 at the Philippine International Convention Center by Agricultural Credit Policy Council staff.

2 Executive Director, Deputy Executive Director, and Staff Researcher, respectively.

I. The Philippine rural credit situation

1. In 1987, the total estimated demand for agricultural production credit in the Philippines is more than PHP 60 billion.

2. The government has direct control of only PHP 1 billion in agricultural funds. The Department of Agriculture (DA) controls only about PHP 850 million and these have been consolidated into the Comprehensive Agricultural Loan Fund (CALF).

3. At present, there is a large supply shortfall in agricultural financing and low/diminishing credit support to the agriculture sector. In real terms, agricultural production loans granted grew on the average and by as much as 8.8% in the period 1978-83;in 1984-86, though, a negative growth of 18.6% was registered. In 1980, agricultural loans enjoyed a 9.2% share in total institutional credit; in 1984, this share had fallen to 8.1% and two years later, to 7.5%.

4. The formal credit delivery structure using the nationwide network of rural banks is severely constrained from responding effectively to the requirements of rural development by financial and management problems.

5. On the other hand, the banking system, especially its principal component—the commercial banks—are very liquid. The estimated excess reserves of the system in mid-1987 is over PHP 35 billion.

II. Present credit policy and the government's role in rural financial markets

6. Credit as an issue is politically popular and relatively easy to implement. Yet the Philippine experience with credit programs showed their doubtful value.

7. The facts are clear: (A) cheap credit did not really help the small proportion of farmers who received the subsidized loans, (B) those who benefited were the large farmers, (C) the government's performance as a banker was a dismal failure, and (D) credit programs created an overdependence by rural banks on government money and led to the neglect of rural resource mobilization.

8. Credit subsidy was therefore wasteful and, worse, regressive.

9. Present credit policy relies on the market to allocate precious financial resources to their best alternative use.

10. The government, therefore, encourages the mobilization by private financial institutions of rural resources to generate loanable funds for the agriculture sector in lieu of using cheap government funds.

11. The Central Bank has implemented a rehabilitation program for rural banks and continues to provide the proper economic and financial atmosphere for private enterprise including rural banks to prosper.

12. The DA in cooperation with other government agencies has created the CALF to provide guarantee schemes that will encourage rural lending and reduce the bank's cost of absorbing defaults.

III. Informal financial markets

13. There seems to be a good basis for giving the informal credit system operating in the countryside some very serious thought. An estimated two-thirds of farmer borrowers source their credit needs from informal lenders for various reasons. The impression one gathers is that the vacuum left by the diminishing credit support of formal financial institutions has been filled by informal lending.

14. The issue is whether this system can be co-opted into delivering rural credit or left alone to continue its informal lending activities. Will it address the earlier-mentioned shortfall in the supply of loanable funds efficiently and equitably? What features of this system could be adopted by formal financial institutions?

IV. The role of cooperatives in rural financial markets and policy thrusts

15. There is some evidence that attempts by the government to institutionalize cooperation as a strategy to improve economic and social conditions have not been very

successful, notwithstanding a series of legislation and financial support by government.

16. The Philippine cooperative system is divided into four major sectors: (A) cooperatives under PD 175 (i.e., agricultural, credit, consumers, industrial and service), (B) electric cooperatives, (C) sugar cooperatives, and (D) transportation cooperatives.

17. Over the years, the structure of cooperatives that evolved for those under PD 175 turned out to be complex, multilayered, and specialized. There are various types of cooperatives (credit, consumers, marketing, producers, service, multipurpose) classified by stage of development (e.g., pre-cooperative like the *Samahang Nayon*, primary, secondary, regional federation, and national federation) and supported by numerous institutions with specialized functions and funds.

18. The record shows that government investment in cooperatives, particularly in agricultural cooperatives during the period 1973-1986, have been substantial yet there were few success stories.

19. In contrast, the privately organized and inspired non-agricultural cooperatives—credit cooperatives in particular—grew steadily in number and resources.

20. It appears reasonable, therefore, for government to adopt a policy of "benign" neglect toward cooperatives by assuming only a supportive and secondary role in their formation and growth and, instead, allowing the unhampered self-interest of private individuals to determine and decide whether a cooperative type of

organization will help the individuals concerned attain their perceived goals.

21. This implies, on the part of the DA, a de-emphasis on active promotion and organization of cooperatives and, instead, intensified training, audit, and supervision programs for privately organized cooperatives.

22. The areas where government will intervene thus have to be redefined. Presently, this would call for the rationalization of the various cooperative laws and regulatory bodies affecting cooperatives, aside from the abovementioned training, audit, and supervision activities.

V. General recommendations for improving the agricultural credit scenario

Provide the infrastructure and the environment to make agricultural lending viable.

On credit demand

a. Pursue a continuing education and information campaign to shape farmers' attitudes and behavior for proper utilization and prompt repayment of loans.

b. Improve loan administration by establishing a lead agency to serve as repository of information on agricultural credit and as a consultative agency in determining viable agricultural projects.

c. Undertake coordinated planning of loan requirements.

d. Reduce borrowing cost by simplifying loan documentation requirements or eliminating unnecessary layers in the lending process.

On credit supply

e. Reorient rural financing schemes by adopting client-oriented/area-specific agricultural financing programs.

f. Minimize risks or losses in agricultural lending activities through the development of project viability, strong market support, improved farm ventures, expanded crop insurance, integrated farm financing, credit selectivity, innovative collection mechanism, and improved loan administration.

g. Build up more stable fund sources for agricultural financing through intensified rural savings mobilization, equity financing, and rationalization of use of foreign-sourced funds.

h. Gradually phase out interest subsidy on present credit programs.

On the delivery structure

i. Accelerate rehabilitation of rural banks, expand commercial bank participation in agricultural financing, and rationalize policies on branching and establishment of field extension offices.

j. Mobilize qualified non-bank channels including anchor

firms (e.g., self-help groups), credit cooperatives, and farmer organizations for credit delivery.

k. Conduct comprehensive credit management training programs for banks.

l. Promote the development of a secondary market system to accelerate financial flows, particularly in the trading of agricultural loan papers.

m. Encourage the growth of self-help groups with savings and credit activities for members and linking them with formal financial institutions.

CHAPTER 6

Agricultural credit policy: Some lessons from the Philippines and other developing countries[1]

Working Paper, Economic Development Institute, The World Bank (1991)

V. Bruce J. Tolentino

Abstract

This paper describes the experience of the Philippines in implementing specialized credit programs in support of agricultural production over the post-war period, up to the late 1980s. It reviews the reasons underlying the financial

[1] Revised after presentation at the seminar, Impact of Agricultural Policies: Experience from Asian Countries and Possible Implications for Vietnam, Hanoi, Vietnam (21-23 August 1990). The Seminar was cosponsored by the Food and Agriculture Organization of the United Nations and the State Planning Commission, Socialist Republic of Vietnam.

liberalization program implemented in the early 1980s in response to the disappointing results of the "supply-leading" approach which prevailed earlier and draws the lessons of the Philippine experience.

Introduction

Over the past two decades, the international donor and development funding community has pumped funds of more than USD12 billion into specialized lending programs implemented with the governments of many developing nations. The basic goals of these programs include stimulation of growth and even redistribution of incomes in specific areas and among particular populations considered as priority investment targets or areas of "greatest need." At the same time, governments also attempted to direct and regulate their countries' financial markets, with the objective of focusing the lending of their banking and financial systems to preferred areas of investment.

Two decades of international experience have made it clear that these policies and programs have not performed as expected. In many cases, these programs have instead created problems and distortions which now require correction before progress can be achieved to resolve the initial conditions. These problems included, among others, banking subsystems highly dependent on aid (both foreign and domestic), a mentality that equates government lending with welfare assistance, an interest rate structure that favors areas of lower, not higher, comparative advantage for the developing economies and, significantly, a highly developed informal curb financial

market that complements and, to some extent, substitutes for the constrained formal financial system (Adams, et al.,1984). This paper describes the experience of the Philippines in implementing specialized credit programs in support of agricultural production over the post-war period up to the late 1980s. The Philippines went through the full cycle of fully adopting the "supply-leading" approach popularized through the 1970s and the disappointing results, and is now in the midst of the painful process of reform. The Philippine case illustrates the experience of many other developing nations since it carries many lessons. Countries that open their economies to market forces will do well to pay close attention to these lessons.

The Keynesian prescription

There seems to be little question that the increased availability of credit (meaning a larger supply of loans) leads to faster economic growth. The main problem centers on just how the greater availability of credit to development projects and enterprises may be stimulated and secured.

There continues to be great tension between approaches that rely on government fiat and allocation, if not direct provision, of loan funds to preferred sectors and purposes (the "targeting" approach) on the one hand, and on the other the more recently popularized "financial liberalization" package growing out of the work of Shaw and McKinnon (the "financial markets" approach) initially published in 1973.

To a large extent, the traditional analysis and prescription of the process of growth grew out of the work of John Maynard Keynes (1935). The familiar Keynesian prescription for growth focuses on keeping interest rates low to stimulate investment which, in turn, produces greater output. The Keynesian approach also emphasizes the need to dampen preferences for cash, such that holdings of productive assets are maximized (Coats and Khatkhate, 1984). This was echoed by Tobin who extended the basic Harrod-Domar growth model to incorporate money, showing that the higher the return to money in a household's portfolio of assets, the smaller is the proportion of wealth allocated to capital, thus decelerating growth (Tobin, 1958). The works of Keynes and Tobin have formed the principal theoretical foundation for controlled, low-interest rate policies. The Keynesian prescription of low interest rates fits well with the appealing, and seemingly common-sensical "supply-leading" strategy of financial development (Patrick, 1968). In the supply-led strategy, finance is provided in advance of effective demand. Thus, specialized lending institutions and programs were created to service priority commodities, sectors, purposes, and clientele. The presence of bankers and banks, it was argued, would help stimulate entrepreneurship and investment. Many developing countries adopted this strategy and still maintain such programs despite growing evidence that it has not only failed to effectively and efficiently stimulate development but has also introduced counterproductive distortions into the financial markets of the developing world (Meyer, 1989).

The Philippines' experience with supply-led finance

The Philippines embraced the doctrine of supply-leading finance quite early. In 1934, the Philippine legislature enacted a stringent "Anti-Usury Law" which prohibited loan interest rates of over 16% per annum. In the early 1950s, the government instituted a very liberal qualification, capitalization, and supervision regime for the establishment of rural banks. Accompanying the push for bank organization was a "one town, one bank" policy. The rural banks were also provided with generous subsidies, tax exemptions, and low-interest seed funding and rediscounting facilities. Numerous specialized, targeted lending programs funded out of public funds and borrowing were also established, to the extent that there were over 50 such programs by 1986.

The Philippines fully held on to the supply-leading strategy up until the late 1970s, when it became obvious that the strategy was not working. In the early 1980s, under extreme pressure from outside creditors and domestic imperatives, the Philippine government did implement the financial liberalization program. The Anti-Usury Law was repealed in 1979. Interest rates on both loans and deposits have been fully market-determined since late 1985. Only about half of the specialized lending programs remain, and these are mostly those that operate at close to market rates and are less targeted. Many of the special privileges and subsidies enjoyed by the rural banks have been withdrawn and the "one town, one bank" policy is no longer followed. An extensive program to rehabilitate the rural banking system is now being implemented. It is expected that the rural banks will emerge from the process as

a smaller but stronger and more independent set of banks with a comparative advantage in lending to agriculture, particularly to low-income farmers (Dominguez, 1988).

Financial liberalization in the Philippines: The prospects

Do all the changes described above imply that the Philippine financial system has been liberalized?

