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RURAL DEPOSIT MOBILIZATION IN ASIA

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Abstract

Domestic resource mobilization is becoming increasingly important in many developing countries because of the problems they are facing in attaining additional foreign resources and aid. But in many countries systematic disincentives must be removed before the full rural deposit mobilization potential can be realized. This paper presents an analysis of rural deposit mobilization in four Asian countries: Bangladesh, Indonesia, the Philippines and Thailand. With the exception of Bangladesh, there is no clear upward trend in share of rural deposits relative to total deposits. Institutions specializing in rural lending appear to mobilize an even smaller share of their total resources than the rest of the banking system.

Determinants of savings behavior are discussed considering incentives for both savers and lenders. Administered interest rates are identified as a problem because they often result in negative real rates on deposits for savers while making rediscount and other government funds cheaper for banks/branches than mobilizing deposits. Efforts to expand banks/branches into rural areas have been thwarted by credit policies which make them unviable. Therefore, reforms in interest rates and other financial policies are often a necessary first step in expanding rural deposit mobilization.

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INTRODUCTION

Domestic resource mobilization is becoming increasingly important in many developing nations, in part because of problems they are facing in obtaining additional foreign resources. Commercial lenders are frightened by high levels of foreign indebtedness. Donor agencies are reluctant to provide additional large grants and loans because they are also concerned about indebtedness and their total real resources are no longer growing at a rapid rate. Concern is also mounting over the past inefficient use of aid. Many financial institutions that have received large amounts of aid have failed to attain expected levels of institutional efficiency and viability. Thus many countries are stressing resource mobilization strategies to help fund agricultural sectors that have been buffeted in recent years by weak commodity demand and volatile prices.

Although the need for domestic resource mobilization is widely recognized, there is less consensus about the ability to mobilize rural funds. Many policymakers are skeptical that deposit mobilization will succeed in rural areas because of low incomes, preferences for non-financial savings, and unfamiliarity with formal intermediaries.

This paper discusses rural deposit mobilization in selected Asian countries. Some Asian countries have done exceptionally well (especially Taiwan and South Korea), but the central argument of this paper is that the countries studied (Bangladesh, Indonesia, the Philippines and Thailand) have not stressed rural deposits because of cheaper funds available from donors and governments. Systematic disincentives must be removed before the full potential for rural deposit mobilization can be realized.

DEPOSIT MOBILIZATION AS A SOURCE OF LOANABLE FUNDS

Although there have been significant year-to-year variations, the banking systems in these four countries reported private deposits representing 50-75 percent of total liabilities between 1970 and 1982 (Meyer and Esguerra). There appears to have been a downward trend in Bangladesh and the Philippines since 1978, and since 1980 in Indonesia. In Thailand the share of deposits fell from 1970 to 1978, then rose to their highest level of 79 percent in 1982. Table 1 reports rural deposits as a percentage of total deposits.[1/] Bangladesh showed a fairly consistent upward trend in rural deposits from under 10 percent of total deposits in 1976 to over 15 percent in 1982. In the other three countries, rural deposits have fluctuated widely between 22 and 34 percent with no clear trends.

These data can be interpreted in two ways. One interpretation is that deposits, and especially rural deposits, have not become significantly more important as a source of bank liabilities. A second interpretation is that rural deposits have done well by keeping up with growth in total deposits so the rural deposit share is roughly unchanged. While private deposits and rural deposits have not been an exceptionally dynamic source of bank liabilities, their growth has not been a drag on resource mobilization through financial systems in these countries.

Another way to analyze rural deposit trends is through the performance of specialized rural financial institutions. Such institutions should have advantages in rural deposit mobilization because of their objectives, their location in rural areas and their operational policies and procedures. Data were analyzed for the Bangladesh Krishi Bank (BKB), the Philippine rural banking system, and the Thailand Bank for Agriculture and Agricultural Cooperatives (BAAC). These institutions are important sources of formal agricultural credit. Table 2 reports their sources of funds for 1978 to 1982. Deposits are overshadowed by other sources of funds; governments, through central banks, provide the largest single source of funds. BKB increased deposits so the deposit share rose from approximately 23 percent to about 29 percent, while rural banks in the Philippines maintained a deposit share of about 32 percent. BAAC deposits represented about 16 percent of total funds in 1978, fell to 12 percent by 1980, and recovered to 15 percent in 1982. BAAC benefits from Central Bank credit and regulations requiring commercial banks to deposit funds with BAAC if they do not meet agricultural lending targets. These two sources represent 50 to 60 percent of total BAAC funds.

These three important rural credit sources clearly are not self-financed by deposits. In fact, they mobilize a smaller share of resources than the rest of their respective banking systems. Governments played an important role in creating them and continue to support them with funds. The sources of deposits are not reported, but it is likely that they come from rural and urban sources.

