Philippine Rural Finance: Innovations and Current Issues

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Abstract:

Obtaining loans from Philippine banks is difficult and government support to credit was inadequate. The overall rural sector in the Philippines needs better access to credit since it could enhance their livelihood by means of expanding their agricultural activities. Farmers must also be encouraged to use high yielding inputs such as seeds, farm mechanization equipment and other harvesting and planting equipment in order to improve the quality and quantity of output. This could improve the loan repayment rates on the part of the farmers. More competition and not government subsidies to individuals or institutions is the key on having an efficient, sustainable and forward-looking rural finance sector.

Introduction

Credit is important to the poor farmers because it could help them invest in the land that they are tilling and they could eventually gain profits from the fruits of their investments: inputs, credit and labor. The overall rural sector needs better access to credit since it could enhance their livelihood by means of expanding their agricultural activities. On the other hand, the lack of access to credit by farmers, could lead into having sub-optimal inputs and therefore, agricultural output. An improvement in the quality and quantity of agricultural products could result to improved mean income of farmers and improved overall welfare of the agricultural sector. Hence, to achieve this goal we must first improve production inputs. Since the poor farmers have little or even no capital, they just utilize all the capital that they have just to plant a crop without maximizing the use of land and therefore the profits associated from it. Furthermore, these same farmers are the ones who have very little access to formal loans and are the "prey" of some abusive informal creditors. Either a monopoly or an oligopoly of credit lenders is clearly seen in this situation. In such cases, a considerable amount of deadweight loss to the rural society is evident and destructive to the overall welfare of not only of the poor farmers, but also the rest of the rural population itself. Because of this situation, there arises a need to reform the system of rural credit that has been plaguing the rural population for several decades now. A set of policy measures is needed in order to address the problems in rural credit such as: poor access of farmers to formal loans, incompetent services of rural banks, lack of competition in the rural finance and credit institutions and the prevalence of the monopolistic or oligopolistic money lenders in remote rural areas. Since level of investment is lower on the part of the poor farmers, a reform on rural credit would further enhance investment on agriculture, and with that expand agricultural output of the rural population, hence improving per capita income. Several issues on rural credit would be addressed and the following that, reforms through the set of policy measures would be presented in order to influence the decision-making bodies concerned with this issue.

Objectives of the Paper

The main objective of this study is to review the innovations in the rural finance sector of the Philippines.

The specific objectives are:

1. to identify the agricultural credit and its sources

2. to present an overview of the Philippine rural credit system

3. to discuss underground credit market transactions under the Comprehensive Agrarian Reform Program (CARP)

5. to review the trends of the loans to the agriculture and rural sector

4. to analyze the innovations and current issues in the rural financial sector of the Philippines

6. to present policies that would address the current issues in the Philippine rural financial sector

Agricultural Credit and its Sources

Several studies had been done to find out the benefits that could be derived from credit. Salonga (1998) suggested that "credit provided assistance to the economy as a whole and to the agricultural sector in particular." It also provided access to goods and services, created employment, financed business, and expanded production and income. With the increased agribusiness activities in the rural sector, more employment opportunities would be given to the rural population. Here, they could be employed eventhough they have a little background on formal schooling. In addition, they could also not opt to migrate to urban areas since employment is easily available in their area. In order to finance these activities, credit must be made accessible to the small and medium farmers so that they could finance agricultural ventures and even hire people who do not have jobs. In this setting, more people in the rural areas would be productive and not just work just to have food on the table. Binohlan (2000) reported that "the extention of credit could influence the productivity of farmers to new economic opportunities and enhance their ability to acquire inputs to accelerate growth of the rural areas." Specifically, credit increased the level of diversity of inputs. The farmers who had access to credit were able to shift from low-yielding variety to high-yielding variety of seeds or seedlings. Shifting to high yielding varieties of inputs is essential for better survival of crops, fisheries or livestock; hence, profit maximization. In order to improve the competitiveness of the crops and other agricultural products, the farmers must innovate through their inputs. As competitiveness rise, the farmers' income rises also. Binohlan (2000) found out that "credit increased the productivity that bought a corresponding increase in net income of the borrowers." Binohlan (2000) also noted that that "credit brought an increase in utilization of equipment since some borrowers invested heavily in the equipment." The promotion of investments in infrastructures, such as farm mechanization equipment, makes the harvesting of crops more efficient. Also, farmers' cooperatives, who jointly borrow from credit institutions, could benefit as a group with their investment, since harvesting in a wider tracts of land is made more efficiently than a smaller tracts of land Moreover, this form of technology-input could reduce the labor requirement during harvest season, and even make their products more competitive.