At best, the Philippines' record at liberalization is mixed. Despite intense public resistance, the most obvious repressive factor—the interest rate structure—has generally been market-oriented since late 1985. Progress has been made toward minimizing the special, privileged lending and rediscount windows of the government and the Central Bank (CB). Specialization among the different types of banks has been slightly reduced. The CB is now actively shifting away from the role of development banker to that of steward of macroeconomic stability and monetary management. There is opinion, however, that despite the steps described above, the financial liberalization program is a "facade" (Montes, 1988). Several constraints to full financial liberalization remain, as outlined below.

The quotas. The government has not made any progress in repealing Presidential Decree (PD) 717—the Agri-Agra Law—which mandates that banks allocate at least 25% of their loan portfolios to agricultural projects and the beneficiaries of agrarian reform (Caiieda, 1988). In fact, there is legislation currently being debated in the Philippine Congress that aims

to strengthen the repressive features of PD 717by disallowing alternative investments in government securities as compliance by banks with the law. There is also a law that requires that at least 75% of deposits generated in a given geographical region be loaned out in that same region. Although the intent of these quotas may be laudable, the actual effects are contrary to the objective.

When the quotas are effectively enforced, loans are forced toward projects that are normally rejected by the banking system. Bankers face greater risks, incur greater levels of default, and the costs of such risk and default are borne by society as a whole, further constricting the availability of credit (ACPC, 1988).

The experience of the Philippines with quotas has shown that the banking system has been able to evade the requirements, in a manner consistent with their basic characters as enterprises, not social welfare agencies. The actual proportion of agricultural loans in the Philippine financial system's portfolio has averaged only 10% over the past two decades (Tolentino, 1988b). Banks routinely generate most of their deposit holdings in the rural areas, lend in the Manila area, but book or record some of the loans in the accounts of their provincial branches (Blanco and Meyer, 1988).

Taxation. The adverse effects of tax measures and policies on the financial market also need to be considered. The Philippine government currently taxes loans (the 5% gross receipts tax) and collects a final withholding tax of 20% on the interest income earned on deposits. Indisputably, these tax measures, aside from inappropriately shifting the task of tax collection away from the Bureau of Internal Revenue to the banks, also dampens the provision of loans and the incentives

to save (Llanto, 1988). In an era when interest rates on savings deposits are below the inflation rates of 8–10% per annum, the real deposit rate is negative and is further eroded by taxation.

Reserve requirements. A further constraint to liberalization is the high reserve requirement of the CB, which is currently 21% on most categories of deposits. Such high reserve requirements effectively tie up a large proportion of potentially loanable funds and cause the banks to incur opportunity losses, since the interest paid by the CB on the reserves is at a rate far below market levels at only 4–6%. Funds tied up in reserves also hamper the development and growth of the capital market, thus constraining long-term finance and the desirable lengthening of the term structure of the portfolio of the Philippine financial system (McKinnon, 1987). Some 95% of the system's loan assets are short-term (Tolentino, 1986). In an economy that must focus on long-gestating, diversified agricultural projects to get development moving, a mismatch between credit terms and project characteristics can be fatal.

Rediscounting and directed credit. The use of the CB's discount window as a tool for the allocation of credit to preferred sectors has often countermanded the window's more appropriate role in the management of the money supply. The most well-known of the two dozen or so rediscounting-based programs of the Philippines was the Masagana99 program for rice, where after providing initial seed funds—"special time deposits" at below-market rates for rice loans to rural banks—the CB rediscounted the resulting loan documents, again at subsidized interest rates. Similar programs were established for corn, various types of livestock, poultry, vegetables, fisheries and aquaculture, tobacco, cotton, and for the projects of cooperatives, rural youth, and farmers' and women's groups (Table 1). With the program's implementation, however, rapidly deteriorating repayment rates and weak portfolios

quickly dissipated the funds and forced their closure. By 1986-87, most of these programs and their remaining balances at the CB were consolidated into the Comprehensive Agricultural Loan Fund (CALF).

Specialized financing programs. Citing the perception that banks are "unsympathetic" to the credit needs of the poor, many Philippine government agencies established special lending programs directed at their particular clientele (Table 2). These programs were made part of the extension functions of the various agencies. Thus, about 30 of these programs were eventually set up in the departments (ministries) of agriculture, fisheries, natural resources, trade and industry, local governments, even education. As in the case of the CB's rediscounting programs, mounting arrearages, poor financial control, and lack of clear accountability forced the consolidation of at least some of these funds into CALF.

Liberalization in bank organization and branching. The CB has been quite restrictive in the issuance of licenses for the establishment of new banks and branches of existing banks. The basis for the CB's restrictiveness is its role in the protection of depositors and the maintenance of stability in the financial system. The problem is that the CB's exercise of this role results in unnecessary barriers to entry that limit the density of banks, minimize competition, and stunt intermediation, particularly in the rural areas. There is disagreement on the CB's use of savings trends by particular "service areas" as a principal criterion in its licensing decision. Moreover, the perceived arbitrariness in the definition of "service areas" by the CB was questioned (Chan, 1989). Although the government has recently made general statements reflecting a liberalized stance on branching, such has yet to be reflected in the CB' s actual handling of branching applications.

The reform of regulation. The general experience with financial liberalization has shown that the process is multifaceted. When the rules causing financial repression are reformed, the administrative and regulatory structures which implemented the oppressive rules also need to be reformed. The Philippines' reform experience has left in its wake a regulatory structure that is not compatible with private-sector ownership and management and minimum government intervention in business and enterprise. For instance, the fact that the government contributed most of the liquidity used for lending by the rural banks induced regulations whereby the government effectively ran the rural banks through detailed rules governing almost all aspects of bank operations and decision-making.[2] Thus, an extensive review of the regulatory structure is required to determine those regulations which continue to repress the financial system, since liberalization changes the premises upon which regulatory activities are founded. Improvements must also be made in the infrastructure of prudential regulation, in the capacity of the CB and other financial regulatory agencies to examine bank operations and portfolios and identify potentially failing banks.

Financial repression

In implementing the supply-leading strategy of finance, the Philippines' financial sector came to be "repressed." Financial regimes characterized principally by controlled low-interest rate policies have come to be described as "repressed" (McKinnon, 1973; Shaw, 1973). The primary feature of

[2] Including the requirement that the Central Bank approve the detailed operations budgets and capital investments program of the rural banks.

financially repressed economies are restrictions on interest rates, often rationalized not only as stimuli for investment but also as protection of the public against "usury." Financially repressed economies also suffer high reserve requirements imposed on bank deposits; compulsory credit allocations that reduce incentives for holding claims on the domestic banking system; the distortionary provision of subsidized loans; and the costly yet ineffective proliferation of specialized, government-run lending institutions created to cater to "preferred" sectors and borrowers. The distortionary effects of these restrictions are often exacerbated by price inflation. The results of repression include negative real deposit rates of interest on monetary assets. Thus the demand for money, and especially the supply by households of financialized savings, falls as a proportion of GNP.

Financialized savings, however, is the primary source of investment funds, particularly in developing countries where the stock and bond markets are small and the capital markets thin. Financial repression thus exacerbates the fragmentation of the financial market, where:

a. Interest rates on bank lending vary arbitrarily from one group of preferred borrowers to another.
b. The process of self-finance is impaired. The accumulation of cash balances in preparation for lumpy, discrete investments is made more costly.
c. Socially costly inflation hedges become attractive, private liquidity is minimized, and financial deepening outside of the formal banking system becomes prohibitive.

Financial repression and the informal financial market

An even more important adverse effect of financial repression is the reduction of the flow of loanable funds through the formal banking system. Thus, potential investors are forced to either self-finance or resort to the informal curb market for loans (McKinnon, 1988). Self-finance can be costly, since a process of accumulation of the required savings must be completed before large-scale investments are made. Thus, investment programs require more time than would be necessary through an efficiently functioning credit system that arbitrates between the time preference options of borrowers and savers.

In financially repressed economies, the informal financial market is observed to be very large and active. Detailed evidence on the informal market, like evidence available on the underground economy, is very sketchy. Fragmentary evidence from the Philippine economy and similar countries, however, indicate that in the rural areas, only three to four households out of ten ever borrow from any source (Tolentino, 1988a). Of those who do, three-quarters borrow from informal sources. The rest either self-finance or enter into quasi-lending arrangements, such as contract growing and production (Tolentino, 1988b).

The nominal interest rates charged in the informal sector are often considered to be very high. This is to be expected since default rates and servicing costs of such loans are very high. In addition, given that a significant proportion of lending is done by the informal sector, the total volume of bank lending is kept low, keeping per-unit lending costs high in the overall market.

Government intervention as a solution

Providing "solutions" to what is perceived as the relatively high level of interest rates and the constricted availability of loans has often been the rationale for government intervention in finance, and the cause of the consequent development of financial repression. Controls on interest rates and quotas on lending to favored clientele have had effects opposite to expectations and have instead exacerbated the problems these were intended to solve (Gonzalez-Vega, 1977). Governments that have enacted repressive regulations have also found that the task is not as straightforward nor as cheap for all concerned as it often seems.

For example, the U.S. government has traditionally provided a high level of implicit subsidies to American farmers via government guarantees on bonds issued by the extensive U.S. Farm Credit System. During the past few years, however, the U.S. government has found that it can hardly afford to cover the losses resulting from the guarantees, which have grown and pyramided over the years. Recent events in the system, as well as the symptomatic bank failures in Texas and Illinois, point to the fragility of the system dependent on government support. The U.S. government is now scaling down the guarantees and relying more on market forces. The European Economic Community is also now realizing the enormity of the long-term burdens that their system of agricultural credit and price supports implies, and initiatives are now being enacted to scale such subsidies down to more affordable and less distortionary levels.

Financial liberalization

The liberation of the economy from the constraints of repression has come to be accepted as a basic part of the agenda for development proposed by policy analysts and academicians (McKinnon, 1987). The basic prescription for a financially repressed economy, according to the received wisdom, is the freeing of interest rates so that real interest rates are kept positive, close to open market levels, and attractive enough to draw financialized savings into the stream of loanable funds. Mandated allocations of credit to favored or preferred sectors must be abolished. Appropriate macroeconomic policies, particularly the maintenance of a stable price level and an equilibrium exchange rate, complete the environment so that potential investors can judge the true scarcity price of capital, and invest according to an undistorted set of criteria based on the productive efficiency of the investment.

Several countries that adopted the Shaw-McKinnon prescriptions seem to have achieved remarkable success. At various times, Japan, Korea, Taiwan, and Singapore have maintained highly positive real rates of interest and rates of financial growth. Yet, other countries that incorporated the Shaw-McKinnon solutions in their economic liberalization programs ended in near-collapse, particularly in the Latin American cases of Argentina, Chile, and Uruguay. It is thus clear that the financial liberalization solution is not perfect, and much refinement is needed. The prescriptions for financial liberalization have come to be accepted almost as truisms in the community of policy analysts and academicians. In the larger world of government policymakers and politicians, however, acceptance of financial liberalization has been much

slower, ensnared in great reluctance and met with intense resistance. Even in countries where some progress in financial liberalization has been achieved, observations on recent experiences as well as the perceived exigencies in development requirements in the short term have made the possibility of reversals in policy and a renewal of repression all too real.

Foundations of an efficient agricultural credit system

The lessons from the case of the Philippines, most of which are replicated internationally, point to a short list of fundamental features of the appropriate environment for an efficient agricultural credit system. These include:

a. achievement and maintenance of stable macroeconomic conditions;

b. maintenance of "correct prices," particularly for agricultural outputs and inputs; and

c. enactment of an adequate system of laws and regulations for the financial system.