DETERMINANTS OF SAVINGS BEHAVIOR

Successful rural deposit mobilization strategies require an understanding of the determinants of household savings. Although individual studies have arrived at mixed conclusions, a consensus of opinion now seems to be emerging. Incentives for both savers and financial institutions need to be considered.

Interest Rates

A fundamental question concerns the influence exerted by interest rates on savings. The alternative possibilities are summarized by Lanyi and Saracoglu (page 6): "While an increase in interest rate may stimulate savings by making future consumption less expensive relative to current consumption (substitution effect), it may also tend to reduce saving by lowering the amount of present saving necessary to buy a given amount of future consumption (income effect)." Their analysis, largely based on Asian and Latin American experience, suggests that the substitution effect is most important in developing countries, although not overwhelmingly so. Malaysia and Korea are identified as examples where a steady policy of positive inflation-adjusted interest rates has led to steady growth in financial intermediation.

The form in which savings are held is more important for deposit mobilization than the amount of savings. In countries where interest rates have been depressed over long periods, where financial institutions and instruments are underdeveloped and fragmented, and where there is great economic and political uncertainty, savings are typically held in the form of real estate, consumer durables, precious metals and foreign currency. Rural savers logically concentrate their wealth in land, livestock, crop inventories and jewelry. When interest rate repression is an important determinant in this pattern of savings, a substantial increase in interest rates can be expected to increase financial savings.

Most Asian countries have pursued policies which retard growth of the financial sector (Fry). Nominal interest rates are usually set by administrative fiat. All countries included in Fry's study (including Indonesia, the Philippines, and Thailand) target credit through ceilings and/or floors for credit flows to priority sectors or borrowers, and differentiated interest rates for size, group, sector or location of borrower, or source of funds. Subsidized government funds are available for rediscounting loans made by commercial lenders or specialized institutions to priority borrowers. These controls frequently lead to low rediscount rates for farm lending, and negative real rates for both agricultural loans and deposits.

The interest rate problem is demonstrated in Table 3. Only the Philippines' structure of partially floating interest rates permits market forces to influence deposit rates. The other three countries administratively fix almost all lending, rediscount and deposit rates. Two key relationships are noted. First, the rates paid for some deposits are set at levels equal to, or even above, some agricultural loan rates. These rates, of course, underestimate effective intermediary costs because they exclude the effects of reserve requirements and administrative costs. Therefore, effective deposit costs are considerably higher than agricultural loan rates.[2/] Second, rediscount rates are frequently lower than rates paid on some types of savings and time deposits. The spread between rediscount and agricultural lending rates is not always large, but is frequently larger than for loans from mobilized deposits.

This interest rate structure shows that financial institutions, especially those required or encouraged to make agricultural loans, cannot afford to mobilize large amounts of private deposits. They must rely on rediscount funds and other subsidized funds which are often cheaper and more reliable. When lenders mobilize rural deposits, they frequently channel them to urban areas where lending rates are higher. Savers are discouraged by low and negative real rates of return. Therefore, interest rate reform is often a necessary first step for increasing incentives for both savers and financial institutions.

Access to Banking Facilities

Access to deposit-taking facilities is another important factor affecting rural deposit mobilization. All four countries have pursued policies to expand rural banks and/or branches. However, policies designed to push out credit have created problems in making them financially viable. Beginning in 1976, nationalized commercial banks in Bangladesh were required to make agricultural loans and to establish two rural branches for each urban branch licensed. By 1982, two-thirds of the scheduled bank branches were located in rural areas compared to less than half in 1976 (Rana). This policy was suspended, however, because the expansion was not coordinated, resulting in a surplus of branches in some areas and a deficit in others. Furthermore, many rural branches are not viable because of the low interest rates for agricultural loans and because subsidized rediscount funds are available for only 50 percent of agricultural loans. The banks, therefore, are still basically urban-oriented and channel many rural deposits to urban areas.

The Philippine Rural Bank Act of 1952 marked the beginning of a major effort to expand rural banking. The Government provided equity capital for rural banks, technical assistance in bank organization and operation, and training of officers. Other incentives were Central Bank rediscounting at preferential rates and exemptions from a variety of taxes, charges and fees. Some rural banks accepted demand deposits, but now this function has been exclusively granted to commercial banks. The number of rural banks multiplied at a fast rate, reaching 931 banks with 1,029 offices by 1978 (Lee and Jao), but serious loan repayment problems have created great financial problems for many rural banks and slowed their expansion.

The Bank of Thailand relaxed its control over opening new commercial bank branches in 1975. About three times as many branches were opened in 1976 as compared to the average number opened per year during the previous four years. However, the rate of expansion slowed in 1977 because banks experienced difficulty in meeting credit targets requiring that at least 60 percent of local deposits must be lent locally and at least one-third of the loans had to go to farmers (Meyer, Baker and Onchan).