Philippine Credit System

The Philippine credit system is a mixture of both formal and informal credit markets and institutions. The formal credit institution consists of the commercial banks, thrift banks, rural banks, the Land Banks of the Philippines (LBP), the Development Bank of the Philippines (DBP), and credit guarantee institutions. The informal sector consists of informal moneylenders (such as traders, millers, farmers, friends, landowners, relatives, neighbors and more recently the overseas Filipino workers) credit unions and credit cooperatives, loan associations, and rotating saving or “paluwagan.” Moreover, the informal sector serves the financing needs of small scale and subsistence agriculture and the majority of the rural population. According to Octavio as cited by Malabanan (2000), “formal markets were found mostly in urban areas, while the informal credit sources were more commonly found in the rural and agricultural areas.”

Underground Land Market Transactions and the CARP

Land and property rights are intrinsically linked to the demand for credit; however, land market transactions are subject to restrictions under CARP. The credit market is the vital link in the utilization of land as a productive resource, so certain policies need to be revised in order to make credit more accessible to the poor farmers. Due to legal restrictions, buyers of credit have to enter in underground arrangement, thus increasing transaction cost involved. Under support services of the CARP, the government is mandated to provide adequate credit support to the poor farmers. An improvement in the implementation of support services is greatly needed in order to aid the farmers.

Rural Credit

Providing credit subsidies to farmers could induce the use of appropriate inputs: seeds; commercial fertilizers and modern technology, which would increase farm productivity. However, providing credit subsidies to farmers would deplete government funds and there is also a tendency to have dole-outs. The Directed Credit Program (DCP) of the government aimed to provide subsidized credit the farmers; however, it resulted to having a culture of dependence (on the part of the farmers) and political patronage was also evident. In the end, the DCPs collapsed due to these reasons: poor loan collection, weak accountability on the part of the farmers, dependency of rural banks on government funding, hidden subsidies, deposit mobilization was not initiated, mounting arrears of small-farmer-borrowers with rural banks, the government deregulated interest rates, and channels used by government for subsidies credited by large farmers. Continuing the implementation of DCPs would only lead to further waste of limited resources. Furthermore, these programs would be provided by huge government funding. In turn, the government transferred the implementation of Agricultural Loan Fund from the central Bank to the Land Bank of the Philippines (LBP). Small borrowers would continue to face credit constraints for as long as there are serious economic policy biases against agriculture and rural areas, weak institutions and rural infrastructure inadequacies.

According to Llanto, (2005), “loan outstanding of commercial banks to Agriculture, Fishery and Forestry have been decreasing over years.” One reason is the perception by these banks of small farmers are high credit risks. Llanto, (2005) suggested that because of this, “the farmers get loan from Land Bank, farmers’ cooperatives, and the rural banks of their towns. Loan portfolio of rural banks exhibited positive trends after reforms of 1997 but growth in the rural bank was not enough to compensate for the decline in universal and commercial bank lending in most regions.” According to Llanto (2005), “60% of borrowers depend on informal lenders.” Obtaining loans from banks is difficult and government support to credit was inadequate. This arises in having a basic policy framework, that is, market based rural finance which would provide adequate financing to rural areas and smallholder agriculture. With this new policy framework, the dependence of farmers to informal lenders, who charges a high interest rate, would be minimized. By decreasing the cost involved in loans, profits of farmers would now be maximized; hence they income increases.

History of the Reforms in Rural Finance

Llanto (2005) presented the following timeline of the reforms in the Philippine rural finance:

Policy measures	Key provisions
Issuance of lie National Strategy for Microfinance (1997)	* Market orientation of interest rates. * Rationalization of subsidized directed credit programs * Donors primarily as providers of technical assistance, i.e., capacity building * Recognition of savings mobilization as an integral pail of successful microfinance programs

Enactment of the Social Reform and Poverty Alleviation Act, December 11, 1997	* Defining capacity building to exclude any and air forms of seed funding, equity inclusion and partnership funds from government to microfinance institutions * Deletion of equity funding from the list of specific uses of the Peoples Development Trust Fund PDTF), a trust fund created under the law aimed at funding capability-building activities for MFIs. * Rationalization of directed credit and guarantee programs * Emphasis on savings mobilization
Enactment of the Agriculture and Fisheries Modernization Act (AFMA) December 22, 1997	* Phaseout of directed credit programs in the agriculture sector over a four-year period (i.e. ending February 2002) * Rationalization of loan-guarantee programs * Adoption of market-based interest rates

	* Non-provision of credit subsidies * Review of mandates and performance of government agencies and GFIs in light of the rationalization of directed credit programs
Issuance of EO 138 (August 10, 1999) directing government agencies implementing credit programs to adopt the NCC Credit Policy Guidelines.	* Non-participation of GNFAs in the implementation of credit programs GFIs to be the main vehicle in the implementation of government credit programs * Adoption of market-based financial and credit policies * Increased participation of the private sector in the delivery of financial services
Approval of the design of the Agricultural Modernization Credit and Financing Program (AMCFP)	* No further implementation of directed credit programs by CNFAs by he end of 2002 * Limit lending decisions only to banks, viable

	cooperatives, and microfinance NOOs * Adoption of market-determined lending rates to enable conduits to cover their costs and achieve sustainability in the long run * Focus of the Department of Agriculture on monitoring and evaluation of AMCFP, provision of infrastructure, institution building, research and extension, and the provision of an appropriate policy environment conducive to increased private sector participation
Establishment of the framework for a more appropriate and effective regulation of deposit taking cooperatives	* Formulation and adoption of the Standard Chart of Accounts for credit cooperatives (December 1999) * Formulation of accompanying accounting manual (December 2000) * Formulation and launching of the performance standards for credit cooperatives (October 2002)