A stable macroeconomy. To achieve stability in the macroeconomy, inflation must be moderated and fiscal discipline enforced. High and volatile interest rates induce extreme conservatism among bankers and other financial intermediaries. The first losers from such conservatism are the relatively small and riskier borrowers, most of whom are farmers and fisherfolk. Fiscal prudence, particularly

for state enterprises, must be enforced. A critical problem, particularly for centrally planned economies, is the free access by state enterprises to the government budget and the central bank. Since state enterprises are often wasteful, nonviable operations, their losses are often unquestioningly made good or absorbed by the national treasury. The result is fiscal hemorrhage, which drains scarce public money, causes deficit financing, and pushes up interest rates and inflation even more. A "hard budget constraint" must therefore be applied on state enterprises, where these are forced to operate within predetermined cost limits and production targets.

"Correct" prices. That prices reflect the true scarcity or availability of goods is critical in the market economy. Prices reflect, in summary form, the entire set of influences on the quality and availability of the commodity. Thus, efforts that artificially push output prices up will induce unwanted surpluses, whereas price ceilings induce underproduction. In either case, the result is a mismatch between desired and supplied quantities. Examples of these pricing problems often involve food parastatals. Low food prices induced by price controls will cut down production and will lead to production shortfalls, triggering pressures that will necessitate periodic conflicts between users and producers, with government often helplessly caught in the crossfire.

Adequate financial infrastructure. For banks and financial intermediaries to serve their functions in an orderly fashion, appropriate rules for business must be created. These include the framework for the establishment and operation of banks and other financial intermediaries; standards for banking behavior; and protection and definition of property rights and their transfer, where necessary. The rules for banks have to do with the protection of depositors and the minimization of

collusive behavior among banks. Prudential regulation ensures the non-exploitative and judicious investment and handling of public funds. Property rights regulations define collateral and the enforcement of repayment. When all is said and done, however, the first and foremost precondition for successful agricultural lending is, of course, successful agriculture. Where policy succeeds to make agriculture profitable, then, lending to agriculture will be largely profitable.

The components of an efficient financial system

International experience points out six basic elements of a financial system responsive to the opportunities in the economy:

a. **Market-determined interest rates on loans and deposits** to maintain the viability of the lender and to provide sufficient remuneration for depositors.

b. **Savings mobilization** to gather idle funds from the public and to transform these into loanable funds. Such mobilization will require the maintenance of a positive real rate of interest or deposits, as well as introduce a range of alternative savings instruments to attract and maintain deposits.

c. **Non-directed finance,** which will ensure that finance will flow unimpeded, and in full quantity, to the most viable projects. Losses or revenue reductions engendered by investments in nonviable projects result in losses to society as whole.

d. **Closure or restructuring of failed or failing banks/ state enterprises,** where banks and enterprises that serve only to drain state resources should be closed, revitalized, or rehabilitated. All enterprises should be subject to a firm budget constraint and predetermined performance standards, and their management teams adequately trained.

e. **Encourage banking and branching,** where the widespread presence of financial intermediaries provides competition in the provision of banking services, resulting in lower costs to users and greater efficiency in services. The regulations that ought to be enforced by the government should cover principally capital adequacy and sound management. These same rules should apply to cooperatives as well.

f. **Informal lenders and alternative financial intermediaries** should be recognized as providing useful financial services that banks cannot supply. These informal institutions include traders, suppliers, dealers, even large-scale farmers, who provide credit which are closely interlinked with their primary business. These institutions are often quite maligned for real and imagined exploitation. Where such is true, the most effective way to reduce the exploitation is through the introduction of competition and the provision of effective market choices for the farmer.

The lessons, in summary

Regarding agricultural credit, the experience of the Philippines and other developing nations indicate the following specific measures to avoid, as well as measures to implement:

Avoid

- controls on interest rates; -instead, inflation must be controlled.

- quotas on loans or explicit direction of credit to specific sectors; instead, support the sectors with public goods such as research, extension, irrigation, market development, technology, and training.

- restrictions on bank organization and branching; instead, provide or encourage alternative financial intermediaries, including cooperatives.

Implement

In addition to avoiding the above measures, countries that wish to improve agricultural credit should implement programs that aim to:

- improve domestic capacity, both public and private, to manage financial institutions and administer credit programs;

- improve capacity to monitor and audit financial institutions;

- mobilize savings from the public, for the generation of loanable funds in banks;
- strengthen cooperatives and credit unions;
- recognize the services of informal/alternative lenders; and
- strengthen financial discipline for state enterprises and banks.

Table 1. Rediscounting programs in the Philippines

	Name of program	Implementing agency	Funding source	Eligible beneficiaries
1.	*Masagana 99* (M-99)	DA/NAFC (lead agency)	GOP	Rice farmers
2.	*Maisagana*	DA/NAFC (lead agency)	GOP	Corn farmers in all regions except Region 3
3.	*Gulayan sa Kalusugan* (GSK)	NAFC	IAFF/ALF; IRF	Vegetable growers in Regions 1, 3, 4, 5, 6, 9, 10, 11
4.	Supervised Credit for Orchard Crops	CBP, RB, BPI	GOP	Fruit producers
5.	National Soybean Production Program (NSPP)	DA/NAFC, CBP	YCF:MAF	Soybean growers in 17 selected provinces
6.	IAF-Virginia/Burley Tobacco Financing	CBP, PVTA	IAF:PVTA	Tobacco growers in Ilocos Norte, Ilocos Sur, Pangasinan, La Union, Abra, Mindanao
7.	PTA Supervised Farm Credit Assistance for Native Tobacco	PTA	ALF:PTA	Tobacco growers
8.	National Root crop Production Program (NRP)	NAFC, CBP	YCF:MAF	Potato and cassava growers

	Name of program	Implementing agency	Funding source	Eligible beneficiaries
9.	*Kalabaw ng Barangay*	CBP, BAI	IAFF/ALF:IRF	Cattle breeders
10,	*Bakahang Barangay* (Cow/Calf)	CBP, BAI	IAFF/ALF:IRF	Cattle raisers
11.	*Bakahang Barangay* (Fattening)	CBP, BAI	IAFF/ALF:IRF	Cattle fatteners
12.	*Kambingang Barangay*	CBP, BAI	IAFF/ALF:IRF	Goat raisers
13.	*Biyayang Dagat*	BFAR	FLGF	Fishermen
14.	CB-MECS Supervised Experience Educational Program	CBP, DECS	GOP	Agricultural students
15.	*Kabataang Sakahan para sa Kaunlaran*: Out-of-School Youth (KASAKA:OSY)	CBP, DA	KASAKA:OSY	Out-of-school youths on agri-business projects
16.	Intensified Rice Production Program (IRPP)	DA/NAFC, CBP	YCF:IRPP	Rice farmers in 30 selected provinces
17.	Expanded Com Program (ECP)	DA/ NAFC,CBP	YCF:MAF	Com farmers in 46 provinces
18.	Cotton Financing Program (CFP)	Philcotton, CBP	ALF:PCC	Cotton producers
19.	Grains Quedan Financing	QUEDAN	Nat'l Gov't/ Fund earnings	Franchised bonded warehouse
20.	Agricultural Loan Fund (ALF) Project	CBP	IBRD, USAID	Single proprietorship, partnerships, corporations or cooperators
21.	Integrated Rural Financing (IRF) Program	LBP	DA/CALF	Farmers with landholdings of 7 ha, (PD 27), 5 ha, and less
22.	Industrial Guarantee and Loan Fund (IGLF)	CBP/DLG	The World Bank	Manufacturing concerns and those service industries supportive of manufacturing activities such as warehousing, repair shops, etc.

Note: Programs no. 1 to 19 are SID-funded programs which were eligible for rediscounting up to 1985 (CBB Circular 1086).

Source: Profile of Agricultural Credit Programs, Agricultural Credit Policy Council.

Table 2. Seed funding programs in the Philippines

	Name of program	Principal Implementing Agency	Funding source	Eligible beneficiaries
1.	*Kilusang Kabuhayan at Kaunlaran* (KKK)	KKK Secretariat	GOP	Small entrepreneurs
2.	*Pagkain ng Bayan*	Pagkain ng Bayan	GOP	Provincial/city governments constituents
3.	FSDC Programs	Farm System Development Corporation (FSDC)	GOP	Integrated Services Associations (ISAs)
	a) Irrigation System/Infrastructure Development			ISAs
	b) Adaptive Farm Technology Development			ISAs
	c) Gasifier/Woodlot Project			ISAs
	d) KAISA-Agro Industries • Livestock Center • Feedmill project/enterprises • Rice Integrated Cooperative Enterprises (RICE) • Trading project			*Kalipunan ng mga ISA*s in Ilocos Sur and Quezon
4.	Taal Lake Development Program (TLDP)	FSDC-TLDSP	GOP	Small-scale fishermen along Taal Lake
5.	CARE (Coastal Area Resource and Enterprise Development) Program	FSDC	GOP	Coastal fishermen
6.	Laguna Lake Cooperative Development Lakeshore residents along Laguna Lake Program	FSDC, LLDP	GOP	Lakeshore residents along Laguna Lake
7.	Cooperative Development Loan Fund	CDLF, MAF	GOP	Registered cooperatives/SNs
8.	*Samahang Nayon* Support Program	BACOD	GOP, USAID	SNs

	Name of program	Principal Implementing Agency	Funding source	Eligible beneficiaries
9.	Cooperative Marketing Program	BACOD, CBP	GOP, USAID	AMCs, SNs and other cooperatives in 15 provinces
10.	Palawan Integrated Area Development Project	PIADPO/CB	ADB/CB	Farmers engaged in agricultural products crops in Palawan
11.	Philippine Aquaculture Development Project	CBP, DA-BFAR	ADB	Residents of Aklan, Capiz, Iloilo; owner/lessee of fishpond
12.	AMP: NFA : Private Sector Modernization Program	AMPO/NFA	ADB	Farmer-cooperatives of modular farms; farmer associations; individual farmers
13.	AMPO: NAF: Thresher Amortization Program	AMPO/NFA	ADB	Regular assignees of NFAs milling contracts
14.	DBP's Special Agricultural, Small & Medium Industries Lending (A-SMILE)	Devt. Bank of the Philippines (DBP)	Social Security System (SSS)	Entrepreneurs engaged in projects related to agriculture, manufacturing and trading
15.	BKKK-*Kabuhayan sa Nayon*	Technology and Livelihood Resource Center (TLRC)	National Livelihood Support Fund (NLSF)	Preferably clients of TLRC; those with no outstanding loan in arrears in any BKK lending program; residents in urban areas
16.	Laguna de Bay Fishpen Development • Project	LLDA	GOP/ADB, OPEC	Resident-fishermen in Laguna Lake areas
17.	Quedan Financing for Food and Agricultural Marketing Enterprises	Quedan Guarantee Fund Board	National Government/ Fund Earnings	None-scale type proprietors are priority borrowers (business must be existing)
18.	Northern Palawan Fisheries Development Project	Philippine Fisheries Development Authority	ADB/ Government Counterpart	Fishermen in project areas who pass eligibility criteria
19.	Livelihood Enhancement for Agricultural Development (LEAD)	Dept. of Agriculture (DA)		Farmers' organizations, fishermen's groups
20.	Multi-Livestock Dispersal Loan Program	Bureau of Animal Industry (BAI)	GOP	Member of cooperative or farmers' organization for at least 1 year

	Name of program	Principal Implementing Agency	Funding source	Eligible beneficiaries
21.	CDLF-BANGKOOP: CRB Capital DNACPC-CALF Infusion Program	DA/ACPC-CALF	CALF	Cooperative rural banks
22.	CDLF-BANGKOOP: SANDUGUAN: Rice Seed Production Project	DA/ACPC-CALF	CALF	Identified Sanduguan farmer-members
23.	Export Industry Modernization Project II	TLRC	Overseas Economic Cooperative Fund (OECF) of Japan	Small- and medium-scale entrepreneurs
24.	Northern Samar Integrated Credit Financing Program	NSIRDPO, Visayas Cooperative Development Center (VICTO)	Australian International Development Assistance Bureau/Coop. Fund	Organized groups (farmers, landless folk, workers, tenants, fishermen)
25.	*Tulong sa Tao* Program	Dept. of Trade and Industry - Bureau of Small and Medium Business Development (DTI-BSMBD)	National Government	Micro-entrepreneurs, including government retirees (civil and military) and political ex-detainees
26.	Countryside Economic Development Program	Philippine Coconut Authority (PCA), United Coconut Planters Bank (UCPB)	PCA	Coconut farmers owning less than 20 hectares of land planted to coconuts
27.	NSLF-Wholesale Lending Program	Office of the President/ National Livelihood Support Fund (OP/NSLF)	Consolidated funds of the KKK	Must have no outstanding loan in any KKK/ NLSF project; family income of individual borrowers or beneficiaries of borrowing organizations must be below poverty threshold.