Other Determinants of Deposits

Besides interest rates and access to financial institutions, other less well-documented factors influence rural deposit mobilization. Several countries have successfully used prizes, raffles, lotteries, and other devices to stimulate deposits. Prizes raise the effective rate of return, while raffles and lotteries offer the possibility of an exceptionally high return and appeal to the gaming spirit of savers. Complicated procedures for making and withdrawing deposits lower effective rate of return. The value of time to make and withdraw deposits, costs of passbooks, photographs for identification cards, and other miscellaneous costs can significantly reduce real returns. Von Pischke argued that the most important advantage for rural people may be convenience, that rural deposits may be more "service" than interest elastic.

Although the potential for rural deposits is great, the unit cost for the financial institution per depositor or account may be large for small deposits made by rural people. Some costs and procedures identified above are used to screen out small deposits. Innovations and streamlined procedures are required to reduce costs and open up deposit possibilities for more savers. Some of the huge subsidies currently spent for agricultural loans should be directed towards experiments with savings innovations so solutions to these problems will be more quickly found.

CONCLUSIONS

The major rural financial institutions in Bangladesh, Indonesia, the Philippines and Thailand have not been very successful in mobilizing rural deposits. Fragmentary data suggest, however, that a large untapped potential exists. Institutions heavily engaged in agricultural lending often have few incentives to mobilize rural deposits. Rules, regulations and incentives are geared towards expanded lending. Administered interest rate structures combined with high reserve requirements are major disincentives for deposit mobilization. Rediscount and other government funds are cheaper than deposits. Interest rate reforms are required that increase the return to savers, raise the cost of refinance funds relative to deposits, and increase the lender's return from rural loans. Establishing floating rates in the Philippines and the recent increase in rediscount and lending rates for agriculture in Bangladesh are steps in the right direction. The expansion in rural banking can be reinvigorated through proper incentives to savers and intermediaries.

Huge amounts of capital are going to be required in the future as developing countries continue to modernize agriculture. The wide fluctuations in rural incomes experienced in many countries during the past 7-8 years have meant additional financial demands to help farms even out cash flow. Foreign sources of funds are likely to be more limited in the future than in the past. Therefore, the deposit mobilization potential in rural areas must be tapped. The past one-sided emphasis on cheap agricultural loans with related disincentives for deposit mobilization must be reversed. The creation of viable financial institutions with active deposit mobilization activities should become a high priority.

Notes

1/ Data on rural deposits are at best approximate indications of deposits by rural households. Undoubtedly some urban households and businesses have deposits in rural areas and some rural households have urban deposits.

2/ The average cost of funds to an intermediary is, of course, lower than these rates because come deposits earn low or zero rates of interest.

Table 1
Rural Deposits as a Percent of Total Deposits
1976-1983

	Country			
Year	Bangladesh	Indonesia	Philippines	Thailand
		(Percent)		
1976	9.7	25.8	NA	34.2
1978	13.6	23.5	31.9	31.9
1980	14.9	22.0	24.6	33.8
1982	15.6	27.4	30.7	34.1

Source: Papers by Mridha, Siswanto, TBAC and Bavovada.

Table 2
Share of Deposits for Selected Institutions
1978-82

Year	BKB	Philippines Rural Banks	BAAC
		(Percent)	
1978	23	32	16
1979	25	32	14
1980	25	31	12
1981	28	32	15
1982	29	32	15

Sources: Asian Development Bank; TBAC; Bank of Thailand, Quarterly Bulletin, December, 1983.

Table 3

Selected Loan, Rediscount and Deposit Rates

Rate	Country			
	Bangladesh[a/]	Indonesia[b/]	Philippines[c/]	Thailand[d/]
	(Nominal Interest Rates Per Annum)			
Lending Rates for Major Agricultural Preograms:				
Short-term credit	12 & 17.5	9 - 13.5	floating	7 - 14
Medium/Long term credit	13 - 14	10.5	floating	7 - 16
Deposit Rates:				
Demand	4.5 - 8.5	3 - 9	floating	0.5 - 9
Savings	10	9, 12 - 15	floating	9
Time 12 months & over)	14	18 - 19	floating	13
Rediscount Rates for Agriculture	6	3 - 4	floating	5

Source: Meyer, Richard L. and Emmanuel F. Esguerra, "Rural Deposit Mobilization in Selected Asian Countries", APRACA Workshop on Rural Savings Mobilization, October 3-5, 1984, Manila, Philippines.

a/ All rates effective from October 1980 for all scheduled banks. Recent changes in loans and rediscount rates for agriculture not included.
b/ Data as of 1984 except lending and rediscount rates are for 1982.
c/ Data as of March 9, 1984.
d/ Data as of 1982.

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