Enactment of the General Banking Act(GBA). May 23, 2000, which includes provisions mandating the BSP to recognize the unique nature of microfinance as it formulates banking policies and regulations.	* Lifting of the moratorium on branching, specially for microfinance banks * Issuance of BSP Circular 272 on January 30, 2001, implementing the microfinance provisions of the CBA * Review of he examination process to reflect he special nature of microfinance, e.g., non-collateralized loans

The New Era: Market- Based Rural Finance

In the year 2000, the government stopped allocating funds to the DCPs and transferred the funding to Agricultural Modernization Credit Financing Program (AMCFP). The Government Financial Institutions (GFIs) would now provide wholesale loans to private financial institutions, that in turn lend to end-borrowers (the farmers). Rural banks eventually discovered deposit mobilization as a sustainable source of lending funds and copied the lending techniques from Non-Government Organizations (NGOs). Recent reforms led to: satisfaction of farmers, innovative microlending techniques and active participation of private financial institutions in the rural financial markets. New entrants in this sector provided more competition to incumbents, the led into having more innovative, client focused, and more efficient financial institutions. The inefficiencies involved in providing loans were eliminated, if not reduced, and the overall transactions costs were reduced. Loans now are more accessible to the farmers and it would take less time for the farmers to receive their loan. This is important because before, the untimely release of credit can cause delay in the planting of crops, hence, the crops would not be productive as it should be. Now, because of the timely release of the loan, farmers could start planting at the right time of planting season. The rural credit institutions provide now the sustainable financial services to microenterprises and small and medium enterprises in the rural areas. This in turn would lead to the development of the not only in the rural agriculture sector, but also the small industries in the rural areas. The development of these industries would in turn reduce rural unemployment and increase the mean income of the residents in rural areas. This reform's key goal is for private institutions to be main providers of financial services in the rural. The government is successful in intervening in this rural financial market. Furthermore, more competition in this market would make it more and more efficient and sustainable in the long run. Given this situation, farmers would benefit and government allocation of funds for these programs would be minimized; hence, less pressures on the budget deficit faced by the government.

Loans to the Agriculture Sector

Agriculture Production Loans

Only a portion of the total loans granted to the AFF sector went to agriculture-production; while others went to other agriculture-related activities. As seen in Table 1, agriculture-production loans made up 31% of the total agriculture-loans granted in 2002, which is equivalent to a mere 2% of the total loans granted to all sectors (Llanto, 2004). On the other hand, in terms of a 5-year average, only 35% of the total agriculture loans actually went to production. According to Llanto (2004), “commercial banks held a significant share of total agricultural production loans granted by all banks while in 2002, private commercial banks’ share of total agriculture-production loans granted was 63%.”

As seen in Table 1, government and private commercial banks provided 60% of the total agriculture-production loans granted. The main provider of agriculture-production loans are the private banks, which provided 94% of those loans in 2002. The share of the combined government banks was only 6% in 2002. On the other hand, the share of agriculture-production loans of rural banks in 2002 was 18% (highest), while thrift bank had 17%. If based on a 5-year average (1995-2002), the share of rural banks was 14%. On the other hand, a 15% share of agriculture-production loans were from the thrift banks.

Table 1: Agricultural Production Loans Granted, By Type of Bank (in billion Philippine Peso)

	1987	1990	1995	1996	1997	1998	1999	2000r	2001	2002P
Government Banks	1.49	5.93	6.46	8.05	8.38	9.09	9.39	8.39	7.62	8.55
PNB	0.70	1.68 P	a	a	a	a	a	a	a	
DBP	0.13	0.25 P	0.99	1.22	1.12	0.69 r	0.26 r	0.26	0.21	0.90
LBP	0.65	4.00 P	5.47	6.83	7.26	8.40	9.13	8.13	7.40	7.65
Private Banks	25.97	35.31	76.11	556.66	367.86	105.99	161.09	105.29	114.98	141.31
PKBs	21.01	27.25 P	43.27 P	519.75 r	335.24 r	73.03 r	123.01 r	68.63	77.98	89.37
TBs	1.51	3.12	20.37	20.61	22.94	15.31	18.76	20.75	21.04	25.28
PDBs	1.01	1.14	6.36	4.23	6.03	5.28	7.93	6.72	7.70	9.62
SMBs	0.09	1.34	7.04	4.35	4.74	4.17	5.28	8.65	6.30	6.78
SSLAs	0.41	0.64	6.96	12.03	12.17	5.86	5.55	5.38	7.04	8.88
RBs	3.46	4.94 r	12.47	16.30	9.69	17.66	19.32	15.92	15.96	26.65
ALL BANKS: Total Agri Prod'n Loans Granted	27.46	41.25	82.57	564.72 r	376.24 r	115.08 r	170.48 r	113.69	122.60	149.86
Total Agri Loans Granted	n.a.	n.a	n.a.	n.a.	n.a.	299.04 r	401.88	335.31	414.28	487.73
Total Loans Granted to All Sectors	404.35	590.08	6,262.83	10,636.25 r	10,141.48 r	8,650.83 r	9,909.13	9,478.18	7,123.32	6,874.93