	Name of program	Principal Implementing Agency	Funding source	Eligible beneficiaries
28.	BKKK: *Balikatan sa Kabuhayan*	TLRC	NLSF	Preferably clients of 1LRC; do not have any outstanding loan in arrears in any BKK lending program.
29.	The Small and Medium Industry Loan Program: A Land Bank-SSS Partnership (SMILP)	Land Bank of the Philippines (LBP)	Social Security System (SSS)	Sole proprietorships, partnerships, and/or corporations with assets and/ or sales at PHP 5M, which are involved in: a) agribusiness, b) manufacturing, c) utilities, d) transportation and communications, e) commercial production, particularly of food, and f) export-related businesses
30.	Financial Incentives for Economic Livelihood Development Scheme for Small Coconut Farmers' Organizations (FIELDS-SCFO): A PCA-LBP Tie-Up	Philippine Coconut Authority (PCA)/ LBP	•PCA	Small coconut farmer beneficiaries who are active members of accredited farmers' organizations and operate coconut farms of 10 hectares
31.	Agrarian Livelihood Program	Agrarian Livelihood Program Office (ALPO)	Bagong Kilusang Kabuhayan at Kaunlaran-National Secretariat (BKKKNS)	Agrarian reform beneficiaries in 10provinces
32.	Agro-Industrial Technology Transfer Program (AITTP)	Technology and Livelihood Resource Center (TLRC)	Overseas Economic Cooperation Fund (OECF) of Japan	Producers/processors of agri- or aqua-based projects

Lending programs implemented since 1973 other than those which utilize rediscounting facilities.

Source: Profile of Agricultural Credit Programs, Agricultural Credit Policy Council

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CHAPTER 7

The Cooperative Guarantee and Loan Fund: A proposed program for lending to the poor through cooperatives

Working Paper No. 87-05
Agricultural Credit Policy Council
(20 November 1987)

V. Bruce J. Tolentino

Introduction

In the aftermath of social unrest that fuelled the 1986 People Power Revolution, it became clear that:

a. A response must be made to the popular call for government to provide a special facility for lending to the poor.

b. Government lacks the skills and resources necessary to independently respond to such a call, and the involvement of the private sector is thus indispensable.

c. Cooperatives and credit unions are effective institutions for pooling the limited resources of the poor, and for intermediating between their members and fund sources.

d. While the only feasible long-run source of credit are private-sector banks, interim arrangements to provide for a transition from non-bank to bank lending must be established. This will allow an opportunity for banks to become familiar with lending to the poor through cooperatives, and for the cooperatives to learn how to work with the banks.

The Cooperative Guarantee and Loan Fund (CGLF)

A proposal is thus presented to create the "Cooperative Guarantee and Loan Fund" or CGLF, which aims to encourage lending by banks to cooperatives through a combined loan and guarantee scheme. The scheme will be based on an equal sharing of project financing requirements between the cooperative, the bank, and the government. All transactions will be conducted through the banks. Cooperatives will apply to the banks for loans. The banks will exercise their normal creditworthiness appraisal procedures. Should the cooperative and its project be found creditworthy, then the total loan requirements of the project will be shared as follows:

- Banks: 1/3 of the loan from its own resources;
- Government: 1/3 of the loan as a special time deposit in the bank; and
- Cooperative: 1/3 as equity in the project.

No arbitrary limits to loan and project sizes are envisioned.

Guarantees

In addition to government assistance for funding, guarantee coverage may be arranged for up to 85% of the bank's 1/3 exposure. In certain cases, the cooperative's relending exposure to its members may also be covered by a guarantee.

The Philippine Crop Insurance Corporation (PCIC) is perhaps the best institution for the provision of the above guarantees.

The cooperative's equity

The cooperative's 1/3 equity in the project may not be as large as it seems. The definition of acceptable equity may be broadened and relaxed to include non-purchased and noncapital inputs like labor. The requirement of an equity contribution is consistent with the cooperative's basic objective of share contributions and the mobilization of member capital.

Market-oriented interest rates

Interest rates applicable to the projects under the program must be market-oriented. In general, the rates will be keyed to the Manila Reference Rate on the short-term debt (STD) between the government and the bank. Lending rates between the bank and the cooperative are subject to negotiation between them.

CGLF: A transaction program

The long-run objective is for the government to eventually pull out of its direct lending role. The STD contribution must be limited to a maximum of one or two cycles, beyond which the banks must take over the share of the government. The cooperative's equity should be maintained and even increased. After the initial cycles, the cooperative must have built up a track record of performance and the bank would have developed an in-house capacity to work with cooperatives and farmer groups.

Administrative structure

With a few modifications, the existing structure of the Cooperative Development Loan Fund (CDLF) can be used to operationalize the CGLF. It is necessary to introduce the guarantee features and the role of the bank, and to strengthen the appraisal and collection capacity of the staff.

The existing portfolio of the CDLF can be expanded with additional contributions from the recent Dutch grant through the National Agricultural and Fishery Council.

CHAPTER 8

Policy statement: Fisheries development and the proposed Fisheries Development Bank of the Philippines[1]

Policy Brief Vol. 2 No. 5
Agricultural Credit Policy Council,
(31 July 1989)

House Bill (HB) 21886 proposes the establishment of the Fisheries Development Bank of the Philippines, which will "secure the balanced development of an integrated fishing industry by extending loans and financial assistance to individual fishermen, fishing boat operators, fishpond and fish pen operators, fish processors, fish packers or canners, ice and refrigeration plant operators, net manufacturers, manufacturers of other fishing equipment or supplies, and those engaged in aquaculture, fishing operations or connected with services necessary for the promotion and development of an integrated fishing industry."

[1] This document is based on a summary paper written by Dr. Richard L. Meyer of the Ohio State University, May 1989. Developments after May 1989 were added by ACPC Staff.

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

The proposed Fisheries Development Bank of the Philippines shall, among various powers, be empowered to:

- Grant loans to fishermen for the (A) construction and/or purchase of fishing vessels, fishing gear, and equipment; (B) establishment of fish processing plants, refrigeration, and ice plants; (C) purchase of refrigeration and cold storage trucks exclusively for transporting fish and fish products; (D) establishment of slipways and shops to service the needs of the fishing industry; (E) construction and improvement of fishponds; (F) preparation of project studies; and (G) hiring of consultants to operate aquaculture and fishing projects.

- Grant operating loans to cooperatives and other associations for the purpose of processing, marketing, and exporting fish and fishing products; and

- Issue bonds, raise loans, or assume other obligations.

Comments on HB 21886

While its intended beneficiaries uphold the Bill as "necessary and deserving of national support," the creation of the Fisheries Bank poses negative repercussions which may, in the long run, outweigh the benefits it professes.

1. Government subscription of PHP 250 million to the Bank's capital stock has a high alternative cost.

The creation of the Bank contradicts the current efforts of the government to privatize government-owned and controlled

corporations (GOCCs). The Asset Privatization Trust has yet to bid out 299 GOCCs to raise funds for the Comprehensive Agrarian Reform Program (CARP), and yet here is another bill which requires the Government to fully subscribe to the Bank's capital stock: at PHP 100 million as initial subscription within one year from the approval of the Act and PHP 30 million annually thereafter for a period of five years. Such large sums are better used for infrastructure development.

2. It is not good policy to target loan beneficiaries.

The Bill imposes restrictions not only on the possible uses of funds from loans granted by the Bank but also on the allowable uses of equipment purchased through these funds. As an example, it is stipulated that refrigerator and cold-storage trucks financed by these loans are to be used exclusively for the transport of fish products.

The Bank then becomes a disservice to agriculture because it defies crop diversification thrusts. It may also become a disservice to the fisheries industry in particular, since concentration of the Bank's loan portfolio in the fisheries sector would mean a greater risk borne by the Bank. Portfolio concentration would subject both Bank depositors and borrowers to possible supply disruptions.

3. A concentrated loan portfolio means greater risk.

Financial intermediaries are able to reduce risks by diversifying their loan portfolios. This enables them to, in effect, borrow short-term from their depositors and transform these funds into long-term loans.

The concentration of the loan portfolio in a single industry, especially to subsistence fishermen, greatly increases risks since the borrowers in this case would be subject to common external shocks. Marginal fishermen are, at present, not covered by crop insurance. Given the risky nature of the Bank's loan portfolio, it is doubtful whether the Bank can effectively compete in the market for funds and savings. In the long run, this would stymie the volume of funds flowing into the fisheries industry, unless the Bank is continually supported by government subsidy.

It should be noted that a fisherman's need for sources of credit is as great as his need for alternative channels into which his savings may be put. This can be met by encouraging branching of existing banks in areas more accessible to small fishermen.

4. Interest rates should cover intermediation costs.

If a bank is to operate without subsidy, then the rates of interest it charges its borrowers must cover the full costs of funds, including the cost of borrowing the funds to be relent, the full administrative and monitoring costs, and any allowances for bad debts. The full cost of funds varies depending on the riskiness of the project financed. Thus, optimal policy requires that the rates vary according to project risk.

The Bill, however, imposes a ceiling on the interest rates that the Bank may charge, which shall be fixed by the Secretary of Finance and approved by the Monetary Board. This, in effect, guarantees that the Bank interest rate policy is rigid and grants subsidy to riskier borrowers.

5. Subsidies benefit larger fishermen more than smaller ones.

If the intention of creating a special bank is to provide subsidies to subsistence fishermen, then the strategy requires repackaging because the amount of subsidy one gets is proportional to the size of loan one obtains.

A freely flexible interest rate policy is essential to ensure that riskier projects are charged higher rates. The relationship between interest rates and riskiness is, on the other hand, essential in ensuring, first, that loan beneficiaries seek to attain their objectives through the least risky means and, second, that any increase in project riskiness is adequately compensated for by an increase in probable profits to enable the borrower to pay the higher interest charges.

Commodity-specific credit does not solve the problems of the fisheries sector

Loan targeting under a special credit arrangement for a specific sector has been empirically proven to entail high administrative expenses and tends to perpetuate the "dole out" syndrome. The government should veer away from this financing strategy to preserve the gains achieved in improving the rural financial system and in support of the on-going climate of recovery.

On-going programs such as the guarantee facilities under the Comprehensive Agricultural Loan Fund (CALF) in effect enhance the farmers' or fishermen's profitability and

bankability. Once a borrower is bankable, credit will naturally flow to him regardless of the commodity he is raising or the location of his project.

Besides, studies show the need to focus on the conservation of depleted fisheries resources, to move our small fisheries sector from capture to culture, and to alleviate the over-exploitation of offshore fishing grounds of small fishermen. The development of the fisheries sector should be focused along these lines.

CHAPTER 9

Policy statement: On the taxation of interest income from financial savings

Policy Brief Vol. 1 No. 6
Agricultural Credit Policy Council
(June 1988)

One of the major requirements of a growing economy is the availability of financial capital for investment and capital formation. Where there is a huge savings-investment gap, the economy becomes constrained to tap foreign resources to fill this gap, especially in the presence of an imperfect and developed capital market. This exercise takes the form of grants, aid, soft loans, or commercial loans. Indeed, the necessity of foreign borrowing to meet the country's funding gap has lately been the subject of much discussion.

The problem of a huge savings-investment gap can be effectively dealt with by vigorous and sustained domestic resource mobilization. This consists of educating the public of the virtues of private saving and creating an economic and financial environment conducive to transforming hoarded

assets like jewelry and land into financial savings in banks and other financial intermediaries.

To induce savings in financial assets, there must be positive real returns. Recent financial reforms, which allowed interest rates to be determined by the market, is a concrete step in the right direction. Savers are profit maximizers; they compare alternative real rates of return to assets in their portfolios. To maintain the positive real return to financial savings, the appropriate fiscal and monetary policies which reduce the inflation rate to tolerable levels have been pursued by the government.

However, there still is an important area of reform and this is the present tax treatment of financial savings. Sections 21(e), 24(e), and 25(a) (6) of the National Internal Revenue Code, as amended, provide that interest from any Philippine currency bank deposit and yield from deposit substitutes and from trust funds and similar arrangements derived from sources within the Philippines and received by a citizen or resident foreign corporation, shall be subject to a final withholding tax of 20% which shall be withheld by the payor-corporation and/or -person.

This revenue measure has collected for the government an annual average of PHP 1 billion over 1981-1988. It is a relatively minor revenue collection device and represents a "reform" in the tax system only insofar as the government's revenue-generation campaign is concerned. Prior to the enactment of a final withholding tax at source, interest income is supposed to be declared by the taxpayer as part of his total gross income for income tax purposes. Nevertheless, the bank deposits secrecy law provided a convenient tax loophole for unscrupulous taxpayers because it prevented verification

by the Bureau of Internal Revenue (BIR) of interest income from bank deposits. Hence, the enactment of a 20% final withholding tax.

This was the main reason for imposing the final tax on bank deposits. On the other hand, the same tax treatment has been accorded to deposit substitutes in view of the BIR's difficulties in monitoring and accessing information on money market transactions for tax purposes.

The Agricultural Credit Policy Council (ACPC) submits that this particular tax is no longer relevant. It is anti-developmental and must be scrapped. Policymakers must balance the revenue needs of government with the larger negative implications of this tax.

The exhortation to mobilize domestic savings and keep them in the form of financial assets will be a hollow pronouncement if government then conveniently taxes these savings. Government can, in fact, be accused of inconsistency.

From the Tax Code's point of view, interest income, like other types of income, is legally taxable. However, there is a valid reason for advocating the exemption of interest income from any form of taxation. The case for tax exemption is built on the following points:

- The tax works at cross purposes with the objective of promoting savings consciousness; and

- Taxation of savings weakens domestic resource mobilization.

Instead, a progressive expenditure or consumption tax can be considered. In a developing country there are ample reasons for changing the tax base from financial savings to the public's expenditure or consumption level.

Saving is a desirable objective and a tax imposed on it militates against its growth and widespread acceptance. On the other hand, a consumption tax can be designed to be as progressive or discriminating among alternative consumption activities as can be. It is about time that our tax authorities consider a consumption tax and totally support the domestic resource mobilization efforts of the economy.

CHAPTER 10

Policy statement: Legislated interest rate ceilings on loans: pro- or anti-small borrower?

Policy Brief Vol. 11 No. 4
Agricultural Credit Policy Council
(16 May 1989)

Several legislative bills have been proposed in both the Senate and the House of Representatives that either place a ceiling on the interest rate on loans or limit the intermediation spread of banks. Examples of these are House Bill No. 19740 and Senate Bills No. 202, 474, and 638. While the objectives of these bills are laudable in that they aim to help small borrowers, the end results are likely to be harmful rather than beneficial to the targeted group, particularly those in the rural and agricultural sectors.

Past experience in the Philippines, as in other countries, has shown that anti-usury laws and legislated ceilings on loan interest rates have been ineffective, unenforceable, and counterproductive. They also harm the very sector they mean to protect, i.e., the small borrowers. This paper aims to show why. Indeed, for reasons of equity, the welfare of small borrowers

must be our concern. Other alternatives to reduce the interest rate, however, may work better toward achieving this welfare objective. Foremost among these are measures which will reduce the cost of intermediation of lenders. This can be achieved through such legislative moves as the abolition of the gross revenue tax (GRT), of the Agri-Agra Law (PD 717), and of the 20% withholding tax on savings deposits; and measures that will decrease the reserve requirement of banks and the level of domestic borrowing by government. Such measures should result in lower intermediation cost and, therefore, reduced loan rates.

The Usury Law of 1916

Interest in helping small borrowers through a legislated cap on the lending rate is not new. As early as 1916, Republic Act (RA) 2655or the Anti-Usury Law *(An Act Fixing Rates of Interest Upon Loans and Declaring the Effect of Receiving or Taking Usurious Rates, and For Other Purposes)* was passed.

This law essentially legislated the lending rate and authorized the Monetary Board to prescribe the maximum interest rate on loans, as well as to change this rate "when warranted by prevailing economic and social conditions."

Various amendments to RA 2655 were made from 1916 to 1980, all intended to strengthen the law and increase its implementation. These amendments are embodied in RAs No. 2992, 3291, and 4070; Commonwealth Act No. 399; and Presidential Decrees No. 116, 858, and 1684.

Usury Law abolished

With the enactment of interest rate reforms in the early 1980s, the Usury Law was in effect abolished. There were important reasons for allowing this law to lapse, and although it took the country more than half a century to realize the folly of its past legislative actions, we have learned something valuable in the process. Ceilings on loan interest rates—in both formal and informal markets—should not be legislated. Why?

The consequences of interest rate ceilings

The effects of setting loan interest rates below the rate determined by the market can be summarized as follows:

1. It results in a decrease in the supply of credit, rather than an increase as the law proposes to achieve. At the ceiling rate, the amount lenders are willing to provide is smaller than the level they would have been willing to lend at the market rate, and less than the amount borrowers would like to avail of that rate.

2. With the shortage of credit, the group most discriminated against are the small borrowers, the sector which the law aims to protect. The result is that small borrowers, particularly rural households and farmers, have less access to credit than they previously had.

3. The reasons for (2) can be traced to the following:

   a. Interest rates on loans must be high enough to cover the lender's costs. The total cost of lending includes administrative costs, default costs, arrearages burden, and costs of intervention (see Fig. 1).

   b. If interest rates are legislated downwards below what the market would dictate, lenders will:

      • increase other (non-interest) charges on the loan to cover their cost; or

      • ration out credit so that only the 'more worthy' credit borrowers—the larger, collateralized, less risky ones—will have access to loans.

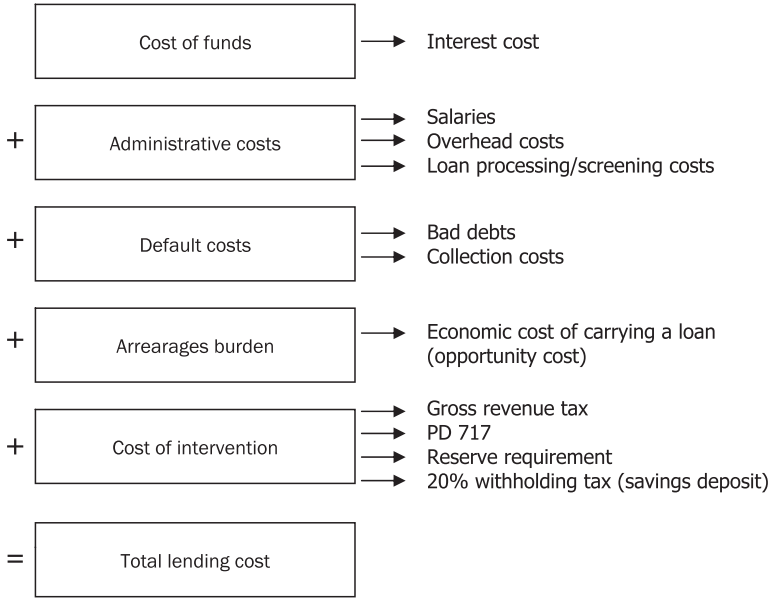


Figure 1. Costs faced by a bank/financial intermediary

4. Interest rate ceilings on loans work against efforts to mobilize savings. Pegging down the interest rate on loans will have a depressive effect on the deposit rate and will therefore dampen the incentive to save. As a result, the major potential source of lending funds, i.e., savings, will dry up.

5. Artificially low interest rates encourage corruption, capital flight, and unproductive investment (Sicat, 1983).

6. Other effects of holding interest rates below the market rate (Adams and Vogel, 1988) are:

   a. It leads to a further concentration of income distribution;

   b. Productive resources are allocated to less efficient projects; and

   c. The viability of the financial system is undermined.

In addition, any blanket application of a ceiling on loans is not feasible because of at least three reasons:

- Types of lenders vary widely. This is true even just within the formal financial market, but much more when we consider the informal sector. Formal lenders are made up of banks, credit unions, financing companies, pawnshops, savings and loan associations, and cooperatives. Informal lenders are also wide-ranging in type and include moneylenders, millers, input dealers, farmers, relatives, friends, neighbors, merchants/traders, and landlords.

- The operating conditions of lenders vary due to differences in their size, location, cost and market structure, clientele, and range of services offered.

- Market conditions are continually changing. Therefore, any interest rate that is legislated cannot be expected to remain being the "correct" rate as market conditions change. The rate structure, once legislated, becomes inflexible and cannot keep up with changes in such important variables as the rate of inflation. This is the case even if the legislated rate undergoes an annual review by a body like the Monetary Board.

Analysis by the TBAC provide additional information on this issue:

- What matters to the borrower, especially the small borrower, is not the cost of credit but its availability.

- The explicit cost of credit, e.g., the interest rate, represents only a small proportion (6 to 8%, depending on the source) of the total cost of production incurred by a farmer. Other input costs such as labor, fertilizer, and pesticides make up the greater part of the farmer's cost of production (Management Association of the Philippines, 1986).

- Usury laws are or unenforceable given the nature of transactions in the informal market. Costs of enforcement are high and are likely to outweigh the benefits.

Based on the foregoing, the Agricultural Credit Policy Council (ACPC) thus holds the following position:

ACPC policy statement

The ACPC does not favorably endorse anti-usury legislation and legislative ceilings on loan interest rates. Past experience in the Philippines, as in other countries, has shown that such laws are ineffective, unenforceable, and counterproductive. They also harm the very sector they mean to protect, i.e., the small borrowers.

ACPC instead endorses other alternatives to reduce interest rates, such as those aimed at reducing the cost of intermediation of lenders. Such measures, which include the abolition of the gross receipts tax, the Agri-Agra Loan Quota Law, and of the 20% withholding tax on savings deposits will be more effective in reducing interest rates on lending and, therefore, in helping small borrowers.

CHAPTER 11

Suggested guidelines for credit programs

Policy Brief Vol. 1 No. 88-08
Agricultural Credit Policy Council
(8 November 1988)

The Agricultural Credit Policy Council (ACPC) is often asked to comment on and provide reactions to proposals related to the planning and organization of credit programs, or programs with credit components. Hereunder is a brief list of features which should be part of any credit program. The list was prepared based on the experience of the Philippines and of many other countries over the past twenty years.

A. On the role of the implementing government agency

1. Government line agencies must focus on technical assistance, project development, and packaging services. The banks provide the funding. If the technical assistance is sound, then the projects should be viable and the banks should be more interested and willing to lend to these projects.

2. Government services should include brokering between borrowers and banks.

3. Government agencies must also focus on providing or facilitating the provision of other critical support services such as transportation, irrigation, roads, public markets, electrification, ports, extension services, seeds, and other rural infrastructures and services. These services/facilities are critical components of the rural delivery system, among which the financial intermediation subsystem is just one.