Source: BSP-DER, SRSO, Statistical Bulletin, RB System Annual Reports, LBP and DBP.

n.a./ Data not available

r/ Revised, based on actual reports from BSP

P/ Preliminary. Amounts were forecasted due to non-availability of actual data. For 2000 & 2001, LBP and DBP figures are actual Amounts

a/ Starting 1995, PNB was classified under PKBs

b/ For PKBs, estimated amount was based on actual data for first semester, 2000. For TBs, annual amount was estimated from actual data for first 3 quarters, 2000.

Source: Bangko Sentral ng Pilipinas, BSP-DER as cited by Llanto (2004)

Financing Support: Loan to Output Ratio

Table 2: Loan to Output Ratio by Sector

	1995	1996	1997	1998	1999	2000	2001	2002
AFF Sector	n.a.	n.a.	n.a.	66.21	78.72	63.76	75.41	82.33
Industry Sector	29.96	198.75	136.35	123.42	108.06	84.13*	n.a.	n.a.
Service Sector	134.81	838.23	728.51	541.97	557.94	474.65*	n.a.	n.a.

Source: BSP

(*) Data only up to Oct. 2000

Source: Bangko Sentral ng Pilipinas as cited by Llanto (2004)

The ratio of loans granted to the sector to gross value added (GVA) of the sector can be considered as a rough indicator of formal financing support to the agriculture, fishery and forestry sector. As seen in table 2, overall loan to output ratio is highest in the service sector while it must be considered that this sector received the largest financing support from banks. As also seen in Table 2, the agriculture, fisheries and forestry (AFF) sector received less than P1.00 in loans from the banks for every peso output in agriculture in 1998-2002 (Llanto, 2004).

Table 3: Ratio of Production Loans to GVA IN Agriculture, %

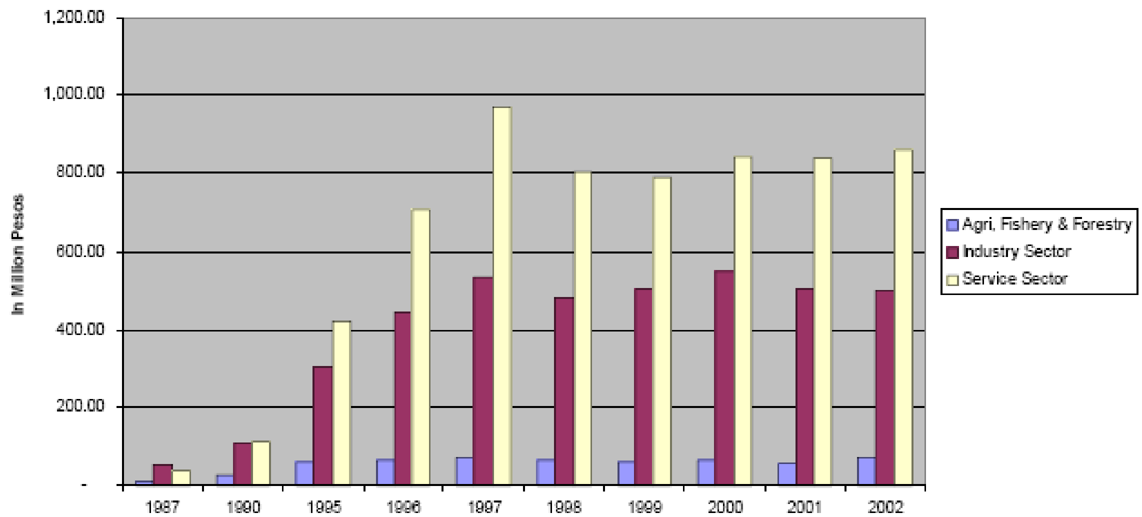
	1987	1990	1995	1996	1997	1998	1999	2000	2001	2002
Loan to Output Ratio	16.75	17.48	20.03	126.11	82.15	25.48	33.40	21.62	22.32	25.30

Source: Bangko Sentral ng Pilipinas as cited by Llanto (2004)

As seen in Table 3, in 2002, the agriculture-production loan to output ratio was 25% in 2002, a slight increase from 22% in 2001. According to (Llanto, 2004). This situation means that there is a P0.25 financing support from banks for every peso output of the agriculture-production sector. He also commented that the loan to output ratio in 1996 was quite a departure from the usual trend with 126%. The report of Bangko Sentral ng Pilipinas as cited by Llanto (2004) states that on that particular year, there was a significant rise in the loans granted by all banks for agriculture-production. The banks financed only P0.26 of every peso output of primary agriculture when the loan to output ratio was averaged in the last 5 years (Llanto, 2004).