B. On the role of the banks and participating financial institutions

4. Banks provide the loans and perform cash handling and collection functions.

5. In general, small projects should be presented to small banks, credit unions, or cooperatives. Proposals for large loans should likewise, in general, be presented to large banks.

6. Potential borrowers should "shop around" and contact as many banks as possible since different banks have different policies and standards.

7. The final decision on whether or not a loan will be made must rest with the banks or financial institutions (including cooperatives and credit unions) participating in the project. The basic test of the bankability of a project is the acceptance or non-acceptance by the banks.

8. The financial institutions participating in the project must share a portion—at least 15%—of the funding requirements and/or the risks involved in the project.

C. On the role of donor agencies and external funding

9. In general, the Philippine banking system is capable of supplying most of the financial requirements for short- and medium-term (less than three years) projects.

10. Donor agencies and external funding is welcome to support the following components of credit projects:

    - project development
    - project packaging
    - group organization or training
    - feasibility study preparation
    - technical and management assistance
    - monitoring costs
    - evaluation costs

11. Donor funds for relatively large-scale (more than PHP 10 million), long-term (over 5 years), heavily technical, and unusually high-risk projects are welcome.

12. Seed funds may be secured to serve as initial funding for projects. Such seed funding should still be coursed through banks. These funds provide additional liquidity for the banks to undertake new, innovative, and riskier ventures.

13. Seed funding for short-term projects may be secured only:

- to the extent that banks and participating financial institutions are demonstrated to be unable to provide full funding;
- when seed funding is provided only for a limited period (not more than one or two production cycles);
- when seed funding is provided only for part of the project requirements, with the balance covered by group equity and partial bank funding.

D. On the savings mobilization/capital build-up component

14. Credit programs must incorporate a savings mobilization or capital build-up program.

15. It is preferable that the savings generation phase be started before the lending phase. The savings performance of potential borrowers will establish a track record and a measure of debt capacity of the borrowers.

16. The savings mobilization or capital build-up component is also critical in developing the internal, independent liquidity of the credit program without the need for further funding from outside sources.

17. Savings accounts deposited with the lending banks also serve as partial collateral for loans and thus enhance access by the depositors to loans, i.e., especially in cooperatives where loans are a multiple of deposits.

E. On the equity contributions of borrowers

18. The savings mobilization/capital build-up component also provides the mechanism for borrowers to be able to raise an equity counterpart for the project. Such contributions lessen the debt burden of the borrower and increase the probability of repayment.

19. The equity contribution of the borrower must not necessarily be in cash. Depending on the standards of the financial institution participating in the project, labor, raw materials, project sites, and other facilities may be acceptable.

20. Given the above broad definition of equity, the minimum expected from the borrower should be 20% of the total size of the project.

F. On the interest rate

21. As a general rule, the interest rate borne by a project should not exceed its expected internal rate of return (IRR). Projects with IRRs lower than the prevailing market rate of interest should not be undertaken.

22. Interest rates to be charged the borrowers must cover the full cost of funds, including cost of borrowing the funds to be relent, the full administrative and monitoring cost, any allowances for bad debts, and any applicable foreign exchange risk premiums.

23. When the full interest rate estimated to be charged in the project exceeds the market rate in the area, certain costs may be borne by the project budget, up to a limited time and extent only. These costs may include project development costs, training costs, and monitoring costs.

G. On collaterals and guarantees

24. Where collaterals of some form are available, these should be linked to the loan. Collaterals are not necessarily real estate. In certain types of projects, especially where non-banks are involved, chattel mortgages on equipment maybe acceptable, as well as any improvements on and pledges of various types of personal property. It is the documented experience in all credit programs that some level of collateral greatly increases the chances of repayment and thus program viability.

25. Coverage of the project by one of the credit guarantee programs—like those of the Guarantee Fund for Small and Medium Enterprises (GFSME), Quedan Guarantee Fund Board (QGFB), Philippine Crop and Insurance Corporation - Comprehensive Agricultural Loan Fund (PCIC-CALF), Industrial Guarantee and Loan Fund (IGLF), and the Bagong Pagkain ng Bayan - Guarantee Fund for Local Government Units (BPnB-GFLGU)—can substitute for collateral to some extent.

CHAPTER 12

Exploring new horizons in farm credit delivery through the *Comprehensive Agricultural Loan Fund*

Working Paper 87-09
Agricultural Credit Policy Council
(June 1987)

V. Bruce J. Tolentino and Leo P. Cañeda[1]

The national perspective

The national program for economic recovery is heavily anchored on rural and agricultural development. The reliance on agriculture is explained by the following:

- The Philippine economy has a comparative advantage in agricultural production.
- Agriculture has demonstrated strong growth linkage effects.

[1] Messrs. Tolentino and Cañeda are Executive Director and Senior Economist, respectively, of the Agricultural Credit Policy Council.

- The growth of agricultural output has been increasing relative to other sectors despite policy biases against agriculture.

In particular, the last three years saw agriculture as the leading source of growth in a period of economic difficulties. While other sectors of the economy performed negatively, agricultural output growth even doubled. By 1986, the share of agriculture in the country's gross domestic product (GDP) had expanded to about 30% from an average of 26% in 1980-1985.

However, the agricultural credit system has been found to have not been truly supportive nor responsive to the requirements of agricultural development. Apart from already low credit support to agriculture (i.e., agriculture receives only about 9% of the total credit disbursements of the banking system), the volume of agricultural credit releases, particularly in the last three years, has been declining. The ratio of agricultural loans to output likewise has been decreasing. This implies that less and less credit supported each peso value of agricultural output produced. Total agricultural production loans granted by the banking system in 1986 reached only PHP 25.1 billion—9% below its comparable level a year before and less than half of the estimated total farm credit requirements of about PHP 60 billion.

The slowdown in agricultural financing has been traced to (A) inherent problems in agricultural lending, such as high risk/high cost and low profitability of agricultural projects;(B) impairment of the agricultural credit delivery structure; and (C) other "reasons" including the limited experience/ expertise of banks in small farm lending, slow utilization and fragmentation of agricultural program funds, and, to some extent, weak demand.

Nonetheless, prospects in agricultural financing appear bright. An increasing number of banks view agriculture as a sunrise industry and are thus more than willing to expand their involvement in agricultural lending. The export possibilities for some commodities are improving. The government is strongly committed to pursue an agro-based economic development strategy. There is also a relative lack of investment opportunities elsewhere in the economy. Finally, the ongoing effort to rehabilitate rural banks affected by agricultural loan defaults is expected to contribute substantially to the unclogging of the farm credit delivery system.

The Comprehensive Agricultural Loan Fund

Against this backdrop, the Comprehensive Agricultural Loan Fund or CALF was formally launched on 19 February 1987 to address the problems facing the agricultural credit system and to sustain or support initiatives undertaken to promote the flow of credit to agriculture.

Specifically, CALF aims to:

1. First and foremost, encourage lending to small agricultural projects by private banks by assuming up to 85% of the risks involved; and

2. As CALF involves the integration of several agricultural loan funds into a single fund, to professionalize the management of these funds, minimize their administration costs, and nurture their growth through optimum investments.

The ultimate consolidation of about 49 separate agricultural loan funds under CALF is likewise expected to enable the Department of Agriculture (DA), the principal administrator of the fund, to respond not only to the production but also to the broader credit requirements of farmers (i.e., provision/ expansion of agricultural processing and marketing credit). CALF may also, in the long run, influence the direction of agricultural credit resources by lending to priority commodities or areas.

The thrust on small farmers as the main beneficiaries under CALF reflects a recognition of the need to strengthen credit support to this particular segment whose projects are considered riskier than ordinary agricultural projects. The proposition has been that private banks' participation in small farm financing will be accelerated with government intervention. In this case, intervention is in the form of a guarantee coverage under CALF.

The total available cash balance of agricultural loan funds initially integrated into CALF (covering only those funds directly controlled by the DA) amounted approximately to half a billion pesos as of the end of 1986. These funds include:

- Bureau of Animal Industry Livestock Loan Fund
- Bureau of Animal Industry Guarantee Fund
- Kabataang Sakahan sa Kaunlaran Fund
- Special Agricultural Rehabilitation Fund
- Yellow Corn Fund
- Integrated Rice Production Program
- Small Fisherman's Special Credit Fund
- National Food and Agriculture Council Agricultural Loan Fund
- Fisheries Guarantee and Loan Fund

- Philippine Virginia Tobacco Administration Integrated Agricultural Financing
- Philippine Virginia Tobacco Administration Agricultural Loan Fund
- Philippine Cotton Corporation Agricultural Loan Fund
- National Grains Authority-Bureau of Public Works Fund
- National Food Authority Agricultural Loan Fund
- Livestock Loan Trust Fund
- Pagkain ng Bayan
- Cooperative Development Loan Fund

Box A describes the operations of CALF. Procedures for loan availment and guarantee coverage under CALF are described in box B, further on.

A. Basic information about CALF

Which agency administers CALF?

The DA administers CALF, specifically through the Technical Secretariat of the Agricultural Credit Policy Council (ACPC), an attached agency of the DA.

How is CALF operated?

CALF is operated broadly as a guarantee facility. This means it is not a source of seed funds for lending. The banks have to use their own funds, which in turn will be guaranteed by the CALF, for lending to farmers. This also means that farmers have no direct access to CALF because the decision to avail of the guarantee coverage is purely the bank's. To avail of a

CALF-guaranteed loan, the farmer goes through the usual lending process that starts with the filing of a loan application with the bank.

At present, CALF is operated through the expansion/ modification of existing guarantee facilities: the Philippine Crop Insurance Corporation-Agricultural Guarantee Fund (PCIC-AGF), the Guarantee Fund for Small and Medium Enterprises (GFSME), and the Quedan Guarantee Fund Board (QGFB). Thus, if a farmer wishes to avail of CALF, he or she can go to any bank accredited with any of these guarantee programs/institutions.

Which loans or projects are eligible?

Any agricultural project is eligible for guarantee coverage including (A) small- and medium-sized agricultural projects from the GFSME; (B) projects involving grains and storable commodities from the QGFB; and (C) agricultural production projects from the PCIC.

What are the terms for loans covered by the CALF guarantee?

Loan terms depend on the lending policy of the bank as well as the guidelines of the GFSME, the QGFB, and the PCIC. However, to qualify for guarantee coverage, loans must be secured.

Source: The Comprehensive Agricultural Loan Fund (CALF): A Primer, 18 May 1987

CALF: Survey of issues

The creation of CALF has elicited mixed reactions. While some of the fund "owners" (usually a government agency or corporation) objected to the integration of their funds into CALF as "it will affect the implementation of ongoing projects," some farmer groups resented "CALF's taking away from them the major pipelines of credit." Some rural banks, on the other hand, doubted the capacity of CALF to reach out to small farmers, alleging it would mainly utilize the existing network of more solvent private commercial banks, which are traditionally big farmer-oriented.

Other apprehensions pertained to CALF's potential for raising farmers' borrowing costs as farmers would ultimately shoulder the guarantee fee and commercial bank spreads. The prospect of more loan default was also a concern, "considering that farmers would postpone repayment in anticipation of drier institutional credit since the funds have been taken away by CALF." By and large, the basic arguments against CALF impinged on the availability and cost of already scarce credit to agriculture in general and smallholders in particular.

The response of the government to the above issues was both informational and prospective. While underscoring the need to rationalize and/or improve Philippine agricultural finance policy, it repudiated the allegations as resulting merely from misinformation and refusal to outgrow the old, costly ways of doing agricultural credit. The notion, for instance, that CALF is another specialized lending scheme should be corrected, for indeed it will be operated broadly as a guarantee scheme—meaning, there will be no direct lending under CALF. Farmers will, as usual, get

their loans from the bank which, in turn, will turn to CALF for guarantee coverage of their exposure to the farmers.