The “forward-backward” policy applied in rural finance sector of the Philippines had several results. In 1999, the Agricultural Credit Policy Council of the Philippines (ACPC) concluded that banks were still reluctant in providing loans to the agricultural sector. According to the Small Farmer and Fisherfolk Credit Accessibility Survey (2002) as cited by Llanto (2004), in 2001, majority of the respondents indicated that it was difficult for them to avail credit. The government has exerted a lot of effort in increasing the flow of credit in the rural sector, however, formal credit institutions still try to avoid providing loans to the rural sector due to their perception of high covariant risk in this sector. The following figure presents the industry share of loans outstanding from commercial banks.

Figure 1: Industry Share of Loans Outstanding from Commercial Banks



Source: Bangko Sentral ng Pilipinas as cited by Lllanto (2004)

Table 1: Loans Granted by all Banks According to Sector

(in Billions of Pesos)

	1996	1997	1998	1999	2000	2001*	2002
AFF sector (a)	n.a.	n.a.	299.04	401.88	335.31	414.28	487.73
Industry sector (b)	1,385.04	1,063.26	1,034.73	984.51	874.13	n.a.	n.a.
Service sector (b)	8,610.66	8,661.74	7,452.40	8,677.83	8,275.20	n.a.	n.a.
Total loans granted (a)	10,636.25	10,141.48	8,650.83	9,909.13	9,478.18	7,123.32	6,874.93

Source: Bangko Sentral ng Pilipinas
(a) Data came from revised reports of the ACPC based on BSP data; figures will not add up
(b) Data on private development banks (PDBs), Stock Savings and Loan Association (SSLA) and savings banks (SBs) only until October of 2000; data on specialilzed government banks (SGBs) only until May 1994
(*) Except for the AFF sector, data are only from commercial banks (KBs)
Note: Loan figures, except AFF, were based on reported loans granted to subsectors according to reports by each type of bank; 'AFF' means agriculture, fisheries and forestry.

Source: Bangko Sentral ng Pilipinas as cited by Llanto (2004)

Figure 1 and Table 1 show that loans granted to the Agricultural and Fisheries (AF) sector barely increased during the 1990-2002 period. It only implies that the commercial banks were still reluctant in providing loans to the AF sector. These commercial banks haven't changed their perception of the AF sector as a risky venture. It is understandable that the commercial banks would not enter risky ventures such as providing loans to small farmers due to their profit-maximizing and cost and risk-minimizing motive. On the other hand, if the government forces them to provide loans to small farmers (through a certain government policy), there is a large probability that they would incur loan defaults from these loans and eventually, it would have a contagion effect on the overall financial sector of the Philippines.

Table 2: Source of Loans of People in the Rural Sector 1996-1997, 1999-2000 and 2001-2002

Source	1996-1997 %	1999-2000 %	2001-2002 %
All borrowers	100.0	100.0	100.0
Formal institutions	24.0	38.6	34.4
Informal lenders	76.0	61.3	60.3
Both formal and informal			5.3

Source: Various surveys conducted by ACPC as cited by Llanto (2004)

Llanto (2004) cited that "only large farm owners were provided loans since they are the only ones who could offer collateral to the banks and added that small farmers and other people from the rural sector still depend on the informal sector for their credit needs." The results of these surveys show that eventhough a lot of reforms and innovations were implemented in the Philippine rural finance sector, poor people in the rural sector finds it more convenient to borrow money from informal moneylenders than from the formal sector.

Key Issues in Rural Finance

First the issue of Lack of investment and credit needs to be addressed. By providing more credit support services, farmers could further enhance their inputs, thus increase their productivity through it. Since farmers shifting to livestock and poultry were able to borrow from banks and little amount of loans were available to long-gestating crop farmers, more and more farmers are trying to shift to livestock and poultry. These farmers are gaining more profit through this new venture. This new trend seems better because the farmers are no longer venturing in the crops where our country has no comparative advantage. Financing Smallholder Agriculture is a great need for the agriculture sector since a lot of small farmers and fisherfolk depend on informal loans (Llanto, 2005). Rice farmers and other small borrowers need greater access to formal loans, to aid them in their production and investment production requirements, from competitive rural financial markets. There is also the so-called “Missing Middle” or the Rural Financing Gap. As successful clients increase their enterprise the credit demand also increase. This gap is caused by the never-ending history of perceptions of farmers as: high systemic risk borrowers where lenders (commercial banks) incur huge transactions costs and low profitability. In addition, rural and microfinance institutions may not be keen on providing larger loans due to reasons such as: fear of mission drift, capital limitations and lack of management in small-enterprise lending. This event may seem understandable because before only the Philippine government has the experience of providing “overly-subsidized” loans to the farmers and not this banks who focused on lending to urban investors and other individuals. There are also constraints to formal loans such as: collateral requirements for larger loans, inexperience for small-enterprise lending and lack of boiler type of lending technology that hinders the development of rural credit. The key goal here is to have lending institutions that can offer relatively bigger loans more efficiently.

Eventhough distributional reform such as CARP has positive impact on the crop yield, it poses constraints on the trading of the agricultural lands. This further worsens the accessibility of credit to small borrowers (e.g. rice farmers).Agrarian Reform has negative impact on the collateral value of those lands through: ownership ceiling, transferability of lands (remember the mother CLOAs issue) and holding period, uncertainties created by slow implementation of agrarian reform, negative effects on collateral value, barriers to private investments in agriculture and result to informal markets for land transactions. This “black market” for land transaction became the result of the reform. Before, the income of the farmers comes almost solely on the profits derived from the harvest. Today, incomes from non-farm activities and other sources, such as remittances from OFW family members, have become significant source of rural income. Understanding the agricultural supply chain may create opportunities for rural-based clients, in which they have the opportunity to choose where position themselves in chain. Due to insufficient capital, inadequate infrastructure and weak institutions, small farmers find it difficult to cope with the demands of the global markets, for competitively priced goods. Higher input cost is driven by high processing and marketing cost and distribution cost. The scenario here must not have been significantly improved compared to the scenario in the past. There is a need to have more and improved transport and storage facilities, efficient transport infrastructure and more roads to marginalized rural areas. The history of rural credit is shaped by: scarcity of collateral, absence of complementary institutions to reduce risk and covariant risks and market segmentation. Policy measures must be formulated in order to address these problems in order to attain development in this sector in the future.

Issues Regarding the Credit Support Services Under CARP

Bello (2004) cites that the current policies of agricultural credit are embodied under the inclusive institutional framework of R.A. 8435 of the Agricultural and Fisheries Modernization Act (AFMA) of 1997, wherein the statute prescribes the related measures to modernize the agriculture and fisheries industries into highly profitable and competitive sectors through an adequate, focused and rational delivery of needed support services, such as credit to farmers.

The Section 20 of the Act unequivocally highlights the following:

1. Promotion of growth in the countryside

2. Access to credit by small farmers and fisherfolks

The following credit policies/programs that Bello (2004) cited are the necessary policies that could help address the problem of inaccessibility of credit (of the formal credit sources) to small farmers. The following are the required measures that Bello (2004) cited with some of my insights below the policies.

Emphasis on the proper management and utilization of the funds of the AFMA.

The AFMA must not only promote the modernization agriculture and fisheries through technology, but also through the provision of credit support services. The already “scarce” funds of AFMA must be utilized in such a way that only the small or poor farmers or fisherfolk would be prioritized by the program and not the rich farmers.

Creation of Agro-Industry Modernization Credit and Financing Program (AMCFP) and consolidation of all loanable funds under the program

The AMCFP is important since it would serve as a “new window” for formal credit support services of small farmers and fisherfolk. The consolidation of all loanable funds under the program must ensure proper utilization of the funds

Greater involvement of financial institutions, including viable NGOs in the management of Agro-Industry Modernization Credit and Financing Program (AMCFP)

An active participation of these institutions in the management of the AMCFP would lead to proper utilization of these funds in the sense that NGOs can team up with financial institutions. The NGOs already know the target beneficiaries. Through their coordination with the financial institutions, credit would be provided to target beneficiaries who have lack of access to formal credit services.

Rationalization of Credit Guarantee Schemes and Funds and the establishment of the Agriculture and Fisheries Credit Guarantee Fund under the management of Quedancor

As mentioned also earlier the already “scarce” funds of AFMA must be utilized properly. Credit must be rationed in such a way that small farmers and fisherfolk are prioritized.

Phase-out of Directed Credit Programs (DCPs)

As mentioned in the paper of Bello (2004) and Llanto (2005), the DCPs were a failure since the design of the program was poorly built and farmers dole-out their loans. A new program must be constructed in such a way that the flaws of the DCPs would be avoided, the capacity to pay of small farmers would improve and small farmers would have an incentive to pay back their loans.

Market-determined interest rates

A market-determined interest rate would not lead to a distortion of the incentives of the providers of credit in rural areas. An increase in competition in the rural credit market would tend to decrease the interest rate. The government must encourage new entrants in the rural credit market in order to increase competition, hence increase access of small farmers to credit and the efficiency of the provision of loans.