On the taking away of funds from the credit system, the DA through the ACPC claimed that no such thing happened because the funds, in the first place, were never on stream. What were "pooled" into CALF were the remaining cash balance of the various loan programs, the implementation of which in the past had resulted in huge arrearages and the consequent impairment of the agricultural credit delivery system—major problems which any existing or future agricultural credit policy should seek to address.

Furthermore, it was argued that CALF was never intended to target any specific subsector. Bank loans guaranteed by CALF would be provided to any farmer, big or small, as long as he is viable and/or bankable. Enhancing farmer viability, as the DA would admit, does not spring from credit availability alone; thus, the overemphasis on credit as crucially affecting farm productivity appears doubtful at best. Data show that despite dramatic decreases in bank credit to agriculture in the last four years, agricultural output increased.

The government experience in supervised credit financing would also attest that despite the liberal flow of credit to farmers (or to some specialized sectors), farmers' production, income, and repayment barely improved due to, among others, the fungibility of credit and the reluctance of the banks themselves to lend to farmers, which the banks equated with "committing financial suicide." The latter reveals a natural reaction on the part of banks, i.e., a bank, whether commercial or rural or another type, would lend only if it is assured of recouping its investments. It is therefore not plausible that a particular bank or financing institution would be partial to a specific sector since project viability is still the primary lending criterion.

B. Procedures for loan availment and guarantee coverage under CALF

1. The borrower (an individual, an association, or a cooperative) submits a loan application directly to the local bank nearest to the project site.

2. The bank performs the usual assessment of the project's viability and the borrower's creditworthiness. Should the bank approve the loan, then the bank finances the project as part of its regular operations.

3. As a matter of standard operating procedure, the bank may seek the advice and assistance of the local offices of the DA in relation to the technical aspects of the loan. The DA offices are expected to cooperate fully with the bank and the borrower in ensuring the feasibility of the project.

4. A guarantee may be secured by the bank for the project financed from either the GFSME, the QGFB, or the PCIC.

Source: The Comprehensive Agricultural Loan Fund: A Primer, 18 May 1987

Finally, the government rejected the view that CALF will necessarily increase borrowing costs, claiming that the nominal lending rate would depend on market trends and that "the more vital issue is not cost but the availability of timely, adequate credit." Accordingly, credit comprises at most only 6% of total production cost; the effort at cost reduction should therefore focus on the more costly inputs, e.g., fertilizer, pesticides, and labor.

The possibility of more loan default occurring with the creation of CALF was likewise discarded, considering that farmers—especially those still with credit experience and presumably the more credit-worthy ones—would not resort to anything that would drastically affect their credit standing and prospects for refinancing.

Given all these arguments, the fact remains that CALF has generated more interest than usual, bespeaking of an encouraging trend for Philippine agricultural finance policy and for the economy in general. These types of cross-sectional "pooling" of ideas are deemed necessary in the formulation of practical and economically sound credit policies. To judge CALF (or its merits) at this point, however, appears premature. This is not to imply that we should jump into anything new; we tried an approach in the past which cost us our fortunes. The time has come for us to innovate; let's give CALF a chance!

CHAPTER 13

Informal lenders dominate rural finance

Working Paper No. 87-06
Agricultural Credit Policy Council
(12 November 1987)[1]

V. Bruce J. Tolentino[2]

Informal lenders have always provided most of the credit to agriculture. This observation is based on empirical evidence. For example, the Nationwide Farmer Indebtedness Survey of the Technical Board for Agricultural Credit (TBAC, 1985) shows that only 28% of all small farmers ever borrow, and of those who do borrow, 2/3 are served by informal sources. Other studies by many researchers also support this observation (Table 1).

[1] With Dr. V. Bruce J. Tolentino as Executive Director, Dr. Gilberto M. Llanto as Deputy Executive Director for Policy Research and Analysis, and Orlando S. Abelgas as Deputy Executive Director for Comprehensive Agricultural Loan Fund.

[2] Executive Director, Agricultural Credit Policy Council.

Advantages to borrowers

Compared to banks, informal lenders are very accessible to borrowers, providing the loans at the farmer's house and collecting the repayment at the farm gate. Payments even in kind are accepted. Informal lenders also demand the minimum of processing and paperwork and lend not only for production but also for consumption purposes.

Usurious interest rates?

In nominal terms, the borrowing rates charged by informal lenders appear to be much higher than those charged by banks. However, these nominal rates do not consider the borrowing costs incurred by the farmer in terms of processing time, loss in production due to delays in the release of loans, transportation between the borrowers' home and the bank, paperwork, literacy requirements, and the need to repay loans in cash. All of these factors translate into added costs in borrowing. Thus, when the effective borrowing rate is considered, the rates charged by banks are comparable to, if not higher than, those charged by informal lenders. This helps to explain why in spite of the lower nominal borrowing rate charged by banks, most farmers still choose to borrow from the informal sector.

The imperative for government policy

Government policy must provide an atmosphere within which banks can reduce the effective borrowing rate at which borrowers approach the banks. Therefore, policies to reduce intermediation and transactions costs are critical. These include the reduction of taxes on loans and deposit incomes, the lowering of reserve requirements, streamlining of the regulatory requirements imposed by government, the increase in investments in rural infrastructure which reduce the cost of transportation and communications in the rural areas, and the provision of guarantee schemes which reduce the bank's cost of absorbing defaults.

The high cost of default

The cost of the lender absorbing such defaults is critical, since the lender, informal or formal, also shares the risks in lending. The basic collateral that the lender exacts is the condition that when a borrower defaults, he cannot borrow again. The cost of such risk taking translates into higher lending rates by the banks and the informal lenders.

Informal lenders will always be around

Informal lenders serve a special set of borrowers who cannot be served by the banks. Small loans, costly servicing, personal, and consumption-oriented loan purposes are the hallmarks of

lending by the informal sector. The informal lenders are also of many and varied types. There are the large landowners who serve about 1/3 of the borrowers. Then there are the traders, input dealers, and warehouse owners. There is also the new breed – the spouses of contract workers overseas who lend out the cash that they receive from abroad. Thus, the informal lending business has always been strong as our economy grows, and as monetization overcomes barter, more informal lenders will in fact arise. However, the growth of the informal sector will, of course, be parallel to that of the formal sector. It is illusory to believe that the formal sector will ever completely replace the informal, since these serve different markets and effectively cannot substitute one for the other.

Table 1. Summary of studies indicating extent of borrowing from formal and informal sources.[3]

Period Covered	Author/ Year of Publication or Release	Number of Loans/ Farmer-Borrower	Credit Source	
			Informal	Formal
			(In %)	
1954–55	De Guzman (1957)	2411 loans	12.0	88.0
1957–58	Gapud (1958)	256 loans	10.0	90.0
1957–58	Sacay (1961)	916 loans	13.	87.0
1960–61	BCS (1963)	1,679,000 loans	7.8	92.2
1967–70	Mangahas (1975)	151 borrowers	11.9	88.1
1970–71	Mangahas (1975)	297 borrowers	20.9	79.1
1969–70	Almario (1970)	138 loans	37.7	62.3

[3] Data comparability is limited by differences in sampling.

Period Covered	Author/ Year of Publication or Release	Number of Loans/ Farmer-Borrower	Credit Source	
			Informal	Formal
			(In %)	
1969–70	Balagot (1974)	134 borrowers	21.6	78.4
1973	DA (1974)	620 loans	51.3	48.7
1973–74	PCARR-Baecon (1977)	3304 loans	92..2	7.8
1974	Cigaral (1977)	421 borrowers	94.0	6.0
1975–76	DA			
	Iloilo (Feb 1977)	341 loans	82.7	17.3
	Ilocos (1977)	703 loans	67.6	32.4
	Zamboanga (Apr 1977)	551 loans	74.6	25.4
1976	DA (1976)	268 farmers	17.2	82.8
1977	UPBRF (1977)	1079 loans	36.9	63.1
1977	DA (1977)	405 farmers	5.2	94.8
1977	TBAC (1978)	656 borrowers	25.8	74.2
1978	DA (1978)	338 farmers	3.,8	96.2
1978	TBAC (1981)	2110 loans	17.4	82.6
1979–80	NIA-SGV (1980)	299 farmers	20.0	80.0
1981–82	TBAC (1984)	871,600 loans	40.2	59.8
1986*		626,300 farmers	34.0[4]	58.7[4]

[4] Some 7.3% of the borrower-respondents tapped both formal and informal credit sources.
* A public opinion survey conducted by the Social Weather Station from October 4 to 29 covering 1,200 respondents revealed that 2 out of 3 borrowers obtained their credit from informal sources.

CHAPTER 14

In defense of the "unscrupulous vegetable trader": A re-examination

Working Paper No. 88-05
Agricultural Credit Policy Council
(1988)[1]

V. Bruce J. Tolentino[2]

In recent weeks there has been a resurgence of articles in the newspapers and magazines lamenting the poverty of the small farmer and heaping blame on the "evil", "unscrupulous", "usurious", price-manipulating, and dictating trader/middleman. A particular case pointed out is that of the vegetable industry of Benguet. It is alleged that traders, "like demi-gods', dictate prices, reap huge profits, and laugh all the way to the bank, all at the expense of the poor farmer.

[1] With Dr. V. Bruce J. Tolentino as Executive Director, Dr. Gilberto M. Llanto as Deputy Executive Director for Policy Research and Analysis, and Orlando S. Abelgas as Deputy Executive Director for Comprehensive Agricultural Loan Fund.

[2] Executive Director, Agricultural Credit Policy Council.

Indeed, is the above picture of the trader accurate? To re-examine that picture, let us put ourselves in the place of the trader, a businessman like so many others, a member of the so-called much-maligned "Divisoria Mafia".

The trader's business cycle begins when he makes a forecast about the future prices of vegetables. If he sees a profit opportunity, the trader then advances, or borrows, a large amount of money to finance a truck, vehicle operating maintenance costs, seeds, fertilizer, pesticides, labor, and his own wages. He then travels to Benguet. On the highway, he meets many checkpoints, both legal and illegal. He has to make many payoffs. The road to Buguias is very bad. The wear and tear on his truck, not to mention on his body, is tremendous.

Our trader reaches the farm gate, and based on his forecast of future prices, he strikes a deal with the farmer. The trader unloads his truck of the inputs, then leaves the farmer alone for the entire production cycle.

Some weeks or months later, after making two more passages along the terrible Halsema Highway, the trader is back to pick up the produce. He does not know if the farmer has produced the right quantity and quality of vegetables. He only hopes that such is the case.

Our trade-entrepreneur finds that the farmer has produced the vegetables in acceptable quantity and quality. Great! They strike a deal, or recall the price they agreed upon before, all on faith. The vegetables are packed, by hand, in baskets which the trader supplies and loaded onto the truck.

The journey back to Divisoria is the most difficult one. Time is of the essence since the vegetables are very perishable. The trader prays that his truck is in good condition, so that it won't fail him even over the very bad road. Also, the bumpiness of the ride bruises and mangles much of the produce. Any delay will cause a lot of waste in the produce. The sun is hot and wilts the greens. Potatoes and beans turn to mush in the heat and bumping.

Along the way, there are many checkpoints. Some are run by the Philippine Military. Others are manned by the "other side." But they have one thing in common. The men manning the checkpoints are hungry—and fresh vegetables make a great meal. The trader drops off kilos or sacks of produce at the checkpoints to promote goodwill and assure a safe passage.

As the trader rides toward Divisoria, he hopes that when he gets to the market, he is one of the few who have gotten through with a load of similar goods. If other traders have arrived earlier with the same vegetables, then the price will drop. He can be wiped out in an instant. The investments of the past months would drain into the ground.