The section 22 of the AFMA also states that:

"…an agriculture, fisheries and agrarian reform credit and financing system shall be designed for the use and benefit of farmers, fisherfolk, those engaged in food and non-food production, processing and trading, cooperatives, farmer's/fisherfolk's organizations and small and medium enterprises (SMEs) engaged in agriculture and the fisheries"

ARBs and Small farmers must be made bankable first

Most of the ARBs lack the appropriate assets that they could offer as collateral that is why banks are hesitant of lending to them. The government must provide support services to this farmers though irrigation, post-harvest facilities, fertilizer and seed inputs among others in order to increase the productivity of their land. As productivity of the land increases, yield also increases. As yield increases, production increases and farmers have more output to sell. This would eventually increase the income of these farmers and would eventually make them bankable in the eyes of formal credit institutions.

Banks should continue their role as credit wholesalers

The wholesale loans are beneficial to small farmers since a lot of them can avail credit from formal sources. The interest rate from these wholesale loans is also reasonable enough compared to the interest rate from the informal sector.

Cooperative must be realized as sources of credit

Currently, the cooperatives are considered as included in the "informal sector" and unqualified as credit conduits due to the lack of training of their officials. As cited in the credit and agrarian reform module, "cooperatives need to be strengthened first and and this could be done through training on managerial capability, value formation, and accounting procedures, among others." We must also consider the Non-government Organizations (NGOs) and other agri-based People's Organizations as alternative conduits of credit to small farmers, as well a the whole rural community. Furthermore, these conduits must be monitored continuously in order to ensure their viability.

Innovative credit approaches to small farmers and ARBs

The scheme that must be considered is the credit-market-tie-up, which is a scheme usually adopted by formal credit institutions. Such scheme, diminishes the probability of defaults without requiring much collateral from the ARBs. However, formal credit institutions or other credit conduits must ensure the timely delivery of loans to the borrowers. In addition, such measures should also be adopted and implemented in order to make sure that there is no pole vaulting.

Conclusion

The government must provide support services (e.g. provide loans that would serve as capital) to the small scale farmers so that they could venture on the land for agricultural purposes. This has the potential to spur investments in agriculture and reduce poverty in rural areas. By prioritizing the small-scale and poor farmers, and not the large-scale farmers and huge agribusiness firms, the degree of inequality (highly skewed inequality) in the access to credit in the agricultural and rural sector would be lessened, and the people who really need help from the government would benefit. We must now stop the preferential access of big farmers and big agribusiness firms, who uses their influence to the government to get a greater bulk of loans. Farmers' empowerment and training seminars to induce an entrepreneurial behavior among farmers would help them to manage their finances and loans effectively, thus improving loan repayment from credit institutions. For as long as the formal credit institutions is out of the reach of farmers, the informal creditors would continue to abuse the poor farmers. In that scenario, the moneylenders are getting richer and richer through usury while the poor farmers are getting a heavier and heavier load with their huge loan amount. We could stop this abuse by improving the access to formal credit institutions in the town proper, such as improved roads, transportation facilities, and info-drives by the Department of Agriculture. As of the moment, the Philippines do not have the capability to shift from being an agricultural economy to an industrialized economy. Since a big bulk of the population is dependent on the agricultural sector, we must improve the quality of life of the rural population by giving them livelihood and improving the efficiency and growth of the agricultural sector. By providing employment in these areas, rural people would no longer migrate to urban areas. An enhanced participation of the private sector would revive, innovate and make the rural credit and finance sector more efficient and sustainable. More participation of the private sector is needed in the rural finance sector. We more, inflows of investment and capital to the rural areas, more loans that are in bigger amounts would be provided to the small-scale farmers and more jobs would be generated. Farmers must also be encouraged to use high yielding inputs such as seeds, farm mechanization equipment and other harvesting and planting equipment in order to improve the quality and quantity of output. This could improve the loan repayment rates on the part of the farmers. We must also realize the potential of farmers' organization and cooperative as a source of low-interest loans. Furthermore, this would enhance the cooperation and camaraderie among farmers in times of good harvest or even natural calamities. All the government efforts in providing loans must now pass through the Land Bank or the Development Bank of the Philippines, in order to avoid using the loans for political intentions. In addition, the participation of the private sector in the rural finance would help these government banks in providing the loans. More competition and not government subsidies to individuals or institutions is the key on having an efficient, sustainable and forward-looking rural finance sector. The policy makers must learn from the mistakes committed by the government, so that inefficiencies and loopholes would be avoided in the new policy measures. No matter how good a policy paper is on paper, but for as long as the implementation is weak, the goal in rural finance would remain too far to be reached.

To sum up, the policy measures would consist of the following schemes:

1. The mistakes done with government intervention (during the Marcos regime) in credit markets by means of subsidized credit and loan guarantees must not be repeated; hence, the rural financial sector must not be politically distorted (e.g. source of "*gatasan,"* corruption and political patronage) in future policy reforms.

2. Shifting from subsidized credit programs to market-based rural finance have provided better opportunities for rural finance as a whole. Furthermore, it proved to be sustainable on the part of lenders, borrowers and savers.

3. Reforms must be anchored under Executive order 138 of the Ramos administration, Agriculture and Fisheries Modernization Act of 1997, the revised General Banking Act, and the National Strategy for Microfinance. Proper funding would lead to a better implementation of these provisions.

4. Greater private sector participation in rural and microfinance markets would increase investments and competition in this sector.

5. Continued improvement and innovation on the microcredit lending techniques, pioneered by credit-granting NGOs would promote more efficiency in the rural finance sector

6. Deposit mobilization campaign would not only provide farmers and other members of the rural community with loans, but also, with deposit-taking services

7. Land Bank should prioritize in giving more loans to rural activities and poor farmers.

8. The conspicuous financing gap would be remedied by enhanced commercial bank participation in finance.

9. The perceptions of high and systemic risks of lending to rural areas, huge transactions cost involved and low profitability must be changed in the part of potential investors in rural finance. The government must invest in more infrastructure projects in the agricultural sector in order to reduce the systematic risk involved in this sector. Hence, the reforms must serve as a proof to the private sector that the perceptions in the past are no longer a reality in the present.

10. The problem of lack of investment-credit provided to farmers would be remedied by greater foreign and private sector participation in rural finance. With augmented investments in this sector, more and more farmers would have access to credit. Moreover, they would also receive ample amount of funds to buy their preferred inputs.

11. The issue of inadequate financing of smallholder agriculture, typically small rice and corn farmers, would be addressed by improving their access to formal credit and giving them priority.

12. Having a competitive credit market in remote rural areas would improve the access of poor farmers to formal credit; hence, providing more competition to informal lenders.

13. The negative impact of agrarian reform on land and credit markets must be addressed in the coming policy review of the Comprehensive Agrarian Reform Program (CARP). The clear definition of rights of the beneficiaries must be addressed (partitioning of the mother CLOAs).

14. The problem of inability of rural lenders to deal with systemic risks would be solved by having a rural finance market that has less government-created distortions, market-based approach and higher accountability of farmers in their loans.

15. The agriculture supply chain potential must be realized by farmers, in order for them to decide where to position themselves in the chain. With the help of the government in developing their entrepreneurial capabilities, they could also invest in the chain; thus making the chain more productive and efficient.

16. Funds that would be used for credit must not only be sourced form short-term deposit funds since the demand for investment-credit is a demand for medium- and long-term funds. A developed capital market would pave the way for the increased number of investment credit provided to farmers.

17. Long term development funding from multilateral loan sources such as World Bank and Asian Development Bank and bilateral sources such as Japan Bank of International Cooperation would help much in providing development funds to the rural finance and development projects in rural areas. Furthermore, these institutions should tie-up with

Non-Government Organizations (NGOs) or cooperatives, and not the government, in order to avoid the inefficiencies in the bureaucratic processes.

18. Policymakers should focus to the development of the capital market that would aid the mobilization of long-term funds.

19. There must be reviews conducted on certain policies and the regulatory environment regarding saving mobilization and term transformation and the development of finance services that are very responsive to demand by a wide range of clientele, including rural-based clients.

20. Loan portfolio diversification programs must be encouraged in this sector in order to reduce the risks involved.

21. Sufficient capitalization and technical expertise support of the Land Bank, alongside with expanded networks and financial muscle, would develop better financial service.

22. Risk reducing instruments must be dealt away from loan guarantees of the part of the government (dole-outs) and crop insurance. Better Risk reducing instrument include: improved access to technology and market information of prices, efficient rural infrastructure, investments in agricultural research and development, credible regulatory regime, promotion of good rural financial market governance and credit information bureaus that is accessible to various types of lending institutions in the rural areas.

23. More active participation of the National Credit Council (NCC) and the BSP would improve the development of an effective and credible credit information bureau.

24. Review the legal and operational requirements for making all regulated lenders provide information on all loans and for sharing this information with credit bureaus databases in the private sector. If this project is legal and feasible, the availability of such information would increase the ease of assessing the creditworthiness of borrowers; thus, reducing transactions and operational cost in lending to small borrowers in the rural areas.

25. The constraints imposed on land and credit markets by the restrictions on land transactions and property rights must be reviewed by the government officials and policy makers.

26. Freer and more flexible market would widen the opportunities for increasing the level of overall welfare of farmers and agrarian reform beneficiaries.

27. Finally, more investments in storage, rural infrastructure and transport will lead to a better integration of markets, including the rural financial markets. Furthermore, such improvement would lead into higher value-added and quantity, better-quality products and higher amount of income of the small farmers, and ultimately reducing the probability of default loans.

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