When the trader arrives at Divisoria, he is relieved to find that the competition is not too bad. By hand he unloads the vegetables. He has to sort them out, wash and clean them up, and repack into retail lots. He picks off the rotten leaves, he throws away the moldy portions. He ends up with only about 60% of the quantity of vegetables he originally paid the farmer for back in Benguet. Moreover, the trader has only a few days to distribute and sell everything, or it all rots.

Let us summarize the trader's costs:

- Interest costs on borrowings
  (or opportunity costs on own money)
- Depreciation of the truck
- Operating costs for the truck
- Payment to the farmer
- Fertilizer
- Seeds
- Pesticides
- Payoffs to inspectors
- Payoffs to military checkpoints
- Payoffs to non-military checkpoints
- Spoilage due to handling
- Spoilage due to heat
- Spoilage due to time

CHAPTER 15

Policy statement: A three-faceted strategy toward the provision of credit for small farmers and fishermen[1]

Policy Brief Vol. 2 No. 3
Agricultural Credit Policy Council
(3 April 1989)[2]

A number of government programs—*Masagana 99*, *Maisagana*, *Biyayang Dagat*, to mention a few—were created to enable small farmers/fishermen to gain access to formal sources of credit. Innate to the programs were various incentives and regulatory mechanisms such as credit quota scheme, deposit retention scheme, and rediscounting privileges—all intended to encourage banks to lend to the small farmer/fisherman.

But all these efforts proved futile. The supply of formal agricultural credit has, in fact, declined. From a level of 18% of total loans in 1966, the figures fizzled to 5% in 1975 to regain, but not substantially, to less than 10% in 1985. Survey

[1] This paper reflects the official position of the Council based on the approved guidelines on agricultural lending.

[2] With Dr. V. Bruce J. Tolentino as Executive Director, Dr. Gilberto M. Llanto as Deputy Executive Director for Policy Research and Analysis, and Orlando S. Abelgas as Deputy Executive Director for Comprehensive Agricultural Loan Fund.

results have also shown that the proportion of farmers who borrow from formal sources has declined consistently from 37.1% for the period 1967–1974 to 23% in 1981–1986 and to a dismal 7.5% in 1988. Moreover, the bulk of subsidized credit has been channelled to large farmers to the detriment of the smaller ones, and to government securities rather than to farm credit.

The lessons we have learned from these strategies point out that alleviating small farmers from their present plight cannot simply be addressed through credit, but with a set of policies that would take into account the special nature of the rural economy, specifically, the fundamental issue of why small farmers do not get credit.

Why don't small farmers get credit?

The credit needs of small farmers have not been sufficiently met, mainly because:

1. The total credit need is huge

This need is estimated at PHP 6 billion per cycle or PHP 12 billion per year. Considering the diminutive government resources of only PHP 700 million available for lending, only about 6% of farmers' credit needs per year can be satisfied using government resources.

2. Many small farmers/fishermen are not bankable

First, they do not possess acceptable collateral; second, agricultural projects are adversely considered very risky. The

experience with agricultural credit programs shows an average repayment rate of only about 65% over the past 20 years.

3. The credit delivery system is Inadequate for lending to small farmers

In the first place, the formal system is not suitable for rural lending since the costs and risks of such lending are high. In the second place, there is inadequate support for innovative and cost- and risk-reducing intermediation schemes.

4. The cost involved in lending to agricultural projects is high

The minimum administration cost of government agri-credit is estimated to be about 11%; the minimum lending cost by banks is 5% (Untalan and Cuevas, 1988); and the minimum transaction costs of small borrowers are 25% of the interest rate (Abiad, 1988).

Appropriate credit policies and strategies

The appropriate credit policies should be geared towards attacking the aforementioned reasons why farmers do not get credit. A three-pronged strategy is required in this case since it would involve policies for three sectors: the farmer, the bank, and the government. The policies aimed at increasing the flow of credit to agriculture can thus be divided into three categories:

1. Measures to build up farmer creditworthiness and bankability;

2. Measures to increase government support in agriculture like increased expenditure for rural infrastructure; and

3. Measures to reduce bank risk and monitoring costs.

Specifically, farmers' creditworthiness and bankability can be increased, first, through training and educating them on credit awareness, loan acquisition, skills, and loan repayment ability. Second, stress should be given to building up strong and viable farmers' organizations such as cooperatives, credit unions, Rotating Savings and Credit Associations (ROSCAs), and non-government organizations (NGOs), which play a major role in increasing small farmers' access to credit. Government support at this level can be done through:

- Giving subsidies for the education, training, and audit needs of such organizations; and

- Redistributing of land to the landless workers and tenants under the CARP.

Banks' risk and monitoring costs, on the other hand, can be reduced by increasing support for the expansion of the guarantee and crop insurance programs and subsidizing costs of information, monitoring, training, and registration. Additional cost-reducing strategies are:

- Savings mobilization schemes;

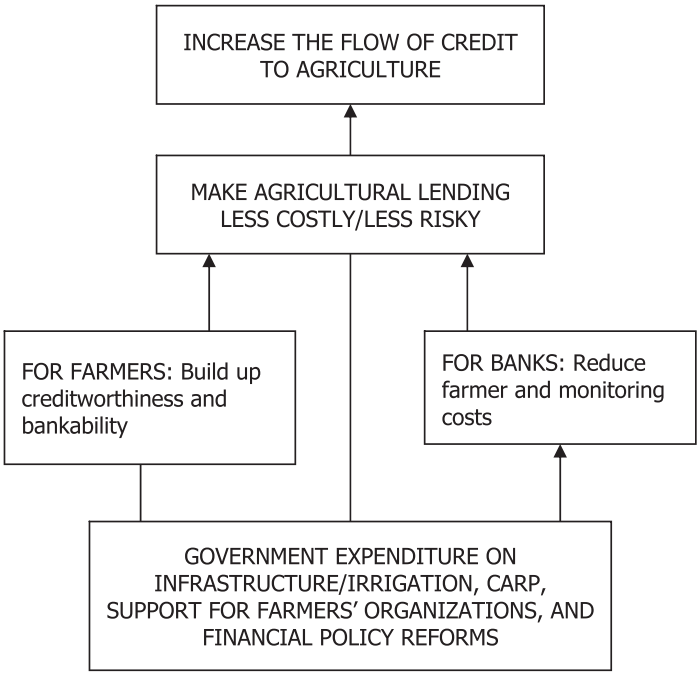
- Simplification of the documentation process in banks;

- Encouragement/support for lending to organized groups like cooperatives;

- Liberalization of bank branching and entry; and

- Elimination of regressive and counter-active credit policies such as the gross receipts tax, the credit quota and deposit retention limit schemes, the 20% withholding tax on savings, and the reduction of reserve requirements.

Government efforts to induce greater rural credit flow can likewise be enhanced via the provision of agricultural transport and communication infrastructures such as farm-to-market roads, irrigation, electricity, and processing and post-harvest facilities. Similarly, government should push for the reduction of prices of farm inputs and other basic commodities through lesser interventions in the financial market and the improvement of the peace and order conditions.



Priorities for programs and legislation to facilitate the provision of credit for small farmers and fishermen

Given these policy directions, an indicative legislative agenda has to be effected by the present administration. The priorities for legislation should contain the following actions:

1. To promote the bankability of farmers/fishermen and agricultural projects:

a. increase the budget expenditures for agriculture and rural projects. The government should take initiative in developing the sector through support services, other than credit;

b. strengthen agricultural extension service. This involves upgrading of capabilities of extension workers from the government and the private sectors, reaching out to more farmers;

c. eliminate trade policy biases against agriculture. Trade policies that harm the sector, like import liberalization of farm produce, should be repudiated;

d. reduce the overvaluation of the peso. This is in line with boosting agriculture trade by preventing further undervaluation of agricultural exports and making the exports competitive in terms of quality and quantity; and

e. support the development and expansion of people's organizations. Cooperative credit unions, NGOs, and

other self-help organizations have an important role to play in the development of the agricultural sector. Hence, such groups should be encouraged specifically through education, training, and audit services.

2. To encourage innovations in the financing of projects:

a. liberalize bank branching and the establishment of new banks. This would provide a healthy competition among banking institutions, hence, improve and expand banking services in the countryside;

b. facilitate the speedy implementation of the Rural Bank Rehabilitation Program. Rural banks have the comparative advantage of lending to small farmers. A stronger and viable banking system is needed in time to enable them to cope with the ongoing national recovery programs for the rural sector; and

c. encourage the establishment of cooperative rural banks (CRBs). CRBs as unique lending and savings institutions should be recognized and improved.

3. To decrease intermediation costs:

a. abolish the gross receipts tax. This creates a form of double taxation to banks in addition to their corporate or income taxes;

b. abolish Presidential Decree No. 717. This law is unnecessary since banks channel their funds to government securities rather than agricultural credit;

c. abolish regional savings/loan quotas. This law is also regressive since it prevents banks from the optimal allocation of their resources;

d. oppose any lending quotas. In general, this calls for a market-oriented determination of interest rates and other lending policies;

e. reduce reserve requirements on deposits. Reserve requirements create a tax on the intermediation which inhibits optimal utilization of bank funds;

f. minimize regulatory requirements on banks. The Central Bank of the Philippines should limit its role to stewardship of the banking system and concentrate its efforts on monetary policies;

g. direct fiscal spending to the provision of rural, agricultural, transport and communication infrastructure; and strengthen and promote cooperative and self-help groups. This action is necessary since such groups are expected to perform financial intermediation functions for small farmers/fishermen as well as provide brokering and monitoring services between small borrowers and banks.

4. To reduce government intervention:

a. abolish the 20% withholding tax. This move will encourage savings in the countryside as well as in the other sectors;

b. oppose ceilings on interest rates. Interest rates should be determined by market forces to mobilize savings and deliver loans effectively;

c. liberalize policy on the establishment of banks and branches;

d. promote cooperatives, self-help groups, ROSCAs, and farmers associations. These groups will serve as effective and innovative agents for financial intermediation;

e. minimize regulatory constraints on banks. This calls for reducing bureaucracy in the banking system, regulatory specialization, and distinctions among types of intermediaries; and

f. give the Central Bank a more focused role. The role of the Central Bank should be geared only towards the management of interest rates and money supply.

5. To reduce risks of borrowers and banks:

a. increase support for guarantee and crop insurance programs. These programs are potential risk-reducing mechanisms to support the credit needs of the agricultural sector, particularly the small farmers/fishermen;

b. provide adequate agricultural extension assistance. Extension services should be made stronger and supported by both the government and the private sector;

c. massive fiscal spending for the provision of rural, transport, and communications infrastructures;

d. improve peace and order conditions. This will facilitate the smooth delivery of goods and services to/from the rural areas; and

e. increase appropriations for rural infrastructure. Development is comparatively faster in places where transportation and communication facilities are favorable.

To sum up, all these efforts represent a departure from the traditional view of providing credit to the small farmer/ fisherman via subsidized credit, concessional lending, and heavy government intervention in the financial system. The present thrust now involves major changes not only in the financial aspect but in the entire support service delivery system for the rural sector.

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 **also known as the Central Bank of the Philippines (CBP)*
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 **also known as the Bangko Sentral ng Pilipinas (BSP)*
CFP	Cotton Financing Program
CDLF	Cooperative Development Loan Fund
CGLF	Cooperative Guarantee and Loan Fund
CRB	cooperative rural banks
DA	Department of Agriculture **formerly the Ministry of Agriculture and Food (MAF)*
DANR	Department of Agriculture and Natural Resources **predecessor of the Department of Agriculture (DA)*
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 **currently the Department of Education (DepEd)*
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
DTl-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 **currently the Department of Agriculture (DA)*
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
	**predecessor of the Agricultural Credit Policy Council (ACPC)*
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
PRSMP	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
RSMP	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 **predecessor of the Agricultural Credit Policy Council (ACPC)*
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